ASSESSING THE REGULATORY, ECONOMIC, AND MARKET IMPLICATIONS OF THE DODD-FRANK DERIVATIVES TITLE

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

FEBRUARY 15, 2011

Printed for the use of the Committee on Financial Services

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CONTENTS

	Page
Hearing held on:	
February 15, 2011	1
Appendix:	
February 15, 2011	73

WITNESSES

Tuesday, February 15, 2011

Cawley, James, Chief Executive Officer, Javelin Capital Markets, on behalf of the Swaps and Derivatives Market Association (SDMA)	58
Donahue, Donald F., Chairman and Chief Executive officer, The Depository Trust & Clearing Corporation (DTCC)	53
Duffy, Terrence A., Executive Chairman, CME Group Inc.	55
Gensler, Hon. Gary, Chairman, U.S. Commodity Futures Trading Commission (CFTC)	10
Giancarlo, J. Christopher, Executive Vice President, GFI Group Inc.	60
Reiners, Craig, Director of Risk Management, MillerCoors LLC, on behalf of the Coalition for Derivatives End-Users	51
Schapiro, Hon. Mary L., Chairman, U.S. Securities and Exchange Commission (SEC)	8
Tarullo, Hon. Daniel K., Governor, Board of Governors of the Federal Reserve System	11
Thompson, Don, Managing Director and Associate General Counsel, JPMorgan Chase & Co., on behalf of the Securities Industry and Financial Markets Association (SIFMA)	57

APPENDIX

Prepared statements:	
Bachus, Hon. Spencer	74
Hinojosa, Hon. Ruben	75
Cawley, James	77
Donahue, Donald F.	81
Duffy, Terrence A.,	257
Gensler, Hon. Gary	277
Giancarlo, J. Christopher	288
Reiners, Craig	309
Schapiro, Hon. Mary L.	312
Tarullo, Hon. Daniel K.	323
Thompson, Don	330

Additional Material Submitted for the Record

Garrett, Hon. Scott:	
Written responses to questions submitted to Hon. Gary Gensler	337
Editorial from The Wall Street Journal dated February 11, 2011, entitled, "The Futures of America"	348
Hinojosa, Hon. Ruben:	
Written responses to questions submitted to Donald F. Donahue	350
Letter from The Financial Services Roundtable to David A. Stawick, Secretary of the Commission, CFTC	353
Written responses to questions submitted to James Cawley	357
Written responses to questions submitted to Terrence A. Duffy	361
Written responses to questions submitted to Hon. Gary Gensler	364

Page

Hinojosa, Hon. Ruben—Continued
Written responses to questions submitted to J. Christopher Giancarlo 366
Written responses to questions submitted to Hon. Daniel Tarullo 369
Perlmutter, Hon. Ed:
Written response to a question submitted to Craig Reiners 370
Waters, Hon. Maxine:
Editorial from The New York Times dated February 14, 2011, entitled, "Vanishing Act: 'Advisers' Distance Themselves From a Report" 371

ASSESSING THE REGULATORY, ECONOMIC, AND MARKET IMPLICATIONS OF THE DODD-FRANK DERIVATIVES TITLE

Tuesday, February 15, 2011

U.S. House of Representatives,
Committee on Financial Services,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the committee] presiding.

Members present: Representatives Bachus, Hensarling, Royce, Lucas, Manzullo, Biggert, Capito, Garrett, Neugebauer, McHenry, Marchant, Pearce, Posey, Fitzpatrick, Luetkemeyer, Huizenga, Duffy, Hayworth, Renacci, Hurt, Dold, Schweikert, Grimm, Canseco, Stivers; Frank, Waters, Maloney, Velazquez, Watt, Ackerman, Sherman, Meeks, Capuano, Hinojosa, Clay, Baca, Lynch, Miller of North Carolina, Scott, Green, Ellison, Perlmutter, Carson, Himes, Peters, and Carney.

Chairman Bachus. In the interest of time, I am going to submit my written statement for the record and will not make an opening statement. And I will recognize some members on our side until our 10 minutes has expired.

I urge members to give a brief statement or submit a written statement so we can move along. We will adhere to the 10 minute-limit on each side. Without objection, all members' written statements will be made a part of the record.

I want to welcome our witnesses and I look forward to your testimony. And with that, I recognize the ranking member for his opening statement.

Mr. Frank. Thank you, Mr. Chairman, and I will ask to be recognized for 3 minutes. We will stay within the 10 minutes. The hearing today is a prelude to a very important set of decisions we are going to be making today on the Floor.

We have two very able and dedicated regulators who were extremely cooperative with us as we drafted the bill. We actually have three, but Mr. Tarullo is not on the Floor this week with his appropriation since his agency doesn't receive one.

The budget that we have been presented for the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) prevent them from doing the job the American people need them to do. The CFTC is a very small agency compared to the massive industry we have asked them to regulate.

I believe it is clear. We will hear more about this from the people on the Financial Inquiry Commission that the lack of regulation of derivatives in various aspects contributed greatly to the financial crisis.

We gave the Commodity Futures Trading Commission and the SEC instructions with some latitude as to how to deal with that. We are, at this point, in jeopardy of their not being able to carry out that mandate. The SEC has other responsibilities in investor protection and elsewhere that are in jeopardy.

So I hope we will, as we go through this hearing, and talk about the importance of this to be done thoughtfully and in coordination between the SEC and the CFTC, keep in mind that an absence of funding will make all of this invalid.

Agencies that are not well-funded are not going to do a good job. I would say to people in the industry, the laws and the rules, the law has already been adopted, the rules are about to be promulgated, it is not in anybody's interest to have agencies that are not well-funded, not able to have the equipment they need, not able to have the personnel they need to carry these out.

And that, I think, is the overhanging question as we go through this hearing. We are about to debate a budget from my Republican colleagues that will provide such inadequate funding for the SEC and the CFTC as to make all of this academic. I will be offering an amendment to increase funding for the SEC. The CFTC does not come under the jurisdiction of this committee so I have no amendment to offer there.

I believe the Administration has made some neutral proposals about how to increase its funding, and I hope that those are also adopted. But we will be voting on an amendment to raise the SEC—not to the level I wish it could be at, but to a far closer level to what is needed.

And as we go forward and we talk about the importance of doing this, and I would say even to those who are critical, who wish we hadn't done some of what we did, unfunding the rules that remain in place is the worst of all approaches.

Chairman BACHUS. I thank the ranking member.

Mr. Royce is recognized for 1 minute.

Mr. ROYCE. Thank you, Mr. Chairman. One of the lessons of the recent sale of the New York Stock Exchange, a great symbol of America's financial strength, to a German exchange is that our markets are now competing against mature financial hubs throughout Europe and Asia.

And much of this competition is because of the unfriendly business environment we have managed to create here in the United States. We have the second highest corporate tax rate in the developed world. We have the most active trial bar in the world. And we have a regulatory structure that burdens business without yielding many benefits.

In the derivatives realm, if transaction costs to end users of derivatives increase because of duplicative rules, because of complex, unworkable prescriptions, because of damage liquidity, then end users simply will send their business to European dealers, whether it is Barclays or Deutsche Bank, with whom many already have trading relationships.

Failure to create a commonsense regulatory structure that recognizes this fact will do little to protect investors, but will go a long way to benefit these growing financial hubs around the world. While Title VII wasn't what I would have liked to have seen, the benefit was that it gave the regulators, the supposed grownups in the room, the final say. Unfortunately, all signs thus far indicate that this, too, was a mistake.

I look forward to hearing from the panel. And I yield back.

Chairman BACHUS. Mr. Lucas?

Mr. LUCAS. Thank you, Mr. Chairman, for holding today's hearing. In the last Congress, I worked with my colleagues on this committee, as well as the Agriculture Committee, to bring meaningful and responsible reform to derivatives regulation.

Although I was not supportive of the final legislation, it is now critical that we work together to ensure that the implementation of Title VII is done right. These new regulations will undoubtedly have a tremendous impact on our country's financial sector and overall economy.

As we work our way through the rulemaking process, it is important that the process be accomplished in a thoughtful and transparent manner, and that the necessary regulatory certainty be provided for all market participants. I remain concerned that the current timeline for implementation is unrealistic and that more time is needed to adequately implement the law.

Additionally, we must ensure that the new rules are consistent with the congressional intent of Dodd-Frank. I look forward to continuing this discussion and hearing from our witnesses, and I yield back the balance of my time, Mr. Chairman.

Chairman BACHUS. Mr. Scott, for 2 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. As we have seen from the recent financial crisis, derivatives bring with them a number of certain potential dangers if not properly backed with capital, or if the market lacks sufficient transparency. But despite these past troubles, derivatives do serve a very valuable purpose for American businesses by protecting them against legitimate risk.

The Dodd-Frank legislation passed in large part by our committee aims to regulate credit default swaps and other derivatives. Title VII of the law requires central clearing and exchange trading for derivatives that can, and I emphasize can, be cleared and provides the role of both regulators and clearinghouses in determining which contracts should be cleared.

In addition, the law adds financial safeguards by ensuring that dealers and major swap participants have adequate financial resources to meet their responsibilities. And regulators now have the authority to impose capital and market requirements to swap dealers and major participants.

These regulations on derivatives were passed as part of Dodd-Frank to increase accountability and transparency and to encourage stability in financial markets following the 2008 crisis. However, the effectiveness of this law depends heavily on how such rules are implemented by the regulators.

I look forward to hearing opinions from today's witnesses on how the requirements enacted in Dodd-Frank are being adhered to now, how the regulatory process is proceeding, and how those regulations are contributing to increased financial stability, which is the end result we all seek.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Garrett is recognized for 2 minutes.

Mr. GARRETT. I thank the Chair. I thank the entire panel. Over the last several months, there has been a tremendous volume of discussion on all the rulemaking coming out of Dodd-Frank and the profound effects that it is going to have on the derivatives markets and the broader economy as well.

But when you look at this freight train of rulemaking that is really running down the track to a July deadline, I think not enough alarm has been raised over the potentially devastating impact that this rulemaking may have on the U.S.-based derivatives marketplace.

And when I talked to several market participants, they told me that if the rulemaking, particularly of the CFTC, were to be implemented in its current form it could literally spell the end of the U.S.-based derivatives market. It would simply cease to exist.

That is because the potential negative consequences are many and far-reaching, from making it prohibitively expensive for thousands of your small, Main Street companies to engage in responsible risk mitigation, to making it basically impossible for many of our financial firms to compete around the world. So the real world impact, of course, will be felt in the loss of jobs, lots of jobs.

Millions of manufacturing jobs have been lost, jobs over the last several years, but we have still remained a leader in financial services. But if these rules get implemented as is, that will no longer be the case.

We will hemorrhage millions of excellent, high-paying jobs to other localities around the world where there will be little to no appetite, I think, to follow some of the more outlandish rulemakings that are part of a grand and I would say unnecessary expense that could have massive negative consequences.

It is bad enough, I think, that Title VII was written literally in the middle of the last night of the Dodd-Frank conference back in June. So let us not here now exacerbate the mistakes made that night by rushing through a rulemaking process that is even more far-reaching than that contemplated by the bill's authors.

Derivatives, I think, have been a favorite whipping boy, if you will, of many critics. But if we continue down this road, and there is not a lot of time to change course, there is—literally may not be a U.S.-based derivatives market to kick around in this country anymore. I yield back.

Chairman BACHUS. Mr. Lynch for 3 minutes.

Mr. LYNCH. Thank you, Mr. Chairman. I thank the ranking member. I would also like to thank the witnesses for coming to this committee today to help us with our work. The derivatives title of the Dodd-Frank Act is essential to reforming our financial system. I believe the derivatives market, its opacity and extreme leverage, caused a great deal of the difficulty and pain of the financial crisis.

The interconnectedness of derivatives products and their use magnified among anonymous counterparties that concentrated risk, and much of it outside of the reach of our regulatory framework.

We have asked the SEC and the CFTC to issue numerous rulemakings and hold public hearings and begin the process of regulating the over-the-counter derivatives market, which neither agency has held jurisdiction over in the past.

I am concerned, however, that despite the increased responsibilities through Dodd-Frank, the SEC and the CFTC have received flat funding due to the extension of the continuing resolution. The ability of these agencies to police the markets and enforce securities and commodities laws is severely limited under current funding levels.

What is particularly concerning is that by holding these agencies to Fiscal Year 2010 budget levels, neither has been able to hire staff with expertise in the OTC derivatives markets, which differ significantly from their prior responsibilities in securities and futures markets.

And to make matters worse, the Republican proposal for a full year C.R. would cut $178 million from the SEC and $174 million from the CFTC. And that would force both of these agencies with new responsibilities to lay off staff.

We need to ensure that these regulators have the tools and resources to complete the objectives that Congress has laid out. Don't worry about the markets running away to Europe. They are trying to strengthen their markets just the way we are trying to. This is a red herring.

And if you think regulation is costly, how about the $7 trillion that we just lost from not regulating the derivatives market? That has not been taken into consideration. I look forward to the testimony. I thank you, Mr. Chairman. And I yield back.

Chairman BACHUS. Mr. McHenry, for 1 minute.

Mr. MCHENRY. Thank you, Mr. Chairman, for yielding time. Over the past few decades, the derivatives market has developed into a highly sophisticated and yet essential market for U.S. businesses of all sizes. Therefore, it is vital that the regulators who have been empowered under Dodd-Frank continue to allow American businesses to manage their risk and protect themselves against market volatility. This is about jobs.

A recent survey suggests that higher capital requirements could potentially cost end users on Main Street billions of dollars each year and put up to 130,000 jobs at risk. That is something we simply cannot afford to do while our economy is attempting to regain its strong footing. I would encourage the regulators to keep this in mind. And certainly our oversight hearings here in Congress will keep that in mind. And I yield back.

Chairman BACHUS. Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I will yield back my time. Thank you.

Chairman BACHUS. Ms. Hayworth, for 1 minute.

Dr. HAYWORTH. Thank you, Mr. Chairman. Senior colleagues here have rightly noted that the United States has become an increasingly hostile environment for investment relative to other developed nations.

I am very concerned that our highest duty in this Congress is to ensure the security and freedom of our Nation and our people. The specifics of what we do here have a material effect on jobs and on prosperity. And that is literally the dignity and sustenance of our families.

If we impede enterprise, as would be the case through excessive regulation of end user derivatives, and to wit, a Fortune 100 employer in my district would have to curtail key investment if required to meet capital requirements for end users as may be specified in Dodd-Frank, then we will lose our mission as a Congress and endanger our future as a nation.

So I look forward to hearing your comments on how we can relieve that burden from our American enterprise. Thank you. I yield back my time.

Chairman BACHUS. Thank you.

Mr. Dold?

Mr. DOLD. Thank you, Mr. Chairman.

Chairman BACHUS. One minute.

Mr. DOLD. I want to thank the witnesses for their time and for coming out today. And I certainly share some of the concerns that have been addressed by some of my colleagues today.

Derivatives have been productively and efficiently used for a significant period of time by reducing risk and reducing price volatility, increasing stability. These derivatives markets directly benefited companies, employees, consumers, and our overall economy.

In the past several years, certain companies have made some mistakes in the derivatives markets, to be sure. They didn't verify that their counterparties had sufficient collateral. They didn't verify that their counterparties had the ability to pay. They didn't determine whether their counterparties had too much exposure in other derivatives markets or market risk.

However, as far as I can tell, the end users did not make these mistakes systematically. And now these end users are faced with the uncertain prospects of margin regulations that sufficiently and unnecessarily change their longstanding successful businesses' models while focusing them to play capital inefficiently.

If they are forced to do so, then we will unnecessarily force scarce capital to be unparked unproductively on the sidelines. I believe that we will lose jobs here in the United States, and we will damage our economy.

And instead of reducing risk and reducing price volatility and increasing stability for businesses, employees, consumers, and indeed, I believe all Americans, we will get the opposite result as risks that would otherwise have been absorbed into the derivatives markets are passed along. I thank the chairman for the time. And I yield back.

Chairman BACHUS. Thank you, Mr. Dold.

Ms. Waters, for 1 minute.

Ms. WATERS. Thank you very much, Mr. Chairman. The Dodd-Frank Wall Street Reform and Consumer Protection Act was designed to address the lack of transparency and capital in the derivatives market, to prevent the industry and its clients from needing another taxpayer-funded bailout.

Specifically, the legislation calls for the SEC and the CFTC to regulate the OTC derivatives market to pre-approved contracts before clearinghouses can clear them, and to punish bad actors. In fact, the Dodd-Frank Act charges the SEC to promulgate seven rules to implement reforms to the OTC markets.

Some critics of the Dodd-Frank Act incorrectly represent that these reforms to the OTC market will result in fewer jobs. On the contrary, creating a system with transparency and regulation allows market participants to know what the rules of the game are and protects them from the impact of reckless trading of the sort that led to the 2008 financial crisis.

We saw that impact in 2008. Two years later, we are still seeing the effects of high unemployment, lack of credit, and limited business investment that resulted from the 2008 financial crisis. The Dodd-Frank Act will provide the transparency and regulation the OTC market needs to protect counterparties and taxpayers. In the process, it will save jobs.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman BACHUS. I thank you.

Mr. Canseco, for a minute-and-a-half.

Mr. CANSECO. Thank you, Mr. Chairman. And thank you very much for being here today, members of the panel. The breadth of rulemaking as a result of Dodd-Frank is extraordinary. According to the Committee on Capital Markets Regulations, the CFTC and the SEC are both making about 10 times the amount of rules per year than they did before Dodd-Frank was passed. The amount of days it takes for a rule to get from the proposed stage to implementation has been halved at the SEC.

These two agencies, along with the Federal Reserve and others, have been asked to take on an incredible task that has serious implications for our financial markets and economy. Dodd-Frank left a great deal of discretion to the agencies. That is why today's hearing is so important. Our job is to ensure that as the Federal agencies write these rules, they do not negatively impact the ability to hedge risk in our economy.

From my experiences in the private sector, where I actually worked with the derivatives, I know how important the ability of a company to hedge its risk using derivatives is to our economy and to our consumers.

Many of the benefits of derivatives are hidden to consumers. But when our fellow citizens go to the store to buy gas, milk, clothes or whatever else, they sometimes don't realize that the affordability of these products is due in large part to the manufacturer's ability to hedge risk. With this in my mind, I look forward to hearing from today's witnesses on this important issue. And I yield back my time.

Chairman BACHUS. Mr. Carson, for 1 minute.

Mr. CARSON. Thank you, Mr. Chairman. I welcome the opportunity to review Dodd-Frank to ensure the bill accomplishes what we intended it to do when it was written in this committee last year.

However, I am deeply opposed to defunding the bill because our friends on the other side were opposed last year, and continue to be opposed. The bottom line is that no legislation is perfect, and the opposition has a right to propose changes.

However, banks and financial institutions have brought reform upon themselves. It was through their carelessness and disregard for the rights of citizens that our economy nearly collapsed and spurred action by Congress in the first place. Thank you, Mr. Chairman. I yield back.

Chairman BACHUS. Thank you.

The last speaker on our side is Mr. Stivers, for a minute-and-a-half.

Mr. STIVERS. Thank you, Mr. Chairman. I would like to thank the witnesses for being here today. It is really important that we get Title VII right, both in law as well as regulation. There are companies in my district including American Electric Power who are end users. That company has 4,000 jobs in my district. There are many other companies who use derivatives to reduce risk in their business model.

And I am really concerned about the inconsistency between the SEC and the CFTC on their rules and regulations, especially with regard to the definition of a dealer or trader as well as capital requirements.

And because this is so important both to reducing risk in our system, cost to consumers, and jobs in our districts, I really look forward to hearing from the witnesses and working with the witnesses to make sure we take a consistent approach that doesn't affect jobs or increase prices but looks out for the safety and soundness of the system. Thank you so much.

And thank you, Mr. Chairman, for holding this hearing.

Chairman BACHUS. Thank you. And now we introduce our first panel: the Honorable Mary Schapiro, Chairman of the U.S. Securities and Exchange Commission; the Honorable Gary Gensler, Chairman of the U.S. Commodity Futures Trading Commission; and the Honorable Daniel K. Tarullo, member of the Federal Reserve Board of Governors.

I want to welcome all our witnesses. Without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony.

Chairman Schapiro.

STATEMENT OF THE HONORABLE MARY L. SCHAPIRO, CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION (SEC)

Ms. SCHAPIRO. Thank you very much, Chairman Bachus, Ranking Member Frank, and members of the committee. Thank you for inviting me to testify today on behalf of the Securities and Exchange Commission regarding our implementation of Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is a pleasure to appear with my colleagues, Chairman Gensler and Governor Tarullo.

As you know, these provisions are intended to bring greater oversight and transparency to the derivatives markets and to clear any payment and settlement activities and with that, to increase the stability of our financial system.

While implementing these provisions is a complex and challenging undertaking, particularly in light of our other regulatory responsibilities, we recognize the importance of this task, and we are committed to getting it right.

These rules are intended, among other things, to reduce counterparty risk by bringing transparency and centralized clearing to security-based swaps, reduce systemic risk, protect investors by increasing disclosure, and establish a regulatory framework that allows OTC derivatives markets to continue to develop in a transparent, efficient, accessible, and competitive manner.

Since passage of the legislation, we have been engaging in a very open and transparent implementation process seeking input on the various rules from interested parties even before issuing new rule proposals.

Our staff has sought meetings with a broad cross-section of interested parties. We joined with the CFTC in holding public roundtables. And we have been meeting regularly with other financial regulators to ensure consistent and comparable definitions and requirements across the rulemaking landscape.

Today, the SEC has proposed nine swaps-related rules. Among them are: rules that would address potential conflicts of interest at security-based swap clearing agencies, execution facilities and exchanges that trade security-based swaps; rules that would specify who must report security-based swap transactions, what information must be reported, and where and when it must be reported; rules that would require security-based swap data repositories to register with the SEC; rules that would define security-based swap execution facilities and establish requirements for their registration and ongoing operation; and rules that would specify information that clearing agencies would provide to the SEC in order for us to determine if the swap must be cleared and specify the steps that end users must follow to rely on the exemption from clearing requirement.

In addition, with the CFTC, we proposed rules regarding the definitions of many of the key terms under the Act. Our staff also is working closely with the Federal Reserve Board and the CFTC to develop a common framework for supervising financial market utilities, such as clearing agencies, which are designated by the Financial Stability Oversight Council as systemically important.

In the coming months, we expect to propose rules regarding standards for operating and governing of clearing agencies, rules to establish registration procedures for security-based swap dealers and major security-based swap participants, and rules regarding business conduct, capital, margin, and segregation and recordkeeping requirements for dealers and participants.

We will also propose joint rules with the CFTC governing the definitions of swap, security-based swap, and the regulation of mixed swap. We recognize the magnitude and interconnectedness of the derivatives market. And so, we intend to move forward at a deliberate pace, continuing to thoughtfully consider issues before proposing and adopting any specific rules.

The Dodd-Frank Act provides the SEC with important tools to better meet the challenges of today's financial marketplace and fulfill our mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formulation.

As we proceed with implementation, we look forward to working closely with Congress, our fellow regulators, and members of the financial community and the investing public.

Thank you for inviting me to share with you our progress on and plans for implementations. And I look forward to answering your questions.

[The prepared statement of Chairman Schapiro can be found on page 312 of the appendix.]

Chairman BACHUS. Thank you.

Chairman Gensler?

STATEMENT OF THE HONORABLE GARY GENSLER, CHAIRMAN, U.S. COMMODITY FUTURES TRADING COMMISSION (CFTC)

Mr. GENSLER. Good morning, Chairman Bachus—congratulations on your chairmanship—Ranking Member Frank, and members of this committee. I thank you for inviting me to speak about the Dodd-Frank Act.

