Julia: **Welcome to a DerivSource podcast. I'm Julia Schieffer, the founder and editor of DerivSource.com.**

Most predict 2015 will be more of the same in terms of regulatory reform and market-wide change for the derivatives industry, however there no doubt that there will be new challenges market participants must contend with as regulation progresses and implementation kicks off to meet these new requirements.

Cross-border issues, margin concerns will continue to colour the coming twelve months, but the focus will also shift to other areas such as MiFID.

In this DerivSource podcast you'll hear from some industry experts as to what they believe to be the most dominant issues in 2015.

CCP clearing in Europe will be a main focus in the coming year as firms prepare to meet this new requirement, and Damon Batten, Principal Consultant at Catalyst Consulting, believes the focus on clearing and the recognition of third party CCPs will dominate going forward.

Damon: I think in 2015 the dominant theme will be that there will be no letup in the current regulatory agenda, and so regulation will for another year dominate thinking in derivatives markets.

In the first half of the year we're likely to see an entry in force of the EU clearing mandates, first the interest rate swaps but with CDS and FX NDS likely to be hot on its heels, and we should also see some further news on the EU recognition of third country CCPs and whether they will indeed recognise the US as being equivalent in terms of their clearing rules.

And then moving in to the second half of 2015, we should see a significant ramp-up towards the first phase of the bilateral margining requirements (they're due to be introduced in December 2015), and we are also over the course of the year likely to see some significant further developments on MiFID II with indeed a draft of the second level legislation expected at some point during the year.

Looking a bit further afield beyond the EU and US, we're also likely to see some significant movement on the clearing mandate discussion in that Asia-Pacific region, very likely that there will be new clearing mandates introduced in Hong Kong, Australia, perhaps India, and indeed the extension of client clearing mandates will also be moving forward in Japan.

Julia**:** **Rafael Plata, Secretary General at EACH (the European Association of CCP Clearing Houses), explains his views as to how CCP clearing will evolve this year and what clearing houses will focus on.**

Rafael: Will likely be the implementation of the clearing obligation in the European Union. As you know, one of the parts of the G20 commitment was actually to increase clearing through central counterparties. That had to be implemented through a regulatory process in the EU and that is now coming to an end with the implementation of the regulation next year. What this means is that as from more or less around the summer next year, because times are not confirmed yet, interest rate swaps will start being centrally cleared by CCPs in the European Union and then other asset classes will follow gradually.

All in all, this will mean that some ten to fifteen per cent of the OTC derivatives market will be centrally cleared in the coming years, starting from the summer next year, and in figures this means something like $70 trillion US Dollars of notional outstanding being cleared in the EU and other jurisdictions which probably again means that derivative markets will become safer and more efficient through CCP clearing.

Each institution represents the interest of CCPs in the European Union, so we've got two big projects, or two big targets, for 2015. One of them would be dealing with the upcoming legislative proposal on recovery and resolution of CCPs, and the other one would be dealing with the review of the EMIR legislation which surprisingly enough is already there, so the review of the clearing obligation, CCP requirements, etc, is scheduled to start next year by the European Commission.

So, recovery, resolution, and EMIR review will be probably the two priorities for each country in 2015.

Julia**:** **One of the major challenges firms face as they prepare for CCP clearing is the legal documentation required. Now, this is a huge undertaking and firms will have to start working on drafting up the appropriate terms and renegotiating contracts this year in order to be ready in time.**

Allan Yip, Partner at Simmons & Simmons, explained this in some detail.

Allan: One thing I would say is the clearing obligation under EMIR, and in particular the legal documentation but also the operational work in relation to that, we're a bit behind in Europe when it comes to the clearing obligation. It's not in force yet; the relevant secondary legislation is likely to be published in Q1 2015 but then with phase-in between six months and up to three years for the ultimate end users.

I think the reason for the phase-in is to allow the industry to get ready for it, and one of the biggest challenges the industry is going to face is in relation to documentation; we've heard people talk about 'documaggedon' and the amount of time and effort it's going to take to get clearing documents in place, and I think that is something that even though the clearing obligation itself may not come into effect until sometime in 2016 for many people, 2015 must be the time when people focus on getting the clearing documentation in place if they don't want to be facing a situation where they have to sign what is in front of them without being given the opportunity to negotiate it.

***Julia*: In addition to CCP documentation, Allan also mentioned that margin (an issue that we've all been talking about for 2014 and previous to that) is going to continue to be a big dominant issue, and in particular the uncleared margin requirement.**

Here are his views as to what exactly is going to be the focus for the coming year.

