EXPOSÉ OF THE DISSERTATION

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The Impact of Margin Requirements for Non-Centrally Cleared Derivatives

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Content

1. The Development of Global Standards for noncentrally cleared Derivatives

At the Pittsburgh Summit Meeting in September 2009, the heads of state and governments of the G20 countries agreed that, by the end of 2012 at the latest, all standardised over the counter (OTC) derivative contracts should be traded on exchanges or, optionally, on electronic trading platforms and settled through a central counterparty (CCP).[1] Furthermore, they required that all OTC derivative contracts be reported to trade repositories. In 2012, the G20 agreed to increased capital requirements for noncentrally cleared derivatives, with the aim of reducing systemic risk and promoting central clearing. [2] In the aftermath of the 2008/09 financial crisis, international cooperation was required because of the large-scale interconnectivity and interdependence of the derivatives market, and to discourage regulatory arbitrage and uneven playing fields between states.

The G20 called on the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) to develop several new global standards. In July 2012[3] and February 2013,[4] the Bank of International Settlement (BIS) conducted two consultation rounds, along with a quantitative impact study.[5] The final framework[6] outlined the 'Eight Key Principles' for margining noncentrally cleared derivatives. These include appropriate margining practices, the exchange of initial and variation margins, and a consistent approach for calculating margins that would guarantee full coverage of counterparty risk exposure. To ensure adequate risk coverage, these margins needed to be immediately available and to have an appropriate haircut to ensure adequate risk coverage. The Eight Key Principles were implemented through EMIR (EU) 648/20124[7] (hereafter referred to as "EMIR") for the European Union, and the Dodd-Frank Act[8] for the United States. Due to its enormous impact on the financial industry (higher operational expenditure, legal fees, corporate and management re-structuring, etc.,), this regulatory framework was introduced in two phases over four years. After some delay, Phase One started on 1 September 2016 with the implementation of the requirement to exchange variation margins between the major players in the market.[9] Phase Two implemented the variation margin requirements for all other players in the market, with initial margin requirements being phased in annually through 2020. Ultimately requiring both counterparties in a transaction to calculate the variation margin daily and allocate it to a separate account. This implementation caused severe legal and operational issues and required counterparties to establish significant additional capital reserves on their balance sheets. Morgan Stanley

[1] G20 Leaders Declaration, Pittsburgh summit 24–25 September 2009; See II Annex.
[2] G20 Leaders Declaration, Los Cabos summit 18–19 June 2012; See II Annex; Higher capital requirements are set out in Basel III.
[3] BCBS and IOSCO, First Consultation Paper on margin requirements for noncentrally cleared derivatives (July 2012).
[4] BCBS and IOSCO, Second Consultation Paper on margin requirements for noncentrally cleared derivatives (February 2013).
[5] Published in the Annex of the Second Consultation Document for Margin requirements for noncentrally cleared derivatives.
[6] BCBS and IOSCO, Final Paper on margin requirements for noncentrally cleared derivatives (March 2015).
[7] Council Regulation (EC) 648/2012 on OTC derivative, central counterparties and transactions registers, OJ L 201/1 (2012).
[8] Dodd–Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203 (2012).
[9] BCBS and IOSCO, Press Release, Revisions to the implementation of margin requirements for noncentrally cleared derivatives issued by the Basel Committee and IOSCO (18 March 2015); As major players are considered investment banks with an aggregate month-end average notional amount of non-centrally cleared derivatives of more than €3 trillion (only five dealers are affected: Morgan Stanley, Goldman Sachs, J.P. Morgan, Citi, Bank of America).

mentioned in the 2016 Form 10-K report that 'new regulation of OTC derivatives markets in the U.S. and similar legislation proposed or adopted abroad will impose significant new costs and impose new requirements on our derivatives activities'.[10] Goldman Sachs has identified in its Form 10-K report that regulation regarding OTC derivatives negatively impacted market liquidity 'as market participants and market practices and structures adjust to new regulations'. [11]

Market participants who used the International Swaps and Derivatives Association (ISDA) Master Agreement to trade derivatives, had to adhere to the 2016 ISDA Variation Margin Protocol which requires parties to either amend their existing Credit Support Annex (CSA), or enter into the newly issued 2016 variation margin CSA. Furthermore, capital reserves had to be made available on an ad hoc basis for entry into derivative transactions. In addition, operational systems had to be rebuilt to comply with regulatory standards (e.g., separate accounts for segregation of initial margins, a system for daily valuation, etc.). In my research, I hypothesize that the G20 mandate has had a tremendous cost and liquidity impact on the market for noncentrally cleared derivatives and that the efficacy of this international regulatory framework is questionable.

