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The Committe of European Securities Regulators
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Standardisation and Exchange Trading of OTC Derivatives

CFA Institute is pleased to comment on the Committee of European Securities Regulators (CESR) consultation paper on Standardisation and Exchange Trading of OTC Derivatives (the "Consultation").

CFA Institute, through its members' experience in international markets and different investment disciplines, represents the interests of investors and investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide. CFA Institute promotes fair, open, and transparent global capital markets, and advocates for investors' protection.

We appreciate the opportunity to comment on the proposals to increase standardisation of over-the-counter (OTC) derivative contracts and exchange-trading of such contracts. These two elements have a significant impact on the microstructure of derivatives markets, which are currently dominated by dealer participation and bilateral trade execution.

Standardisation of derivatives currently traded OTC is a necessary step to facilitate greater market transparency through the use of exchanges and other organised, non-discretionary multilateral electronic trading venues. Transparency alleviates information asymmetry, underpins investor confidence and liquidity, and facilitates calculation and monitoring of risk exposures. These factors strengthen the functioning and resiliency of markets and thus benefit both investors and regulators. CFA Institute is therefore supportive of efforts to increase standardisation and exchange trading of derivatives.

We concur with CESR that, within this framework, users of derivatives should be permitted to retain the flexibility to customise contracts in certain, limited circumstances. In our view, such circumstances should be confined to situations where at least one counterparty is seeking to hedge a legitimate identifiable commercial risk.

Executive Summary

The Consultation addresses standardisation and exchange trading separately, providing an overview of the current environment, an assessment of what standardisation and exchange trading entail, and the benefits and limitations of each.

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In general, CFA Institute is supportive of both greater standardisation in OTC derivative markets and greater use of exchange trading for such contracts. In a survey of CFA Institute members in October 2009[1], 68 percent of members agreed that all standardised and standardisable derivative contracts that currently trade over-the-counter should be required to trade on a regulated exchange. Likewise, 78 percent of members agreed that such contracts should have to clear centrally. Finally, 66 percent of members agreed that electronic reporting of over-the-counter trades would provide an appropriate level of transparency for all investors for those derivatives that continue to trade OTC.

Accordingly, CFA Institute is supportive of complementary initiatives to strengthen post-trading infrastructure through central counterparty clearinghouses and trade repositories. We note, however, that such initiatives are not substitutes for on-exchange trading, which addresses the separate issues of trading transparency, liquidity, and price discovery.

CFA Institute's other positions are that price transparency is one of the most important goals of financial markets, and that investors should have full access to relevant market information. Standardisation and exchange trading further these goals.

Our main observations on the Consultation's questions are as follows:

Standardisation

- CFA Institute broadly concurs with CESR's analysis of the benefits and limitations of standardisation. We believe there are additional risks that may come with standardisation. Our concern is that if firms are required to trade on exchange but there is very little interest in a contract that meets their needs, these firms may find the costs of managing their risks prohibitive and choose to forego hedging their business risks all together. However, on balance, we consider the benefits of greater standardisation to outweigh the limitations, and thus support the drive towards greater standardisation.

- The ultimate goal of standardisation should be to facilitate, first, greater transparency of the markets' pricing of specific risks and, second, greater oversight of the OTC market. To achieve this second goal, standardisation should work to increase contract fungibility, so that products are substitutable and transferable across multiple parties.

- We encourage regulators to work constructively to encourage industry bodies to further their initiatives to increase standardisation in respect of legal uniformity, process uniformity, and product uniformity.

- We also support the establishment of working groups and taskforces (that cross both regulatory and industry participants) to facilitate industry input into the regulatory process and promote exchange of information.

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[1] The survey results are based on the responses of 755 CFA Institute members based in the United States. The results are available at http://www.cfainstitute.org/Survey/us_iwg_poll_report.pdf

Exchange Trading

- CFA Institute supports greater exchange trading of derivatives. Exchange trading facilitates efficient price discovery through displayed pre-trade quotations and publication of post-trade prices and volumes. Public price transparency underpins investor confidence and helps strengthen liquidity, thus contributing to more resilient markets.

- The non-discretionary nature of exchanges and other organised electronic multilateral trading venues ensures fair market access and fair treatment of investors. It is also easier to monitor for potential instances of market abuse when transactions are conducted through such transparent, organised venues.