Allan: The second issue I would pick is in relation to the margin requirements. This is part of the risk mitigation requirements, just as the same as under Dodd Frank, there is the requirement to post margin in relation to uncleared trades. Now, the rest of the risk mitigation obligations under EMIR have come into force and the industry is dealing with those already, but in relation to the margin requirements they are due to come in at the end of 2015 and those requirements, broadly speaking, require parties to exchange variation margin but also they contain some fairly prescriptive rules in relation to the posting and receiving of initial margin, mainly that you've got to do it in the first place, but also that the initial margin must be segregated and that's going to be new for many participants, particularly on the end user side, because whilst they are used to posting margin, they will be receiving margin, sometimes for the first time, but also all the margin that they post and receive must be segregated. And that's going to require a lot of operational work to set up structures, potentially with third-party custodians as well, there are prescriptive rules in relation to methodology by which the initial margin must be calculated. So both on the dealer side and on the end user side that's going to require a lot of operational work in terms of building out the systems and inputting the relevant fields, but also on the legal side because with the new margin rules coming in, effectively the industry is facing a situation whereby all existing credit support arrangements, presumably under the ISDA credit support documentation, will have to be re-documented and amended in certain forms to take account of the particular segregation issues and new documentation with any third-party custodians and control of all the segregation issues. I think that that is going to be another very big issue that the industry is going to have to deal with next year.

Julia**:** **The impact of greater capital requirements will have on the markets in terms of cost and liquidity and preparing for regulation implementation generally has been a big issue that the market has been discussing recently, and this has been a big issue in particular amongst the broker community.**

I asked Alex McDonald, the CEO of the Wholesale Markets Brokers Association, what he viewed to be the most dominant issue for the coming year.

Alex: We think that the dominant issue next year, in 2015, will be the self-same issue which dominated last year, the year before, and the year before that, which is capital and liquidity, and particularly the interplay between the two.

Evidently, the increasing costs of capital on the market participants has reduced activity at the margin, but it is also forcing markets to re-evaluate themselves in where they have predominantly acted as principal, agents are now going to act far more in terms of pass through and venues, so therefore some of the moves that we saw before 2010 in the equity markets where the role of intermediaries to act as both principal and as agent is going to be evident across the markets now.

So, in this sense, the requirement for liquid and utile venues, particularly SEFs, MTS and OTF, will be higher going forward as they act as arrangers of liquidity for participants who are acting perhaps on behalf of others as much as on their own balance sheet. So we think that this is going to dominate. This transformation which is, if you like, a confluence of stricter Basel requirements both for capital and liquidity, plus more formal and organised venue requirements is going to create a new market structure, not only in the EU, and probably not only in the US, but around the world.

The second issue that we think will dominate 2015 will be the difficulty in rule implementation of both EMIR and MiFID in the EU. Perhaps this parallels some of the stickiness in setting out the rule sets in Dodd Frank where we have seen now a series of no action relief letters which have moved several of the problems, perhaps too difficult to solve in the short term, out to the end of next year, and for EMIR the difficult issues of trade reporting which have dominated 2014 will need to be solved in 2015. Meanwhile, the process of writing out Level II rules for MiFID, particularly the regulatory technical standards which are going to be set out in a consultation paper at the start of the new year, is really going to dominate the first half of 2015, and the actual detailed setting out of those regulatory technical standards will dominate the second half of next year.

***Julia*: The list of requirements and challenges is long, but there may be an easier time to be had if the market, particularly the buy-side and the sell-side, collaborate more.**

Allan Yip offered his hopes for the coming year.

Allan: I think what I would hope to see is the sell-side and the buy-side working together in a more let's say efficient way, particularly in relation to some of the things that are coming in 2015 in relation to the legal documentation that's required, whether it's in relation to documentation to meet some of the margin requirements or clearing documentation there has been a tendency still for the two sides to be a bit partisan, so the dealer community would propose some documentation, sometimes behind closed doors, and then present that to the buy-side saying "here we go, can you please approve this".

I think what would be really good for the industry as a whole would be for the process to be more collaborative at an earlier stage. That's something that I think industry groups can play a big role in.

***Julia*: That's our quick preview into 2015. Obviously there will be some surprises next year, as there usually are, but many of the issues as we've discussed already are known or will be continuing on from the last year or two.**

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