2. The Impact of Margin Rules

2.1. Regulatory Impact

After the financial crisis of 2008/09, the G20 decided to regulate the market with the abovementioned objectives. However, the restrictions imposed through margin requirements had to be necessary and justifiable.[12] Cases like Lehman Brothers and American International Group shed light on what global financial regulators – G20 and Financial Stability Board (FSB) – wanted to achieve with margin requirements. Political fora such as the G20 often satisfy the public demand for immediate action without asking whether such regulations are necessary or considering their long-term legal, economic, and financial impacts. The purpose of regulation cannot be justified based on the need to respond to a public outcry. Moreover, the lack of regulation in a pre-crisis period cannot justify post-crisis overregulation. It is important to question whether the G20 mandate, the framework provided by BCBS and IOSCO and European Regulations, were adequate for achieving the previously defined goals as inadequate measures can often lead to overregulation or superficial solutions further leading to unnecessary liquidity shortages or weak investor protection. There may be other regulatory measures that, if implemented in place of these, would affect liquidity to a lesser extent and are thus more desirable.

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[10] Form 10-K Morgan Stanley, Annual Report for the year end December 31, 2016.

[11] Form 10-K Goldman Sachs Inc., Annual Report for the year end December 31, 2016.

[12] Benedict Kingsbury et al., The Emergence of Global Administrative Law, 68 Law and Contemporary Problems 15-62 (Summer 2005).

Margin requirements for noncentrally cleared derivatives must be justifiable in terms of public interest as they promote the trend of CCP clearing, which ultimately influences investment decisions. I hypothesize that several regulations for noncentrally cleared derivatives do not support the G20's aim appropriately and posit that some selected measures are inadequate as other alternative measures could achieve the same results with less impact. In this study I will examine whether the implementation serves the public interest by analyzing both the stakeholders' and the publics' interests.

2.2. Market Impact

Are margin requirements a necessary transaction cost? North[13] argues that low transaction costs boost economic growth. Margin rules therefore seem like a practical solution to keep the thriving derivatives markets in check. Moreover, the requirement to post high-quality collateral, such as T-Bills, with an appropriate haircut requires states to issue more government bonds than needed and makes the government more dependent on the derivatives market, as stricter margin requirements result in a higher demand for government bonds.

Margin requirements result in higher entry costs and ultimately prevent other competitors from entering the derivatives market. Counterparty credit risk exposure is thus dominated by a relatively small number of large derivatives counterparties, which develop — as in the case of the CCP — into systemically important global banking organizations that become 'too big to fail'. Is this what the G20 mandate seeks to achieve? The G20 promotes clearing over the CCP, which is, due to operational reasons, only available for standardized products (so-called plain vanilla products). However, in the past, clearing over the CCP was the exception, whereas now it will become the norm. For example, actively managed portfolios mainly hedge through structured derivatives and therefore need to clear noncentrally, whereas passively managed portfolios (e.g., index tracker funds) hedge through plain vanilla derivatives. New technologies, such as artificial intelligence and smart contracts, could allow clearing complex products over the CCP. It remains unclear whether margin requirements are an economic tool that are used to control the size of the noncentrally cleared derivatives market.

[13] North, DC., Transaction Costs, Institutions, and Economic Performance (ICS Press 1992); Pistor, Katharina. The Code of Capital: How the Law Creates Wealth and Inequality. Princeton; London: Katharina. The Code of Capital: How the Law Creates Wealth and Inequality. Princeton; London: Princeton University Press (2019).