I am pleased to testify on behalf of the Commodity Futures Trading Commission. And I also want to thank my fellow Commissioners and all of the staff of the CFTC for all their hard work and dedication in fulfilling our mission.

I also am pleased to testify along with Chairman Schapiro and Governor Tarullo. President Obama announced our nominations on the same day back in December of 2008. And I guess this is the first time we are appearing in public together at a hearing.

But it reminds me that in 2008, the financial system and the financial regulatory system both failed the American public. It wasn't one or the other. But I think it was, in fact, both. The effects of that crisis reverberated throughout the American and global economies.

In the United States, hundreds of billions of taxpayer dollars were put on the line to bail out the financial system, ultimately to secure the American public's economy. But millions of jobs have been lost and are still lost.

Though the crisis has many causes, the unregulated swaps market played a central role. And Congress, I believe, responded by passing Dodd-Frank, specifically Title VII, to bring transparency and to lower risk in the swaps market.

The CFTC is working closely with the SEC, the Federal Reserve, and other regulators to implement those features. We also are coordinating our consultation internationally. And we have received thousands of comments from the public, both before we have made proposed rules and after we have made some proposals that inform the Commission. And yes, the final rules will change based on those comments.

One area where the CFTC is seeking input is with regard to the implementation of various requirements of margin, which many Members here have raised with us. And in the Dodd-Frank Act, Congress recognized different levels of risk posed by transactions between financial entities on the one hand and those involved with non-financial entities or what many people are calling end users.

Consistent with this, consistent with what Congress said that the non-financial end users would be exempt from clearing, we believe at the CFTC that margin requirements should focus only on transactions between financial entities rather than those transactions with the non-financial end users that so many Members have talked about in their opening statements.

To adequately fulfill our statutory mandate, the CFTC does require additional resources. The U.S. futures market today, $40 trillion notional size. The U.S. swaps market, roughly $300 trillion, roughly 7 times the size, far more complicated, and it is very important for all the end users to have transparency, openness, and competition.

Yesterday, the President submitted his fiscal budget for 2012 that included $308 million in funding for the CFTC. This is essential for us to be able to fulfill our mission.

In 1992, our agency had 634 people. It shrank. From 1992 to 2008, it was down to 440 people right in the midst of the crisis. Only last year, with the help of this committee and all of Congress, did we get back to our 1990s headcount, about 680 people.

But staff is not enough. Technology is critical. The only way to really regulate these vast markets is with sufficient funding for technology to be efficient. Our small agency has to be efficient, working closely with the SEC and international regulators.

Furthermore, I would say that the CFTC's funding, if it were returned to the 2008 levels when we were only 440 people, the agency would be unable to fulfill its statutory mission. Every program would be affected.

It would be market surveillance, industry oversight, enforcement. We would be unable to pursue Ponzi schemes and other frauds or market manipulation. Inevitably, we would have to develop a backlog of registration applications or rule reviews or appellate filings and the like.

The CFTC, I would contend, is a good investment for the American public. Its mission, ultimately, is to promote transparency, open and competitive markets which lower costs to end users and helps promote economic activity. We will get this margin thing right. We understand congressional intent on that.

The CFTC is a cop on the beat that ensures markets are protected from fraud, manipulation, and other abuse. I look forward to working with Congress to ensure that we can accomplish our mission of protecting the public. Thank you and I would be happy to take questions.

[The prepared statement of Chairman Gensler can be found on page 277 of the appendix.]

Chairman BACHUS. Thank you.

Governor Tarullo?

STATEMENT OF THE HONORABLE DANIEL K. TARULLO, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. TARULLO. Thank you, Chairman Bachus, Ranking Member Frank, and members of the committee. I appreciate this opportunity to provide the Federal Reserve Board's views on the implementation of Title VII of the Dodd-Frank Act.

The Board's responsibilities fall into three broad areas. The first relates to consultation and coordination with other authorities, both foreign and domestic. Dodd-Frank requires that the CFTC and the SEC consult with the Board on rules to implement Title VII.

In providing feedback to their request for consultation, we have tried to bring to bear our experience from supervising dealers and market infrastructure and our familiarity with markets and data sources to assist the commissions.

But important coordination activities related to derivatives regulation also are occurring internationally. Most prominently, the group of 20, or "G20," leaders set up commitments related to reform of the OTC derivatives market that would form a broadly consistent international regulatory approach.

The Basel Committee on Banking Supervision has recently strengthened international capital standards for derivatives and created leverage and liquidity standards applicable to them.

The Committee on Payment and Settlement Systems is working with the International Organization of Securities Commissions to update international standards for systemically important clearing systems, including central counterparties that clear derivatives instruments, and trade repositories.

The goal of all these efforts is to ensure a level playing field that will promote both financial stability and fair competitive conditions by preventing activity from flowing to less regulated jurisdictions.

The second task given to the Federal Reserve with respect to Title VII relates to the strengthening of infrastructure. Central counterparties are given an expanded role in the clearing and settlement of swap and security-based swap transactions.

If properly designed, managed, and overseen, central counterparties offer an important tool for managing counterparty credit risk and thus can reduce risk to market participants and to the financial system.

Title VIII of the Act complements the role of central clearing to heighten supervisory oversight of systemically important financial market utilities. This heightened oversight is important because financial market utilities such as central counterparties concentrate risk and thus have the potential to transmit shocks throughout financial markets.

As part of Title VIII, the Board was given new authority to provide emergency collateralized liquidity in unusual and exigent circumstances to systemically important financial market utilities. We are carefully considering how to implement this provision in a manner that protects taxpayers and limits the rise in moral hazard.

The third task, committed to the Board by Dodd-Frank with respect to Title VII, is that of supervision. Capital and margin requirements are central to the prudential regulation of financial institutions active in derivatives markets, as well as to the internal risk management processes of those firms.

The major rulemaking responsibility of the Board and other prudential regulators under Title VII is to adopt capital and margin regulations for the non-cleared swaps of banks and other prudentially regulated entities that are swap dealers and major swap participants.

The Board and the other U.S. banking agencies played an active role in developing the enhanced capital leverage and liquidity regime agreed to in the Basel Committee. These requirements will strengthen the prudential framework for OTC derivatives by increasing risk-based capital and leverage requirements and by requiring banking firms to hold an additional buffer of high quality liquid assets to address potential liquidity needs resulting from their derivatives portfolios.

The statute also requires the prudential regulators to adopt rules imposing initial and variation margins on non-cleared swaps to which swap dealers or major swap participants that they supervise are party.

The statute directs that these margin requirements be risk-based. Within these statutory constraints and instructions, the Board and other prudential regulators are working to implement the margin provisions in a way that takes appropriate account of the relatively low systemic risk posed by most end users.

For example, one approach under consideration is to allow a banking organization that is a dealer or major participant to establish a threshold with respect to an end user counterparty based on a credit exposure limit that is approved and monitored as part of the credit approval process below which the end user would not have to post margin.

The Board understands that posting margins imposes costs on end users, possibly inhibiting their ability to manage their risks. The Board also believes that the margin regime should be applied only to contracts entered into after the new requirement becomes effective.

Thank you for your attention, and I would be pleased to answer any questions you might have.

[The prepared statement of Governor Tarullo can be found on page 323 of the appendix.]

Chairman BACHUS. Thank you. There were two Presidents in recent history who actually reduced government spending as a percentage of GDP, President Clinton and President Reagan. So I say that in a bipartisan way, one on each side. A part of that was a growing economy, and I think that is going to be the key to us facing our national debt and our deficit.

So I want to applaud, Chairman Gensler, your statement today. And I think, if I heard it correctly, it is that all end users would be exempt from CFTC clearing and margin requirements—

Mr. GENSLER. Yes, sir.

Chairman BACHUS. —the way they are on the over-the-counter swaps?

Mr. GENSLER. Consistent to how Congress exempted the non-financial end users from clearing, as we take up these rules at the CFTC, which we hope to in the near term, that the same end users—(h)287 is the provision in the statute, would not have any margin requirements. It is really consistent with what Congress did on the clearing requirement.

The financial company consistent with what Congress did might be. Again, we are still sorting through these proposals to put them forward to the public and get comments.

Chairman BACHUS. I know Members on the Majority feel it is critically important that we don't impose margin requirements or clearing requirements on end users. And by end users, you said non-financial companies, these that do not hedge risk as a part of their inherent business.

Mr. GENSLER. That is correct. Hedging is a really important thing. Tens of thousands of commercial end users use these products, used them successfully before 2008, and need to use them for our economy to prosper. Dodd-Frank at its core though promotes transparent, open, and competitive markets. And markets that are transparent and competitive get the lowest pricing.

I believe Dodd-Frank at its core will lower costs to these commercial end users because of the transparency and competitiveness and also because they will be less prone to risk. The American public did have to stand behind that $700 billion in the TARP. So it is a balancing that actually Congress put forward.

Chairman BACHUS. Of course, the $700 billion, none of that was a result of commercial non-financial end users, yes?

Mr. GENSLER. But it did at its core have a risk from the unregulated swaps marketplace, particularly credit default swaps. And then we all know the story of AIG.

Chairman BACHUS. I appreciate you and I—do you need the cooperation of Congress? Do we need legislation to clarify that these over-the-counter swaps will not be required to have margin requirements for clearing?

Mr. GENSLER. We at the CFTC believe that the Act is well-written and it gives us sufficient authority to ensure that such margin requirements on the swap dealers do not cover the non-financial end users. But that authority is there for us to move forward. Of course, it will be subject to notice and comment, public comment.

Chairman BACHUS. Governor Tarullo, you looked at that provision. Do you agree?

Mr. TARULLO. Mr. Chairman, what we have done is to read the statute as it is written. The statute as it is written tells us that each registered swap dealer and major swap participant for which there is a prudential regulator has to meet minimum capital and minimum initial and variation margin requirements. That applies broadly and there is obviously no exception provided for any class of counterparties.

However, the statute goes on to say that these standards shall be risk-based. And bringing to bear the risk-based or systemic risk-based perspective, which we have tried to bring to our activities on Title VII generally, what we are thinking in terms of is a risk-based approach to margin requirements which would recognize that for end users, generally there is much less risk associated with derivatives transactions.

So in essence we will create—if this approach turns out to be the one we adopt, and it is the one that is being worked on internally now—these thresholds within which or under which margins would not be required.

And precisely because end users in general present substantially less systemic risk—and in many cases no systemic risk—the threshold for end users would be substantially higher than those for financial market participants.

Chairman BACHUS. All right, thank you. Let me very briefly, I think the proper sequencing of your rule needs to have a definition of swap and commercial risk prior to some of your other definitions. Are you aware that you are going to need to define those terms fairly soon?

Mr. GENSLER. The statute defines many terms. Jointly with the SEC, we made proposals in December on “swap dealer”, “major swap participant” and the like. The comment period actually closes February 22nd.

And what we encourage the public to do, and we posted this on our Web site, is if you have comments on any of our other proposals at the CFTC, even if the comment period is closed, please include those comments in the definition comments so that we can consider them.

We do have discretion, even after a comment period is closed, to get those comments to the right files, to the right team. I know as a Commissioner, we will read them.

Chairman BACHUS. But the definition of “swap” and “commercial risk”, your other definitions are going to depend on that—

Mr. GENSLER. We also put out the definition of “commercial risk” in December—

Chairman BACHUS. Okay.

Mr. GENSLER. —and that is open through the same period of February 22nd. We look forward to hearing broadly from the public whether we got that right, consistent with what Congress did.

Ms. SCHAPIRO. I would just add, I think we all share your concern that we get the sequencing right so that particularly those who have to comment understand the full scope of the potential implications of all the rules on them, whether or not they are going to be determined to be a dealer or a major swap participant or some other kind of participant in the marketplace.

So we have gotten a lot of that done. The not-so-narrow but important issues of swap, mixed swap, security-based swap are—they are basic statutory definitions, but obviously there is more work for us to do there and we are very committed to getting those out quickly.

Chairman BACHUS. Thank you.

Ranking Member Frank?

Mr. FRANK. Thank you. Let me ask Mr. Gensler, you talked about, and Mr. Tarullo has concurred and I assume Ms. Schapiro does too, that we are not going to see margin requirements imposed on end users and they don’t have to clear.

I do want to address though the perception some may have that therefore nothing has changed. You did mention the transparency. So what will be the effect with regard to end users?

Ms. SCHAPIRO. Even the uncleared swaps have to be reported to the swap data repository and public—

Chairman BACHUS. Which means the price will be made public?

Ms. SCHAPIRO. Yes. Price and calling information, yes.

Mr. FRANK. Which is what we—I will tell you that I had a visit that validated that in my mind from a couple of people in the financial industry. It was an older one and a younger one from two companies. And the younger one said that they had these problems. And I said, we are not going to go after the end users and all we are talking about is price being made public.

And he said yes, that is what we don’t like, then people could come in ahead of us. And I asked if that meant that he was afraid of competition? And his older colleague said, we are not really pressing that argument. So I just want to make it clear we are not talking about margin requirements and clearing requirements.

We are talking about reporting requirements, which have, if I am correct, the advantage first of all of giving the end users some ability to get a better price because they will not now be captives and they will get to know what other people are charging.

And secondly, you won't have an unknown quantity of those in the economy. Will there be mechanisms for us therefore keeping track of what the totals are that are out there, Ms. Schapiro?

Ms. SCHAPIRO. I think the transparency is really the critical piece here because it allows market participants to understand, particularly with respect to post-trade transparency, at what price those transactions have occurred and that will encourage price competition.

There is a provision that will allow for blocked trades to be disseminated on a delayed basis so that the concern about the potential for front running a large position or front running the hedging of a large position should be able to be dealt with through the delayed dissemination there.

Mr. FRANK. Because, as someone said, we are talking about making it more pro-competitive—

Ms. SCHAPIRO. Absolutely.

Mr. FRANK. Because people can't be competitive if they don't know the number. Now, I want to just ask you about the budget proposals. You have been urged to take more time but also be more thorough.

At the levels that have been proposed in the budget that came out of the Appropriations Committee, Mr. Gensler, what effect will that have on your capacity to accommodate what members of this committee are asking you to do?

Mr. GENSLER. The number, I believe, was to take us from $168 million in the continuing resolution down to $112 million. We would have to have a significant curtailment of our staff and resources. We would not be able to police or ensure transparent markets in futures or swaps.

Mr. FRANK. So that is—the new responsibilities you get for the derivatives market, including primarily, as you said, the financial part, the AIGs, the credit default swaps, you would not be able to undertake those responsibilities?

Mr. GENSLER. There is no doubt in my mind. We would have to go from 680 staff, actually smaller than 440 if it was for the whole year because we are already halfway through the year. We would have to shrink even further than that.

Mr. FRANK. Ms. Schapiro, you were given in the bill new responsibilities, investor protection and elsewhere. What would the effect of the proposed budget be on your ability to carry those out?

Ms. SCHAPIRO. I am sorry. It will have a very real effect on the SEC's ability not just with respect to Dodd-Frank implementation but also with respect to our core mission, which is already being impacted by the continuing resolution. But most particularly, we have responsibilities now for hedge fund examinations starting after hedge funds are registered in July.

So we have to build a registration capability. We have to be able to examine and have examiners deal with hedge funds. We will be recipients of large amounts of data that are required under the Act for systemic risk reporting purposes for hedge funds, being a mechanism for managing—

So let me say, because I don't want to go over the time, and the systemic risk in the data is important again.

Ms. SCHAPIRO. —right and over-the-counter derivatives surveillance. We cannot rely on an SRO in that space. That task will fall to the SEC.

Mr. FRANK. I remember when Mr. Bernanke told us in 2008 that he was going to have to advance $80 billion to AIG. And a week later, they needed another $90 billion or $100 billion because nobody, including AIG, had any idea what the exposure was. And that presumably will no longer be the case.

But just to summarize with regard to hedge funds and derivatives, many of us believe they were insufficiently, not just regulated, but we didn't have much information about them, that they were a blank slate. And we have with hedge funds fairly light regulation but registration and monitoring. With derivatives, the financial entities are regulated but the end users are not.

But I take it that if you were to get the budget levels that were proposed in the bill that came out of the Appropriations Committee, neither one of your agencies would be able to do anything significant regarding your new responsibilities involving derivatives and hedge funds. Is that correct?

Mr. GENSLER. That is correct. We would basically be involved in a large reduction in force, about 65 percent—

Mr. FRANK. Right, but you—the effect of that would—

Mr. GENSLER. —the end users wouldn't benefit from any transparency.

Mr. FRANK. Ms. Schapiro?

Ms. SCHAPIRO. I don't know whether it will be in reduction of force or technology decline, but we will certainly not be able to operationalize many of the rules that are we implementing as a result of the new law.

Mr. FRANK. Thank you, and I should mention just one more thing. The total amount of money for the two agencies together that you are asking—that is in the President's budget is how much?

Ms. SCHAPIRO. President sought for the Securities and Exchange Commission $1.4 billion.

Mr. FRANK. And Mr. Gensler?

Mr. GENSLER. In 2012, 308, in 2011, 261.

Mr. FRANK. All right, so for this current year, about a billion-and-a-half. And Ms. Schapiro, how much money does the SEC take in to the Federal Government?

Ms. SCHAPIRO. I believe last year our budget was $1.1 billion and we brought into the Treasury on just from transaction fees about $1.3 billion to $1.4—

Mr. FRANK. So at the expense of getting adequate regulation, we are going to turn you into a profit center. Thank you.

Chairman BACHUS. Thank you. Thank you, Mr. Frank.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

Chairman Gensler, in your testimony, I believe you said something along the lines that unregulated swap markets played a central role in our economic crisis. I am assuming you are mainly alluding to AIG. Is that correct?

Mr. GENSLER. Yes, but also I think it helped accelerate the asset bubble in housing, credit default swaps more generally.

Mr. HENSARLING. Okay, just to remind us all of the record, in March of 2009, the head of the OTS, Mr. Polakoff, testified to a question that I asked. Again, in retrospect it wasn't the lack of authority. It wasn't the lack of resources. It wasn't the lack of expertise. You just flat out made a mistake. Is that a correct assessment? Answer, yes, sir. In 2004, we failed to assess how bad the mortgage economy, the real estate economy would become in 2008.

So at least the regulator in question thought they had the authority and the expertise. I peeked into the testimony, into the testimony of the panel to follow yours. So to some extent, I am going to try to foist a bit of a conversation here. We are going to hear from a gentleman, Craig Reiners with the MillerCoors Company.

And quoting from his testimony, "A requirement for end users like MillerCoors to post margin to its counterparties would have a serious impact on our ability to invest in and grow our business. Though end users are not directly subject to the trading requirements, excessive capital requirements imposed on our counterparties aimed at forcing end users onto regulated exchanges, execution platforms and clearinghouses could significantly increase our cost."

Chairman Gensler, a provision that was supposedly aimed at Wall Street may be increasing the cost of a six pack. And I think you just got the attention of the American people.

[laughter]

Has your agency considered the pass-through cost concerns in your economic analysis as you develop these new rules?

Mr. GENSLER. I read very closely the testimony of MillerCoors. We have met with MillerCoors. We are aware and focused on the cost of a six pack because we also oversee agricultural markets. And I would say our intention is not to have margin requirements apply to an end user such as MillerCoors. So very directly to his point, we are very focused on his testimony and his concerns.

Mr. HENSARLING. We will be monitoring your progress at the local convenience store. I also saw testimony from Mr. Terry Duffy, executive chairman of the CME Group. And he testified, "Entities such as CME often cannot fully anticipate the meaning of a proposed rule when that proposed rule is reliant on another rule that is not yet in its final form."

For example, rules dealing with the definitions of swaps, security-based swaps, swap dealer as you well know, Mr. Chairman, the list goes on. Mr. Duffy goes on to say as such, "They must be established before interested parties can meaningfully address other proposed rules."

So your Commission, I believe, has proposed some rules, comment periods have closed on other rules, and yet many commentators don't even know without the proper definition clarity whether or not certain rules will apply to them. So how can you have a meaningful comment period, Chairman Gensler?

Mr. GENSLER. I have read Mr. Duffy's testimony very closely as well, and we have indicated to Mr. Duffy, with whom we are meeting at 2:45 today, that we want all of the CMEs and all of the public's comments.

If these rules have been staggered partly because we are humans, we need to just move them out. But if you have comments on earlier proposals where closed periods have happened and they relate to this definitions rule, include them.

Send them in. We will use our discretion. We will distribute them. We will get them into the right comment files, just like this entire hearing, I think we are going to put in our comment file. Everything that you all have to say is important to our process as well.

Mr. HENSARLING. I think the gentleman makes a good argument. I hope you can find a better way to run a railroad because I think again we are dealing with trillions of dollars. We are dealing with capital. We are dealing with jobs. And I just think it is so critical that we have an effective rulemaking process.

I see my time is winding down. One more question for you, Chairman Gensler. I understand that you are advocating the adoption of position limits even for passive investors such as commodity index funds. Is that correct?

Mr. GENSLER. Consistent with the Dodd-Frank Act, we have put out a proposal in January and we look at forward to the public comments. So I think it is consistent with what—

Mr. HENSARLING. Does the CFTC have any data to indicate how the proposed position limit rule would affect the operation of these passive funds?

Mr. GENSLER. We publish data regularly on passive funds or index investments in the marketplace, and that is on our Web site. We have included some of that data in the preamble in the rule, but we look forward to the public comment in the proposed rules on agricultural, metals, and energy position limits.

Mr. HENSARLING. I see my time has expired. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Ms. Waters?

Ms. WATERS. Thank you very much, Mr. Chairman. I am very concerned about the representation that Dodd-Frank is going to lead to fewer jobs. And I understand that many of those who are critics have been citing a study by the Business Roundtable that claims that the margin requirements in Dodd-Frank will result in 100,000 fewer jobs. First, just quickly, let me ask each of our witnesses today.

First, Ms. Schapiro, have you seen this study?

Ms. SCHAPIRO. That was released yesterday, so yes, I did have an opportunity to look at it, but I have not studied it in detail.

Ms. WATERS. Mr. Gensler, have you seen the study?

Mr. GENSLER. I read the survey, the Keybridge survey last night around midnight on the Web.

Ms. WATERS. And Mr. Tarullo, have you seen the study?'

Mr. TARULLO. I did read it. Yes, ma'am.

Ms. WATERS. Can you tell us how effective regulation of the derivatives market can actually help to save jobs? Let me start with Mr. Gensler.

Mr. GENSLER. I think that at the core, we lost over 7 million jobs in this country because both the financial system and regulatory system failed the test and swaps were part of that. So I think it saves jobs by just making the whole system safer for America.

It also helps end users have more transparency and lower costs, competition in the marketplace. As long as we handle I think congressional intent on this margin and many of the other end user issues, which we want to work with you on, transparency promotes economic activity, transparency, and competition in the market.

Ms. WATERS. Thank you.

Ms. Schapiro, I agree with Mr. Gensler that failed regulation caused a loss of jobs. So how can better regulation cause a loss of jobs? Can you discuss a little bit how better regulation, effective regulations can help to save jobs?

Ms. SCHAPIRO. I think effective regulation can promote capital formation, which is in essence the creation of jobs. When companies feel that they can go to the market and raise capital, that their stocks will be priced fairly, that investors will have the opportunity to invest in their company, buy their shares of stock and sell those when they want to, it enables companies to raise the money necessary to create jobs.

By the same token, when investors have confidence in the safety and the soundness of our financial institutions and the regulatory regime, they have a level of comfort in investing. So I think there are a number of studies that will show that good regulation, intelligent regulation—it is not overregulation, not underregulation—can actually lower the cost of capital for industry.

Ms. WATERS. Mr. Tarullo?

Mr. TARULLO. Ms. Waters, I would just say that the study to which you alluded acknowledged that what it did was a kind of quick and dirty economic assessment because the study didn't have access to all the data they would need to give a more sophisticated response.