- Liquidity (as it relates to exchange trading) is best defined in terms of market depth (measured by open interest), breadth, and resiliency. Narrow bid-ask spreads and low volatility are consistent with liquid markets.

- Contract fungibility is necessary for liquid exchange trading. Contracts must be substitutable and transferable across multiple parties in order to sustain market liquidity.

- The primary element that would prevent additional OTC derivative instruments to trade on exchange platforms would be a lack of interest, whether from corporate end users, investors, or speculators. It would be commercially unviable for derivatives exchanges to continue listing instruments that generate minimal interest among these groups.

- We note that if contracts cannot be accurately margined, collateralised and marked to market, such that they are not permissible for CCP (central counterparty) clearing, then it follows that exchange trading would also not be practicable. Hence, there is a clear link between the scope for CCP clearing and exchange trading.

- We do not consider Systematic Internalisers (SIs) to be relevant venues for 'exchange trading' of derivatives currently traded OTC, as SIs are bilateral venues. If it is determined that SIs are relevant venues for the trading of OTC derivatives, amendments to the existing SI framework would be necessary for such trading to yield the same benefits as exchange trading of derivatives contracts (such as public price transparency and market integrity).

- Moreover, if it is determined that SIs are to provide the same benefits that RMs and MTFs provide, they should also be subject to the same rules to provide for a level playing field. Similarly, for a crossing network to qualify as a MiFID "organised trading venue", it should engage in similar activities and be subject to the same rules as other "organised trading venues".

- We support CESR's assertion in paragraph 117 that exchange trading of derivatives is desirable and that such trading of standardised contracts should be incentivised as much as possible. We consider higher capital requirements for bespoke OTC derivatives positions, combined with stricter rules on collateralisation and margining,

to be the most appropriate and effective incentive towards greater use of exchange trading.

- CESR should also work towards generally reducing costs for derivatives exchanges including, for example post-trading costs for exchange-traded contracts and facilitating interoperability.

Please do not hesitate to contact us should you wish to discuss any of the points raised.

Yours faithfully,

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With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, London and Brussels, CFA Institute is a global, not-for-profit professional association of more than 101,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 139 countries, of whom more than 89,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 58 countries and territories.

CFA Institute develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). CFA Institute is best known for developing and administrating the Chartered Financial Analyst® curriculum and examinations and issuing the CFA Charter.

Specific Comments

I. A Preliminary Step on the way to Exchange Trading: Standardisation

CESR notes that there are three elements to be considered in relation to standardisation:

- Legal uniformity (standard transaction documentation and definitions);
- Process uniformity (includes straight-through-processing, confirmation and settlement)
- Product uniformity (includes standard valuation, payment structures and dates)

CESR's assessment of the degree of standardisation is set out in section 2.3 paragraph 41 of the Consultation, which illustrates in tabular form the degree of standardisation amongst credit, interest rates, equity, commodity and foreign exchange OTC derivatives.

1. Do you agree with CESR's assessment of the degree of standardisation of OTC derivatives? Is there any other element that CESR should take into account?

The table noted above provides a useful summary of the degree of standardisation amongst OTC derivatives. The assessment also indicates that credit derivatives are the most standardised asset class, whilst OTC equity derivatives are the least standardised.

We are not aware of any other factors that would materially alter this analysis. We also concur with the three elements of standardisation put forward by CESR (legal, process and product uniformity).

2. Do you agree with the benefits and limitations of standardisation noted above? Please specify. Can you also describe and, where possible, quantify the potential impact of the limitations to standardisation? Are there any other elements that should be considered?

CESR notes the following benefits of increased standardisation in paragraph 39 of the Consultation:

1. Operational risk reduction (standardised products lend themselves to higher degrees of automation and consequently reduce operational risk).

2. Facilitates the use of clearing (clearing house operations are simplified when contracts exhibit fungible terms).
3. Ease of unwind (this can improve efficiency when positions need to be offset or terminated for risk purposes)
4. Facilitates the reporting of information for regulatory purposes.
5. Enhances contractual certainty.

Other benefits of standardisation listed by CESR include greater transparency and pricing comparability across homogeneous products; greater capacity for and facilitation of information sharing; and more meaningful trade data stored in trade repositories.

