

# CDS TRADING Q&A

**Global regulation is set to dramatically change the way credit default swaps (CDS) are traded. Below we have attempted to answer some of the most frequently asked questions in relation to how the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Dodd-Frank Act”) is likely to impact e-trading of OTC derivatives.**

## **1. How will the Dodd-Frank Act change the CDS market in the U.S.?**

Among the most significant provisions of the derivatives section of the Act are:

- (1) mandatory clearing, through regulated central clearing organizations, of all swaps that the CFTC or the SEC has determined should be cleared (“clearable swaps”);
- (2) mandatory trading of clearable swaps on a board of trade designated as a contract market or a securities exchange or through a “swap execution facility” or SEF (in each case, subject to certain key exceptions) and;
- (3) reporting of swap information to swap data repositories.

## **2. When will the new rules for the trading of CDS take effect in the U.S.?**

We expect the CFTC to finalize the SEF rules for CDS index trading during 2012, and we expect the SEC to finalize its rules for securities-based swaps in 2013. We anticipate that clearable swaps will be mandated to trade on contract markets or SEFs beginning in 1Q 2013. Despite continuing uncertainty around the exact regulatory timeline, MarketAxess and its clients are working to develop the infrastructure necessary to trade CDS.

## **3. What steps has MarketAxess taken to prepare for implementation of the Dodd-Frank Act?**

First, MarketAxess has participated in several regulatory roundtables and a number of other meetings with both regulators and legislators, sharing our experiences in electronic trading for OTC markets and our views regarding appropriate rules for derivatives clearing, trading and price reporting. We have also submitted extensive written comments on proposed rules to the CFTC and SEC.

Second, we are fully engaged with market participants, including buy- and sell-side customers, affirmation hubs, and central clearing organizations, to prepare for these changes. Our progress is reflected in a tripling of our client-to-dealer CDS trading volume from 1Q12 to 2Q12.

Third, in response to the anticipated requirements of Dodd-Frank, we have built and now offer multiple protocols to trade CDS indices and CDS single-names, including: request-for-quote (RFQ); request-for-market (RFM); live markets with streaming, executable prices for CDS from multiple dealers; and list trading.

Our deep experience in developing trading technology for the less liquid credit markets will allow us to quickly adapt and enhance trading protocols as mandated by Dodd-Frank and according to the market's demand.

#### **4. What is a SEF?**

The Dodd-Frank Act defines a SEF or 'swap execution facility' as a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system. The CFTC and the SEC have each proposed a detailed set of rules regarding the organization, administration and operation of SEFs. (The CFTC has jurisdiction over CDS indices, while the SEC regulates the trading of single-name CDS.)

#### **5. What percentage of the market do you believe will trade electronically?**

The potential size of the market will depend on how the regulators define which swaps are standard and must be cleared through one of the clearing institutions. Based on DTCC trade warehouse and other publicly available data, MarketAxess estimates that the current total average daily trading volume in the global client-to-dealer CDS market is between \$40 and \$50 billion in notional value, including indices and single-name CDS. Our current expectation is that at least 75% of the daily CDS trading volume will represent clearable swaps that will have to be traded on an exchange or through a SEF according to the Dodd-Frank Act as currently proposed.

#### **6. Is any of the CDS market likely to migrate to exchange trading?**

Much like the cash market in credit instruments, liquidity in CDS can be thin and discontinuous for a number of structural reasons. Although we expect the most actively traded index products to be fairly liquid in the context of the market, most of the single-name CDS and many of the less actively traded indices will be substantially less so. We believe the trading protocols available on MarketAxess, including our sophisticated RFQ capabilities that are tailored to less liquid markets, are more suited than a 'central limit order book' (CLOB) or exchange model to the type of trading typically done in CDS. That said, given the range of liquidity across the CDS market, we intend to offer clients a choice in protocols available for trading CDS.

#### **7. What will be your relationship with the clearing organizations?**

As an independently-owned SEF/MTF, we anticipate connecting to the clearing organizations to deliver trades executed on our platform to the clearing organization of the counterparty's choice. As the regulatory rulemaking evolves, we will continue to work actively with all industry participants to best understand and address the needs of the market.

#### **8. What are MarketAxess' capabilities in CDS?**

We provide a comprehensive suite of CDS trading capabilities. MarketAxess offers institutional investors a single trading platform with easy access to multi-dealer competitive CDS pricing. The streamlined RFQ trading protocol gives investors live, executable levels in both index and single-name CDS. Investors can also trade baskets of CDS single-names using our patented list trading protocol, which is a proven efficiency tool. In addition, we offer live, 'streaming markets' for CDS indices in both the U.S. and Europe, including U.S. high grade and high yield indices (CDX) as well as European indices (iTraxx). CDS single-name trading includes investment grade, high yield and emerging markets names.

Our straight-through processing, post-trade feeds and reporting capabilities can deliver significant operational efficiencies to CDS market participants. We also plan to augment our

superior trade execution capability with robust pre-trade CDS analytics featuring Markit intraday index pricing.

#### **9. Will there be a TRACE-like data source for CDS?**

In the U.S., the Dodd-Frank Act mandates that both cleared and uncleared swaps be reported to a registered swap data repository, and the CFTC and SEC have proposed rules for real-time public data reporting of swap transactions, including price and volume. As a result, we expect that there will be a greater level of transparency, both pre- and post-trade, in the CDS markets than has existed to this point.