What they basically did was to say, "Based on our survey, here is what we think the relative level of utilization of derivatives is. And we are going to multiply that by a margin requirement which we think might be imposed. And that gives us the cost—that the cost of the margin requirements—"

Ms. WATERS. I am sorry, so you are saying it was not a scientific study?

Mr. TARULLO. They couldn't—they were not being misleading in the least. They basically just said, "We are going on the basis of a survey and extrapolating. We don't really have the data."

But I think, ma'am, the most important point to make is that they were assuming that there would be margin requirements applicable to all these end users surveyed. And what you have heard this morning is that is not going to be the case.

Ms. WATERS. And so can you tell us how effective regulation of the derivatives market can actually help to save jobs?

Mr. TARULLO. Yes. From our point of view again, which is one of systemic risk and trying to contain systemic risk, I think the keys are always watching for leverage and transparency. And because in the absence of transparency, you have ineffectively operating markets, and as we see, you can have runs during crisis periods.

And in the presence of excessive leverage, you can have collapses of institutions and markets as well. So I think a well-honed, well-conceived regulatory system in the financial sector is one that is designed to allow the allocation of capital to its most productive uses.

Ms. WATERS. So basically, all three of our witnesses at the table today really do believe that an effective regulation of the derivatives market can actually help to save jobs. Is that correct?

Mr. GENSLER. Yes.

Ms. SCHAPIRO. Yes.

Mr. TARULLO. Yes, although, of course, "effective" is what everybody is going to be discussing as we go through this regulatory process.

Ms. WATERS. Thank you very much. I yield back.

Chairman BACHUS. Thank you.

Mr. Royce?

Mr. ROYCE. Thank you, Mr. Chairman. Mr. Gensler, as to the application of the CFTC proposed rules to foreign counterparties and to foreign dealers, I was going to ask you about a concern here over regulatory arbitrage and over the fact that they are going to wait this out.

You implement your policies here. We see more and more derivatives business go to Europe. And at the end of the day, we have American financial companies severely disadvantaged vis-a-vis their foreign competitors.

I mentioned in my opening statement that in the long run, onerous rules that are unnecessary will without doubt drive capital to non-U.S. markets. And you have testified here that you are in contact with regulators in Europe, you expect them to follow the American approach, but how do you have those concrete assurances? Do we have a Memorandum of Understanding with European regulators? Tell me how you assure us of that fact?

Mr. GENSLER. We are working very closely—all three of our agencies are working very closely with the Europeans and Asian regulators. We actually share our pre-proposal documents, memos—

Mr. ROYCE. Right.

Mr. GENSLER. —and drafts with them. I think, depending upon budgets, I guess, but I will be back over in Europe in March in front of the European Parliament possibly.

So we are working very closely. Their proposals, I am optimistic, are quite consistent on clearing this end-user approach, swap data repositories, the dealer regimes. They are a little bit time-wise behind us, a little later than us.

Mr. ROYCE. Yes, they are going to be later. And I don't know where Brazil and Toronto and Singapore are going to be here, but I think it is going to be very hard to try to convince us that American firms are not going to lose business to European competitors when that is already happening now.

Let me ask you another question, and that has to do with the fact I know today the SEC and the CFTC, you are saying they are trying desperately to get this collaborative environment. But on the most important rules, you are failing to get that kind of collaboration between the two agencies.

The differences in the derivatives markets you oversee are virtually nonexistent. There is a lot of overlap there in products and users. And the fact is that you insist on producing two very different sets of regulations here.

And if this is the end result, end users and investors are not going to be better off. It is going to be a boon for foreign companies. I will just give you a few of the—in terms of what is discussed in the business press—real-time reporting, where the agencies have different rules for the definition of what real-time means.

First, block trade definition and reporting time for block trades, the number of data fields that must be reported is different, which entity is tasked with submitting trade information to the public, all different.

Second, we have the block trade definition where the SEC wisely asked for further public comment and will likely embrace different definitions, depending on asset class and liquidity, whereas, the CFTC has offered a rigid, one-size-fits-all approach that many argue is overly restrictive.

And then third, we have the swap execution facility rules, where the CFTC requires sending a request for a quote to at least five liquidity providers. The SEC takes, I think, a more reasonable approach here in allowing the customers to choose how many liquidity providers it will request quotes from.

But the bottom line is, it is different in every case. And I would like your comment on that as well, if you would.

Ms. SCHAPIRO. I would be happy to comment on that, Congressman. I would say a couple of things. One is that we are working very closely together and there are many more things that are the same than that are different, although, you have pointed out, I think, some important differences.

Mr. ROYCE. I picked up 50-some in the business press that have been pointed out—

Ms. SCHAPIRO. I will—

Mr. ROYCE. —where they differ.

Ms. SCHAPIRO. We are still at the proposal stage so there is lots of opportunity through the comment process and through our extensive meetings with industry and others to bring these rules closer together.

And when we propose something, for example, it is different than the CFTC. We actually ask people what would be a better approach? Is the CFTC's approach a better, more realistic approach or is the SEC approach better, or is there yet a third way to go about dealing with this?

I would say also that there are some differences in the markets that we are regulating. The security-based swap markets, which really just represents about 5 percent of the notional value of the swap markets, trade quite differently than the interest rate markets do, for example. And so, to some extent, the differences in the marketplace will dictate—some things that are different.

But I will—let me please agree with you though, that where our rules are going to fall upon institutions that are contracting and working in both markets, it really is incumbent upon us to make them as close to identical as possible so that institutions aren't put under the burden of two separate sets of rules.

Where the rules go to, for example, differences in the way orders might interact within the marketplace, there might be some justification for slightly different rules because of the nature of the products that are being traded.

Mr. ROYCE. Mr. Chairman, thank you. Mr. Chairman, I have questions for the record, without objection, on position limits, which were meant to curtail speculation but could end up hitting the long-term passive investors. I meant to ask that question, but, I will put that in the record and then get the response from the witnesses. Thank you, Mr. Chairman.

Chairman BACHUS. All right. Thank you, Mr. Royce.

Mrs. Maloney?

Mrs. MALONEY. Thank you, Mr. Chairman, and I thank all of the panelists for your public service and your testimony today. In the continuing resolution, there is—literally on the Floor this week, there is a drastic cut in funds from what the President requested in his 2011 budget for the SEC and the CFTC.

And our Republican colleagues have proposed that the SEC budget and the CFTC budget be cut back to 2008 levels. Now, that is the level and the year that the economy cratered and fell. And I can hardly imagine that any of my colleagues are pleased with the level of oversight that was performed by our regulatory agencies in 2008.

So cutting them even more than what they had then, I feel will make it impossible for them to implement Dodd-Frank and be responsible regulators. According to the Inspector General of the SEC, the Republican proposal would force the agency, the SEC, to cut roughly 600 in staff. Is that correct, Ms. Schapiro?

Ms. SCHAPIRO. I believe that is correct, although I will say, I think the budget proposal coming out of the House is not to put the SEC all the way back to 2008 levels, although it does represent a cut off of the continuing resolution number.

Mrs. MALONEY. I would say that if you put it in perspective with the numbers, a total loss of household wealth as a result of this "Great Recession" has been estimated to be approximately $14 trillion and the over-the-counter derivatives market is valued at about $600 trillion. And in 2010, the GDP of the entire world was just over $74 trillion and the infamous flash-crash on May 6th temporarily wiped out over $1 trillion.

So it seems to me rather penny wise and pound foolish not to invest in the agencies that are required to come forward with the new rules, the new studies, and to prevent the Madoffs of the future. Now, as I understand it, and correct me if I am wrong, the Dodd-Frank bill calls for 95 new rules from the SEC. Is that correct?

Ms. SCHAPIRO. It depends a little bit on how you count but that has been the ballpark estimate, yes.

Mrs. MALONEY. And 61 from the CFTC, right?

Mr. GENSLER. We think it is more on the order of 45.

Mrs. MALONEY. Forty-five? Okay.

Mr. GENSLER. That is right. But I don't know. People can count different ways.

Mrs. MALONEY. And how many studies are you required—I know the bill had 60 studies—to do?

Ms. SCHAPIRO. The SEC is required to do 20 studies—more than 20 studies and to create 5 new offices within the agency.

Mrs. MALONEY. How in the world are you going to do that with a reduced budget? Can you hire the people to oversee the new—the derivatives and everything that you have to do?

Ms. SCHAPIRO. No. Clearly, we will not be able to operationalize the rules that we are promulgating and ultimately adopting under Dodd-Frank under that budget scenario. I will say, if we were able to hire people, we can get them.

We are getting amazing talent willing to come to the Securities and Exchange Commission at this time and work with us on all of these important issues. But we are under a hiring restriction right now.

Mr. GENSLER. And I would just say this: The staff of the CFTC has been excellent under this uncertainty of the budget. They are just doing terrific work. I think we will be able to, working with the SEC and the public, continue writing rules, but there is no doubt that in 2012, we will not be able to oversee the markets and ensure the transparency in the markets.

If we were taken back to 2008 levels, however, then we would be in a very different circumstance because we are in a unique circumstance where we were just growing back to where we were in the 1990s, so taking us back to 2008 would have to entail, unfortunately, significant reductions in force.

Mrs. MALONEY. The OTC derivatives market is valued at about $600 trillion, and in 2010, the budget for the CFTC was just $169 million. So as my colleagues call for more oversight and accountability, we certainly need to give the tools to the oversight agencies to get the job done. So I certainly hope that my colleagues on both sides of the aisle will support appropriate funding for the CFTC and the SEC.

There has been talk that we are not competitive in the world. Some of my colleagues said that we have a competitive disadvantage, but with Basel II the capital requirements are the same. Is that correct? Our capital requirements are not higher, are they, Mr. Tarullo?

Mr. TARULLO. That is correct.

Mrs. MALONEY. So we are in an even playing field on the capital requirements and the leverage requirements? Are we on an equal playing field there?

Mr. TARULLO. Yes. We have internationally agreed upon a leverage ratio, yes.

Mrs. MALONEY. So do you believe that our markets are in some way disadvantaged—

Mr. TARULLO. First—

Mrs. MALONEY. —because we have regulations?

Mr. TARULLO. Certainly with respect to—

Mrs. MALONEY. But a regulation that didn't appear to work in 2008.

Chairman BACHUS. Mrs. Maloney, we will let him answer the question.

Mrs. MALONEY. Okay. Yes.

Mr. TARULLO. Certainly with respect to capital, we have been able to standardize across all the members of the Basel Committee. There is obviously still discussion going on about the standards to be applicable to central counterparties as such. Those are the ones that Chairman Gensler was referring to a few moments ago.

Chairman BACHUS. Thank you.

Mrs. Biggert?

Mrs. MALONEY. But my time has expired.

Mrs. BIGGERT. Thank you, Mr. Chairman. This first question is for Chairman Gensler. Currently, the CFTC is looking at setting position limits on swap data. And my concern is—and I know I asked this question, I think of you and of Secretary Geithner in 2009—whether there was an analysis that looked at the critical and necessary data regarding this?

And it seems—I am concerned that—and in fact, multiple futures exchanges have raised concern that without this critical data, there will be improperly set position limits which would negatively impact liquidity and effective price risk hedging. And it seems like you are putting the cart before the horse if you don't have the study of this data that is so important.

And, I think it—not analyzing it before you put a new regulation in, and my concern, not only here, but there is talk of some dealers looking at moving abroad, and we are going to lose those jobs. Could you comment on that?

Mr. GENSLER. The proposal the Commission put out in January is consistent with the congressional provisions that we put something out with regard to the physical commodities, metals, energies, and agriculture. The agency has had, in working with the exchanges, position limits and most of these for what is called the spot month, but also looking at the other months, what is called the back months.

And there really would be three steps to this. A proposal phase—we have asked the public for comment on the very data that you are talking about. We are going to be well-informed. Final rules will not be taken into consideration until we get comments. We got 8,200 comments on an earlier position limit proposal a year ago. No doubt, we will get a lot of public input, and it will be helpful.

We changed the proposal based on those earlier comments. We will probably change the final based on these comments.

The third phase is actually getting data from the market when the swap data repositories are stood up, and we anticipate that that is going to take some time.

Mrs. BIGGERT. But that is really crucial in how you are going to be able to set those limits so that there won't—there won't be something done before you get that data?

Mr. GENSLER. We have actually anticipated that the proposal says that even once it is a final rule, it would not be implemented until there is data upon which to apply a formula. Position limits historically have been done based on a formula of the total size of the market. How big is the market and so—

Mrs. BIGGERT. But my concern is that we are going to have some of these traders that are going to go abroad because they can't wait, with all the comments and then to have the—to set that later on. It seems like you are putting the cart before the horse in not having the data before you really set those limits.

Mr. GENSLER. Again, Congress asked us to put proposals out. We are soliciting comments. It is very important to get comments on these 28 physical commodity markets. We have had position limits in the agricultural markets for decades. There were positions in the energy markets and metals markets in the 1980s and 1990s, in fact, all the way through 2001.

And we look forward to public comments. But it does say in the proposal that they would not go into effect until they are based on the actual statistics on the size of the futures market as well as the swaps market.

Mrs. BIGGERT. Okay. Now Congress may have been wrong in how they designated that should be done, but—let me go on to another question.

Chairman Schapiro, the Department of Labor has proposed a new definition of "fiduciary" which would significantly modify 35 years of established law defining who is an investment advice fiduciary and then the SEC has completed their 913 study which looks at the standard of care required of broker-dealers and investment advisors providing personal investment advice about securities to retail customers.

Both of these proposals will be setting advice standards for retail IRAs. Have the DOE and the SEC consulted on these proposals or is there something that could come out differently as opposed to—

Ms. SCHAPIRO. Congresswoman, you are right, we published our investment advisor broker-dealer fiduciary study several weeks ago. We were very clear there to say that it does not implicate the fiduciary standard under ERISA.

And you are also correct that the Department of Labor has recently proposed to expand the fiduciary definition under ERISA and that has the potential to affect some ongoing arrangements and relationships between broker-dealers and their IRA clients.

We are very prepared to work with the Department of Labor. We have offered any information or expertise that we can provide to them about the regulation, in particular of broker-dealers in the context of advising ERISA accounts. And we will continue to reach out to them and see if we can be of help.

Mrs. BIGGERT. But have you actually been in contact with them?

Ms. SCHAPIRO. Yes.

Mrs. BIGGERT. Okay. Thank you. I yield back.

Chairman BACHUS. Thank you.

Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman. I would like to use my time here to kind of zero in on the part of this that I had the most involvement in, Section 733, which became known as the Watt-Meeks amendment, and ask a couple of questions about the proposed regulations that cover that section.

It seems to me that one of the great accomplishments of Dodd-Frank was to pull derivatives trading out of the shadows and into the sunlight, requiring standardized swaps to be traded on swap execution facilities or exchanges that create pre-trade price transparency.

Section 733, known as the Watt-Meeks amendment, even includes a rule of construction and directs the SEC and the CFTC to update their rules to require the use of the best technology available for creating pre-trade price transparency.

We were intentional in not asking for flexibility for swap dealers. When swap dealers had flexibility before Dodd-Frank, they chose the least transparent method of trading, which was telephone calls. So instead, Congress said that swap execution facilities must give multiple participants the ability to trade swaps by accepting bids and offers made by other participants using the best technology for pre-trade price transparency.

Chairman Gensler, it seems to me that your draft rule comes pretty close to doing what we were trying to get to. Am I correct that you require a swap execution facility to include a central trading screen where everyone can see everyone else's prices?

Am I clear that you are not going to allow swap dealers to trade only on some dark corner of the platform where one participant asks for quotes that only he or she can trade and that dealers will have to put their prices on the central trading screen? Am I correct that is what you intend?

Mr. GENSLER. It is correct that the proposal brings transparency, that the facilities have to allow any participant to put a live bid or offer. So everybody can see that.

Mr. WATT. Okay. All right.

Mr. GENSLER. But no one will be required to do it. There is no market maker obligation. It is just if you want to, you get a choice. But the end users would also have a choice if they didn't want to put a firm bid or a firm offer, they could also use a request for quotes.

Mr. WATT. All right—

Mr. GENSLER. But you have that—

Mr. WATT. —and then let me go to Chairman Schapiro. Because it seems to me that your proposal differs and hasn't taken Congress' directive as seriously as the CFTC is, because you are allowing security-based swap execution facilities—and I am quoting from your proposal "could simply enable every participant to choose to send a single request for a quote to just a single liquidity provider," which seems to me not to be what we are trying to get to here.

Are you all interpreting these things differently? Or are you setting up a situation here where you are going to have the potential for a race to the bottom with the two agencies potentially interpreting this thing differently or setting up a different set of rules and enabling participants to argue that the lowest common denominator ought to be at play here?

Ms. SCHAPIRO. I don't think so, Congressman, and we have taken it very seriously but we have taken a slightly different approach, I think in part dictated by the fact that the security-based swap market, which were swaps on single issuers or of narrow indices of securities, are really quite different than the much more liquid foreign exchange or interest rate or commodity swap markets.

So we thought that it did dictate for a slightly different approach in our proposal. And again, it is just a proposal. We would not permit single dealer platforms under our proposal. What we would do is define SEF as a trading platform that allows more than one participant to interact with the trading interest of more than one participant.

And under that, the quote requesting party must have the ability to send a single request for quotes to all the participants on that trading platform. But if that party also seeks to limit the number of participants to whom their quote goes to, they would have, at their option only, not at the SEF's option, the capability to do that.

Mr. GENSLER. And if I might say, where the two agency's proposals line up is both of them say that to be an execution platform, you must allow any market participant, even if you all weren't in Congress and you set out to be a market participant, you could get in and make a live bid, a live offer, put your capital at risk and compete.

Markets work best when they are transparent and there is competition, and both rules have that. There is a little bit of difference on this request for quote approach, and we are looking for public comment to see if they should be synched up as well.

Mr. WATT. Thank you, Mr. Chairman. I yield back.

Chairman BACHUS. Thank you, Mr. Watt.

Mr. Garrett, the subcommittee chairman?

Mr. GARRETT. I thank the Chair. And so, when you think of all the rules that have already come out and all the regulations, the proposed and the mounds of paperwork that have come out in just a short period of time, with these agencies not specifically funded to the level that they want to be funded at, I can only hazard a guess what we would be looking at right now if they had all the money that they really asked for.

I guess the takeaway from this hearing so far is, from the other side of the aisle, the solution to all the problems that we have is to simply spend more money on it. And I guess the takeaway from this side of the aisle so far is the solution to the problems is we want to get it right as far as the rules or regulations that these agencies are promulgating.

If you look at past history. If you look at reg—NMS and you look at—compare that to what we are doing today. Now that was regs—and rules coming out of the law of around 80-some-odd pages. We are looking at 1,000-some-odd pages.

That took, I am told, from 4 to 6 months from rulemaking—period of time, here. There they did it for approximately 15 months, and there they took over, I guess, oh, about a 3-year period of time to roll them all out and actually get into implementation.

Here, we are compressing this into a much, much shorter period of time and a much larger area of the environment where we are going to ask the industry to come up with an entirely new architecture, structure, build new complex—new technology systems that they don't have yet, create a whole new operational process they don't have yet, a whole new legal documentation process that they don't have yet, creation of new clearinghouses, SEFs, connectivity between all these entities.

All of that wasn't there in the past. You are trying to do it now in an extremely expedited manner. So it goes to the point I raised before. If we do it in the way—in the timeframe that you are talking about now, won't this lead to a seizing up of the derivatives market?

Won't it lead to a sending of the derivatives market overseas, or at the very least won't it create unfair advantages between the big players in the marketplace and the very small players who cannot simply keep up with what you are trying to do? I will leave that to Mr. Gensler right now.

Mr. GENSLER. We have asked, in the midst of each of these rulemakings, and we have asked more generally, to hear from the public on the phasing of the implementation. Congress allowed us some discretion, both agencies, that no rules should become effective sooner than 2 months after the July date, the implementation date. But it could be later.

So for the same reason that you just raised, Congressman, we want to hear from the public as to what rules can be done a bit sooner which rules need more time. Because there is a cumulative cost of this. It is a paradigm shift, as you are referring to, and I think we want to, as you say, get it right.

Mr. GARRETT. Ms. Schapiro?

Ms. SCHAPIRO. I would agree with that. I think, unlike the statutory deadlines that we have been working through, we have much more discretion with respect to the implementation timing and sequencing. So that we can put the rules out and make them effective in an order that actually makes sense for the industry in order to build systems, develop compliance—

Mr. GARRETT. Right, so can both of you, realizing that the feedback that you are already getting on all those points, can both of you sit here today and tell us that you would like Congress to give you more time? Because we know we have a deadline of July.

Do either one of you think that you can do this appropriately and meet the deadline of July and still have fairness to the marketplace that we are talking about?

Mr. GENSLER. I think we actually already have the discretion on the implementation.

Mr. GARRETT. On implementation, but how about the rule promulgation?

Mr. GENSLER. I feel that with the significant crisis of 2008, which was a very real crisis, and the excellent staff at the CFTC and Commissioners, what timing has been put out there is doable. We are human. Some of these will happen after July, no doubt.

Mr. GARRETT. That is not in the statute. It is—

Mr. GENSLER. It is not like a firm deadline that I understand. We are going to get this right and some of these will be after July. But we are also going to take up final rule writing in the spring and summer.

Mr. GARRETT. One aspect of it, and I will ask both of you this, is under the—President Obama's Executive Order instructing certain Federal agents to review regulations to ensure they do not stifle job creation and make the economy less competitive, this doesn't apply to either one of you, I don't believe, by the Executive Order.

But is it part of your process that you are going through, that you wish to comply with that Executive Order so you make sure we don't stifle jobs and we don't hurt the economy?

I will start with Ms. Schapiro.

Ms. SCHAPIRO. Sure. Congressman, as you and I have discussed, the terms of the Executive Order don't apply to the Securities and

Exchange Commission. But we have determined that it makes sense for us to try to act as though they do. I should say right off the top that much of what is in there, we already do. We already comply with the Paperwork Reduction Act, the Regulatory Flexibility Act—

Mr. GARRETT. So you are going to try to comply with it?

Ms. SCHAPIRO. —cost-benefit analysis. But in terms of being able to go back and look at some of the rules that have been around for many, many years, and see if they are having an unintended consequence given all the changes in our economy and in technology, in particular, we want to do that. We want to look at the impacts on small businesses.

And we have been very focused in our rulemaking over the last year, in particular, to make sure that where we can give delayed compliance dates for small business, we are trying to do that and be as accommodating as we possibly can.

Mr. GARRETT. Mr. Gensler?

Mr. GENSLER. We took a very close look at the Executive Order. Our practices are consistent, though Congress has given us directions on how to do cost-benefit analysis. It is called 15A of our act. So we have to follow congressional mandate rather than an Executive Order.

In terms of looking at our entire rulebook, we do plan to do the 120-day plan where we would tell the public how we are going to look at our entire rulebook, even if it is not related to Dodd-Frank.

Chairman BACHUS. Thank you, Mr. Garrett.

Mr. Sherman, before I go to you, Mr. Hinojosa has a brief unanimous consent request.

Mr. HINOJOSA. Thank you, Mr. Chairman. I am asking unanimous consent that my statement be made a part of the record.

Chairman BACHUS. Yes, and all statements will be.

Mr. HINOJOSA. Together with two letters, one by Richard Whiting of the Financial Services Roundtable dated February the 7th, and the other is a statement by Craig Reiners of MillerCoors Corporation.

Chairman BACHUS. Thank you, and let me say this to all members, at the end of this hearing, you can submit any letters for the record, if you would like. Thank you.

Thank you, Mr. Hinojosa.

Mr. Sherman?

Mr. SHERMAN. Thank you, Mr. Chairman. Dodd-Frank redirects the CFTC to adopt commodity position limits in order to prevent excessive price fluctuation and, of course, deliberate market manipulation. I know some of my colleagues have asked about this or other aspects of this particular provision.

