

Memorandum

TO: Sarah Josephson, Associate Director, Commodity Futures Trading Commission

FROM: Stephen O'Connor, Chairman, International Swaps and Derivatives Association

DATE: April 5, 2012

RE: Additional Phasing within Asset Classes for Confirmation Obligations under 17 CFR Part 23

This memorandum is in response to your request on February 29, 2012 for additional data to support a recommendation for additional phasing-in by asset class of the Confirmation obligations under 17 CFR Part 23 Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants. We acknowledge that this discussion has themes which may also be relative to obligations under 17 CFR Part 43 Real-Time Public Reporting of Swap Transaction Data and 17 CFR Part 45 Swaps Data Recordkeeping Requirements and Data Reporting Requirements.

In order to replicate and extend the New Trade Volume Counts provided by Morgan Stanley at the February 29th meeting to an industry scale, we requested information from the other G-14 participants to show what percentage of volumes within each asset class are:

- a) Electronically traded, electronically confirmed
- b) Voice traded, electronically confirmed
- c) Voice traded, manually confirmed
- d) Electronically traded, manually confirmed

The results are provided under separate cover in file named "Confirmation Data/Part 23" dated March 29, 2012

We recognize that a review of the results reveals disparities among the above classifications between asset classes, as well as a perceived illogical pairing between trades that are electronically traded but manually confirmed. As such, we are providing additional details below with respect to those scenarios.

Electronically traded, manually confirmed

The primary reason a swap would be electronically traded but manually confirmed is because some smaller banks and clients are able to execute trades via execution platforms, but not set up to confirm those trades on electronic confirmation platforms.

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There are two main reasons this occurs. First, in some of these cases clients are not directly submitting transactions to an electronic trading platform, rather they are transacting via a broker who submits the trade to the platform on their behalf. In this scenario, there is merely an administrative effort required on the part of the client to establish their account with the electronic trading platform. In the second case, smaller banks and clients have adopted electronic trading platforms for direct transaction. However, this on-boarding process is relatively simple and has a low overhead since it involves the use of infrastructure built and maintained by the electronic trading platform, for instance a Bloomberg terminal or a web interface. In contrast, adoption of electronic confirmation platforms requires the effort and cost to build the necessary internal infrastructure to transmit and receive electronic confirmation messaging.

Although it may seem counterintuitive, electronic trading does not necessarily create a motivation or obligation to confirm trades electronically. Parties may not have adopted electronic confirmation platforms due to the cost and effort associated with building out their internal infrastructure to connect to these platforms. For parties who trade infrequently, there may not be enough return on investment to motivate the transition from paper to electronic confirmations. For parties who are non-financial entities, swap trading is not their primary business; therefore establishing additional infrastructure to support these activities may be a relatively low priority when compared to other internal priorities.

Differences between asset classes

The differences between electronic confirmation rates between asset classes can be attributed to distinction in the consumers of their derivative products, adoption of electronic confirmation platforms, or support of products on electronic confirmation platforms.

Counterparties in the Commodities asset class are a disparate mix where the G-14 only represents about 18% to 20% of the market. The remainder of the market is primarily non-financial institutions whose internal infrastructure is not focused on trading, but generation, consumption and supply of commodities. As a result, these institutions are unlikely to adopt or build infrastructure to support electronic trading, confirmation and settlement. In Commodities, there are five different providers of electronic confirmation matching service (eConfirm, EFET, MarketWire, SWIFT and Misys) and currently no single provider covers the whole spectrum of commodity derivatives. Unlike other asset classes in which parties can invest in a single e-matching platform, in commodities users need to invest in several offerings in order to improve their electronic confirmation matching rates.

In FX, the primary impediment to increasing electronic confirmation rates is client architecture. As described above, smaller clients often lack the infrastructure to accept and receive electronic confirmations. Based on their limited trading volumes, they are unlikely to be incentivized to implement the necessary internal infrastructure to send and receive electronic confirmation messaging.