The limitations of standardisation identified by CESR (paragraph 40) include:

1. Legitimate need for bespoke products (need to preserve the ability for non-financial institutions to use customised OTC derivatives to hedge specific commercial risks).
2. Exposure to basis risk (used of standardised products may limit the ability of market participants to perfectly hedge their risk profile).
3. Loss of hedge accounting benefits (use of standardised products may result in an imperfect match between the underlying and hedge position, thus losing favourable accounting treatment).
4. Product maturation (a sufficient degree of product maturation is necessary to support greater standardisation).

We broadly concur with CESR’s list and the analysis of the benefits and limitations of standardisation of these items. We believe there are additional risks that may come with standardisation.

Standardisation and exchange trading of derivatives instruments presupposes an existing market for whatever instruments are created. However, the history of derivatives exchanges is one of trial and error, where some contracts receive significant interest and others do not. Indeed, efforts on the part of exchanges to recreate trading markets for bespoke, over-the-counter instruments have regularly failed to generate much investor interest.

Our concern is that if firms are required to trade on exchange but there is very little interest in a contract that meets their needs, these firms may find the costs of managing their risks prohibitive and choose to forego hedging their business risks all together. This could increase the systemic risks for these firms and potentially for whole market segments.

On balance, nevertheless, we consider the benefits to outweigh the limitations, and thus support the drive towards greater standardisation. At the same time, we also support CESR’s assertion that non-financial companies should be permitted sufficient flexibility to tailor customised OTC derivative contracts where such users are seeking to hedge a legitimate identifiable commercial risk.

Regarding the final part of the question, we are not in a position to quantify the potential impact of the limitations to standardisation.

3. **Do you agree that greater standardisation is desirable? What should be the goal of standardisation?**

As noted in the previous question, we support greater standardisation. The ultimate goal of standardisation should be to facilitate, first, greater transparency of the markets' pricing of specific risks and, second, greater oversight of the OTC market. To achieve this second goal, standardisation should work to increase contract fungibility, so that products are substitutable and transferable across multiple parties. Fungibility is a precondition for liquid exchange trading.

4. How can the industry and regulators continue to work together to build on existing initiatives and accelerate their impact?

In addition to the consultation process, we support the establishment of working groups and taskforces (that cross both regulatory and industry participants) to facilitate industry input into the regulatory process and promote exchange of information.

5. Are there any obstacles to standardisation that could be removed by regulatory action? Please elaborate.

We are not able to comment on this question.

6. Should regulators prioritise focus on a) a certain element of standardisation and/or b) a certain asset class? Please provide supporting rationale.

As CESR notes, certain OTC asset classes are already relatively standardised (e.g. credit derivatives) whereas others remain largely customised (e.g. equity derivatives). On face value, this may suggest focusing attention on certain asset classes. However, as CESR notes, there may be valid economic reasons why certain OTC asset classes are less standardised than others. For example, paragraph 44 of the Consultation notes that widespread usage of exchange trading for equity derivatives means that those transactions that do take place OTC tend to be largely customised. Further, the remaining asset classes covered in the Consultation – interest rates, commodity, and FX derivatives – are all assessed by CESR to have a 'reasonable' degree of standardisation overall. Taking each of these factors into account, it would seem that there is no single asset class that warrants priority over another when determining the regulatory focus. On this basis, we believe that regulators should prioritise attention on a) a certain element of standardisation.

Of the three elements of standardisation, we note that industry initiatives have been successful in establishing master agreements, standardised definitions, and in some cases (such as CDS big bang and small bang protocols) product standardisation. These initiatives have done much to increase legal uniformity and product uniformity. As CESR notes, these two elements are key to achieving electronic, automated processing (process uniformity).
We therefore encourage regulators to work constructively to encourage industry bodies to further their initiatives to increase standardisation in each of these three areas.

7. CESR is exploring recommending to the European Commission the mandatory use of electronic confirmation systems. What are the one-off and ongoing costs of such a proposal? Please quantify your cost estimate.

We are not in a position to estimate the quantitative impact of this proposal.

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II. Exchange Trading

8. Do you agree with the assessment done by CESR on the benefits and limitations of exchange trading of OTC derivatives? Should any other parameters be taken into account?

The benefits of exchange trading cited by CESR include a high level of transparency; enhanced liquidity; ensures operational efficiency and risk reduction (by facilitating straight-through processing); and provides fair market access and treatment amongst market participants.