2.3. Engineering Derivatives under the New Margin Rules

Several counterintuitive regulations exist, including one relating to option collateralization: In an option transaction, Party A pays a premium upfront to Party B. Under the normal mechanics of a bilateral CSA, Party B is obliged to post collateral to Party A if the mark-to-market value of that option moves in Party A's favor at the beginning of the period. Hence, Party B could effectively end up financing their options since they would be free to use this collateral, however they liked (e.g. re-hypothecation under NY law). On 4 January 2020 this became standard practice. It is this and other unjustifiable constructions that lead to liquidity shortages. They are the result of a regulatory approach that applies the same regulatory technique to every type of derivative. Regulation that is more in line with the specific characteristics of the derivative and the market in which it is used would lead to fewer liquidity shortages. Furthermore, regulators need to start using technology to respond faster and more accurately to changes in the market. They also need to be able to clear complex derivatives over the CCP as more complex investment strategies have emerged.

2.4. Independent Margin and Variation Margin

While the variation margin protects against the counterparty credit risk arising from fluctuations in market value, the initial margin protects against potential losses between the last exchange of variation margin and liquidation or hedging of positions following a counterparty default. Portfolio managers must now consider the fact that securities in their portfolio will be posted as an initial margin; consequently, the acceptability of assets as eligible collateral is a significant consideration in portfolio management. This means setting up an entirely new margin administration infrastructure from an operational perspective. The initial margin can lead to overcollateralization and consequently to a significant liquidity shortage in the market which in many cases during the financial crisis of 2008/09, proved not to be recoverable by transferors and pledgors. In response to this, ISDA published a White Paper in 2010[14] that proposed four ways for segregating the initial margin from other collateral under the CSA. A third party — the custodian — was introduced as an independent segregation, to protect against default or insolvency of the collecting counterparty along with a new contractual relationship, the Account Control Agreement, which introduced a third party in the transaction. This research investigates the risk mitigation techniques (independent price referencing, electronic price and quoting limits, market making protection, hedging through underliers, caps on leverage, introduction of different base capital types, capital protection schemes) introduced since the financial crisis and their validity under the premises of risk reduction and decreasing impact of companies' defaults.

14 International Securities and Derivatives Association, White Paper Independent Amount (2010).

3. International Legal Challenges to Enforce Margin Requirements

3.1. Unilateral vs Multilateral

The G20 is an international 'ad hoc' forum,[15] which consists of 19 countries and the EU, and accounts for 85% of the world's GDP and two-thirds of its population.[16] The forum was criticized for under-representing emerging market countries[17] and for its lack of underlying legal constitution (e.g., charter, treaty, statute).[18] Similarly, IOSCO and BCBS are not based on international treaties, act mainly by consensus, and develop standards that are not legally binding. In 2009, the G20 founded a new global body, the FSB, to oversee the efforts made regarding noncentrally cleared derivatives. It is unclear what kind of enforcement tools and techniques — apart from political accountability to the public — are available to the FSB.

Based on the premise (i) that there is no unified legal system with the authority to regulate and enforce requirements for noncentrally cleared derivatives and (ii) that the market is mainly cumulated in certain states; there is a question of whether 'cooperative unilateralism' amongst the main affected stated a better option would be than multilateralism. Unilateral actions by a powerful state (or a group of powerful states) could be more effective than measures based on multilateral agreements. This is primarily since other states probably would have taken the same measures and developed and enacted similar regulations. Second, since it takes time to establish a sufficient international legal system, unilateral measures are already available. Finally, a unilateral approach set by a few states overcomes the cooperation issue, accelerates the decision-making process, and is more flexible for amending industry standards.[19]

3.2. Legal Framework

The standards set by the international bodies mentioned above have only suggestive character and are informally agreed upon. The final policy framework — 'The Eight Key Principles' — set in 2012[20] by IOSCO and BCBS[21] was based on the request of the G20.[22] The G20 called IOSCO and BCBS to

[15] Kern Alexander, and others 'The Legitimacy of the G20 - A Critique Under International Law' SSRN Electronic Journal 1 (2014).
[16] https://www.bbc.com/news/world-48776664
[17] Alexander and others (n 10).
[18] G20 Leaders Declaration, Washington D.C. 14 –15 December 2008.
[19] Verdier Pierre-Hugues, 'Global Banks on Trial: U.S. Prosecution and the Remaking of International Finance' Oxford University Press (2020).
[20] Published 06 July 2012; First update 2 September 2013; Second update 18 March 2015; Third update 23 July 2019; Fourth 03 April 2020.
[21] IOSCO and BCBS, Margin requirements for noncentrally cleared derivatives (April 2020).
[22] G20 Leaders Declaration, Cannes 3 – 4 November 2011.

