newsBRIEFS

Germany Spells Out Details of Algo Flagging Rule

Starting in April, all direct participants on Eurex will be required to comply with a new requirement to flag all orders generated by algorithmic trading with a distinct identification key. In December, the exchange supervisory authority of Hesse, which oversees Eurex, addressed a key issue: how should market participants determine what types of trading will be subject to this new requirement.

The interpretative guidance describes a definition of an algorithm and provides a number of examples to show how this definition should be applied. For example, a trading system that engages both automated market making and statistical arbitrage will need to apply two different labels, one for each strategy. The guidance also explains that if there is a change to how a decision is taken within an algorithm, a labeling change is required as well.

The guidance also discusses how the algo flagging requirement should be applied to participants who rely on other firms for market access. For example, it applies to smart order routing systems if those systems automatically decide on the point in time, price and size of the executions without human interference.

ICE Completes NYSE Euronext Deal, Outlines Timetable for Liffe Transition

IntercontinentalExchange on Nov. 13 completed its acquisition of NYSE Euronext in a stock and cash transaction valued at roughly $11 billion. The combined organization will bring together some of the leading futures and options markets in Europe and North America and will rank as the world's second largest derivatives exchange based on trading volume.

On Dec. 12, ICE set out a timetable for migrating Liffe contracts to the ICE trading platform and the ICE Futures Europe exchange during 2014, starting with agricultural commodity contracts in the summer, equity derivatives in the third quarter, and interest rate contracts in the fourth quarter. ICE also plans to migrate the Eurodollar and GCF Repo contracts listed on Liffe U.S. to its U.K. exchange in mid-2014.

ICE said it plans to retain the data center operated by NYSE Euronext in Basildon, just outside London, and will continue to operate the matching engines for Liffe markets from this site. ICE said customers should be able to continue using their existing co-location facilities and network connections for trading Liffe markets.

In recognition of the unique character of the Liffe interest rate markets, ICE said it will expand the functionality of its trading platform to include the pro-rata allocation algorithm that is commonly used to match trades in this market.

In line with the EMIR trading reporting rules that take effect in February, all futures and options executed and cleared for all ICE markets in Europe, including Liffe and ICE Endex, will be reported to ICE's European trade repository, ICE Trade Vault Europe.

On Nov. 29, ICE reached an agreement with the Depository Trust and Clearing Corp. to migrate the clearing of interest rate futures listed on NYSE Liffe U.S.

The contracts will be transitioned from New York Portfolio Clearing, which is 50% owned by DTCC, to ICE Clearing Europe. NYPC's operations will be wound down and open interest transferred by the third quarter of 2014, subject to regulatory approval.

As part of this agreement, ICE has assumed NYSE's license for futures on the DTCC GCF Repo Index. In addition, ICE and DTCC said they are in discussions regarding a new cross-margining solution for a broad range of interest rate products.

CPSS/IOSCO Focus on Market Infrastructure Risks

International regulators are looking at the role that third-party service providers play in the operational reliability of clearinghouses and other financial market infrastructures. On Dec. 18, the Committee on Payment and Settlement Systems and the International Organization of Securities Commission jointly published a consultation on a methodology for regulators to use when assessing service providers that are "critical" to the operations of the financial market infrastructure.

The goal is to provide regulators with a framework for assessing the risk that financial market infrastructures might not be able to operate because of a malfunction at a third-party service provider, such as an information technology firm.

The consultation recommends that regulators establish five oversight "expectations," such as robust information security management, reliability and resilience of systems, and strong risk identification and management.

The consultation builds upon the CPSS-IOSCO *Principles for Financial Market Infrastructures*, which was published in April 2012. Comments on the consultation must be submitted by Feb. 20.

Société Générale in Talks to Buy Newedge

Société Générale announced in November that it has entered into exclusive negotiations with Crédit Agricole to acquire its 50% stake in Newedge, which would bring Société Générale's shareholding to 100%. The bank cited the trend toward more centralized clearing of over-the-counter derivatives as a key factor in driving the full acquisition of Newedge.

"This transaction would enable us to give our clients access to an integrated offer across global markets, from execution to prime and clearing services on both listed and OTC products," said Didier Valet, head of Société Générale's global banking and investor solutions division. "In addition, due to the evolution of the regulatory framework, we want to invest in post-trade activities in order to enlarge our client offer."