We firmly agree with these benefits. In particular, exchange trading facilitates efficient price discovery through displayed pre-trade quotations and publication of post-trade prices and volumes. Public price transparency underpins investor confidence and helps strengthen liquidity, thus contributing to more resilient markets. Further, as CESR notes in paragraph 66, the lack of transparency in OTC trading makes it difficult for supervisors to establish a fair view of transactions and positions. Such opacity may affect other market segments whose pricing is related to the prices established by certain derivatives contracts.

In addition, the non-discretionary nature of exchanges and other organised electronic multilateral trading venues ensures fair market access and fair treatment of investors. It is also easier to monitor for potential instances of market abuse when transactions are conducted through such transparent, organised venues. Combined, these factors uphold market integrity. CFA Institute is therefore supportive of exchange trading.

Finally, derivatives exchanges, by working closely with central clearing facilities, ensure the uniform application, valuation, and imposition of margin. It was the failure of CDS market participants to require AIG to post margin on its CDS business that permitted it to continue to sell coverage to financial institutions even as its book of business had grown beyond what would have been feasible in an environment that required the firm to post margin.

The limitations of exchange trading cited by CESR include the requirement for contracts to be standardised (in contrast to OTC markets which enable users to trade flexible and bespoke contracts); reduced room for product innovation; and potential detrimental effect on liquidity from ‘excessive’ transparency.

We acknowledge CESR’s consideration of the limitations of exchange trading, but disagree with respect to two of the three factors.

Firstly, we do not consider exchange trading to reduce the room for product innovation. Irrespective of the drive towards more exchange trading, the financial industry has, over the years, consistently demonstrated its ability to adapt, innovate, and create new products. The evolving nature of financial markets is such that certain products will migrate to exchanges over time as they mature, whilst new products will continue to be developed by financial institutions that do not immediately lend themselves to exchange trading. We therefore do not consider ‘room for innovation’ to be a concern for regulators. This view is reinforced by the fact that – as the recent financial crisis has amply demonstrated – not all innovation is beneficial.

Secondly, we do not consider exchange trading to lead to 'excessive transparency'. The concerns that transparency could potentially harm liquidity or discourage participation in these derivatives markets are no more applicable to derivatives markets than they are to other types of financial markets. In the equity markets, a well-calibrated transparency framework that provides both pre- and post-trade transparency, deferred publication for 'large' trades and waivers from disclosure of pre-trade quotations under specific circumstances has led to well-functioning, liquid trading. We also note that cash equities are the most transparent asset class and yet this market has proven to be the most resilient functioning market throughout the recent financial crisis. For these reasons, we do not consider exchanges to lead to 'excessive transparency', nor for price transparency to have a detrimental effect on liquidity.

9. Which sectors of the market would benefit from/ be suitable for (more) exchange trading?

The Consultation notes that credit derivatives are the most standardised OTC asset class. CESR also comments, in its analysis of the degree of exchange trading, that (paragraph 58): "credit derivatives are not included, because of the negligible amount of exchange trading". For both of these factors, credit derivatives (such as CDS) would benefit from more exchange trading.

10. In your view, for which sectors of the market will increased transparency associated with exchange trading increase liquidity and for which sectors will it decrease liquidity? Please specify.

As noted above, CFA Institute is generally supportive of increased transparency in all markets. We are not able to comment on how increased transparency will affect market liquidity for specific contract types.

11. Do you identify any other elements that would prevent additional OTC derivatives to be traded on organised platforms?

The primary element that would prevent additional OTC derivative instruments to trade on exchange platforms would be a lack of interest, whether from corporate end users, investors, or speculators. It would be commercially unviable for derivatives exchanges to continue listing instruments that generate minimal interest among these groups.

12. How should the level of liquidity necessary/relevant to exchange trading be measured?

Liquidity is generally defined and measured in terms of depth (open interest amassed at various price levels); breadth (the number and breadth of market participants); and resiliency (the ability of price levels to withstand market pressure). In addition to depth, two frequently used measures of liquidity include bid-ask spreads and volatility. Narrow bid-ask spreads are typically associated with a large number of market participants (thus increasing the range of pricing points at which users can trade). Low volatility (or variability of price changes) is typically indicative of resilient markets.

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13. Do you agree with CESR's assessment of the characteristics and level of standardisation which are needed for a contract to be traded on an organised trading platform?

CESR notes that a high degree of the three elements of standardisation – legal, process, and product uniformity – forms the cornerstone for eligibility for exchange trading. In paragraph 84, CESR cites the following additional factors: size of the underlying market; size and diversity of market participants; liquidity (in terms of the pool of buying and selling interest); availability of CCP clearing; and contract fungibility (the extent to which one contract fully substitutes another).