As part of this authority, the CFTC is entitled to consider exemptions for different classes of investors to allow for enhanced protections without unduly restricting investors' options. I am concerned that the Commission's proposed regulations make no distinction between investor classes, treating market speculators the same as ordinary commodity index fund investors.

Is that the way these regulations should work? Or should there be a distinction between commodity index funds that buy and hold, versus those that are in and out of the market in days, hours or minutes?

Mr. GENSLER. We put out proposed rules that, as Congressman Sherman has said, did not make a distinction because the statute doesn't make a distinction in that way. The statute does make a distinction between bona fide hedgers, which in the statute, and this has been true in our statutes since the 1930s in some regard, relates to having some physical commodity in a merchandising channel.

Congress, in Dodd-Frank, tightened that definition. So we have to comply with the intent of Congress. And it tightened it with regard to swap dealers. Swap dealers were, under various No-Action letters from the CFTC, able to be bona fide hedgers.

And Congress tightened that to say, only to the extent that you actually are helping somebody on the other side hedge something who has the physical commodity in a merchandising channel, and so forth. So we are trying to take this up as Congress decided. But we look forward to the public comments on it. It is going to be a very thick comment file.

Mr. SHERMAN. Every time I ask a regulator about something, they always say it is Congress' fault. Has your Commission recommended a technical fix? Or do you think that it is appropriate as a matter of policy not to distinguish between the in-and-out investor on the one hand and the commodity index fund on the other?

Mr. GENSLER. We have not recommended a technical fix. This was something that was debated in many committee hearings, maybe not in this committee, but in other committees, about the role of index investors and so forth.

But we do look forward to the public comment and your comments and, as to getting this—

Mr. SHERMAN. Yes, I may disagree with you on whether the existing statute gives you the flexibility here. The statute does say you are supposed to adopt limitations as appropriate. And I look forward to working with your attorneys to convince them that we don't need the technical fix.

Assuming your attorneys do come to you and say, "Yes, you can distinguish between classes of investors in these regulations," as a matter of policy, should there be a difference between the index fund on the one hand and the day trader on the other?

Mr. GENSLER. I think I am just going to say I am going to keep an open mind. With 8,200 comments on the last position limit rule, I think this one is going to be such a thick comment file and I am going to keep an open mind as a Commissioner, to these views.

Some have recommended there be class limits on all indexers. Some have recommended that there should be no limit. So there is a wide set of comments that we are already receiving on index investing.

Mr. SHERMAN. I hope you are able to give a clear and more definite response to some of my other colleagues' questions. But on this one, I just gather that you are keeping an open mind as to both the law and the policy. And I yield back.

Chairman BACHUS. Thank you.

Let me say this: This first panel will be excused at 12:15. And we will seat the second panel. And I know Mr. Reiners from MillerCoors is sitting there on the first row, ready to testify. So we will find out what your announcement this morning does to the price of beer, whether—if it helps it or hurts—

Mr. GENSLER. Hopefully, the transparency will keep beer for all Americans well-priced.

Chairman BACHUS. I think the margins requirements may help.

Mr. GENSLER. I hope so.

Chairman BACHUS. Mr. Neugebauer? Thank you, sir

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Mr. Gensler, I have some serious concerns about the high cost and the severe consequences and burdens that Dodd-Frank is going to be putting on a number of different agencies.

And I have asked all of the entities that are affected by Dodd-Frank to furnish us information of what is the startup cost and what is the continuation cost of just implementing Dodd-Frank.

I have heard from your counterparts on either side. I got a nice thank-you letter for me sending you a letter. But I am looking for a little bit more robust and detailed response to that letter from your agency, as well.

Mr. GENSLER. I think that you received it this morning. And I apologize if maybe it is just in transit. But I would be glad to take any questions about the letter.

Mr. NEUGEBAUER. Thank you. I think one of the things we saw in the President's budget that he laid out is that he is estimating that it is a $6.5 billion number to implement Dodd-Frank, maybe going to hire over 5,000 new people. I believe that number, when we do the calculations and I think when we get some history on that, I think it is going to be a much bigger number than that.

But one of the things I am concerned about is, for example, the CFTC's chief compliance officer rule requires firms to designate a chief compliance officer; establish and administrate a complete new set of compliance policies, including implementation and compliance with hundreds of pages of business conduct rules; prepare an annual report to regulators; perform a review of every requirement under the Commodity Exchange Act, and your agency's estimate of what this would cost the market participants is $13,600.

Everybody else out there who is about to implement this said this is going to cost millions of dollars to comply with that. And so one of the things that I think is flawed about this and the fact that we are accelerating this process and putting these rules out at record levels is we are not doing any cost-benefit analysis of these rules.

And we have underestimated, in many cases, the cost of complying with these. So as we talk about Dodd-Frank, in the sense that we think this is going to be a wonderful thing for transparency and integrity in the markets, the question is, what are the markets going to look like when we get through making them more transparent and operating with integrity? Are they actually going to be incrementally more transparent and is there going to be incremental integrity in the markets?

But also, the cost of achieving that? And what I am very concerned about is, long term we are going to be pushing those markets to other places. In fact, in the past few weeks, I have sat down with some of the people who are participating in these markets. These markets are looking for a pressure relief valve because they are looking at these kinds of costs. And for our smaller participants, this is an extremely big problem.

And so I guess the question I have to you is, what kind of cost-benefit analysis is going on as you are churning these regulations out to actually determine the cost of compliance and the impact of that cost of compliance to the markets?

Mr. GENSLER. And if I might also answer your earlier question, in the letter and in the budget, this agency has talked about $308 million, $77 million related directly to Dodd-Frank, and about 240 positions directly related to Dodd-Frank in the 2012 numbers.

We as an agency are mandated by our statute, Section 15A, on how to do cost-benefit analysis, which was adopted many Congresses ago. That has directions, actually rather detailed, about taking into consideration the price discovery function, the lowering risk, about the integrity of markets to which you just referred.

We also asked, in each of our rules, a question to please help us. As commenters come back with the cost, because those are important for our consideration before we move to final rules, to actually hear from the public.

I think the figure you might have referred to—though I don't know every rule by heart, is within the Paperwork Reduction Act piece of it. We asked for comments on those costs as well as the cost-benefit analysis costs so that as we go forward to consider final rules, we get the public's thoughts on that, as well.

Mr. NEUGEBAUER. So are you doing cost-benefit analysis?

Mr. GENSLER. Oh, absolutely, in compliance with our statute.

Mr. NEUGEBAUER. When in the process are you doing that, before you send out the rule or after you get comments from the rule?

Mr. GENSLER. It is an ongoing process, but it is pre-proposal, it is part of the proposal phase, and then it is informed further by commenters as we move to the final rule, as well.

Mr. NEUGEBAUER. Is that cost-benefit analysis made available to the people that you are requesting comments for so they can record—

Mr. GENSLER. Yes.

Mr. NEUGEBAUER. —kind of respond to your analysis and—

Mr. GENSLER. Yes. And I don't know if Chairman Schapiro—we are under different guidelines, but yes.

Ms. SCHAPIRO. We publish our cost-benefit analysis. Our economists develop data the best they can. They might use survey information. They might look to analogous rulemakings to see what costs were associated there. We see comments on the cost-benefit analysis. And it is, as Chairman Gensler said, further informed by the comment process.

Oftentimes the people who have the best handle on costs are going to be the industry charged with complying with the rules or implementing the rules. And so we are highly reliant on their information.

Mr. NEUGEBAUER. So is this—

Chairman BACHUS. I thank the chairman. And I will thank the gentleman from Texas.

Mr. NEUGEBAUER. Thank you.

Chairman BACHUS. Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Gensler, I just have a couple of quick questions that I wanted to ask. I was pleased to see you refer to the cooperation with foreign counterparts in your prepared testimony. The Dodd-Frank Act, of course, recognizes the limits of the U.S. jurisdictional authority by clarifying that provisions of Title VII do not apply to activities outside of the United States unless they have a direct and significant connection with activities in, or effect on commerce of, the United States.

My first question is, what steps have you taken or do you propose to take or intend to take to ensure that United States firms can compete internationally on a level playing field with their foreign competitors and foreign jurisdictions?

Mr. GENSLER. We have had extensive dialogue and discussion with regulators around the globe and with the very industry that you are referring to, the large international banks. The international banks that are not headquartered here, that are in Europe and in Asia, have largely come in and say they anticipate registering as swap dealers to offer swaps to U.S. counterparties.

So whether you are a European bank or Asian, you want to offer swaps to U.S. counterparties. The U.S. banks, of course, have considered that they would be registering, sometimes not once, but maybe two or three different legal entities would register.

But at the core, we are working with the other regulators sharing our drafts with them. Of course, we have a statute that has been passed. And the only other country that has one so far is Japan. The European Parliament is taking their proposal up this spring.

Mr. MEEKS. So there is continuing dialogue, do you think, because I am interested especially with the—

Mr. GENSLER. There is continuing dialogue, but there is also, through international forums, something that Chairman Schapiro I think co-chairs, IOSCO, which is an international forum. There are panels that the Federal Reserve sits on. We are just a small agency. We are usually the junior member.

But these international forums have actually pretty aligned and consistent rules on clearing, for instance, data repositories. And we are also going to be entering in to Memorandums of Understanding with at least a half a dozen other foreign regulators.

Mr. MEEKS. Let me also—because you also noted in your testimony that the CFTC recently proposed position limits on several commodities. And I have been told that the experience in London shows that it could be difficult to ascertain the true position in aggregate of traders.

Do you believe that sufficient transparency exists for the CFTC to effectively enforce such limits? And can you speak on the impact of position limits in curbing speculation in commodities such as oil?

Mr. GENSLER. I believe with the passage of time, there will be such transparency because the statute allows that all the information for swaps will come into data repositories. We will benefit from that information. And that is why the rule has a bit of delayed implementation until some of that information is in.

The CFTC is not a regulator that regulates prices. We are a regulator that ensures transparent, open, competitive markets that have integrity. And so it is in that context that position limits have been used to just ensure, in essence, that there are not concentrated positions, particularly in the spot month where corners and squeezes in physical commodities can happen.

Mr. MEEKS. I will tell you one concern that I have, how do we protect the United States from speculation, especially on things like oil occurring outside of the United States, which then has a direct impact on us? Could you tell us what we could do to try to curb and monitor the risk of speculation occurring outside of the United States?

Mr. GENSLER. If I might, speculators have a role in the markets. Hedgers and speculators need each other and meet in a marketplace. This has been true in our markets even when the corn producer or wheat producer wanted to know, how do I hedge my crop, come the harvest? There was a speculator on the other side. So speculators are part of the commodities markets. They are part of the swaps marketplace.

Position limits authority, which was put in place in the 1930s, was to guard against burdens that might come from excessive speculation. One of those burdens that we know about like corners and squeezes, or that the size of the crowd is so small that there are only a handful of speculators that might have concentrated positions in a marketplace.

I don't know if that answers your question. The oil market, the energy markets are global. The financial markets are global. Risk does not know any geographic boundary in today's modern, technological, and communications world.

Mr. MEEKS. I am out of time.

Chairman BACHUS. I thank the gentleman.

Mr. McHenry?

Mr. MCHENRY. Thank you, Mr. Chairman. And to follow up on my colleague from New York's questions, we have missed having a Federal Reserve comment on this question about international competition.

And to that, Mr. Tarullo, looking at the derivatives marketplace, do you foresee a major shift in markets other than the United States as a possibility?

Mr. TARULLO. Congressman, I suppose anything is possible. But I think—what I think you are hearing today is that there are two kinds of processes under way, which actually intersect to a considerable degree. The first is a domestic regulatory reform exercise driven by statute and implemented by the agencies you see in front of you and some others as well. And the second is an international process, which pre-existed the crisis, but which has been energized and extended because of the crisis.

As I noted in my response to an earlier question, on the capital regulatory side we have been able to achieve a considerable harmonization of the kinds of requirements that would be applied to derivatives as well as to other credit and market risk exposures.

In the payment systems arena, I think there is an awful lot of interest among other countries because, frankly, they have seen what can happen when you don't have a transparent, well-collateralized market functioning in derivatives, or indeed, any other set of areas.

So while I can't sit here today and tell you that I think the agencies have collectively gotten the level of agreement, much less implementation, they would like to see, my impression in this area—and it is only an impression—is that things are moving in the right direction.

I think it is important to note that each of the other financial centers that people talk about as growing as the emerging market world grows is in a jurisdiction which is a member of the Financial Stability Board and the Basel Committee. So these people are at the table.

Mr. MCHENRY. Thank you.

Ms. Schapiro, in a Financial Times article today, the Muni Enforcement Division Chief is quoted within—from one of your SEC employers—employees—is quoted as saying that muni disclosures—or the municipal bond market has become, "a top priority of the SEC." Can you comment on that?

Ms. SCHAPIRO. Sure. When we set out to reform how our enforcement program worked 2 years ago, one of the goals we said was to create specialized units where we could have staff focus on particular types of cases become very deep, very expert, more efficient in bringing just those kinds of cases. And municipal securities was an area we thought was particularly important for us to focus upon.

We have seen, as you have read in the paper and seen in some of the cases we have brought, real concern about the quality of disclosure on municipal issuers to investors. And we don't have the authority at the SEC to dictate or to tell municipal issuers the way we can corporate issuers what they must disclose.

We tried to get at that through the intermediaries that buy and sell municipal securities. So we will tell broker-dealers, you can't buy and sell these securities unless you ensure that the municipal issuer is making the following kinds of disclosures.

So that is an indirect tool. It is all we have really with respect to the disclosure except for our anti-fraud authority. So to the extent that a municipal issuer is misleading in its disclosure documents about the state of its pension liabilities or something else that is material, we are able to pursue that as a matter of anti-fraud.

Mr. MCHENRY. Is there a challenge between the government accounting standards and the financial accounting standards—

Ms. SCHAPIRO. There is—

Mr. MCHENRY. —a real challenge?

Ms. SCHAPIRO. —a challenge. We can't dictate what accounting standards they use—

Mr. MCHENRY. GASB.

Ms. SCHAPIRO. —either. Many municipalities use GASB. Some use FASB and I—there are other alternatives out there. But we—so we have a—sometimes have a lack of comparability as a result of not having required accounting standards.

Mr. MCHENRY. And that lack of comparability it—does that pose a challenge in understanding disclosures—

Ms. SCHAPIRO. It—

Mr. MCHENRY. —and enforcement?

Ms. SCHAPIRO. —it is a challenge for investors, we understand. The other problem is the timing of disclosure. We can't say that you must report year-end results within 90 days or a set period of time. And so some municipalities disclose their financial results a year or even more, in some few instances, later.

I will say one of the big improvements in this area has been the creation by the MSRB of the EMMA System, which allows for a great deal of electronic disclosure. And I think that has made life a bit easier for investors.

Mr. MCHENRY. Is there more authority that the SEC would need to have accurate disclosures?

Ms. SCHAPIRO. There is authority we would need. We have been in the process—although for resource reasons we have had to shut it down or pulled in field hearings around the country. We did one in San Francisco and one in Washington to collect the information about the state of the municipal markets, particularly, with respect to disclosure and sales practices, accounting, and other issues, so that we could build a really strong record for what we think the real issues are, and how we might come to Congress and ask for you to help us in solving those.

While we haven't continued the field hearings at this point, we are still collecting lots of comments and meeting with lots of people who have an interest in this market. And I suspect we will come to Congress at some point with some proposals.

Mr. MCHENRY. Thank you.

Chairman BACHUS. At this time, I will recognize Mr. Lynch. But before I do, the witnesses who are on the second panel, if you want to be excused for 10 or 15 minutes and just be back at 12:15, you may want to take a break now.

Mr. LYNCH. Thank you, Mr. Chairman. And again, I thank the witnesses. I was reading this morning in one of the reports that the notional value of the derivatives market is about $600 trillion.

I am also concerned that 97 percent of the U.S. market in derivatives outstanding is actually represented by just 5 commercial banks. They have a very concentrated market here. They also have, not surprisingly, 97 percent of the clearinghouses owned by just 5 banks.

I had an amendment in the Dodd-Frank Bill that was sort of watered down in the Senate regarding the governance of these clearinghouses, and the ownership of these clearinghouses. And I know that we have a proposed rule that is out there.

But there are some real conflict-of-interest risks out there, concerns. One is that these clearinghouses could operate—being operated by these five banks, basically, could operate for their own benefit.

They could operate as cartels. They could restrict the products that are cleared, who gets to play. And probably the most dangerous risk is that we are going to allow these clearinghouses to set their own risk management standards. We are going to allow them to establish their own collateral requirements.

And while we have taken that risk and dealt with it on the bank's side, we are going to allow in these clearinghouses this small group of individuals to establish how much collateral they are going to be required to put up.

And, it is just ironic that we are seeing a huge shift in risk from the banks that are now being dealt with. But we have a gap here, in my opinion, on the clearinghouse side.

Chairman Schapiro, I know you have been doing great work on this, as all of you have. But where are we on this proposed rule? And do you believe that we are heading in the right direction on this?

Ms. SCHAPIRO. Thank you, Congressman. I think we obviously have taken very seriously the requirement that we seek to mitigate conflicts of interest in both the clearing agencies and the swap execution facilities. And we have identified the same risks you have.

The risks that too few products will actually clear, the risk that a small group of dealers if they are in control might limit access by other participants to the marketplace. And the concern that they could lower risk management controls to reduce their collateral requirements.

So what the SEC did was to propose two alternatives for how to deal with ownership in voting within clearing agencies. And we have set some numerical thresholds. One alternative would say that no single participant can vote more than 20 percent of the voting interest.

And all the clearing agency participants collectively would have an aggregate cap of 40 percent. And then, we would have some requirements on the board of directors and on the nominating committee to have independent directors on those.

And the other alternative was to say no individual participant could have more than 5 percent of the voting interest. There would be no aggregate cap. But the board would have to be majority independent and the nominating committee solely independent.

What you can see by that is we are trying a couple of different triggers and combinations to see if we can try to mitigate the conflicts of interest that exist. And at the same time, the access rules that we will ultimately propose that will provide for as maximum access to clearing agencies as possible is yet a third way to help mitigate the conflicts.

I can tell you that almost nobody liked our proposals. We got lots and lots of—

Mr. LYNCH. That is a good sign.

Ms. SCHAPIRO. I am not sure. Some people thought that they weren't tough enough and some people thought they—

Mr. LYNCH. Oh, okay.

Ms. SCHAPIRO. —were way too tough. And we have to balance this with the need to have entities willing to invest in these entities so that we can have robust and strong clearing agencies. So where we are in short is that we are working through many, many comment letters and continuing to refine our approach and continuing to talk and meet with people. And I couldn't honestly tell you right now where we will land

Mr. LYNCH. Okay. Thank you.

Mr. Gensler?

Mr. GENSLER. I would associate my remarks with Chairman Schapiro. But I think on the point of access, Congress said that clearinghouses have to have that open access, meaning membership has to be broadened out.

The futures marketplace and the securities marketplace have pretty open access to clearinghouses in each of the spaces. The swaps marketplace has been more concentrated. The Congressman is absolutely correct on that.

And so we proposed some rules in December to try to open up that membership consistent with what Congress said—nondiscriminatory access. These access provisions are critical. We want the public comment, but I suspect there will be some commenters opposed and some for.

Mr. LYNCH. If I could suggest, rather than just having independent directors who might be agnostic, I think what might work in that context is actually having competing commercial interests on those boards, not necessarily adversarial but having competing interests. That will work as a regulatory force in sort of balancing out the operation of these clearinghouses. I think that is what we have to get at.

Ms. SCHAPIRO. I think that is an excellent point and we actually have fair representation requirements in other contexts that would, for example, have institutional investors be represented on the Board. And so that is something we are very interested in.

Chairman BACHUS. Thank you. And I think we have—

Mr. LYNCH. Thank you.

Chairman BACHUS. —gone over a quite a bit, so thank you.

Mr. LYNCH. Thank you, Mr. Chairman.

Chairman BACHUS. What we will do is we will take two more on each side, in fact it, would it be okay if we took three more on each side? Would that be okay with the panelists? And so, we will take three more on each side.

Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. Tarullo, in your testimony you say that a much discussed part of the Act is the requirement that banks push portions of their swap activity into affiliates or face restrictions to their access at the discount window of deposit insurance.

I guess my question is, what percentage of—I think the gentleman, Mr. Lynch, a minute ago made a comment that 97 percent of the trades are done by 5 percent or 5 banks. Is that basically correct?

Mr. TARULLO. I think that may be a little bit high. I would say it depends on the market. In the commodity swaps market, it is far more diverse, with many more participants.

Mr. LUETKEMEYER. Okay.

Mr. TARULLO. In the interest rate market, it is a pretty common rate.

Mr. LUETKEMEYER. Okay, the point I want to get out though is the risk that the banks have with these entities that are under their corporate umbrella that would be exposed to FDIC insurance.

I think it is imperative that we get those out so we minimize exposure not only to the banks but to the taxpayers, and I am wondering where you are at with that and how your rulemaking is going on there.

Mr. TARULLO. The rulemaking is a joint rulemaking, of course, by all the regulatory agencies. And we don't have a proposed rule on that out yet. I would be happy to get back to you with the status of where we will be.

Mr. LUETKEMEYER. Okay. I think that is very important because I think otherwise we are getting the taxpayer on the hook again for some risky behavior that was the cause of the problem. And we still have them there rather than getting it out of the depositor's pocket.

Mr. TARULLO. And Congressman, sorry, but as one of your colleagues was asking earlier about the coordination of the rulemaking, of course this is somewhat related to the Volcker Rule rulemaking as well because you have the same set of issues of activities being moved out of organizations.

Mr. LUETKEMEYER. Okay, along that same line though with other Federal entities that have branches here in the United States and then have access to the Fed window, how do you minimize our exposure to them through this rulemaking authority?

Mr. TARULLO. Actually, Congressman, as the statute is drafted, it appears as though the exemption that is provided for insured depository institutions for some kinds of derivatives activities—government securities and agencies and high quality bonds—would not be applicable to domestic branches of foreign banking institutions. So actually, there is an asymmetry there, which has been brought to our attention by foreign governments.

Mr. LUETKEMEYER. Okay. In your own testimony, you say that they may require foreign firms to recognize their existing U.S. derivatives activity to a greater extent than U.S. firms.

Mr. TARULLO. Right, that it might require them to restructure in order—

Mr. LUETKEMEYER. Right.

Mr. TARULLO. —to have it outside of any—

Mr. LUETKEMEYER. Okay.

Mr. TARULLO. —insured depository institution.

Mr. LUETKEMEYER. I guess the question is, how concerned are you with the ability of foreign entities to be able to access our Fed window and have our taxpayer dollars involved?

Mr. TARULLO. Congressman, all borrowing at the discount window is fully collateralized with haircuts. And that applies regardless of who is accessing the discount window. Also, of course, discount window access is contingent upon supervision, which ensures that we or our colleagues in the other banking agencies have adequate knowledge of the liquidity and capital position of the institution accessing the discount window.

So it is only when there is supervision here and when we have full collateralization with appropriate haircuts that discount window lending is possible.

Mr. LUETKEMEYER. Are you looking to revise those rules and the circumstances around them right now with what is going on in Europe?

Mr. TARULLO. Not provoked by anything going on in Europe, pardon me. We are of course always looking at the appropriate haircut levels and whether there is a need to refine our discount window access features. But as I say, any accessibility is going to be based upon an entity present here in the United States which is supervised here in the United States.

Mr. LUETKEMEYER. Okay, thank you. My time is about up here. I just have a really quick question for basically all of you. One of the things that is of concern to everybody here today is end users. You all recognize that they were not a part of systemic risk of the problems that were in 2008? Do you—is that an agreed-to statement or is that not?