Shortly after the talks were announced, Newedge announced a series of leadership changes. David Escoffier, formerly deputy head of global market activities at Société Générale, was appointed chief executive officer of Newedge. In addition, Olivier Hartemann, previously chief operating officer for the Asia-Pacific region at Société Générale's global banking and investor solutions division, was named deputy CEO and COO of Newedge.

LCH.Clearnet Re-Introduces Compression Service

LCH.Clearnet resumed offering multilateral compression for interest rate swaps in November, making it easier for members of its SwapClear service to reduce both the size and number of their outstanding positions. This is especially important in the context of the leverage ratio proposal now being developed by banking regulators; banks are looking for ways to reduce notional exposures in order to reduce their capital requirements.

Multilateral compression involves terminating trades that are offsetting and replacing them with new trades that provide the same market risk exposure but with lower notional exposures. Through this service members can manage both the size of cleared gross notional and number of cleared contracts in their SwapClear proprietary accounts.

TriOptima and LCH.Clearnet began compression exercises for cleared swaps in 2008, but LCH.Clearnet was forced to stop offering multilateral compression in April 2013 due to conflicts with Commodity Futures Trading Commission rules that require real-time trade registration. The clearinghouse subsequently modified its regulations and operational procedures, and in November it resumed providing the service.

The service covers all currencies cleared by SwapClear, with each compression cycle covering a single currency at a time. Compression exercises can be managed by third parties—TriOptima is currently the only designated provider—or initiated by the members themselves.

According to TriOptima, demand for compression has been increasing rapidly. Before LCH.Clearnet suspended the service in April, participating banks were able to reduce the notional value of their interest rate swap exposures by $36.7 trillion in 2010, $48.3 trillion in 2011, and $71.8 trillion in 2012. TriOptima also has conducted a compression exercise for interest rate swaps cleared by the Singapore Exchange and is working with several other clearinghouses.

ICE Establishes Foothold in Asia

IntercontinentalExchange announced plans to establish an on-the-ground trading and clearing presence in Asia via an agreement to buy the Singapore Mercantile Exchange from Financial Technologies India. The $150 million deal was set to close by the end of 2013 and included licenses to operate an exchange and a clearinghouse in Singapore.

ICE's chief executive Jeff Sprecher said the deal was aimed at responding to the "regionalization" of derivatives markets under the pressure of new regulations. He also said the ability to offer trading and clearing in Singapore would appeal to customers in Asia hurt by the collapse of MF Global.

Sprecher also noted that it would have taken much longer for ICE to build a comparable infrastructure in Singapore and obtain the necessary regulatory approvals.

SMX currently offers several types of commodity futures with limited volume. FTIL is the operator of several other exchanges, including the Multi-Commodity Exchange, India's largest commodity futures exchange.

HKEx Rolls Out OTC Clearing Service

Hong Kong Exchanges and Clearing began clearing over-the-counter derivatives in November through OTC Clear, a subsidiary set up with support from several global banks. Three banks joined as clearing members at launch—Bank of China, HSBC and ICBC—and another nine banks are shareholders in the subsidiary and are expected to become clearing members.

OTC Clear offers clearing for dealer-to-dealer trading in interest rate swaps denominated in four currencies—renminbi, Hong Kong dollars, U.S. dollars and euros—as well as non-deliverable forwards in renminbi, Taiwan dollars, Korean won and Indian rupee. The first trade cleared by the service was a non-deliverable renminbi seven-day repo swap between Bank of China and HSBC.

HKEx Chief Executive Charles Li stressed the value of the service for clearing OTC derivatives denominated in renminbi. "From the business perspective, OTC Clear fits strategically into our long-term vision of building a leading horizontally complete and vertically integrated exchange in the Asia time zone," Li said in his blog. "Hong Kong has already established itself as the most important offshore RMB center in the world. OTC Clear will leverage this advantage by clearing RMB-denominated derivatives contracts, a tremendous growth area, further enhancing our status and differentiating us from many of our competitors."

HKEx said it plans to introduce client clearing in 2014 after the new legislation on the Securities and Futures (Amendment) Bill is in place and relevant amendments to OTC Clear rules are approved by the Securities and Futures Commission.

In a related announcement, Markit said in November that it began offering connectivity to OTC Clear through MarkitServ, its trade processing service for OTC derivatives. MarkitServ offers connectivity to OTC clearing services offered by three other clearinghouses in Asia: Australian Securities Exchange, Japan Securities Clearing Corporation and the Singapore Exchange.