We agree with this assessment. As we have noted in our response to question 3, contract fungibility is a precondition for liquid exchange trading.

We also note that the ability to accurately set margin and collateral requirements and to mark positions to market on a daily basis are necessary conditions for central counterparty (CCP) clearing. Without such criteria, the risk concentration within CCPs may pose systemic threats. If contracts cannot be accurately margined, collateralised and marked to market, such that they are not permissible for CCP clearing, then it follows that exchange trading would also not be practicable. Hence, there is a clear link between the scope for CCP clearing and exchange trading.

14. Is the availability of CCP clearing an essential pre-determining factor for a derivative contract to be traded on an organised trading platform? Please provide supporting rationale.

It is the clearing of derivative instruments where determinations are made about what level of margin is appropriate and necessary for various counterparties. As noted in our response to the previous question, if this margining process is not accurate, it can put the clearinghouse, not to mention the entire financial system, at risk. For the exchange, a lack of certainty of this type would reduce trust among counterparties, which in turn would reduce trading activity and open interest. Therefore, as we have noted in the previous question, if a contract is not suited to CCP clearing, then it follows that exchange trading of such a contract would not be practicable.

15. Is contract fungibility necessary in order for a derivative contract to be traded on an organised trading platform? Please provide supporting rationale.

As we have noted elsewhere, we consider contract fungibility to be a precondition of liquid exchange trading. If contracts are not substitutable, then they are not transferable across multiple parties representing buying and selling interests. Multilateral activity, underpinned by contract fungibility, is necessary for liquid exchange trading.

16. Which derivative contracts which are currently traded OTC could be traded on an organised trading platform? Please provide supporting rationale.

In our view, the most prominent OTC derivative contracts suitable for trading on an organised trading platform are benchmark index credit default swaps (CDS), certain large single-name CDS issues, and sovereign CDS. As CESR notes, credit derivatives (particularly index CDS contracts) are the most standardised amongst OTC derivative asset classes and

thus best suited to trading on transparent, organised electronic trading venues. Exchange trading of such contracts would do much to improve their liquidity and price efficiency. Further, CDS play an important role in reference pricing for the cash bond and equity markets. As such, improved liquidity and pricing efficiency in CDS markets would generate positive externalities.

17. Please identify the derivative contracts which do trade on an organised trading platform but only to a limited degree and could be traded more widely on these types of venues.

We are not best placed to comment on this question.

18. In the OTC derivatives context, should any regulatory action expand the concept of "exchange trading" to encompass the requirements set out in paragraph 86 and 87 or only the requirements set out in paragraph 86? Please elaborate.

Paragraph 86 notes that the defining aspects of exchange trading (according to the European Commission Communication of 20th October 2009) include:

- A multilateral trading system (to eliminate the bilateral nature of concluding trades);
- Pre- and Post-trade transparency (to provide high visibility to prices, volumes and open interest); and
- East market access.

Paragraph 87 notes that some of the characteristics of "organised trading functionalities" according to MiFID include:

- Non-discretionary and transparent rules;
- Objective criteria for the efficient execution of orders;
- Non-discriminatory access;
- Authorisation/regulation and monitoring by competent authorities;
- Operational resilience; and
- Surveillance of compliance with the organised trading venue's rules.

We believe that the criteria in both paragraphs 86 and 87 are necessary to encompass the concept of exchange trading.

We also note that the MiFID definition of organised trading venues includes Regulated Markets (RMs), Multilateral Trading Facilities (MTFs), and Systematic Internalises (SIs). However, SIs are bilateral execution venues, and so do not meet the criterion specified in the first bullet point of paragraph 86. Furthermore, equity trading transacted through SIs is classified as 'OTC' in trade reports, based on its bilateral nature. Accordingly, we do not consider SIs to meet the concept of 'exchange trading'.

19. Do current trading models and/or electronic trading platforms for OTC derivatives have the ability to make pricing information (both pre- and post-trade) available on a multi-lateral basis? Please provide examples, including specific features of these models/platforms.

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We are unable to comment on this question.