develop consultation standards on margining non-centrally cleared OTC derivatives by June 2012. The FSB is tasked with continuously reporting the progress made to commit to the G20 standards regarding OTC derivatives.[23] As a private association, ISDA will play an important role in the future, as OTC derivatives regulation will likely be governed by private legal rules.[24] This was made clear in the case Caiola vs. Citibank,[25] in which the court supported the private legal rules while relying extensively on the parties' representations in the ISDA documentation and confirmation of this transaction.[26] Several scholars consider that the privatization of legal rules in this field is likely to continue.[27] ISDA will thus gain more power in the international derivatives market and under the circumstances of informality and 'privatized legislation' the suggestive character of ISDAs recommendations can be harder than positive law due to the consensus amongst the market players. Inherent to the regulation of noncentrally cleared derivatives is the level of complexity and cross-regional, which requires international connected industry experts and, due to the rapid changes in the market, a ratification procedure is unrealistic.

4. Research Structure

4.1. Overview

First Research Question: What is the purpose of margin requirements for noncentrally cleared derivatives?

Sub-Questions

1. How and why does the current regulatory approach by the G20, differentiate between centrally cleared and noncentrally cleared derivatives?
2. What are the differences in implementation of the G20 guidelines for different jurisdictions (NY vs UK law)?
3. How does the application of margin requirements differ by product type?

Second Research Question: How can we design regulation for noncentrally cleared derivatives with fewer liquidity constraints than the current legal framework?

Third Research Question: Do we need to rewrite the G20 mandate and the 'Eight Key Principles'?

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[23] See also FSB, Progress Report on Implementation, OTC Derivative Market Reforms (11 October 2011).
[24] Partnoy F, 'ISDA, NASD, CFMA, and SDNY: The Four Horsemen of Derivatives Regulation?' SSRN Electronic Journal (2005).
[25] Caiola v. Citibank, 137 F. Supp. 2d 362, 364–65 (S.D.N.Y. Apr. 2, 2001).
[26] Partnoy (n 24).
[27] ibid.; Horst J, Transnationale Rechtserzeugung: Elemente Einer Normativen Theorie der Lex Financiaria.; Andreas Fischer-Lescano, Transnational Force of Law (2019); Pistor, Katharina. The Code of Capital: How the Law Creates Wealth and Inequality. Princeton; London: Princeton University Press (2019).

4.2. Preliminary Consideration

The BCBS states in its consultation papers[28] that the main issue of mandatory bilateral margin requirements is the high cost for the end-users (e.g., pension funds). Examples of significant costs for the industry include the 'two-way posting' of the initial margin and its segregation without the possibility of rehypothecation, re-pledging, or reuse. Other examples are restrictions on margin eligibility, haircut rules, and costs associated with reporting, valuation, and compliance. These, along with additional margin requirements, must be 'priced in' when offering a price for noncentrally cleared derivatives.

Margin requirements are 'transaction costs' as understood in the Modigliani–Miller theorem (M&M theorem)[29] and by the Black and Scholes model,[30] according to which reducing transaction costs decreases the impact on firms' corporate finance structure (M&M theorem) and increases the accuracy of options pricing (Black and Scholes model). An analysis of existing research regarding the pricing impact of margin requirements is important to understand the importance of such rules.

As stated in several consultation papers, one of the main objectives of IOSCO and BCBS is to reduce the systemic risk of derivatives that are noncentrally cleared. This research requires an understanding of current academic work whether the international standards set by the G20 reduces systemic risk. External cost and systemic risk exposure are minimal for centrally cleared derivatives since they are standardized and the CCP assures their performance.[31] It needs to be investigated whether the systemic risk for noncentrally cleared derivatives can be reduced through capital requirements and other regulations outlined in international standards.