MORE

HSBC to Offer Futures Margin Depository Services in China

HSBC Bank (China) in November received a license from the China Financial Futures Exchange to become a futures margin depository bank, making it the first foreign bank in mainland China to offer such services to qualified foreign institutional investors.

"An increasing number of QFIIs and RQFIIs (renminbi qualified foreign institutional investors) are trading index futures and have a growing need for margin depository and clearing services," said Andy Ng, head of HSBC Securities Services in China. "This license allows us to further enhance our services for QFIIs and RQFIIs, helping them simplify the procedure for trading index futures, increase efficiency in clearing and lower the risks in margin management and deposit outflows."

Under CFFEX's regulations, margins for futures trading among investors, futures brokers and exchanges are required to be deposited and cleared through a futures margin depository bank.

In January 2013, the first batch of QFIIs started trading index futures, and CFFEX introduced administrative measures in August for the QFIIs' custodian banks to apply for licenses to provide margin depository services. HSBC China was the first foreign bank in the mainland to apply for and subsequently receive the license.

As of October 2013, HSBC China was the custodian bank for US$15.9 billion of investment quota for QFIIs, which was equivalent to 34.4% of the total amount approved, the largest market share among all banks. It was custodian bank for 49.6 billion renminbi investment quota for RQFIIs, which was equivalent to a dominant 37.2% of total amount approved.

MF Global Customer Funds Fully Recovered

A federal judge on Nov. 5 granted the motion of James Giddens, the trustee for the liquidation of MF Global, for a final allocation of funds restoring customer commodity claims in full. "This is a milestone achievement in the liquidation, and Mr. Giddens is delighted to be in a position to make a full return of customer property," the trustee's office said in a statement.

The trustee's office said it will move "as quickly as possible" once the court's order is final to begin 100% distribution to all former MF Global commodities futures customers, including customers who traded on U.S. exchanges (4d customers) and foreign exchanges (30.7 customers).

In a separate ruling, on Nov. 18, a federal court approved a consent order filed by the CFTC and made preparations for the remaining funds to be distributed. Just days after the court's ruling, Jon Corzine and other former MF Global executives, as well as the company's accounting firm, filed an appeal of the consent order. The appeal will effectively postpone the final fund restorations until an appellate decision is reached.

In a separate development, the trustee managing Peregrine Financial's bankruptcy is seeking to return as much as $41 million to former customers, marking the second payout since the firm's collapse in the summer of 2012. The sum would include $27.5 million to be returned to U.S. customers with 4d accounts and $13.5 million to be returned to customers with foreign, or 30.7, accounts. With the additional $41 million, a total of 37% of U.S. funds and 85% of foreign funds will have been distributed back to customers since Peregrine filed for bankruptcy.

Morgan Stanley to Sell Part of Global Oil Business to Rosneft

Morgan Stanley announced in December its plans to sell the Global Oil Merchanting unit of its commodities division to Rosneft, Russia's leading oil company. Financial terms of the transaction were not disclosed.

The sale includes a dispersed international network of oil terminal storage agreements, inventory, physical oil purchase, sale and supply agreements, equity investments, and freight shipping contracts.

Approximately 100 front-office executives in the U.S., U.K. and Singapore, or one-third of Morgan Stanley's total commodities front-office personnel, will move to Rosneft Group as part of the transaction.

The transaction does not include Morgan Stanley's client-facilitation oil trading business; its ownership stake in U.S.-based oil storage, marketing and transportation company TransMontaigne; or any of its commodities operations outside of the oil sector. However, Morgan Stanley said it is "exploring strategic options" for its stake in TransMontaigne.

Deutsche Bank Reduces Commodities Business

Deutsche Bank is the latest bank to reduce its presence in the physical commodity markets, announcing in December that it is "significantly scaling back" certain trading operations.

The bank said its trading desks for energy, agriculture, base metals and dry bulk will be wound down over time, but it emphasized that it will retain its commodity derivatives and precious metals businesses. These businesses, which it called "core competencies," will be integrated into its fixed income and currencies platform.

"The decision to refocus our commodities business is based on our identification of more attractive ways to deploy our capital and balance sheet resources," explained Colin Fan, the bank's co-head of corporate banking and securities. "This move responds to industry-wide regulatory change and will also reduce the complexity of our business."