The Interest Rate market is similar to FX in that client behavior is the primary hurdle to improving electronic confirmation rates. Although there has been marked progress over recent years through

dealer engagement with clients, there are still clients who have not adopted electronic confirmation platforms, and are generally happy to accept paper confirmations.

Equity swaps that are confirmed non-electronically are attributable in part to portfolio swaps which are not conducive to confirmation on electronic confirmation platform as they are confirmed subject to a Portfolio Swap Agreement under which all changes to a portfolio are confirmed via end of day negative affirmation. For other equity products, the availability of standard Master Confirmation Agreements (“MCAs”) for non-electronically eligible products is an impediment to moving these to an electronic confirmation platform. The industry conducts a quarterly volume review of non-electronically eligible products to prioritize adoption of new MCAs. This is a prerequisite to collaborating with the electronic confirmation platforms to support and prioritize a new product.

The remaining Credit trades confirmed on paper are primarily comprised of structured trades that are not electronically eligible (e.g. Bespoke Tranche, First to Defaults), mass novations or trades that are fairly standard products but have a bespoke term that renders them ineligible for electronic confirmation (e.g. a single name European Corporate CDS denominated in Australian Dollar).

Overall, structured trades are not conducive to confirmation on electronic platforms due to their complex or bespoke terms which are difficult to normalize in electronic messaging formats since all possible factors and values cannot be predicted and built in advance. In cases where structured products become standardized enough to capture terms electronically, the cost of building out the complex confirmation infrastructure may not be justifiable based on the relative volume of this product as compared to more vanilla products.

Cost of on-boarding parties and products to electronic confirmation platforms

To provide further clarity as to why clients may be reluctant to adopt electronic confirmation platforms and the industry has not prepared further products for electronic confirmation eligibility we offer the following additional narrative related to the cost vs. benefit considerations.

Each asset class uses different electronic confirmation platforms. If a client conducts trades in all asset classes, it would need to build the infrastructure to integrate to as many as four different platforms, and then upgrade messaging each time a new product or functionality is added to each platform. These efforts and costs are routine for Dealers who can generally justify the per trade cost based on volumes, but to a smaller bank or client who trades infrequently, the operational cost may limit their ability to participate in the market.

Upgrading electronic confirmation platforms to support additional products is routinely done if a product is standardized enough to normalize data and the necessary underlying documentation is published in order to limit the electronically confirmed terms. However, sometimes the product volume does not justify the associated cost, especially when a product is no longer actively traded but instead residual activity is mostly comprised of post-trade activity on historic positions.

Evolution of electronic confirmations

Despite differences in the current landscape of electronic confirmations for each asset class, they share willingness and commitment to improve these rates in collaboration with regulators. This has been demonstrated in recent years via the voluntary commitments made to the members of the OTC Derivatives Regulators' Forum ("ODRF"). These commitments have evolved to deliver automation against increasingly challenging milestones appropriate to each asset class.

The progress resulting from these commitments is demonstrable in the following table which shows the average percentage of trades which have been electronically confirmed amongst major dealers (as reported to member of the ODRF via Cross Product Metrics monthly submissions):

Percentage of Trades Electronically Confirmed

	Credit	Equity	Rates	Commodities
Dec-07	94.7	19.3	59.7	41.9
Dec-08	95.8	26.4	66.8	46
Dec-09	99.3	42	73.7	73
Dec-10	98.8	38	79.3	65.4
Dec-11	97.6	36.9	84	62.8
Feb-12	99.1	38.7	84.9	62.8

Please note: The above table does not include FX forwards and options as monthly submission for these have not been requested by the regulators. The above figures include cleared trades for Commodities whereas the file provided under separate cover only includes bilateral trades.

Based on the foregoing, we are confident that electronic confirmation statistics will continue to improve at rates appropriate to each class. We encourage and appreciate regulatory interest and investment in helping us to achieve this goal, but also wish to ensure that this progression is phased realistically based on asset class specific challenges and takes into consideration the increased operational cost and burden to clients to confirm trades electronically and to firms and electronic confirmation platforms to launch support of new products.

If you have any further questions, please contact Mary Johannes (mjohannes@isda.org).