Mr. GENSLER. They didn't cause the problems. They ultimately were—

Mr. LUETKEMEYER. Were caught up in the problem?

Mr. GENSLER. They got caught up into it.

Mr. LUETKEMEYER. Okay.

Mr. GENSLER. —and part of that is to make sure they are not—

Mr. LUETKEMEYER. Okay, I am running of time. I understand that, but by the same token, if they are not part of the problem, you raked them into the problem. And yes, they are—by doing this you now—if we don't go with the letters of intent from Senator Dodd and Senator Lincoln about what was going on here with regards to not imposing some sort of other barriers to end users, we may get there.

And I think this should be a very narrowly focused ruling and regulatory mandate from you and not impose other additional risks or concerns onto the end user.

Mr. GENSLER. I am agreeing with you that the CFTC does not intend to have a requirement of margin with these non-financial end users.

Mr. LUETKEMEYER. Okay.

Mr. GENSLER. But they did get caught up in the problem.

Mr. LUETKEMEYER. Chairman Schapiro, I assume you agree with that?

Ms. SCHAPIRO. We haven't formulated any proposals in this area yet at the SEC, but I think it is safe to say we are extremely focused on this concern that has been raised multiple times this morning. The end users likely to be using the very narrow category of swaps that we regulate are going to be financial institutions—

Mr. LUETKEMEYER. Okay, my comment is they are not the problem, so don't make them the problem—

Ms. SCHAPIRO. We are not going to make them the problem.

Mr. LUETKEMEYER. —by imposing rules and regulations that they don't need, okay? Thank you.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

I have a question or two about the "take my ball and go home" argument that if the regulations here are unpalatable here in the United States or for that matter even if we coordinate with European systems and have similar regulations that some other countries might become host to derivatives trading, which reminded me of how reinsurance is regulated.

Reinsurance companies that are in actual markets are beyond the reach of State regulators, but State regulators get at those markets by their requirements on their insured, the company's insurance companies domesticated in their State.

If they want to get credit for solvency regulation purposes for reinsurance contracts, the reinsurance companies have to meet certain requirements, basically that they be able to pay on the reinsurance contracts.

Governor Tarullo, how are derivatives, credit default swaps in particular but derivatives generally, treated for purposes of safety and soundness regulation now?

Mr. TARULLO. Right now, Congressman, they are subject to two kinds of capital requirements. First, a trading or market risk that is the value of the derivatives goes up and down regardless of who the counterparties are.

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. TARULLO. And second, with respect to counterparty or credit risk, that is if I have a derivatives transaction with you, I rely on your creditworthiness to be able to perform. But we have both kinds of capital regulation in place.

Mr. MILLER OF NORTH CAROLINA. Okay. So if American financial institutions purchased derivatives, credit default swaps or other derivatives from a market that was neither transparent nor had collateral requirements, you would be in a position to deny those contracts credit as an asset and perhaps still consider them as a liability?

Mr. TARULLO. Or certainly we are in a position to require appropriate capital set aside depending on the identity of the counterparty. That is absolutely true—

Mr. MILLER OF NORTH CAROLINA. Okay. Well—

Mr. TARULLO. —so long as we regulate the U.S. institutions.

Mr. MILLER OF NORTH CAROLINA. The reinsurance regulation through States, through the insurance companies proves to be fairly effective regulation. Do you have any doubt that you will be able to avoid circumventing all U.S. laws by your regulation of safety and soundness of financial institutions?

Mr. TARULLO. I think two things. One, with respect to regulated U.S. financial institutions, we are in a position to understand what they are doing and to require them to have appropriate safeguards in place depending on their counterparties. That is not to say with respect to all derivatives activity that we would be in a position to ensure that it was being conducted in a safe and sound fashion.

But the CFTC and the SEC have another regulatory scope and then, as we have all said, we are in discussions with other important financial centers to make sure that they, too, are putting some of these things in place. If I could add one thing, Congressman, there is a degree to which counterparties are attracted to markets that are well supervised—

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. TARULLO. —precisely because they give assurance that these trades will be completed in a timely fashion.

I think people have always understood that the success and liquidity of our securities markets in the United States was in no small part due to the fact that the New York Stock Exchange on its own imposed a lot of requirements on transparency.

Mr. MILLER OF NORTH CAROLINA. Derivatives are frequently justified as risk management, but according to witnesses who sat at that table in the past, only about 10 percent of derivatives contracts involve a party that actually has any interest in the underlying risk, has any risk to manage.

And there have been stories, rumors at least that in many cases companies have bought large credit default swap positions for when they were in a position to cause default and have done that.

An example, again, a rumor that is denied by Morgan Stanley was that they were bondholders for one of the largest banks in Kazakhstan, which was taken over by the government of Kazakhstan. And the bond agreements provided that the bondholders could require that the bonds be paid immediately.

All the bondholders initially said, "Don't worry about that. If you are making the payments, that is fine." And then Morgan Stanley changed their mind and demanded immediate payment, which the bank could not do, causing a default.

The rumors were that Morgan Stanley had bought large credit default swap positions and benefited greatly from the seeming—what appeared to be the illogical conduct of precipitating default of a performing debt.

There are other examples of—where at least arguments that Goldman Sachs was in a position to know things about AIG's solvency that their counterparties did not know. Should there be—what protections are there now for that kind of insider—what might be considered insider trading in the securities arena with respect to credit default swaps?

Ms. SCHAPIRO. The credit default—we have actually prosecuted one case with respect to credit default swaps being invoked in insider trading. I will say the problem that you are talking about is really what we call the anti-creditor problem where you have more of an incentive to see the institution against whom you are holding insurance fail than you do as a bondholder even to work out their problems in an orderly way.

And it is a distortion certainly in the marketplace and it is an area that we have been quite focused on as we look at issues around things like empty voting in the proxy context and more broadly at the reporting and other requirements.

Chairman BACHUS. Thank you, Mr. Miller.

Mr. Posey?

Mr. POSEY. Thank you, Mr. Chairman.

I can't help but think the best fix for future crises is to have some accountability for the first crisis, for the cause of the first crisis. And I believe you know this is coming, Chairman Schapiro, what kind of accountability have we had at the SEC with the people who helped cause the last crisis to date?

Ms. SCHAPIRO. Congressman, I think you know that we have worked tirelessly over the last 2 years to try to reform the Securities and Exchange Commission and to make it an agency that is worthy of the public's—

Mr. POSEY. I have a limited amount of time. Has anybody had their wrist slapped yet?

Ms. SCHAPIRO. I understand. As you also know, most of the employees were—

Mr. POSEY. Wait, please, just—has anyone had their wrist slapped yet? Has anyone been reprimanded? I know nobody has been fired or put in jail but have we blamed anybody? Have we actually told anybody they are responsible for doing wrong and slapped their wrists yet?

Ms. SCHAPIRO. Most of the employees involved are gone. For the remaining employees involved with Madoff against—

Mr. POSEY. That—listen—

Ms. SCHAPIRO. —whom discipline was recommended, we are—

Mr. POSEY. —that is like saying—

Ms. SCHAPIRO. Completing—

Mr. POSEY. —a burglar left the neighborhood to burgle another neighborhood.

Chairman BACHUS. All right. Mr. Posey. Mr. Posey, if you could let the chairman answer the question and then—

Mr. POSEY. She is not answering it, Mr. Chairman.

Ms. SCHAPIRO. I am. We are concluding the appeals process for the final stages of those employees against whom discipline was recommended. That should be completed shortly.

Mr. POSEY. Thank you. So the answer is just no.

Ms. SCHAPIRO. The answer is the disciplinary process, which is laid out in Federal law and is one which I am beholden to follow is winding its way—

Mr. POSEY. I know there is some kind of unwritten rule about giving a yes or no answer here but it would have saved a whole lot of time. Thank you.

Mr. Gensler, how comparable do you think the community—

Chairman BACHUS. Let me say this to all the members. I think that the witnesses are not on trial. And I think they are due a certain amount of decorum and respect. I know that these are intense questions or they are emotional questions, but I do believe the Chairman was trying to answer the question.

And I am not talking to any one member. I am just saying I think it is important that this body treat the witnesses with the dignity and respect that they are due. So I appreciate it.

Mr. Scott?

Mr. SCOTT. Thank you very much, Mr. Chairman.

Mr. Gensler, at last week's agriculture—

Chairman BACHUS. Was he through? Oh I am sorry. Mr. Posey, I apologize. You were not through. You have additional time.

Mr. POSEY. Mr. Gensler, do you think the Commodity Futures Trading Commission was culpable in any way in the cause of the last crisis?

Mr. GENSLER. I think the entire regulatory system failed the American public, so I would have to include all of us regulators, in a sense and yes, in the broadest sense. I think the futures marketplace worked very well—so the futures marketplace did not fail.

Mr. POSEY. I appreciate the "yes" answer, thank you. Has there been any disciplinary action taken against any of the employees who were culpable in your agency?

Mr. GENSLER. No.

Mr. POSEY. Thank you for the direct answer.

Governor?

Mr. TARULLO. I agree with Chairman Gensler that there were widespread problems in the regulatory structure and then in the implementation of the regulatory structure by the regulatory institutions.

What the Federal Reserve has tried to do is to determine how, with the changes in the law, and with what was learned from the last crisis, we can have more effective supervision going forward. So there have been lots of changes, both at the Board and at Reserve Banks in terms of reordering supervision, who is in charge, which people we have working on which matters.

There haven't been any disciplinary proceedings. I wasn't at the Board at the run-up to the crisis, but Congressman, I am not aware of misconduct of any sort. What I am aware of is the collective failure of our regulatory agencies, including the Fed, to determine what was needed and to have the resolve to go and do it.

Mr. POSEY. Thank you. Does effective regulation involve government stopping businesses from making bad decisions? Just a quick yes or no from each of you if possible.

Ms. SCHAPIRO. "No", unless it is going to hurt investors.

Mr. POSEY. Okay.

Mr. GENSLER. "No", unless it is going to break the law.

Mr. TARULLO. It is "no", unless it puts Federal taxpayer funds or the safety and soundness of the financial system at risk.

Mr. POSEY. Okay. And then thirdly, I think we all know, but I would just like to get your answer on this. Is it possible to stop somebody from failing and still allow them to succeed in the free enterprise system, to guarantee nobody fails?

Ms. SCHAPIRO. No. We should not guarantee that nobody fails. We should allow institutions to fail.

Mr. GENSLER. I think there has to be a freedom to fail. I think there will be banks that fail in the future as there have been for centuries in the past.

Mr. TARULLO. I agree.

Mr. POSEY. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Chairman BACHUS. I thank the gentleman.

Governor Tarullo, I think, pointed out that he was not at the Board during the financial meltdown or the events leading up to it and that is also true of Chairman Gensler—

Mr. POSEY. Me?

Chairman BACHUS. No, I am not talking about—Bill, there is nothing—I am not talking about you. I promise this has nothing to do with your remarks. I was just telling the new members that Chairman Schapiro was not there, and Chairman Gensler was not there, and they inherited quite a mess. So Mr.—who is that—Mr. Green?

Mr. SCOTT. Scott.

Chairman BACHUS. Mr. Scott, I am sorry.

Mr. SCOTT. Thank you, Mr. Chairman. Mr. Gensler, last week I asked you about this concept of margin separation, if you recall the Agriculture Committee meeting, and how it could potentially raise the cost of clearing with only a small amount of management risk management benefits.

I still feel it could be very expensive for market participation if directed towards a problem that does not seem to exist since we are not requiring the same customer protection in future clearinghouses which have never failed. And I know you answered at that time that it was only preliminary, which led me to believe you are reviewing that and taking a look at it.

So I want to explore it a little bit further with you with these questions. First of all, can you please tell me what the CFTC's rationale for using the advanced notice of proposal rulemaking was? Did someone specifically, did someone explore this issue and ask you for this particularly, because it was not included in the Dodd-Frank Bill?

Mr. GENSLER. The Dodd-Frank Bill says that for swaps that brought into clearing, the funds that the people put up shall not be comingled. And then it goes on to say, except for convenience. We had a roundtable to answer your question.

We had a roundtable on this whole topic in the fall and numerous parties from the asset management side who have had segregated collateral accounts would like to continue to have that. I would say some from the clearing community and dealing community did not.

And they all raised very thoughtful considerations. So we thought we would put out what is called an advanced notice of proposed rulemaking, ask the public, and we are considering this before even making a proposal, we are considering those comments.

Mr. SCOTT. Would you, could you characterize for us the general feeling within the industry itself? Where are there disagreements? Does the buy side agree with their counterparts on the selling side, for example?

Mr. GENSLER. No, I would say there is a wide variety of views. Some on what is called the buy side or asset managers currently have segregated accounts, and they want to continue to have that. In the clearing community, you are absolutely correct.

They have been accustomed for decades, our agency has said for convenience you can comingle even though the statute said not to except for convenience. That started in the 1930s. Convenience in the 1930s was different than convenience in the 21st Century.

So we are trying to sort that through. We may end up exactly as it is in the futures world. We may end up proposing some alternatives. We have been very well-informed. There is a range of views on that.

Mr. SCOTT. Let us take the buy side. Are they of one mind? Is there disagreement internally within the buy side?

Mr. GENSLER. I would say that there are a variety of views even on the buy side.

Mr. SCOTT. Have the clearinghouses weighed in with you on this issue yet?

Mr. GENSLER. Yes, and their comments are all on our Web site in a public file.

Mr. SCOTT. Let me ask you one other question, Mr. Gensler. What would you say—would you say that the CFTC is effectively managing the resources that it has?

Mr. GENSLER. We are doing—I think the team at the CFTC is remarkable, and yes, we are not perfect. There are always some things that are going to go on and surprise you on any given day of the week. But it is a remarkably talented group of individuals who are trying to protect the public and ensure transparent markets.

Mr. SCOTT. And in the budget the President just released, you and the SEC are two of the agencies that—two of the very few that have received a substantial increase in your budget. How do you characterize this increase? Is this efficient?

Mr. GENSLER. It is a good investment for the American public. We have been asked to take on a market that is about 7 times the market we currently oversee, and it is far more complicated. It has fewer transactions, but the swaps market means more to all these end users than most people even understand. So I think it is a good investment of taxpayer money.

Mr. SCOTT. And then I would like to get on record your response to, if you could provide some insight very briefly on how the CFTC is adhering to Dodd-Frank requirements.

Mr. GENSLER. Dodd-Frank requirements said to consult with other agencies, to consult broadly with the public and international. That is what we were doing. We have had over 500 meetings. We put those on our Web site. We have had close to 4,000 comments that have come in, all on our Web site of course.

And we are complying with the statute. We don't want to overread the law. We take the comments here very seriously and we don't want to underread the law obviously as well.

Mr. SCOTT. Thank you, Mr. Gensler.

Thank you, Mr. Chairman.

Mr. GARRETT. [presiding] And I thank the gentleman. And just to let the panel know, and everyone else in the room know as well, we will have two more members questioning, Mr. Hurt and then Mr. Green, and then this panel will be dismissed.

Mr. HURT. Thank you, Mr. Chairman. And thank you all for being here. I just had really one question, but I was hoping that each of you could answer it. Considering that small banks are subject to the new clearing requirements unless the SEC and the CFTC use their authority to treat them as end users, I was wondering if you could comment on whether they should be included as end users in light of the high costs of compliance against the small percentage of swaps that they make up.

But I was wondering if you could comment on whether they should be and whether they will be? Thank you.

Mr. GENSLER. Maybe I will address it first, because banks generally are in the interest rate space and currency space that the CFTC oversees. We put out a series of questions to get information from the public.

We have been working closely with the Federal Reserve, the FDIC, and also the Farm Credit Administration and the National Credit Administration because those institutions are all involved. And so, we have not put a proposal out.

These small banks, as some of the members have said, were not at the heart of the systemic crisis. But they are interconnected and so the freedom to fail of a large bank sometimes will be dependent upon if they would bring down the community banking system.

You would want to let the large bank fail and not bring down the community banking system. So that is where the risk can propagate. But we are looking for the public comment to see if Congress has directed to consider this possible exemption.

Ms. SCHAPIRO. Small banks are not likely to be heavy users of part of the swaps markets. The SEC will regulate the security-based swaps. But we did propose as an alternative a small bank exemption.

Mr. HURT. But—just to be clear, it sounds like that is something the SEC has proposed but the CFTC is not inclined—

Mr. GENSLER. No, in fact what we did was we—

Mr. HURT. —to support?

Mr. GENSLER. I wouldn't want to leave you with that impression. It is really we are in the midst of a process of getting economic data and public comment on how to move forward. So we didn't make a formal proposal. We said, give us help on this from the public. We are doing the same with the Federal Reserve and all of the various regulators.

Mr. TARULLO. Congressman, you perhaps won't be surprised to hear that our position before, during and after the legislation has been we do think that there is good reason for smaller bank exemption precisely because we want them to be able to do the business of banking. They are not swaps dealers, obviously. They would be regulated if they were. But of course, it is not committed to us by Congress to make that decision. We are just a commenter.

Mr. HURT. Thank you very much.

Thank you, Mr. Chairman.

Mr. GARRETT. Thank you. And the gentleman yields back?

Mr. Green?

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member and the chairman for allowing the time, and I will be sharing it with Mr. Perlmutter. I will move as expeditiously as possible. Let me ask you, Ms. Schapiro, is it true that if the projected budget cuts take place you will have to cut personnel?

Ms. SCHAPIRO. It is not exactly clear yet how we will balance the impact on personnel spending with the impact on our technology spending. We are a larger agency than the CFTC so we have a little bit more flexibility as between those two major buckets of our expenditures, and we haven't worked those issues out yet.

Mr. GREEN. If you have to cut your technology, does this mean that you will not be able to upgrade your systems?

Ms. SCHAPIRO. I think it would be virtually devastating for the SEC to have to cut its technology budget. When I arrived 2 years ago, I discovered that we are many, many years behind our markets in our use of technology, sophistication of our technology, our capabilities with respect to technology. We have made a concerted effort over the last 2 years to try to improve that situation and putting the brakes on it is painful.

Mr. GREEN. And I will quickly add this, currently you have about 3,000—3,800 employees, correct?

Ms. SCHAPIRO. That is right.

Mr. GREEN. And you oversee approximately 35,000 entities?

Ms. SCHAPIRO. Yes, if you count public companies for whom we review the public disclosure, as well as 11,000 investment advisors and 5,000 broker-dealers and exchanges and electronic trading—electronic communication networks and transfer agents and clearing agencies, we get pretty close to that number.

Mr. GREEN. And also those advisors that you mentioned. They manage about $33 trillion?

Ms. SCHAPIRO. Yes.

Mr. GREEN. So you have a pretty big job.

Ms. SCHAPIRO. We do. We have about 12 examiners for every trillion dollars of assets under management compared to about 19 examiners just a few years ago.

Mr. GREEN. And cutting you would—if you had to cut personnel, would it hurt your ability to police?

Ms. SCHAPIRO. I believe it would. That is not to say we can't continue to find, and we have a Tiger Team working on the efficiencies and savings because there undoubtedly are some.

Mr. GREEN. And may I add—

Ms. SCHAPIRO. Yes, I would agree.

Mr. GREEN. —I admire you for being as delicate as you are because I understand that the integrity of the system hinges on your every word. So I appreciate the delicate fashion in which you have handled this. But I, on the other hand, don't have to be quite as delicate.

And I would hope that we would not take the cops off the beat at the time that we need them greatly. We have seen what can happen when markets have a sharp downturn and when integrity is lost. So my hope is that we won't do this. Now, I have to yield to Mr. Perlmutter, the balance of my time.

Ms. SCHAPIRO. I agree with you though. Investor confidence is absolutely critical to our economy, and the cop on the beat is important to that equation.

Mr. GREEN. Thank you.

Mr. GARRETT. We appreciate those remarks and we will move—

Mr. PERLMUTTER. Thank you. I thank the Chair. But I found another microphone, and I just want to follow up on what Mr. Green just had to say.

First, let me just put something to bed, Mr. Gensler, please. On the end user derivatives, hedging for the future by somebody like Coors that wants to buy barley next summer, because they have a business that they have to conduct from year to year. That is not where you are not talking about putting margins on that, are you?

Mr. GENSLER. Absolutely correct. We are not talking about putting margins on them. And barley swaps would be allowed under a proposed agricultural swap proposal we put out.

Mr. PERLMUTTER. But I mean just generally, end users hedging for products that they will need as part of their business are not part of the margin requirement that you are considering?

Mr. GENSLER. We have yet to propose that, but that is correct for non-financial end users.

Mr. PERLMUTTER. Okay. Good. And let me just get back to the basics, though. The basics and what I am bothered about by particular questions of my Republican colleagues is that there seems to be a mass case of amnesia, that 2 years ago, 2½ years ago under the Bush Aministration, the stock market and every financial market crashed terribly, multiplied by derivatives, financial generally in nature.

And my question to the entire panel is based on what happened when so many people lost their jobs, so many people lost their pensions, so many people lost wealth all across this country, do we need people in positions to regulate Wall Street and the financial transactions that take place there? And will the budgets that have been proposed by the Republicans cut into your ability to do that?

Mr. GENSLER. Yes, we need people. We are a good investment. We are only 680 people, to use arithmetic, that oversees the futures market. It is about $60 billion of futures per person. But swaps, we will have a half a trillion dollars of swaps per person. The budget as proposed—

Mr. PERLMUTTER. Half a trillion per person?

Mr. GENSLER. Per person. We think we need more people. And we need more technology.

Mr. PERLMUTTER. I think we can end on that. I thank you. And I yield back to the chairman.

Mr. GARRETT. And I thank the gentleman for yielding back. And I thank the gentleman for reminding us of the Bush Administration, as well.

Mr. PERLMUTTER. I didn't want you to feel left out.

Mr. GARRETT. Without this term. And I would like to thank all the members of the panel and also for all the staff that you bring with you to these meetings, as well.

Ms. WATERS. And Mr. Chairman, may I have a unanimous consent request? I would like to have unanimous consent to enter into the record a story from the New York Times that appeared last night which notes that some economists who were listed as advisors on the Business Roundtable study that I noted in my questioning, have requested that their names be removed from the study?

Mr. GARRETT. Without objection, it is so ordered.

Ms. WATERS. Thank you.

Mr. GARRETT. And again, I thank the panel. And the Chair also notes that some members may have additional questions for this panel, which they may wish to submit in writing. So without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And as soon as this panel makes their way out, we will be looking forward to our next panel.

I thank the members of the panel for their patience, but more importantly, for their testimony that we are about to receive. So let me begin. And I will be brief, as we run through panel two. I think it is set up in the same order that I have here, from left to right, my left to right: Mr. Craig Reiners, director of commodity risk management, MillerCoors, on behalf of the Coalition of Derivative End Users; Mr. Donald F. Donahue, chairman and chief executive officer of the Depository Trust & Clearing Corporation, the DTCC; Mr. Terry Duffy, executive chairman, CME Group; Mr. Don Thompson, managing director and associate general counsel, JPMorgan Chase, on behalf of the Securities Industry and Financial Markets Association, SIFMA; Mr. James Cawley, chief executive officer, Javelin, on behalf of the Swaps and Derivative Market Association, SDMA; and Mr. Chris Giancarlo, executive vice president, corporate development, GFI Group, Inc. And I thank the panel for being with us today.

At this time, before I proceed, I will turn to Mr. Dold from Illinois for an introduction.

Mr. DOLD. Thank you, Mr. Chairman. I just wanted to take this opportunity to introduce one of the panelists to my colleagues. Coming from the Chicagoland area, having worked in the Chicago Mercantile Exchange early on in college, I wanted to take this opportunity to introduce Chairman Duffy, who has been a CME member since 1981.