20. Do you consider the SI-regime for shares relevant for the trading of OTC derivatives?

As noted in our response to question 18, we do not consider SIs to be relevant venues for 'exchange trading' of derivatives currently traded OTC. Whilst SIs can be considered to be organised venues, the transparency requirements pertaining to SIs are narrower than for RMs and MTFs (such as the requirements to only publish pre-trade quotes up to 'standard' market sizes in 'liquid' markets, with no minimum quoting size). Further, as CESR notes, SIs are not required to provide open access and they have discretion over the counterparties they wish to trade against.

Accordingly, trading of derivatives contracts through SIs (as currently defined and calibrated) should be considered to be OTC, as is presently the case for equities. Consequently, SIs are not relevant in the context of the push towards exchange trading.

21. If so, do you consider that the current SI-regime provides the benefits described above which 'exchange trading' may offer or are amendments needed to the SI obligations to provide these benefits to the OTC derivatives market?

As noted in the previous question, we do not consider SIs to offer the same benefits as exchange trading. If it is determined that SIs are relevant venues for the trading of OTC derivatives, amendments to the existing SI framework would be necessary for such trading to yield the same benefits as exchange trading of derivatives contracts (such as public price transparency and market integrity).

Moreover, if it is determined that SIs are to provide the same benefits that RMs and MTFs provide, they should also be subject to the same rules to provide for a level playing field.

22. Which characteristics should a crossing network regime, as envisaged in the review of MiFID, have for a CN to be able to be qualified as a MiFID "organised trading venue"?

CESR defines crossing networks in paragraph 99 of the Consultation as "firms in the EU who operate systems that match client order flow internally".

In our view, for a crossing network to qualify as a MiFID "organised trading venue", it should engage in similar activities and be subject to the same rules as other "organised trading venues." Fair and even regulatory treatment of different types of trading venues engaging in the same type of activity is necessary to uphold a level playing field.

23. In your view does the envisaged legislative approach in the US leave scope for regulatory arbitrage with the current EU legislative framework as provided under MiFID? Would regulatory measures taken in the EU to increase 'exchange trading' of OTC derivatives help to avoid regulatory arbitrage?

The approach toward OTC derivatives markets that has been adopted in the United States is one primarily geared toward pushing exchange-trading and central clearing of these

instruments. The approach seeks to strictly limit the ability of market participants, including corporate end-users, to use bespoke instruments except in rare circumstances.

In this sense, the greater flexibility in the EU could create an opportunity for US end-users and others to engage in regulatory arbitrage, by initiating their hedging trades with institutions located in the EU to ensure that their specific risks are managed. Consequently, regulatory measures taken in the EU to increase exchange trading of these instruments would reduce the opportunity for regulatory arbitrage.

24. The Commission has indicated that multi-laterality, pre- and post-trade transparency and easy access are key aspects of the concept of "on exchange" trading. Do you agree with CESR applying these criteria in its further analysis of what this means in the EU context, in particular in applying MiFID to derivatives trading?

We firmly agree that CESR should apply these criteria in its further analysis into the application of MiFID to derivatives trading. As we note in our response to question 18, the criteria in paragraph 87 should also be considered.

25. If not, do you consider that MiFID requirements and obligations should be refined to cover deviating characteristics of other electronic trading facilities? Please elaborate.

Please refer to our response to question 24. We have no further comments.

26. Are there any market-led initiatives promoting 'exchange trading' that the regulators should be aware of?

Whilst we are aware that individual exchanges have launched specific execution facilities for certain derivatives contracts that are also traded OTC, we are not aware of any industry-wide initiatives.

27. Which kind of incentives could, in your view, efficiently promote greater trading of standardised OTC derivatives on organised trading venues? Please elaborate.

We support CESR's assertion in paragraph 117 that exchange trading of derivatives is desirable and that such trading of standardised contracts should be incentivised as much as possible.

We consider higher capital requirements for bespoke OTC derivatives positions, combined with stricter rules on collateralisation and margining, to be the most appropriate and effective incentive towards greater use of exchange trading. Such bespoke, non-fungible contracts are inherently more volatile in price, and therefore more risky than standardised, liquid products, and thus the capital requirements and collateralisation for these types of contracts should be commensurately higher than for exchange trading.

CESR should also work towards generally reducing costs for derivatives exchanges including, for example post-trading costs for exchange-traded contracts and facilitating interoperability.

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28. Do you believe there would be benefits in a mandatory regulatory action towards greater trading of standardised OTC derivatives on organised venues? Please elaborate.

We don't believe mandatory action would create any benefits or costs beyond those noted in Question 2 above.

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