Global Regulators Back Plan to Overhaul Financial Benchmarks

The Financial Stability Board on July 22 published a report outlining reforms to major interest rate benchmarks such as Libor, Euribor and Tibor.

One set of the recommended reforms is aimed at strengthening the existing "IBORs" and other reference rates based on unsecured bank funding costs by underpinning them with transaction data. "By end-2015, administrators should have publicly consulted on any recommended changes, while currency groups will work to develop transition strategies and address any legal obstacles and risks," the FSB said.

The second set of reforms is aimed at developing "alternative benchmarks" that do not include bank credit risk and that are "closer to risk-free." The FSB noted that many derivatives contracts do not need a reference rate that includes bank credit risk, and shifting to a risk-free rate would reduce the incentive to manipulate rates and reduce the risks to the banking system. In terms of implementation, the FSB said central banks and supervisory authorities should aim to implement at least one International Organization of Securities Commissions-compliant risk-free rate by the second half of 2016.

With respect to the U.S. dollar interest rate markets, the report said the Federal Reserve and the Commodity Futures Trading Commission will continue to encourage greater use of risk-free reference rates in U.S. dollar derivatives markets, such as Treasury rates, repo rates and monetary policy rates.

CME Buys Trayport and Fenics from GFI

On July 30, CME Group announced an agreement to acquire two software companies—Trayport and Fenics—from GFI Group via a two-step transaction that is expected to close by early next year. CME estimated the net cost of the acquisition at $655 million.

Trayport is a provider of trading software used by brokers and other participants in energy markets, particularly in Europe. CME officials commented that approximately 85% of European trading in natural gas, power and coal passes through Trayport systems and said the acquisition will give CME a "deeper relationship" with commercial customers in Europe and an opportunity to develop new products and services to meet their needs.

"You're looking at a client base that includes all the players in the ecosystem," CME chief executive officer Phupinder Gill explained in a July 31 conference call with investors and analysts. He added that these clients have a "fresh perspective" on the types of products they might want to trade or clear through CME, particularly as the regulatory environment continues to evolve.

Fenics provides price discovery, analytics and other technology services for OTC FX options. CME officials said the acquisition of Fenics will allow CME's FX futures business to integrate more effectively with the OTC FX options markets, particularly as that market adopts clearing, and noted that its client base includes a number of Asian banks.

Under the terms of the agreement, CME will acquire all of GFI Group and then sell its brokerage and clearing businesses, including Kyte Group, a London-based futures brokerage, to a private consortium led by GFI management including Michael Gooch, GFI's executive chairman, Colin Heffron, its chief executive officer, and Nick Brown, head of financial product brokerage Americas. GFI's brokerage business will continue as a private company with its management and operations largely unchanged, GFI said.

Eurex to Modify Segregation Rules for Non-EU Customers

Eurex Clearing is changing its omnibus and individual segregation models to serve customers located outside of the European Union. Eurex Clearing said the modifications are designed for clearing members and their customers who are located in jurisdictions where local law might interfere with the clearing models required by the European Market Infrastructure Regulation. The proposed changes will affect the porting of assets in case of default, direct payments to clients (in the individual segregation model), and the choice of models.

New Leadership on Financial Services Policy in European Parliament

Following the recent elections to the European Parliament, a new chairman has been appointed to the Economic and Monetary Committee – Roberto Gualtieri, an Italian politician who is part of the Socialist group of parties. Gualtieri succeeded Sharon Bowles, a member of the Liberal Democrats in the U.K. who stepped down before the election.

During the previous session of Parliament, Gualtieri was a member of the ECON committee but took a more active interest in other matters such as fiscal policy and constitutional affairs. The ECON committee is responsible for oversight of financial reform implementation and bank regulation and supervision as well as oversight of the European Central Bank.

The elections also resulted in an expansion of the committee's size. The number of members rose to 61 from 46, with left-wing parties such as the Socialists and Democrats group and the Greens having proportionally more representation than before.

Among the new members are two politicians with finance backgrounds: Ludek

Niedermayer, a member of the center-right European People's Party and a former vice governor of the Czech central bank from 2000 to 2008, and Steven Woolfe, a member of the U.K. Independence Party and a former general counsel at Boyer Allan Investment Management, a U.K. hedge fund. Kay Swinburne, a member of the European Conservatives and Reformists party from the U.K., remains on the committee and has been named coordinator for her party's activities on the committee.