4.3. Research Questions

4.3.1. First Research Question: What is the purpose of margin requirements for noncentrally cleared derivatives?

To investigate the individual purposes and use of margin requirements, I will ask whether these requirements are necessary and justifiable. One needs to weigh the public interest (e.g., safe and sound banking) against private interests (e.g., business opportunities) for each type of derivative as well as to consider the restrictions of the free market.[32] It is therefore necessary to understand the difference in the

[28] IOSCO and BCBS, Margin requirements for noncentrally cleared derivatives (April 2020).
[29] Modigliani F, Miller MH, 'The cost of capital, corporation finance and the theory of investment' 48(3) American Economic Review 261–297 (1958).
[30] Fischer B, Scholes, M, 'The pricing of options and corporate liabilities' 81(3) Journal of Political Economy 637–654 (1973).
[31] Baker CM, 'Clearinghouses for over-the-counter derivatives' (2018).
[32] From a broader perspective, it raises a question about the optimal balance between public regulation and private ordering within margin requirements.

application of margin rules for the most common derivative types (options, swaps, futures/forwards). The external effect on the economy may vary depending on the counterparty and use of derivatives. Pension funds that use derivatives to hedge their portfolio may not have as significant of an impact as hedge funds that use derivatives for speculation. Moreover, historical analysis of the causes of the financial crisis inherent in the derivatives market and of the public demand for preventive measures will prove beneficial for this research.

To understand the purpose of margin rules, it is necessary to analyse why international standard setters take a different approach for centrally cleared and noncentrally cleared derivatives. One of the main differences in regulation concerns the higher capital requirements for banks that engage in noncentrally cleared derivatives trade. This raises a question; Why in particular do noncentrally cleared derivative trades need to be backed by higher capital requirements? The counterparty itself provides capital, which cannot be adjusted on an intraday level and mainly targets counterparty risk. Margin however, only covers risk on a trade-by-trade basis. This difference could be an indication that banks should live up to the same capital requirements as a CCP. Banks use swap agreements to hedge their positions and lower the impact of capital requirements on overall profit and loss (PnL) — and therefore to lower the level of capital requirements which leads to more interconnectedness in the market. A comparison between different jurisdictions and between international, EU law and national law, as well as differences in the scope and conclusion of law, will help to understand the regulation of noncentrally cleared derivatives.

4.3.2. Second Research Question: How can we design regulations with fewer liquidity constraints for noncentrally cleared derivatives?

A part of my discussion will be concerned with whether maintaining high liquidity is only possible through deregulation. In this context, I will provide examples of international and national regulations that can enhance liquidity and achieve the G20's objectives. I intend to analyse whether regulations preventing the reallocation of assets (e.g., strict rules on rehypothecation or initial margins) to produce the maximum overall welfare, have an impact on liquidity and could contribute to a future crisis.

The G20's main objective is to reduce the systemic risk of derivatives that are noncentrally cleared. In financial terms, this means that the IOSCO and BCBS try to lower the Beta of the individual derivative. Every value of an asset has a different sensitivity to the market movement; this sensitivity is called 'Beta' (β) and is the numerical description of systemic risk. Beta is a measure of how individual assets move when the overall stock market increases or decreases. I will evaluate the elimination of systemic risk based on the approach taken in the consultation paper and compare it to my 'Beta Derivative Model'.

4.3.3. Third Research Question: Do we need to rewrite the G20 mandate or the Eight Key Principles?

Due to the characteristics of OTC derivatives (e.g., the private completion of transactions, the complex web of mutual interdependencies of stakeholders, difficult comprehensibility of the financial instruments, etc.), OTC trading was met with harsh criticism after the financial crisis of 2008/09.The difficulty in determining the risks and the general uncertainty arising therefrom, adversely affect investor sentiment and jeopardize financial stability.[33] This has resulted in a flood of regulations of the OTC derivatives markets[34], not only EMIR and the Dodd Frank Act, but also the CRD IV[35]/ CRR[36] and the Basel III[37] - package of related measures; mainly prompted by the G20. This research question allows me to systematically investigate, through normative research, whether the G20 needs to rewrite its mandate or whether the BCBS and IOSCO need to reexamine the 'Eight Key Principles'. I intend to analyse materials, statuses, precedents, and publications with a descriptive research approach, in order to understand the political intentions and controversies that occurred during the enactment of the G20 mandate. In the next step I will describe the multi-layers character of the of global governance regarding noncentrally cleared derivatives, to understand the respective relationships of the G20 mandate within the legislative framework.[38] The discretion is given to national legislators to accustomate regional market practices, regulatory approaches, and legal systems; which might lead to uneven playing field and regulatory arbitrage. In conjunction with results obtained from the previous research questions, I might make suggestions on how to amend the G20 mandate and clarify what the impact might be on the market this might have.