He started out as somebody on the floor, at the bottom, and has worked his way up to be the top of the chain, the food chain, if you will, and he certainly represents a number of people. He was one of the chief architects in 2007 of the merger between the Chicago Board of Trade and the Chicago Mercantile Exchange, which is now the world's leading and most diverse derivatives marketplace.

He also, at the request of President Bush, served on the National Saver Summit on retirement savings, and is a member of the Federal Retirement Thrift Investment Board. He is widely recognized as a leader and expert in his field. He has testified numerous times before Congress; I don't know if that is a good thing or a bad thing. But we certainly appreciate your time today, as we do all the panelists. And so, we thank you very much and I just wanted to give a little background for my colleagues.

Mr. GARRETT. And I appreciate that. We will now turn to the panel. And I guess one of the most interesting aspects of the entire panel that was already referenced earlier today, and that is the price of beer, okay, going forward.

Mr. Reiners, 5 minutes.

STATEMENT OF CRAIG REINERS, DIRECTOR OF RISK MANAGEMENT, MILLERCOORS LLC, ON BEHALF OF THE COALITION FOR DERIVATIVES END-USERS

Mr. REINERS. Good afternoon, Mr. Chairman, and members of the committee. My name is Craig Reiners. I am a beer guy from Milwaukee. My team manages the commodity price risk for MillerCoors. I am also testifying on behalf of the Coalition for Derivatives End Users. I am very pleased to have this opportunity to offer perspectives on rulemaking relating to the Dodd-Frank derivatives title.

MillerCoors operates breweries in California, Ohio, North Carolina, Texas, Georgia, Virginia, Colorado, and Wisconsin, as well as the Leinenkugel's Craft Brewery and two microbreweries. Last year, we shipped 67 million barrels and sales reached $7.6 billion.

Our 9,000 employees share a vision to create America's best beer company by driving profitable industry growth. MillerCoors insists on building its brands the right way through quality, responsible marketing, environmental stewardship, and community involvement.

Rather than read verbatim from my submitted statement, allow me to highlight our key six messages. Number one, we fully support market transparency. Number two, as an end user, our use of derivatives is strictly used to manage price volatility intrinsic to physical commodities. Number three, our Board-approved commodity risk management policy strictly prohibits speculation.

Number four, we support a broad end user exemption. Number five, we urge regulators to avoid creating unnecessary trading requirements with the unintended consequences of forcing companies to either retain more risk or seek alternatives offshore.

And finally, number six, we urge caution relative to a compressed rulemaking timeline, which may not allow market participants the opportunity to provide valuable feedback.

Now, to a bit more clarification. We support this committee's efforts to ensure derivatives markets operate efficiently and are well-regulated. We agree that proper regulation should reduce systemic risk and increase transparency in the over-the-counter markets. At the same time, the prudent risk of derivatives by end user companies such as MillerCoors does not generate risk or instability in the financial marketplace and played no role in the financial crisis.

On the contrary, these risk management tools are critical to reducing commercial risk and volatility in our day-to-day businesses. Our commitment to our customers is to produce the best beer in the United States and deliver it at a competitive price. In order to achieve those goals, we must prudently manage our commodity risks.

I believe the use of derivatives offers end users of physical commodities the risk management tools to provide a necessary degree of predictability to our earnings. Our single largest risk is aluminum. Our agricultural risks, of course, include malt and barley, corn and hops. Our energy risk portfolio includes coal, natural gas, deregulated electricity, and diesel fuel.

As I mentioned before, our Board-approved commodity risk policy clearly forbids any and all speculation. The policy allows us to use over-the-counter swaps to precisely match the timing and prices of our complex manufacturing and distribution process.

For example, we match our OTC swaps for aluminum with the actual use of cans over the same exact timeframe. This risk management technique allows us to manage costs, reduce price volatility, and manage cash flow within a reasonable parameter. In fact, we would create significantly more price volatility in our business by not hedging.

We believe that end users generally share the concern that if the cost of hedging our risks rises significantly, entry into swaps may no longer be economical. The result would be a reduction in risk mitigation through hedging, which, ironically, could increase risk and exposure to market volatility. We believe that a broad end user exemption is critically important as the CFTC and SEC creates their final rules.

During the regulatory process, we have sought to ensure that the exemption created by Congress would not be unduly narrowed. In particular, we have urged regulators to give thoughtful consideration to key definitions to ensure that end users like us are not saddled with bank-like regulation.

I would like to address the prospect of margin being imposed on future, even previously entered contracts. This requirement would be particularly burdensome to end users like MillerCoors. Retroactive application of margin requirements would upset the reasonable expectations we had when we entered into our existing risk management contracts.

We engaged in extensive negotiations with our financial counterparties to develop our ISDA agreements, which established our expectations for the future and included vigorous credit stipulations. Any retroactive application of margin requirements would be punitive.

MillerCoors urges the financial regulators to avoid creating rigid and expensive trading requirements that unintentionally could cause companies either to retain more risk or seek risk management alternatives. By utilizing OTC swaps, we are able to customize our hedges to perfectly match the underlying exposure.

The current rulemaking timeline is compressed, which may force regulators to prioritize speed over quality. We urge Congress to provide regulators with more time for rulemaking and for regulators to allow market participants sufficient time for implementation. I am confident in the way that these products are utilized by our company and other end users, actually benefits the economy by reducing volatility and increasing stability.

On behalf of MillerCoors and the Coalition, I thank the committee for allowing me to appear today to discuss these important issues. And I am happy to answer any questions you may have. That concludes my testimony.

[The prepared statement of Mr. Reiners can be found on page 309 of the appendix.]

Mr. GARRETT. And sir, thank you for your testimony.

I believe you were all advised of this beforehand, but I will just reiterate, since some of you have testified before the committee before and others have not. And that is the clock in front of you has green, yellow, and red lights. The yellow light gives you the 1-minute warning so you can begin to sum up.

Mr. Donahue?

STATEMENT OF DONALD F. DONAHUE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, THE DEPOSITORY TRUST & CLEARING CORPORATION (DTCC)

Mr. DONAHUE. Chairman Garrett, members of the committee, I am here today representing the Depository Trust & Clearing Corporation a non-commercial industry utility that in 2010 settled roughly $1.7 quadrillion of U.S. securities transactions.

Since 2006, we have operated the Trade Information Warehouse, a global swaps data repository currently covering about 98 percent of all credit derivatives transactions, some 2.3 million contracts, with a notional value of $29 trillion.

I appreciate this opportunity to share our thoughts on the implementation of Title VII of the Dodd-Frank Act. In particular, I will focus on the swap data repository system for providing the necessary transparency into the global OTC derivatives markets.

We share Congress' goal of ensuring more transparency in these markets to further global regulatory oversight and systemic risk mitigation. As many of the regulatory aspects of Dodd-Frank remain in development, transparency is a policy option that is most right for implementation.

I make two fundamental points today. First, transparency is key to any attempt to mitigate systemic risk in the swap markets. All swaps, cleared and uncleared, must be reported to swap data repositories.

To the extent derivatives contributed to the financial crisis, it was due to the lack of a unified view of which categories of market participants held wide exposures in the swap markets. The model needed to address this transparency concern has since been largely formalized for the credit default swap market in DTCC's Trade Information Warehouse.

Leveraging the warehouse, late in 2008 we began providing standard position risk reports to appropriate authorities worldwide and publishing comprehensive market information free of charge.

More recently, as we announced just this morning, we inaugurated an online portal through which global regulators, currently 19 worldwide, can securely and directly access detailed data from the warehouse's global data sets.

Had this level of transparency about the CDS market existed in the run-up to the 2008 crisis, it would have mitigated a substantial amount of uncertainty that then contributed to market instability.

DTCC believes that the most immediate and cost-effective approach to meeting Dodd-Frank's transparency goals will rely on proven repository infrastructure that currently provides regulators and the public this type of comprehensive market information.

Providing transparency in the CDS market is a cooperative effort. I focused on the warehouse achievement to bring to the committee's attention why it has been successful. It would not have been possible without a substantial degree of global regulatory cooperation and support.

But while this global supervisory push was a critical element, it was also important to the success that DTCC is not a commercial entity. We have no motivation other than to provide a central place for reporting and regulatory access to the data for both market and risk surveillance purposes.

This removes commercial concerns from what is and must remain a market utility-based regulatory and supervisory support function. The structure created works because all market participants and all clearers and trading platforms with any significant volume are cooperating. If this cooperation were to fail, the data published and made accessible to regulators would fragment leading inevitably to misleading reporting of exposures.

What would follow would be an exceptionally expensive if not politically impossible task for regulators to rebuild complex data aggregation and reporting mechanisms that the industry and regulators themselves have already created in a single place at DTCC. Both of these results appear undesirable in the extreme.

The challenge ahead is to bring similar transparency to other parts of the swap markets. I commend the work of both the SEC and the CFTC in their thorough and thoughtful approach to this very complex challenge.

It is our sense as an industry-governed utility with both buy and sell side members on our governing bodies that market participants are poised to undertake the significant cooperative effort necessary to complete the transparency of these markets as contemplated by Dodd-Frank.

I urge the committee in exercising its oversight function to focus on removing obstacles to this process and to continue to use proven infrastructure while avoiding injection of commercial considerations that could hinder the cooperative attitude that so far has made progress possible.

Thank you, and I am available for any of your questions.

[The prepared statement of Mr. Donahue can be found on page 81 of the appendix.]

Mr. GARRETT. Thank you.

Mr. Duffy?

STATEMENT OF TERRENCE A. DUFFY, EXECUTIVE CHAIRMAN, CME GROUP INC.

Mr. DUFFY. Thank you. Chairman Garrett and members of the committee, I want to thank you for the opportunity to testify on the regulatory implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I also want to thank Congressman Dold for that kind introduction and of course his leadership, not only in Congress but back in his district.

As the Congressman said, I am Terry Duffy, executive chairman of the CME Group, which includes our clearinghouse and our four exchanges: CME; CBOT; NYMEX; and COMEX. In 2000, Congress adopted the Commodity Futures Modernization Act which leveled the playing field with our foreign competitors and permitted us to recapture our position as the world's most innovative and successful regulated exchange and clearinghouse.

As a result, we remain an engine of economic growth in Chicago, New York, and the Nation. In 2008, the financial crisis focused well-warranted attention on the lack of regulation of OTC financial markets.

The Nation learned painful lessons regarding unregulated derivatives trading. But we also demonstrated that regulated futures markets and futures clearinghouses operated flawlessly before, during, and after the crisis. Futures customers were protected.

Congress responded to the financial crisis by adopting the Dodd-Frank Act to reduce systemic risk through central clearing and exchange trading of derivatives, to increase data transparency and price discovery, and to prevent fraud and market manipulation. We support these goals but our concern is that the CFTC's regulation of futures exchanges and clearinghouses will impose unwarranted cost and stifle innovation.

We are not alone. Several Commissioners have cautioned against regulations that unnecessarily expand the Commission's workforce. While we are proponents of an adequate budget for our regulator, we object to the expansion of the Commission and its budget to enforce regulations that are uncalled for by Dodd-Frank or that take over responsibilities from SROs.

We object to regulations that are not cost-benefit justified. Much of the problem results from the CFTC's efforts to expand its authority by changing its role from an oversight agency, whose purpose has been to assure compliance with sound principles, to a front-line decision-maker that imposes its business judgments on every operational aspect of derivatives trading and clearing.

This role reversal will require a doubling of the Commission staff and budget. It will also impose astronomical cost on the industry and the end users of derivatives. There is no evidence that any of this is necessary or even likely to be useful. Dodd-Frank was not an invitation to pile regulatory burdens on regulated exchanges and clearinghouses.

For example, Congress preserved and expanded a principles-based regulatory approach by expanding the list of core principles and granting self-regulatory organizations reasonable discretion in establishing the manner in which a self-regulatory organization complies with the core principles. The Commission asked for and Congress gave it power to adopt rules respecting core principles but Congress did not direct the agency to put an end to a principle-based regime.

Yet, the Commission immediately and for no apparent reason proposed comprehensive regulations to convert most of the key core principles into prescriptive rules-based regulatory system. This is the ultimate solution in search of a problem. The crisis of 2008 did not arise from a failure of the regulated transparent futures markets.

And the scope of Dodd-Frank is narrower than many of the CFTC rules proposed would suggest. Implementation would be similarly tailored. My written testimony includes numerous additional examples of misdirected or improper rulemaking. We welcome the outreach Chairman Gensler has recently demonstrated in seeking public input on Dodd-Frank implementation.

This is a step in the right direction but more needs to be done. The Congress can mitigate some of the problems that have plagued the CFTC rulemaking process. They can do this by expanding Dodd-Frank's effective date and the rulemaking schedule so that professionals including exchanges, clearinghouses, dealers, market makers, and end users can have their views heard.

This would give the CFTC a realistic opportunity to assess those views and measure the real cost imposed by these new regulations. Otherwise, the unintended adverse consequences of those ambiguities and the rush to regulation will stifle effective exchange innovation.

We are concerned that overly prescriptive regulations, which are inconsistent with the sound industry practices, will make it more difficult to reach Dodd-Frank's goal of increasing transparency and limiting risk.

I thank the committee for its time this morning.

[The prepared statement of Mr. Duffy can be found on page 257 of the appendix.]

Mr. GARRETT. Thank you for your testimony.

Mr. Thompson?

STATEMENT OF DON THOMPSON, MANAGING DIRECTOR AND ASSOCIATE GENERAL COUNSEL, JPMORGAN CHASE & CO., ON BEHALF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA)

Mr. THOMPSON. Chairman Garrett and members of the committee, my name is Don Thompson. I am the senior derivatives lawyer at JPMorgan, and I am here today on behalf of SIFMA. Thank you for inviting me to testify.

As this committee is well aware, American companies use over-the-counter derivatives to manage a wide variety of risks that they encounter in their day-to-day business, such as interest rate risk, foreign exchange risk, and commodity price risk. We act as a financial intermediary to help clients manage these risks in a flexible manner.

Many clients choose to manage risk from the over-the-counter market and as the committee has heard in testimony from American companies, the use of over-the-counter derivatives has a significant impact on their ability to compete internationally. While over-the-counter derivatives have many benefits, it is also the case that there have been problems with their use and with their oversight.

We support many of the provisions in Title VII including mandatory registration of regulation of swap dealers, mandatory clearing of standardized contracts between financial firms, and greater pre and post-trade transparency.

It is worth keeping in mind that these and other reforms taken together will fundamentally alter the market structure of the over-the-counter derivatives market, which will impact liquidity and efficiency in these markets.

Given these wholesale changes, it is critical that the regulations implementing them be done thoughtfully to ensure that American companies continue to have access to these products. We are increasingly concerned, however, that the accelerated pace of rule-making, risks, unintended consequences that will put American end users at a competitive disadvantage.

We are also concerned that the statutory deadlines may be too aggressive, limiting regulatory flexibility to craft appropriate rules. For example, for real-time reporting in block trade levels, gathering data from market participants is a necessary prerequisite to setting effective standards and such data should inform these rulemakings.

In the rush to meet statutory deadlines, there has been insufficient focus on the statutory mandate to examine the effects of proposals on market liquidity. Without care, there is a real risk that the current proposals will drive liquidity out of U.S. markets and increase the cost of or even the ability to manage risk.

We believe the agencies need to carefully implement the statute to preserve liquidity, enable American companies to continue to manage their risks in an increasingly volatile and competitive global marketplace.

Despite transatlantic dialogue over derivatives regulation, we are also concerned about the competitive harm resulting from differences in final regulations between the United States and Europe. This concern extends to the gap in implementation dates in

Europe and other jurisdictions, as well as confusion over the extraterritorial application of Title VII's provision.

This problem can be addressed by a simple clarification of the intended extraterritorial reach of the Act, by harmonizing the implementation timetables between the United States and the E.U., or by both.

In addition, certain proposed regulations treat very similar products differently in a way that will create duplicative reporting and compliance regimes that will be burdensome and will reduce the transparency benefits of information ultimately reported to the public under those regimes.

I would like to conclude by saying that JPMorgan is committed to working with Congress, regulators, and industry participants to ensure that Title VII is implemented appropriately and effectively. I appreciate the opportunity to testify before the committee. I look forward to answering any questions you may have.

[The prepared statement of Mr. Thompson can be found on page 330 of the appendix.]

Mr. GARRETT. I thank you, sir.

Mr. Cawley, please, for 5 minutes.

STATEMENT OF JAMES CAWLEY, CHIEF EXECUTIVE OFFICER, JAVELIN CAPITAL MARKETS, ON BEHALF OF THE SWAPS AND DERIVATIVES MARKET ASSOCIATION (SDMA)

Mr. CAWLEY. Thank you. Congressman Garrett and members of the committee, my name is James Cawley. I am CEO of Javelin Capital Markets, an electronic execution venue of OTC derivatives that expects to register as a SEF or swap execution facility under Dodd-Frank. Thank you for inviting me here today to testify.

I am here to represent the interests of the Swaps and Derivatives Market Association, which is comprised of multiple independent derivatives dealers and clearing brokers, some of whom are the largest in the world. When called to testify today, I was reminded of the main reason for which we are here, to fix the derivatives market such that we never again have to call upon the U.S. taxpayer to bail out Wall Street.

The bilateral counterparty risk baked into every credit derivatives and interest rate swap contract still constitutes an unacceptable systemic risk to the national financial payment system specifically and to the broader economy as a whole. Simply put, such bilateralism acted as an accelerant to the crisis much like gasoline does to a forest fire.

To help ensure in the future that the government and more specifically the U.S. taxpayer doesn't have to bail out the next trading firm that fails, we must ensure that central clearing and, more importantly, transparent execution of OTC derivatives is a success. We must transition away from "too-interconnected-to-fail", where one firm fails and pulls three others down with it.

Central clearing membership requirements should be objective, publicly disclosed, and permit fair and open access as Dodd-Frank requires. This is important because clearing members act as the gatekeepers to clearing. Without open access to clearing, you will not have universal clearing of options, increased transparency, and lessened systemic risk.

Clearinghouses should seek to be inclusive, not exclusive, in their membership criteria. They should learn from their own experience in the list of derivatives space of futures and options.

In those markets, central clearing has operated successfully since the days of post-Civil War Reconstruction nearly 150 years ago, long before spreadsheets and risk models. In those markets, counterparty risk is spread over 100 disparate and non-correlated clearing firms. It works well, and no customer has ever lost money due to a clearing member failure.

To complement broad participation, clearinghouses should not have unreasonable capital requirements. Capital should be a function of the risk a member contributes to the system. Simply put, the more you or your customers trade, the more capital you contribute. The SDMA supports the CFTC's call for clearing broker capital requirements to be proportionate in scale relative to the risk introduced to the system.

We support the CFTC's call that the clearing firms' minimum capital be closer to $50 million rather than the closer to the $5 billion or $1 billion threshold that certain clearinghouses have originally suggested. It is worth remembering that Lehman Brothers and Bear Stearns would have met the $1 billion threshold until the days of their failure.

Certain clearinghouse operational requirements for membership that have no bearing on capital or capability should be seen for what they are, transparent attempts to limit competition. Specifically, clearing members should not be required to operate swap dealer desks just so they can meet their obligation in the default management process.

These requirements can easily be met contractually through agreements with third party firms or dealers. Clearinghouse governance should be balanced and transparent. Such governance bodies should represent the interests of the market as a whole and not the interest of the few.

With regard to conflicts of interest with a clearing member, Dodd-Frank is clear. Dealer desks should not be allowed to influence their clearing member colleagues and strict Chinese law should exist. With regard to trading derivatives, clearinghouses must accept trades on an execution blind basis.

Customers should be allowed to trade with whom they want. They should not be forced to execute trades in such a way where one side of that trade is done with an incumbent dealer.

They should also be able to trade with dealers who do not self-clear but make markets nonetheless and provide the liquidity so vital to the integrity of the system. For their part, swap execution facilities should also offer open access.

They should offer pre and post-trade transparency in an otherwise opaque marketplace. SEFs should seek to report their trades within seconds, as is the case in other markets. It is well-established with the introduction of greater transparency, more market makers and increased competition, a safer playing field will emerge to directly enhance liquidity and market integrity which in turn lowers the systemic risk.

In conclusion, the CFTC and the SEC should be commended for their excellent work. Both agencies have been transparent and accessible throughout the entire process. They have adapted to industry suggestion when appropriate, and Congress should provide them funding that they need.

We must move away from "too-into-connected-to-fail." We must work together to ensure that when the next investment house fails, and they do, that we are properly prepared for it. I thank you for your time.

[The prepared statement of Mr. Cawley can be found on page 77 of the appendix.]

Mr. GARRETT. And I found that illuminating. Thank you very much for the testimony and from the gentleman from the great State of New Jersey and the 5th District as well.

Mr. Giancarlo please?

STATEMENT OF J. CHRISTOPHER GIANCARLO, EXECUTIVE VICE PRESIDENT, CORPORATE DEVELOPMENT, GFI GROUP INC.

Mr. GIANCARLO. Thank you, Congressman, and thank you members of the committee. I am Chris Giancarlo, executive vice president of GFI Group, an American company and a global wholesale broker of swaps and other financial products.

I am also a Board member and former chairman of the Wholesale Markets Brokers' Association. As such, I speak from the perspective of the wholesale brokerage industry that handles over 90 percent of intermediated over-the-counter swaps trading in the United States and around the world today.

Wholesale brokers are the prototype of competing swap execution facilities or SEFs. The core impact of Title VII of Dodd-Frank is to replace a market in which swaps are often traded directly between counterparties with a system for most transactions where a central clearing facility acts as a single counterparty to each market participant and where transactions are executed on regulated trading facilities including the newly created definition of SEFs.

The goal of these two initiatives, clearing and intermediation, is better safety and soundness for U.S. swaps markets. Dodd-Frank promotes a market structure where competing SEFs and exchanges vie with each other to provide better services at lower cost in order to win the execution business of market participants.

Dodd-Frank rejected the anti-competitive single silo exchange model for the futures industry where clearing and execution are intertwined. Dodd-Frank expressly permits swaps to be executed by SEFs using "any means of interstate commerce."

Congress left it to the marketplace to determine the best modes of execution and thereby foster technological innovation and development. Congress specifically did not choose to impose a federally-mandated one-size-fits-all transaction methodology on the swaps market.

Liquidity in today's swaps markets is fundamentally different than in futures and equities markets and naturally determines the optimal mode of market transparency and trade execution.

Wholesale brokers are experts in fostering liquidity and transparency by utilizing trade execution methods that feature a hybrid blend of knowledgeable brokers and sophisticated electronic technology that are specifically tailored to the unique liquidity characteristics of particular swaps market.

There are three critical elements that regulators need to get right. First, SEFs must not be restricted from deploying the many varied trade execution methods successfully used today. It would be detrimental to market liquidity to mandate restrictive transaction methodologies or to experiment with rules taken from the highly commoditized equities or futures markets.

Moreover, U.S. regulations need to be in harmony with those of foreign jurisdictions to avoid driving liquidity toward overseas markets that may offer greater flexibility in modes of trade execution.

Second, the goal of pre-trade transparency can be realized through means that are already developed by wholesale brokers to garner and disseminate pricing information and not by artificial mechanisms that may restrict market liquidity for end users and other traders.

Third, regulators need to carefully structure a public trade reporting system that takes into account the unique challenges of swaps trading. The objective must be to strike a balance between price transparency and market liquidity.

If the rules do not properly define the size of block trades, information, and time delays, they will surely cause a negative impact to liquidity, disturbing end users' ability to hedge commercial risk and to plan for their future.

The Wholesale Markets Brokers' Association has proposed a block trade standards advisory board of recognized experts from data repositories and SEFs to make recommendations to the regulators for appropriate blocks trade rules.