FCA Amends Client Money Rules

In June, the U.K.'s Financial Conduct Authority finalized a set of amendments to its rules as part of a broader effort to improve the protection of client money and custody assets. The final rules, which were incorporated into the *Client Asset Sourcebook* and apply to approximately 1,500 FCA-regulated firms that hold client money, address lessons from recent insolvencies, including Lehman Brothers and MF Global.

FCA director of markets David Lawton said the rules would "improve the protection offered to client assets and should speed up the recovery of client assets on a failure of a firm." The rules will come into effect on a tiered basis over the next 12 months and include the following:

- rules requiring all firms to have a written agreement in place for all title transfer collateral arrangements, including a prescribed mechanism that firms should follow if a client requests protections under CASS for assets and monies subject to TTCA;
- the introduction of a template that firms must use when drafting and exchanging acknowledgement letters with the third parties with whom they deposit or place client money;
- requiring firms in all circumstances to have an acknowledgement letter in place before they place client money in the relevant account;
- a requirement for all clients to be repapered by June 1, 2015, and the new template letters to be countersigned and returned before client money can be held. They must be reviewed at least annually and replaced whenever details change or an error is discovered;
- additional guidance to clarify the obligations placed on firms in relation to FCA-regulated business conducted under the CFTC Part 30 exemption order; and
- a requirement that clearing firms must ensure all client money is received directly into client bank accounts.

FCA is awaiting recommendations emanating from an independent review commissioned by the U.K. Treasury before proceeding with additional proposals around client money distribution rules. FCA will conduct a further review of the client money distribution rules in line with Treasury's implementation of the SAR review recommendations and intends to publish a further consultation on the client money distributions rules later this year.

IOSCO Studies Warehouse Issue in Commodity Derivatives

The International Organization of Securities Commissions announced on Aug. 1 that it has mandated its commodity derivatives committee to research the potential effects of storage infrastructure on the integrity of the price formation process of commodity derivatives in member jurisdictions.

The committee has drafted a questionnaire as a way to gather information on storage infrastructure and IOSCO has asked regulators, market participants, end-users and others to complete the questionnaire by Oct. 31.

IOSCO said it is particularly interested in views regarding: ambiguities about the scope of existing rules applying to storage infrastructures; operational practices of storage infrastructures that create inefficiencies in the price formation process; conflicts of interest arising due to the ownership structure of storage infrastructures; and ambiguities arising from the process of collecting and disseminating information to the market.

CME, Thomson Reuters to Provide Electronic Replacement for Silver Fix

CME Group and Thomson Reuters in August began providing a new London silver price mechanism, replacing the 117-year old method for setting the so-called "London Fix." The previous method, which involved a daily conference call to set prices among a dwindling panel of banks, was disbanded by the London Bullion Market Association on Aug. 14. Under the new electronic solution, CME Group provides the pricing platform and methodology and Thomson Reuters manages administration and governance. The LBMA had reviewed several bids to replace the process from firms including the London Metal Exchange, Bloomberg, Intercontinental Exchange and Platts.

Bank of England Launches New Framework to Test for Cyber-Attacks

A top official at the Bank of England on June 10 outlined a framework to help identify areas where the financial sector could be vulnerable to cyber-attacks. The new framework, called CBEST, uses intelligence from government and accredited commercial providers to identify potential attackers to a particular financial institution.

"The idea of CBEST is to bring together the best available threat intelligence from government and elsewhere, tailored to the business model and operations of individual firms, to be delivered in live tests, within a controlled testing environment," said Andrew Gracie, executive director, resolution at the Bank of England. "The results should provide a direct readout on a firm's capability to withstand cyber-attacks that on the basis of current intelligence have the most potential, combining probability and impact, to have an adverse impact on financial stability."

Australia's Clearing Mandate Taking Shape

Australia has joined the list of countries seeking input on mandatory clearing of over-the-counter derivatives. In July the

Australian Treasury released proposals to initiate OTC clearing requirements for interest rate swaps in four global currencies—the U.S. dollar, the Japanese yen, the Euro and the British pound—and the Australian dollar. The proposals indicated that a draft determination and related rules are expected to be issued by the Australia Securities and Investments Commission during the third quarter with final rules coming into force in early 2015. The clearing mandate would initially apply to "large financial institutions with significant levels of cross-border activity in these products."