[33] Communication of the Commission Ensuring efficient, safe and sound derivatives markets COM 332 final 4 (2009).
[34] Altrock/Müller, Regulierungsflut im OTC-Derivatemarkt meistern (Coping with the regulatory flooding in the OTC derivatives market), Die Bank (2014).
[35] Directive (EC) 2013/36 on the access to the activity of credit institutions and the supervision of credit institutions and investment firms, on the amendment of Directive (EC) 2002/87 and the cancellation of Directives (EC) 2006/48 and (EC) 2006/49, OJ L 176/338 (2013).
[36] Council Regulation (EC) 575/2013 on the access to the activity of credit institutions and the supervision of credit institutions and investment firms and on the amendment of Directive (EU) No. 646/2012, OJL 176/1 (2013).
[37] Basel Committee on Banking Supervision, Basel III: A global regulatory framework for more resilient banks and banking systems, December (2010) (rev, June 2011); Basel III: the net stable funding ratio October (2014).
[38] Kingsbury (12 n).

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6. Preliminary Table of Content

I. Annex – Definitions

Derivative - A contract that derives its value from the performance of an underlying variable (e.g., equity, index, FX etc.)

Option - A contract where the holder has the right, but not the obligation, to buy or sell an underlying asset or instrument at a specified strike on, (or in some cases prior to,) a specified date.

Forward - A non-standardized contract between two parties to buy or sell an asset at a specified future time at a price agreed on at the time of conclusion of the contract.

Swap - An agreement between two counterparties to exchange financial instrument cashflows or payments for a certain time.

OTC - Over-the-counter or off-exchange trading refers to markets where counterparties enter into contracts directly, without the supervision or interference of an exchange.

Margin - The collateral that a holder of a financial instrument is required to deposit with a counterparty to cover some, or all, of the credit risk the holder poses for the counterparty. Such margin can be posted in Cash or securities.

Initial Margin - The collateral collected by a counterparty to cover its current and potential future exposure in the interval between the last collection of margins and the liquidation of positions or hedging of market risk following a default of the other counterparty.

Variation Margin - (Mark-To-Market Margin) is the collateral collected by a counterparty to reflect the results of the daily marking-to-market or marking-to-model of outstanding contracts (i.e. margin tied to the underlying performance).

Clearing - The process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions.

Central counterparty - A legal entity that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer. Their primary purpose is to mitigate counterparty risk between market players.

ISDA - International Swaps and Derivatives Association is a trade organization of participants in the market for over-the-counter derivatives.

ISDA Master Agreement - The most commonly used master service agreement for OTC derivatives transactions. It is a framework of documents, designed to enable OTC derivatives to be documented fully and flexibly. The framework consists of a master agreement, a schedule, confirmations, definition booklets, and credit support documentation. The master agreement is a document agreed between two parties that sets out standard terms that apply to all the transactions entered into between those parties. Each time that a transaction is entered, the terms of the master agreement do not need to be re-negotiated and apply automatically.

Credit Support Annex - Defines the terms or rules under which collateral is posted or transferred between swap counterparties to mitigate the credit risk arising from "in the money" derivative positions.

Counterparty Risk - The risk that a debtor may be unable or even unwilling to make his payment fully and in time, as outlined in the underlying contractual obligation.

Systemic risk - Is the risk of collapse of an entire financial system or market segment.

II. Annex – G20 Mandate

LEADERS' STATEMENT Pittsburgh Summit on 24 – 25 September 2009

'Improving over-the-counter derivatives markets: All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end- 2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.'

LEADERS' STATEMENT Los Cabos Summit on 18 – 19 June 2012

'We reaffirm our commitment that all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012, OTC derivative contracts should be reported to trade repositories and non-centrally cleared contracts should be subject to higher capital requirements. We welcome the FSB progress report on implementation. Now that substantial progress has been achieved in the four safeguards for a resilient and efficient global framework for central clearing, jurisdictions should rapidly finalize their decision-making and put in place the needed legislation and regulations to meet the G20 commitment for central clearing. We acknowledge the progress made to develop the key principles to promote internationally consistent minimum standards for the margining of non-centrally cleared derivatives and encourage international standard setters to finalize the proposed global margin standards by the end of this year, to match the implementation deadline for other OTC derivatives reforms and for the Basel capital framework.'