The regulators and their staff deserve to be commended. They are working very hard to get this right. It is crucial that they gain a thorough understanding of the many modes of swaps trade execution and price dissemination deployed by wholesale brokers and accommodate those methods in trading practices in their SEF rules.

It is only with such understanding that they can draft regulations that are properly tailored and effective. I am optimistic that given enough time and resources, regulators will craft SEF rules that are well-suited to the existing trading methods in the swaps market resulting in shorter and more effective implementation periods.

As the adage goes, "measure twice, cut once." We certainly don't want to have to cut this thing twice. Congress can assist with needed technical corrections to Dodd-Frank and crucially, by providing regulators with adequate time and resources to thoroughly understand the challenges and solutions to garnering trading liquidity in the swaps markets. Taking adequate time to get the regulations right will expedite the implementation of the worthy goals of Dodd-Frank, that is, central counterparty clearing and effective trade execution and provide end users and other traders with more competitive pricing, increased transparency, and deeper trading liquidity for their risk management needs.

I thank you and I look forward to your questions.

[The prepared statement of Mr. Giancarlo can be found on page 288 of the appendix.]

Mr. GARRETT. Thank you. And I thank the entire panel.

We will now turn to the gentleman from New York, Mr. Grimm.

Mr. GRIMM. Thank you, Mr. Chairman, and thank you to the panel. Mr. Giancarlo, since you just finished, I will start with you if I may? I wanted you to expand a little bit about the multiple modes of execution.

I for one think it is important: voice, hybrid, electronic. These modes, if you can expand why it is so important to have multiple modes rather than wholly electronic platform, I would ask you that question.

Mr. GIANCARLO. Thank you, Congressman. Liquidity in the swaps market is very different than in the futures and equities markets, the nature of liquidity. Just to give you an example, 80 percent of the reference entities, swaps on 80 percent of the reference entities in the credit derivatives market, trade less than 5 times a day.

It is not the same type of marketplace where you have a continuous tape that you do in a futures market or an equities market, and therefore the means by which experienced intermediaries bring parties together in this marketplace are very different.

At GFI Group, and at our competing wholesale brokerage firms, we use a range of methodologies. Everything from online auction systems to fixing and matching session as well as fully electronic online platforms. But we also use a mix of humans and electronic systems. And often, that is very effective at bringing parties together.

Mr. GRIMM. That begs the question, if I may, it appears to me that the CFTC has relied heavily upon the regulations governing the futures contract in drafting the proposed rules for the swaps. Are the regulations for the futures industry appropriate for the swaps industry, and if not, why?

Mr. GIANCARLO. There may be some elements of what is—how regulations work in the futures industry that are appropriate but many, many other ways they are inappropriate. And in the proposed regulations, there are a number of areas where the proposed regs simply just don't apply, just simple things like referring to products listed on SEFs or members of SEF. These are concepts that really don't exist in the swaps market. And yet as we read the proposed rulemaking, these concepts still come through, and are inappropriate for what takes place in the swaps market.

Mr. GRIMM. Thank you very much. I appreciate that.

If I can switch over to Mr. Donahue. Your testimony expressed concerns about fragmentation of data. Doesn't the technology exist already for the regulators to easily consolidate the data it receives from various swap data repositories?

Mr. DONAHUE. Congressman, I would certainly agree it exists. I don't think I would use the word "easily." You can consolidate the data. I think our point is the data is already consolidated. The data has been unified in a swap data repository.

Having that consolidated view and having the infrastructure that we have to permit regulators in the market access to that consolidated view is very, very key to meeting the transparency goals that the Act has and that Congress had in adopting the Act.

Trying to—allowing that to fragment and allowing the data to split out into pieces that get distributed in different forms in different data vendors and then imposing the obligation to then reunify that and consolidate that is, we think, going to be a fairly difficult process, a complex process, an expensive process and certainly add very significant time to the market's ability to establish the transparency that Congress and the regulators want.

Mr. GRIMM. One more question, Mr. Donahue, other than the congressional mandate that trades be reported, explain why we need repositories please?

Mr. DONAHUE. Again, the repository gives a consolidated view of all of the activity within a particular asset class so that you can see all of the exposures. You know who has what exposures. You can see information about contracts conducted globally. This is a global market.

Mr. GRIMM. Could I just ask you, why can't the clearinghouses collect the information since they are the central nexus for the derivatives and let them send the information to the SEC and the CFTC?

Mr. DONAHUE. Your question answers that, okay? The clearinghouses necessarily will fragment the data and you are going to be dealing with different groups of data reflecting different activities, different contracts.

You may see offsetting contracts in different clearinghouses. You have to bring it together in some place. You have to aggregate it to see the entire view. That is precisely what swap data repositories do. Going there and using that infrastructure from day one we believe is the appropriate public policy choice.

Mr. GRIMM. I yield back, Mr. Chairman.

Mr. HENSARLING. [presiding] The gentleman yields back his time. The Chair now recognizes the gentlelady from New York for 5 minutes.

Mrs. MALONEY. Thank you very much, and I thank all the panelists. On the central repository, in your statement you said that it should be a utility and could you expand on why you describe DTCC as—why can't we use it as a for-profit model? Why should it be a utility? If you could expand?

Mr. DONAHUE. Congresswoman, I think the crucial point there is the very, very deep degree of market cooperation and collaboration that is needed to make a repository work.

Mrs. MALONEY. Yes.

Mr. DONAHUE. DTCC is a market-governed utility. We are operated on a not-for-profit basis. We have a governing board or a governance committee that has all of the constituencies in the market involved in the governance.

They view us as a neutral meeting place where they can have a particular market need addressed in a way that is responsive to their concerns and meets the needs of the broad range of market constituencies. That is what a utility or an industry cooperative does.

That is very, very crucial to getting the level of cooperation and collaboration that is needed to achieve rapid implementation of the transparency mechanisms that the repository provides. So we think getting the kind of market cooperation both within the United States and also crucially from overseas is very much facilitated by having a market utility supporting that function.

Mrs. MALONEY. When you mentioned overseas, we are definitely in a global market, and DTCC just has activities here in America, correct?

Mr. DONAHUE. No, we actually have offices both in Asia and in Europe and we actually have an implementation of our derivatives support capability in Europe as well as in the States.

Mrs. MALONEY. So that allows you see the entire picture? Is everything in DTCC internationally and locally?

Mr. DONAHUE. With respect to credit default swaps the Trade Information Warehouse is a global infrastructure. It has trade feeds from 1,800 counterparties in 52 countries around the world. The reference entities referenced in the warehouse originate from 90 countries around the world.

The regulator transparency mechanism that we announced this morning gives information to 19 regulators around the world and that number will grow. So it is very much a global infrastructure, and that is very key given the global nature of the marketplace.

Mrs. MALONEY. In your written testimony, you mentioned that it would be, and I am quoting from it, it would be "an exceptionally expensive if not politically impossible task for regulators to rebuild complex reporting mechanisms." Yet there were several amendments in Dodd-Frank that would have done this earlier.

Mr. Gensler from CFTC I believe was testifying that he thought he would build his own clearinghouse. Can you comment on that? Do you think other repositories are necessary in order to have all the information to see the exposure, see the risk, and prevent another catastrophe like we had in 2008?

Mr. DONAHUE. Our view is very much that you need a consolidated view per swap asset class. All right? So for credit default swaps, the trade information provides that. You would need a consolidated view, a repository for interest rate swaps, as an example, for over-the-counter equity swaps.

And consolidating all that information into a unified view, we believe, is very crucial to having the kind of transparency that the market needs. The CFTC could do that. The regulators could do that, consolidating information from a variety of sources. That is a fairly expensive proposition. It is a fairly time-consuming proposition.

Mrs. MALONEY. Would it offer more information than what DTCC now offers—

Mr. DONAHUE. It would—

Mrs. MALONEY. —or would it be a duplication?

Mr. DONAHUE. I think it would be fair to characterize it as a duplication. We are within weeks of having the Trade Information Warehouse in a form that is completely compliant with Dodd-Frank requirements in terms of the breadth of the data we maintain, the kinds of information, and the kinds of counterparties we have reflected.

So I don't see that—pushing, that the regulator level would add anything other than additional expense replicating what already exists.

Mrs. MALONEY. In my opening comments, I talked about the flash-crash, and how we need to try do everything we can to prevent it, and I would like to ask the panelists, how do SEFs prevent events like May 6th, which has been called a flash-crash or the recent hacking into NASDAQ, which was very troubling to many of us? How can you minimize or prevent these type of intrusions or shocks or disruptions to our financial markets?

Mr. GIANCARLO. Congresswoman, if I may?

Mrs. MALONEY. Sure.

Mr. GIANCARLO. As I noted in my testimony, we and other wholesale brokers operate a hybrid model of execution which we call a melding of man and machine. It is a combination of human brokers and very sophisticated electronic trading technology.

In that type of environment, the risks of the machines taking over, if you will, are minimized because the humans are sitting there side-by-side watching trading activity, and they are very experienced in the way markets work. It is almost as if you have a pilot in an airplane; if there is any turbulence, they could take it back off autopilot, take it back into manual control.

One of the concerns we have with proposed regulations that would seek to impose a sort of an electronic model on a marketplace that right now operates on a hybrid model is that would exacerbate the risks of an electronic malfunction—

Mrs. MALONEY. Okay.

Mr. GIANCARLO. —taking the market in a direction that is unintended.

Mrs. MALONEY. Yes, just tell me—Mr. Donahue, do you have a comment? Thank you.

Mr. HENSARLING. You can be brief, sir.

Mr. DONAHUE. Certainly, and I think we—obviously with respect to the NASDAQ point you make, Congresswoman, we certainly have taken very serious note of what happened. Obviously, we don't really understand all the details.

It is something that we are very focused on, and I would think most market participants are very focused on ensuring that their systems are safeguarded against some incident like that, so it is something that gets a lot of focus and a lot of attention.

Mrs. MALONEY. Thank you.

Mr. HENSARLING. The time of the gentlelady has expired. I wish to announce to the remaining members that votes are expected within the next few minutes. We will recognize Mr. Duffy on the Majority side, and Mr. Perlmutter on the Minority side. And then, we will have to adjourn the hearing.

The Chair now recognizes the gentleman from Wisconsin for 5 minutes.

Mr. DUFFY OF WISCONSIN. Thank you, Mr. Chairman. I, too, want to thank the group for coming in and answering our questions and giving your testimony. You all look nice and tight together, very nice. We looked like that earlier today.

Specifically, Mr. Reiners, I would like to ask you a few questions. I am also from Wisconsin, the 7th District. We like our beer in Wisconsin, and cheap beer or inexpensive beer, I should say, not cheap. Also, our district is home to Leinenkugel's, which is a great employer in Chippewa Falls, Wisconsin, and they make great beer there.

And so I think some questions that are relevant to the impact of the Dodd-Frank rules and the beer industry. If you look at the regulations that are about to come down—is it going to be more expensive for you to enter into derivatives contracts to hedge your risk?

Mr. REINERS. We do, both vanilla over-the-counter trades. We do futures trades. We do customized trades as I mentioned in my testimony. So should there be a change in the margin requirements for end users that would change the complexion of our working capital. It would certainly have an impact across-the-board.

Certainly, commodities are a component of our final price and how we manage that price. But it is not the only factor relative to pricing beer.

I have to also speak on behalf of the Coalition that these margin requirements that were discussed off and on really could impact capital investment, could impact how your working capital is employed.

Mr. DUFFY OF WISCONSIN. And with the cost increases, potentially those would, obviously, be passed on to consumers?

Mr. REINERS. If the marketplace—it would be up to the marketplace.

Mr. DUFFY OF WISCONSIN. Okay. And if they are passed on, obviously, the cost of our six packs would go up, is it fair to say?

Mr. REINERS. It would certainly have an impact on the cost of it, yes.

Mr. DUFFY OF WISCONSIN. Okay. I knew that was coming.

Mr. CAWLEY. Congressman? Excuse me, Congressman? If I could just go back because—

Mr. DUFFY OF WISCONSIN. Oh, yes. I am sorry.

Mr. CAWLEY. —there is one other cost you need to consider when you are considering the end user away from margin and the actual processing of a trade. You need to consider the execution costs as well, and sometimes that can go up and go down. So one thing I think will be interesting to look at is when a marketplace becomes more transparent, the execution costs actually go lower.

There is estimated to be about $50 billion worth of execution costs, currently, in interest rate swaps in CDS today on an annual basis. And if you allow central limit order books and transparency into the marketplace where buyers and sellers can meet each other directly, those fees should tend to go down. We estimate that those fees could go down by as much as $30 billion to $40 billion.

Mr. DUFFY OF WISCONSIN. In regard to the issue of transparency, I think everyone here would agree that companies like AIG and all of their contracts we should have more transparency or could have stopped the crisis that I think AIG played a big part in.

But is there a concern of, say MillerCoors is entering into contracts for aluminum, and we talked about the liquidity in the marketplace with aluminum contracts. If you are entering into a contract, and it is probably a big contract—does that have an impact on the market if you are forced to disclose the contract that you are entering into? Is there a cost component with the transparency of end users with an over-the-counter contract?

Mr. REINERS. —in regards to transparency, Congressman, I think it is really all about the details and the careful implementation of any new rules. We would, as a beer guy and someone who actually uses these tools that we are talking about, the level of confidentiality is certainly critical.

You have kind of touched on that, and I think the rules would allow for that, but I think the issue of additional costs, the devil is in the details again. We don't want to add additional cost to the regulatory system because that does translate right in to our cost of goods sold.

Mr. DUFFY OF WISCONSIN. Okay. And just if I could ask the panel one other question? If you look at what we are doing here with our rules, it appears that we are leading the way with reforming our rules and regulation in regard to derivatives as opposed to the E.U. and other Asian markets. If this raises the cost of our contracts—is it possible or feasible that we are going to see more of our derivatives markets go to places like Singapore and Hong Kong or others?

Mr. THOMPSON. We are already hearing from clients, especially European clients who deal with multiple banks including our London branch—things like it is not clear to me whether we will be caught up in Dodd-Frank, but if we deal with Barclays or Credit Suisse or a European bank, we won't be subject to this. Why should we take the risk of dealing with you and having to clear our contracts?

Mr. DUFFY OF WISCONSIN. So it is—

Mr. HENSARLING. The time of the gentleman has expired.

Mr. DUFFY OF WISCONSIN. Thank you, Mr. Chairman.

Mr. GARRETT. [presiding] They have just called votes on the Floor. We should have time to clear the two remaining members' questions.

The gentleman from Colorado is recognized for 5 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman, and I just appreciate the panel being here today waiting through all the questioning of the three previous witnesses. And I know that I have had a chance in the first round of Dodd-Frank to talk to at least the first four of you or your companies, and learned a lot in that process. Derivatives are something that I never expected to have to deal with on an ongoing basis as we seem to be dealing with it, but a couple of points.

I will start with you, Mr. Reiners. We tried in that bill to limit margins or capital requirements for end users in connection with their having to deal with future risk, you guys buying barley on a forward basis or aluminum or whatever it might be.

Listening to Chairman Gensler, I am comfortable that he got that as part of the bill. I appreciate your company's caution that some regulator doesn't get out of hand. And I think you brought it clearly to my attention, and I will keep an eye on it. Do you have indications in a rule that they are going to call and require margin against barley for next year?

Mr. REINERS. No, Congressman. Thanks for the comment. I heard the same thing from the Honorable Chairman Gensler, and I had a prior personal discussion with him on this several months ago, and I heard the same thing here during his testimony. I have to say though that I think I heard some inconsistencies by some other participants today that give me pause.

Mr. PERLMUTTER. All right. I appreciate that, and we will keep an eye out and look to you guys, just something like that to advising us, so we can be a good oversight committee.

The other thing that I am hearing though from several folks is that we have to take time in devising and implementing the rules, and I don't think there is any question about it. But what is your understanding, Mr. Thompson, as to what the timing is of the rules from either the SEC or the CFTC? When are they going to be promulgated?

Mr. THOMPSON. My understanding of the timing, first, with respect to the CFTC is they have already put out a draft of many of the 30 rulemaking work streams that they are charged with promulgating rules on there.

And my understanding of Mr. Gensler's timetable, based upon his public statements, is that he intends to have most, if not all of them, in place by the July 17, 2011, Dodd-Frank Title VII effectiveness date.

Mr. PERLMUTTER. Do you think that date is not a doable date,? Is it premature? Is that your concern?

Mr. THOMPSON. I think sticking to that date runs the risk of serious unintended consequences, in large part, because many of these issues are complex. One thing the chairman notes is that he has gotten a tremendous amount of input from the market. I check the CFTC Web site every day for the comments that come in, and I don't see how they are keeping up with the information that is coming back in to them.

Mr. PERLMUTTER. Let me stop you right there because we want to do this right, but there has to be some point where you get them done. I mean you can always analyze these to the nth degree.

I would ask that both your company, JPMorgan, which is a big player, obviously, and SIFMA, which is a major association, speak on behalf of these agencies, the CFTC and the SEC to the degree they may need people to get stuff done. And I don't know how you want to react to that, if you want to react to that or Mr. Duffy, I know CME has been involved in this.

Mr. THOMPSON. I will just react by saying both JPMorgan and SIFMA have actively provided the comment letters to the agencies on a wide variety of issues where we feel that they need assistance, technical advice or market-based input. And again, my concern is that given the sheer volume of information coming in to them, I am concerned about their ability to—

Mr. PERLMUTTER. —get it done?

Mr. THOMPSON. —take a step back, analyze that, think about it thoughtfully, and incorporate it into the final rulemaking.

Mr. PERLMUTTER. Mr. Duffy?

Mr. DUFFY. I will just say really quickly and just add to what Mr. Thompson said, we have a huge internal legal team analyzing each and every one of these rules. We have huge external legal firms working on these rules. We can't keep up with it. We are kind of perplexed.

How in the world can a couple of Commissioners with a few staffers and their lawyers actually understand what these rules mean and what the effects of them could be for this country 6 months or 6 years down the road? So we do think that the prudent thing would be to take some time and for people to understand these in more detail.

Mr. PERLMUTTER. And make sure it is properly staffed.

Mr. THOMPSON. As an order of magnitude in following up on Mr. Duffy's comments, Mr. Gensler was describing the size of his agency as roughly 400-and-some-odd people. At JPMorgan in New York, we have a team of about 350 people working on various phases of this.

Mr. PERLMUTTER. Okay. Thank you.

Mr. THOMPSON. It is a monumental undertaking.

Mr. PERLMUTTER. Thank you very much, and I yield back.

Mr. GARRETT. Thank you, and before the gentleman leaves, actually, we have a little bit more time, so I am going to yield, split our time—

Mr. HENSARLING. Sure.

Mr. GARRETT. —two-and-a-half minutes, Mrs. Biggert?.

Mrs. BIGGERT. Thank you, Mr. Chairman. I appreciate that. I have just a couple of quick questions that I would like to ask Mr. Duffy. The futures exchanges currently employ limits in most physically-delivered contracts to mitigate potential congestions and to help identify threats that might to manipulate the markets.

It seems like there has been a proposal in the President's recent Executive Order which turns this over to the CFTC. Wouldn't it be better to learn to leave it back within the market rather than put another cost to the Federal Government?

Mr. DUFFY. I do agree it would be best to leave it with the exchanges. We have been doing it for a number of years, and we have done it quite successfully. We have never had a customer lose one penny due to a clearing member default, and that is a 156-year record that we are very proud of, Congresswoman.

So I think we have done an excellent job of managing risks when it comes to these types of problems as it relates to the limits. We have limits on all of our deliverable products, so we already have the limits put in place today.

When it comes to energy, we have hard limits coming in to the last 3 days. We have accountability levels 30 days out on our grain products. They all have government-mandated limits imposed on them today, so these are things that are already in place today.

So I am kind of confused on why the regulator is trying to impose more restrictive limits on the regulated market when Congress told him to go figure out how to rein in the over-the-counter market. And once you do that, then make sure you don't disenfranchise the listed market. So we are very confused on the process the way it is unfolding—

Mrs. BIGGERT. Okay. Thank you. One more quick question, and that is with the European Union and foreign jurisdictions, if they adopt a less restrictive regime, and considering what we talked about, I asked Chairman Gensler earlier this morning that on the position limits, isn't that going to force companies to go abroad?

Mr. DUFFY. They already have. We talked earlier about business going abroad. Our natural gas contract at the New York Mercantile Exchange that we own, once Congress—or once the rhetoric came out that they are going to impose these very stringent limits, we saw a big shift of open interest from our nat gas contracts over to the London nat gas contract. So we definitely saw that.

Last week or 2 weeks ago, I think it was Michel Barnier or one of the other European officials came out and said exactly—I just met with him in August.

I met with Chairman Gensler and they said that they are going to be in lockstep with the United States and our regulations. This was back in August. I asked him when they passed Dodd-Frank in Europe. They don't have Dodd-Frank in Europe.

Also, they just came out last week and said they are not going to impose hard position limits on energy products, but yet they have the ability to do so. This is exactly what this Congress told our regulator to do, but our regulator looks at it in a different light.

Mrs. BIGGERT. Thank you.

Mr. DUFFY. Thank you.

Mr. GIANCARLO. Congresswoman, if I could just add on foreign competition? We are following very closely the directives coming out of MiFID and others coming out of Europe, and they don't also adopt the similarly restrictive approach to modes of execution for SEFs, that is—appear to be coming out of the CFTC.

And we think that if Europe adopts a more flexible approach to intermediation by SEFs that business could also go overseas within that regard as well.

Mr. GARRETT. I thank the gentlelady, and we are really—I am sorry. I am pressed for time here, so I will just throw out a couple of things to Mr. Giancarlo, with regard to the SEFs, two quick things.

One is a little bit in the weeds, and it is the difference in approach with regard to the SEC and the CFTC. The SEC seems to me a little bit more reasonable as far as it goes. The CFTC says no, you have to have five quotes. So if you go out to two car dealers and you get prices, now you have to go out to three more before we are allowing you to proceed. Can you just comment on that briefly?

Mr. GIANCARLO. Yes.

Mr. GARRETT. And two, one of my opening lines here was all that we are doing here is impacting upon jobs and job creation. Can you just talk with regards to SEFs—how does this—and how do we quantify any of this as well?

Mr. GIANCARLO. Sure, absolutely. The SEC has a long history of regulating over-the-counter markets, and as we see in their rulemaking, their approach to regulating the over-the-counter swaps market appears to adopt a great deal more flexibility in their approaches. The CFTC does take a more, shall I say, restrictive or proscriptive approach to the swaps market. It is actually dictating a whole series of methodologies that intermediaries need to adopt.

In the RFQ area, you cited one, which is going out to five—having to receive five quotes, but we see that type of proscriptiveness running throughout a lot of the CFTC proposals, less proscriptive at SEC.

And just on the issue of jobs, that is an important issue for us. Wholesale brokers such as ourselves employ thousands of Americans in jobs all over the country from places like Houston, Texas, to southern California, to right in our State, New Jersey, where we have operations in Englewood, New Jersey, and also in the New York City area where our industry probably employs close to 10,000 people.

Their work is what we call the hybrid model where it is a combination of the human brokers and very, very sophisticated trading technology, technology that is licensed worldwide. But it is the combination of the person and the machine that gives these markets their particular nature.

And what we are worried about is in the very proscriptive type of rulemaking that would require or force all of this in to an electronic-only—

Mr. GARRETT. Right.

Mr. GIANCARLO. —methodology that it would have a severe impact on the hiring that we do.

Mr. GARRETT. I appreciate that, but I am just getting a buzz in my other ear that I have to be down on the Floor. We have to be on the Floor in less than 2 minutes, so I want to thank the panel for their answers.

I would like to enter in to the record with unanimous consent, if I may, from the Wall Street Journal, an editorial dated February 11th, entitled, "The Futures of America."