Canada Proposes Mandatory Clearing Rules

Canadian securities regulators have jointly issued a proposed model rule related to the clearing of over-the-counter derivatives. The proposed rule would establish a timetable for mandatory clearing, would determine which types of OTC derivatives would be subject to mandatory clearing, and would provide exemptions for non-financial end-users. The model rule, once finalized, will be implemented by each of the 10 provinces and three territories within Canada. Comments are due by March 19.

Ontario Finalizes OTC Reporting Rules

The Ontario Securities Commission published derivative trade reporting and data reporting rules in November. The trade reporting and data reporting took effect on Dec. 31 and the reporting requirements included in the rules will take effect on July 2.

"The first set of harmonized derivatives rules represents an important milestone for OTC derivatives reform. These rules will provide the OSC with the right tools to better monitor the derivatives market, address systemic issues before they become significant and protect investors," said Howard Wetston, Chair and CEO of the OSC. "We are delivering on our G-20 commitments and have harmonized these rules at both the international and local level."

The regulator said release of these rules marks one of the most important elements of OTC derivatives reform. The reporting of derivatives transactions to trade repositories will give the OSC access to data that will facilitate market surveillance and shed light on the nature and key characteristics of the Canadian derivatives market. This information will assist the OSC in developing a strong derivatives oversight regime.

The Autorité des Marchés Financiers, the principal markets regulator in Quebec, and the Manitoba Securities Commission also published harmonized province-specific rules in November.

U.S. Futures Industry Releases Insurance Study

CME Group, FIA, the Institute for Financial Markets and National Futures Association released a study on Nov. 15 on the economic feasibility of adopting an insurance regime for the U.S. futures industry.

The study was commissioned by the four sponsoring organizations in November 2012 and was conducted by Compass Lexecon, a consulting firm that specializes in the application of economics to legal, regulatory and policy issues. The study did not provide any policy recommendations, but it will assist policy makers by clarifying the amount of insurance coverage that can be obtained through various solutions and the potential costs for each.

The study found that there was an interest among insurance companies in offering insurance to U.S. futures customers of futures commission merchants that opt to participate in a captive insurance company. However, the study found that the terms proposed by the insurance companies were somewhat restrictive.

The study also assessed the viability of offering the same kind of protection afforded to securities investors by the Securities Investor Protection Corporation. The study estimated that it would take many years for such a program to be fully funded, and concluded that in the short run the program's credibility would require a government backstop.

ESMA Issues Draft RTS for Third-Country Swaps

On Nov. 15 the European Securities and Markets Authority issued final draft regulatory technical standards for OTC derivatives transactions by non-European Union counterparties, as required by the European Market Infrastructure Regulation. The provisions apply to contracts that have a "direct, substantial and foreseeable impact" on EU financial markets. The provisions also are designed to prevent evasion of EMIR requirements.

The draft standards establish certain conditions under which contracts entered into by two non-EU counterparties would be subject to EMIR: the counterparties are based in countries that do not have an equivalent regulatory regime; one of the counterparties is guaranteed by an EU financial institution for a notional amount above a certain threshold; and the contracts are executed via EU branches.

The draft standards must be reviewed by the European Commission, which has three months to decide whether to endorse the standards.

ESMA Approves Registration of Four Trade Repositories under EMIR

The European Securities and Markets Authority in November approved of four trade repositories under the European Market Infrastructure Regulation. They are: DTCC Derivatives Repository, based in the U.K.; Krajowy Depozyt Papierów Wartościowych (KDPW), based in Poland; Regis-TR, based in Luxembourg; and UnaVista, based in the U.K.

"Registering the first European trade repositories is an important component in making derivative markets more transparent and resilient. TRs play a fundamental role in the surveillance of derivatives markets and in risk monitoring," said Steven Maijoor, chair of ESMA. "The data gathered by TRs will enable regulators to identify and reduce the risks associated with derivative markets."

The registrations took effect on Nov. 14, with the reporting obligation beginning on Feb. 12. The registered TRs cover all derivative asset classes (commodities, credit, foreign exchange, equity, interest rates and others) irrespective of whether the contracts are traded on or off exchange.

ESMA will now assume supervisory responsibility for these TRs. It is also continuing to process other trade repositories' requests for registration.