The Treasury proposed two options for implementing the mandate. The first option would capture transactions by any domestic financial firm with $100 billion or more in gross notional derivatives, any foreign firm with $100 billion or more in gross notional OTC derivatives booked or entered into in Australia, and any foreign financial institutions with $100 billion or more of gross notional OTC derivatives outstanding with domestic and foreign financial entities subject to the clearing mandate in Australia.

The second option would cover domestic and foreign firms with $100 billion or more in gross notional OTC derivatives outstanding, but it would also cover entities regulated as a swap dealer in the U.S. or any entity that opts in to a mandatory clearing obligation in the interest rate contracts covered in the consultation.

ASX Cuts Fees to Bolster Swaps Clearing

As Australia moves towards mandatory clearing for interest rate swaps next year, the Australian Securities Exchange is taking several steps to head off competition from LCH.Clearnet, currently the leader in clearing swaps denominated in Australian dollars.

ASX began clearing dealer-to-dealer IRS trades in July 2013 and rolled out a client clearing service in April. The service currently covers fixed-to-floating swaps, overnight index swaps and basis swaps denominated in the Australian dollar, and offers portfolio margining between the swaps and the interest rate futures that trade on ASX. As of this spring, eight banks had joined as clearing participants, and as of August at least one U.S. bank had begun clearing swaps through the service.

"ASX has made significant investments over the last two years to build a world-class financial market infrastructure for the Australian dollar market," the exchange said on July 24. "The new services flowing from these investments include a clearing solution for OTC derivatives, a client clearing solution that gives important new protections to investors and a collateral management service that provides efficiencies to banks that operate in the Australian market."
To further bolster the appeal of its offering, ASX plans to implement a new set of volume discounts in October. ASX said the fee reduction was intended to encourage volume growth and improve its competitive position in the global marketplace. The new fee schedule, which will take effect on Oct. 1, links the fees that clearing participants pay to the volume of Australian dollar interest rate futures and OTC clearing activity they transact with ASX. The fee reduction is only available for the proprietary trading of clearing participants, however.

ASX also has addressed customer needs for legal certainty. Earlier this year it refreshed and reissued its close-out netting opinion in conjunction with the launch of client clearing for OTC swaps. Catherine Eakin, the exchange's legal counsel, commented that ASX worked closely with its clearing members and Australian financial market regulators on the development of ASX's close-out netting rules and commissioned a legal opinion on those rules that was provided to clearing members. She added that ASX is looking at the impact of clearing on close-out netting between clearing members and their clients and considering what other opinions may be needed.

"We have made available to our clearing members external legal opinions to confirm that Australian legal protection of close-out netting between a clearing member and its client is not affected by either ASX's client clearing legal model or the use of the *ASX Cleared OTC Derivatives Supplement* with the client agreement," Eakin said.

ASX published the supplement to assist clearing members and their clients in documenting the relationship between them with respect to clearing OTC derivatives through ASX. The Supplement is designed to be used in conjunction with either a futures trading document or a 2002 ISDA master agreement between the clearing member and its client.

"We are now engaging with bank clients of our clearing members to understand what additional legal opinions we may need to commission on the segregation and portability features of ASX's client clearing service to assist those bank clients to gain favorable capital treatment of their derivatives exposures that are cleared through ASX," Eakin added.

Trade Associations Back Effort to Harmonize Trade Identifiers

A coalition of trade associations sent a letter on July 29 to the International Organization of Securities Commissions seeking its help to achieve consensus in the generation of Unique Trade Identifiers.

"The associations very much support the goals of global data aggregation for OTC derivatives to allow for systemic risk management. We firmly believe that the lack of agreement between regulators will defeat this objective. Accordingly, we would like to discuss with you how IOSCO can help in bringing regulators and industry together to work on a global solution," the group wrote.

The coalition, which includes FIA Europe, notes that the industry is split between two methods for generating these identifiers and urges IOSCO to bring regulators and industry together to support a global solution. Other trade associations that signed the letter include the British Bankers Association, the Global Financial Markets Association, the German Investment Funds Association, International Swaps and Derivatives Association, and the Investment Management Association.