And I would also like to say that the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. And so without objection, the hearing record will remain open for 30 days for members to submit questions to these witnesses and to place their responses in the record.

And with that being said, this hearing is adjourned. And again, I thank the members of this panel.

[Whereupon, at 1:45 p.m., the hearing was adjourned.]

A P P E N D I X

February 15, 2011

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COMMITTEE ON FINANCIAL SERVICES

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February 15, 2011

Chairman Bachus Statement During Derivatives Hearing

WASHINGTON: Financial Services Committee Chairman Spencer Bachus made the following statement during a Full Committee hearing entitled, "Assessing the Regulatory, Economic and Market Implications of the Dodd-Frank Derivatives Title."

"Today the Committee will begin to assess the economic and market impacts of Title VII of the Dodd-Frank Act, which governs the regulation of over-the-counter derivatives. As in many other areas of Dodd-Frank, Congress has broadly delegated authority to Federal regulatory agencies to write the rules, so it is incumbent upon this Committee to exercise rigorous oversight of that process.

"Let's be clear up front right at the beginning of this hearing: End users of derivatives did not cause the financial crisis. They were among its victims. Although the 2,300-page Dodd-Frank Act was promoted as being directed at Wall Street, as we are coming to understand more clearly, it is the end users of derivatives who will bear so much of the regulatory brunt of this law. As a result, hundreds of American companies could take their capital and jobs elsewhere. One study, released just yesterday, concludes that upwards of 130,000 jobs could be lost if U.S. regulators impose new restrictions on derivatives transactions too broadly.

"Others may not see a loss of jobs, but will see increased costs because of these regulations -- costs that will be passed along to consumers.

"The implementation of new derivatives rules should not occur in a vacuum, without regard for their impact on all market participants and ultimately the economy. Although most of the rules mandated by Dodd-Frank must be *adopted* within 360 days of enactment, the Act declined to require such rules to become *effective* by any given date. The regulators have not only the authority, but the obligation, to ensure that changes are carried out in an orderly manner that does not disrupt market functioning, and are phased in over a reasonable timeframe that takes adequate account of differences in derivatives asset classes.

"If we are not careful, the result will be a patchwork of disparate rules that are both complicated to administer and needlessly increase costs on exactly those Main Street businesses that we are counting on to bring our economy back."

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Rubén Hinojosa
Committee on Financial Services
Hearing
"Assessing the Regulatory, Economic and Market Implications of the Dodd-Frank Derivatives Title"
February 15, 2011

Chairman Bachus, I ask unanimous consent that my statement be made a part of today's hearing record. I also ask unanimous consent to submit two letters for the hearing record: One by Richard Whiting of the Financial Services Roundtable dated February 7, 2011, and the other a statement by Craig Reiners of MillerCoors Corporation.

The Dodd Frank Act will considerably strengthen our financial services infrastructure by creating exchanges for derivatives and disclosure in the derivatives markets for the first time.

The law enhances the powers and resources of the U.S. Securities and Exchange Commission (SEC) and requires a comprehensive study of the way that the SEC operates, which will lead to much needed management reforms.

It will enhance regulation over more products and actors, create additional investor protections and consumer safeguards, and promote greater accountability for those who work in our capital markets.

This is not the first time that legislation has been introduced to regulate the derivatives markets. Former Representative Paul Kanjorski of Pennsylvania introduced derivatives legislation in 1994.

In 1994, former Congressman Paul Kanjorski of Pennsylvania introduced a bill to regulate derivatives and other complex financial instruments.

Congressman Kanjorski's bill failed to pass, but the Dodd Frank Act succeeded in regulating and increasing transparency in the derivatives markets. This conference agreement finally addressed the utter lack of regulation in this enormous market by mandating the clearing of most derivative contracts on exchanges so that we have more transparency.

For those derivatives that are not cleared, the bill's reporting and disclosure requirements ensure that information on the transaction is maintained.

A myriad of problems presently confronts the SEC, perhaps none more urgent than the need for adequate resources.

SEC Chairman Schapiro and others have repeatedly stressed the need to increase the funding to the SEC to ensure that the agency has the ability to keep pace with technological advances in the securities markets, hire staff with industry expertise, and fulfill one of its core missions: the protection of investors.

In response, the Dodd Frank Act slightly increased the independence of the SEC in the appropriations process, doubled the authorized SEC budgets over 5 years, and created a new reserve fund to support technology improvements and addressed emergency situations, like the market crash that occurred in May 2010.

It is unfortunate that the Continuing Resolution reduces funding for the SEC substantially.

One word of caution: As the regulatory agencies implement all the various provisions in Dodd Frank Act, we must ensure that the potential economic harm in these derivative provisions is avoided. The regulations must be tailored in such a way that they do not impose undue burden on businesses and that they increase jobs.

Thank you Mr. Chairman.

I yield back the remainder of my time.

Testimony of James Cawley

Javelin Capital Markets

Committee on Financial Services

U.S. House of Representatives

February 15, 2011

Introduction

Chairman Bachus, Ranking Member Frank, and Members of the Committee, my name is James Cawley and I am CEO of Javelin Capital Markets, an electronic execution venue of OTC derivatives that expects to register as a SEF (or "Swaps Execution Facility,") under Dodd Frank. Thank you for inviting me to testify at today's hearing.

I am here today to represent the interests of the Swaps & Derivatives Market Association or 'SDMA' which is comprised of multiple independent derivatives dealers and clearing brokers, some of whom are the largest in the world.

In called to testify today, I am reminded of the main reason for which we are here—to fix the derivatives market such that we never again have to call upon the US taxpayer to bail out Wall Street. The bilateral counterparty risk baked into every credit derivative and interest rate swap contract still constitutes an unacceptable systemic risk to the national financial payments system specifically; and to the broader economy as a whole.

Simply put, such bilateralism acted as an accelerant to the crisis, much like gasoline does to a forest fire.

To help ensure, in the future, that the government or more specifically, the US taxpayer, doesn't have to bail out the next trading firm that fails—we must ensure that the central clearing and transparent, competitive execution of OTC derivatives, as specified under Dodd Frank, is a success. We must transition away from 'too interconnected to fail,' where one firm fails and pulls three others down with it.

Where We Are Now

We are now 2 ½ years since the financial crisis of 2008 and despite several industry-led initiatives, the market has since failed to migrate by itself to central clearing. What have emerged, however, are examples of 'good' and 'bad' clearing initiatives from which lessons can be drawn.

Structural barriers to universal adoption of central clearing have emerged that include: caps on open interest, clearing costs being shifted permanently to end users to the benefit of an incumbent few, and severely restricted access for execution venues and new dealers as they seek to compete and enhance liquidity.

These observations should serve as useful guidance for the SEC and CFTC as they promulgate rule sets based upon Dodd Frank.

Central Clearing

With regard to clearing house membership requirements, they should, as Dodd Frank requires, be objective, publicly disclosed & permit fair and open access.

This is important because clearing members act as the 'gatekeepers' to clearing. Without open access to clearing, you will not have universal clearing adoption, increased transparency, liquidity and lessened systemic risk.

Clearing houses should not place unreasonable requirements for capital, require them to be swap dealers or determine eligibility based upon the preexisting size of a swap portfolio.

Clearing houses should learn from their own experience in the listed derivatives space (of futures and options) where they currently operate. In those markets, central clearing has operated successfully since the days of post Civil War Reconstruction nearly 150 years ago, long before spreadsheets and risk models. In the listed derivatives marketplace, counterparty risk is spread over a hundred disparate and non correlated clearing firms. It works well and no customer has ever lost money due to a clearing member failure.

This is not the case presently with the current OTC Derivatives clearing initiatives on offer. Membership in these entities stands to be too restricted, with a mere handful of highly correlated players not only shouldering the risk, but also controlling the access.

We should be mindful that calls for initial membership capital to be $5 billion or $1 billion, while they sound great, are cosmetic and that only a 'pay to play' system where capital contribution is directly proportionate to the risk introduced is a better way to go.

To that end, the SDMA supports the CFTC's call for clearing broker capital requirements to be proportionate and scale relative to the risk they introduce. We support the CFTC's call that a clearing firm's minimum capital be closer to $50 Million, than to $5 billion or $1 billion as certain CCP's have originally suggested.

It is worth remembering that Lehman and Bear Stearns would have met the $1 Billion threshold until the days of their failure.

We support initiatives to broaden clearing house membership well beyond that of only a few highly correlated players such that if one, or two, or even three clearing members fail—(as evidenced in the Fall 2008), the broader group can comfortably shoulder the burden.

Furthermore, some operational requirements for membership that have no bearing on capital adequacy or clearing member capability should be seen for what they are—transparent attempts to limit competition.

Specifically, clearing members should not be required to operate swap dealer desks just so they can meet their obligation in the default management process. These requirements can easily be met contractually through agreements with third party firms or dealers.

Clearing house governance should be balanced and transparent. Such governance bodies should represent the interests of the market as a whole and not just the interests of the few. To ensure fair governance, clearing house voting should be, as the CFTC and the SEC have suggested, strictly monitored where one entity or group does not exercise undue influence.

With regard to conflicts of interest within a clearing member, Dodd Frank is clear; dealer desks should not be allowed to influence their clearing member colleagues and strict Chinese walls should exist. Dealer desks should not be able to force their clearing member colleagues to offer 'free clearing' if you execute with the dealer desk.

OTC swaps clearing has been quite prevalent in the commodity swaps space since May 2002, following the collapse of Enron in 2001. Moreover, this has occurred without arbitrary rules designed solely to exclude a large number of clearing members. There have not been artificially set high capital requirements for clearing members or rules for default management that only dealers can meet. If this Committee wants to review a model for OTC clearing success, it needs to look no further than the Chicago Mercantile Exchange's Clearport initiative; ICE's OTC clearing initiative in Europe, or the Singapore Exchange's AsiaClear Platform in Singapore.

Derivatives Trading

With regard to trading derivatives, clearing houses must accept trades on an execution blind basis. Customers should be allowed to trade with whom they want. They should not be forced to execute trades in such a way where one side of the trade be done with a clearing member who is also a dealer.

Customers should be allowed to execute on whatever swap execution facility and with whomever they want. They should be able to trade with dealers who do not self clear, but make markets and provide liquidity, so vital to the integrity of the system.

Moreover, clearing houses should seek to settle trades real time and not attempt to increase market risk by extending out settlement periods over days. Regulators should be mindful that delay in the settlement process can only serve to foster fear and lack of faith in a marketplace.

For their part, Swap Execution Facilities should also offer open access and transparency in an otherwise opaque marketplace. They should offer *pre* and *post* trade transparency and offer a fair and objective marketplace--where buyers and sellers come to transact their business.

SEFs should seek to confirm and report their trades within seconds; as is the case in other markets. In these days of high technology, such trade reporting and settlement is not overly burdensome and helps to increase the integrity of a market.

Swap execution facilities should be allowed to compete for liquidity and market share. It is well established in other markets, that, with the introduction of greater transparency, more market makers and increased competition a safer playing field emerges to directly enhance liquidity and market integrity that in turn lowers systemic risk.

Conclusion

The CFTC and the SEC should be commended for their excellent hard work so far. Both agencies have been transparent and accessible throughout the entire process. The rule sets promulgated so far have been well thought out, deliberate and executed with great diligence. While consistent with Dodd Frank, they have adapted to the industry comment when appropriate. For example, with regard to the SEF execution method, they provided for a workable compromise in which *central limit order* books and *request for quote* models would both qualify under the transparency provisions of Dodd Frank.

In conclusion, we must move away from 'too interconnected to fail.' We must move away from tax payer bailouts of Wall Street and we must all work together—Congress, the regulators, the incumbent dealers, the new dealers, the buyside and the clearing firms to ensure that central clearing under Dodd Frank, which is properly thought out works-- and works well. I thank the Committee for the opportunity to speak.

House Committee on Financial Services

Testimony of

Don Donahue
Chairman and Chief Executive Officer

The Depository Trust & Clearing Corporation

February 15, 2011

Chairman Bachus, Ranking Member Frank and Members of the Committee, my name is Don Donahue. I am the Chairman and CEO of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is a non-commercial industry "utility" that, through its subsidiaries and affiliates, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities and money market instruments, as well as a significant portion of the global over-the-counter ("OTC") derivatives market. In 2010, The Depository Trust Company ("DTC"), a wholly-owned subsidiary registered as a clearing agency under the Securities Exchange Act of 1934 ("Exchange Act"), settled more than $1.66 quadrillion in securities transactions.

Since 2006, DTCC has operated the Trade Information Warehouse, ("TIW" or "Warehouse") a centralized, comprehensive global electronic containing detailed trade information for the global credit default swaps ("CDSs") markets. This was implemented in stages and reached full fruition in 2009. The TIW database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a gross notional value of $29 trillion.

I very much appreciate the opportunity to share DTCC's thoughts on the implementation of Title VII of the Dodd-Frank Act. In particular, I will focus on issues raised in connection with the Dodd-Frank Act's creation of a swap data repository ("SDR") system for providing regulators and the public with the necessary transparency into the global OTC derivatives markets as a means to mitigate systemic risk. DTCC shares Congress' goal of ensuring more transparent markets for global regulatory oversight and systemic risk mitigation, protecting the public and ensuring liquid and efficient capital markets. Finally, it is our strong belief that while many of the regulatory aspects of Dodd-Frank Act remain in development, transparency is a policy option that is most ripe for implementation.

Summary of Critical Points

DTCC would like to bring two basic points to the attention of the Committee:

1. *Transparency is Key to any Attempt to Mitigate Systemic Risk in the Swap Markets*

DTCC is supportive of the principle in the Dodd-Frank Act that all swaps, whether cleared or uncleared, must be reported to SDRs. While there remains on-going debate about the causes of the financial crisis of 2008, there is broad consensus that, to the extent OTC derivatives contributed to the crisis, it was due to (a) the very large one-way positions that American International Group, Inc. ("AIG") took in mortgage-related credit default swaps, which threatened the continued viability of a systemically important firm and went unreported until it was too late; and (b) the general lack of understanding with respect to the extent of the exposures across all of the swap markets, contributed to a lack of confidence in the creditworthiness of financial institutions at just the wrong time.

The infrastructure needed to protect against these types of situations has since been put in place for the global CDS market. This safety net was developed as a cooperative effort between the market participants and regulators worldwide under the auspices of the OTC Derivatives Regulators' Forum ("ODRF"), which is comprised of over 40 regulators and other authorities worldwide, including all of the major regulators and central banks in the U.S. and Europe. Although this effort began prior to the 2008 crisis, it wasn't until 2009 that a fully comprehensive global CDS data set was obtained through the cooperative efforts of the ODRF, over 1,700 participants in the CDS market from over 50 countries and DTCC, including the non-standardized mortgage-related swaps held by AIG. With the availability of a comprehensive data set, DTCC was able to publish comprehensive market-wide information free of charge to the general public. DTCC was also able to provide comprehensive standard position risk reports to appropriate authorities worldwide (as well as responding to over 100 *ad hoc* requests from such authorities).

More recently, DTCC launched an "on-line" regulator portal through which regulators and other authorities can directly access and query through secure interfaces detailed position risk data from a global data set relating to their regulatory requirements. At present, 19 different regulators worldwide have linked to this portal.

These position risk reports and the "on-line" portal, applied over that complete global data set (most of the systemically risky trades by AIG were executed in London) would have provided regulators with sufficient early warning of the build-up of risky AIG positions to have enabled them to take corrective measures before the positions became so large that they threatened the fabric of the global financial system.

With respect to public market transparency, the comprehensive global market information that DTCC is now able to publish includes, among other things, net market-wide exposures to each CDS index and index tranche, as well market-wide exposures to each of the top 1,000 individual corporate and governmental entities on which CDS are written (ranked by size of exposure). With respect to more aggregated data, (e.g., overall exposure to sovereign debt, corporate debt and other broad categories) the published data also indicate which broad category of market participants holds what positions (these disclosures are made at this less granular level to protect the identity of position holders). Had this information been available and published in the run-up to the 2008 crisis much of the exposure uncertainty that contributed to market instability at the time, at least in the CDS market, could have been mitigated.

2. *Providing Transparency is a Cooperative Effort.*

My focus on the collective achievement -- and it was truly a collective achievement -- surrounding transparency in the CDS market is not with the intention of boasting about DTCC's contributing role, but rather to bring to the Committee's attention why this effort has been successful.

First, this achievement would not have been possible without the substantial and unusual degree of global regulatory cooperation achieved through the ODRF and the OTC Derivatives Regulators Supervisors Group ("ODSG"). Additionally, for this process to work, it was important that DTCC was not a traditional commercial entity and, as such, had no motivation for holding the data other than to help both the regulators and market participants by providing a central place for data to be reported and for regulators to access it *for both market surveillance and risk surveillance purposes*. DTCC believes it was critical to the success of this process to remove commercial concerns from what is and should remain primarily a regulatory and supervisory support function.

Finally, as a true industry-governed utility, with both buy-side and sell-side firms, not to mention self-regulatory organizations, as stakeholders, DTCC has so far been able to secure the cooperation of virtually all market participants and all clearers and trading platforms with any significant volume. If regulatory cooperation or the cooperation of market participants and their respective clearers and trading platforms is fails, both the published and regulator accessible data would be fragmented, inevitably leading to misleading reporting of exposures and a very expensive "fix" for the regulators and the marketplace generally. Fragmentation of data will leave the task to regulators of rebuilding in multiple instances the complex data aggregation and reporting mechanisms (including extra-territorial trades on locally relevant underlyings) that had already been created. That task was one of the primary reasons that the industry and regulators themselves created a single place for the data within DTCC.

The challenge going forward is to bring similar regulatory and public transparency to other parts of the swap markets.[1] DTCC would like to commend the work of both the SEC and the CFTC in the thorough and thoughtful approach they have so far taken with respect to the very complex subject of swap data reporting, including their suggested improvements to the current structure for reporting credit default swaps and their proposals regarding which features of the current reporting structures would meet regulatory needs in other swap asset classes.

However, given the need to move expeditiously and to assure the continuation of the necessary cooperative attitude among regulators, market participants, clearinghouses and trading platforms worldwide, the focus should be on expanding upon the current cooperative achievements of providing both regulatory and public transparency to the swap markets. Such cooperative efforts take some minimal amount of time to implement safely and soundly (our experience suggests a minimum of 24-36 weeks if participants cooperate). If there is a lack of cooperation, it will take significantly longer.

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[1] There are two other global swap repositories in existence today, one for OTC equity derivatives operated by DTCC in London and one for OTC interest rate derivatives operated by TriOptima in Sweden. These repositories, however, were designed solely as a means to facilitate certain high-level position reporting by the major global dealers and do not hold sufficient data to meet the regulatory needs specified by either the Dodd-Frank Act or the ODRF (including both market surveillance and risk surveillance), which have superseded the initial requirements set forth for these entities.

It is our sense, as a user governed and regulated utility servicing most of the major regulators worldwide, that the market participants and regulators globally are poised to undertake the significant cooperative effort necessary to provide complete transparency to these markets as contemplated by the Dodd-Frank Act. DTCC implores this Committee, in exercising its oversight function, to focus on removing obstacles to this process and to urge the continued use of proven infrastructure in a manner that distinguishes the SDR function from purely commercial considerations and jurisdictional quarrels, which could hinder the cooperative attitude that has made progress possible thus far.

Overview of DTCC

As stated above, DTCC, a user owned market utility, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities transactions and money market instruments and for many OTC derivatives transactions. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing house for derivatives. However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC"), which has been granted registration as a derivatives clearing organization ("DCO") by the CFTC.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Exchange Act, subject to regulation by the SEC. These three clearing agency subsidiaries are DTC, National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $36 trillion. In 2010, DTC settled more than $1.66 quadrillion in securities transactions, which amounts to the equivalent to the full value of the annual U.S. Gross Domestic Product every three days. NSCC provides clearing, risk management, central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and/or central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year – on an at-cost basis.

Overview of the Trade Information Warehouse

DTCC began automating the derivatives market in 2003, in response to the Federal Reserve's desire for an industry solution to mitigate risk. At that time, just 15% of CDS trades were being matched. DTCC's Deriv/SERV system now matches and captures critical data for over 98% of these trades. In November 2006, at the initiative of swap market participants, DTCC expanded further to launch the TIW to operate and maintain the centralized global electronic database for virtually all position data on CDS contracts outstanding in the marketplace. Since the life cycle for CDS contracts can extend over five years, in 2007, DTCC "back-loaded" records in the Warehouse with information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 implementation date. As stated above, the Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of $29 trillion ($25.3 trillion electronically confirmed "gold" records and $3.7 trillion paper-confirmed "copper" records).

In addition to repository services, which include the acceptance and dissemination of data reported by reporting counterparties, the Warehouse provides legal recordkeeping and central life cycle event processing for all swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details on the official legal or "gold" record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants' more customized CDS swap contracts, in the form of single-sided, non-legally binding or "copper" records for these transactions, to help regulators and market participants gain a more clear and complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

DTCC's Warehouse is also the first and only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. Various routine events, such as calculating payments due under contracts, bilaterally netting and settling those payments and less-common events, such as credit events, early terminations and company name changes and reorganizations, may occur, all requiring action on behalf of the parties to such CDS contracts. DTCC's Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these functions by the Warehouse distinguishes it from any swap data repository that merely accepts and stores swap data information.

The Indemnification Provision and Its Impact

Consistent with our discussion about the need for global regulatory cooperation in ensuring access to the data necessary to protect against systemic risk, DTCC is deeply concerned about the indemnification provisions in Sections 728 and 763 of the Dodd-Frank Act. The Dodd-Frank Act requires that repositories obtain indemnifications from foreign regulators before sharing information with them. There was no legislative history behind this provision, which was incorporated late in the legislative process, without having been considered in the hearing process. As a result, it was not subject to extensive discussion and consideration prior to the enactment of the Dodd-Frank Act, and its negative consequences must not have been clear to legislators or the relevant regulatory bodies. DTCC believes that the indemnification provision will significantly impede global regulatory cooperation.

Regulators are not likely to grant DCOs or SDRs indemnification in exchange for access to information. Accordingly, regulators may be less willing to access the aggregated market data, resulting in a reduction of information consumption, domestically and internationally, which jeopardizes market stability.

This provision gives foreign jurisdictions an incentive to create their own local repositories in order to avoid indemnification. Proliferation of local "national" repositories around the world will make it very difficult to obtain a full picture of a particular asset classes, impair market and regulatory oversight, create inconsistencies in data, frustrate data analysis and increase systemic risk.

Further, the provision could have an immediate negative impact on the ability of U.S. regulators to obtain information from repositories located in foreign countries should reciprocal indemnification provisions be enacted in foreign laws. U.S. regulators, like foreign regulators, might be legally or practically precluded from signing such agreements.

In light of the existing indemnification requirement, this Committee should encourage regulators to waive indemnification in situations where foreign regulators are carrying out their regulatory responsibilities *in a manner consistent with international agreements* which includes maintaining the confidentiality of data.

Alternatively, removing this provision of the Dodd-Frank Act in technical corrections bill may be appropriate in order to avoid undermining the ability of U.S. regulators to obtain information in derivatives markets on a global basis.

Regulatory Status of Trade Repositories – Global Cooperation

Derivatives markets are inherently cross-border, as participants in a transaction are often located in more than one jurisdiction. From the outset, DTCC has understood that the TIW serves a global function, and the information held by the Warehouse is relevant to regulators in many locations. DTCC believes it is important to support regulators around the world and has effectively done so since the end of 2008.

The SDR regime established under the Dodd-Frank Act must recognize the global characteristics of OTC derivatives markets and, for that reason, regulators and SDRs should ensure international harmonization. DTCC has worked closely with the ODRF and, with DTCC's support, the group agreed to criteria for the sharing of data, recognizing the need to have critical data on CDS accessible across geographic boundaries and regulatory jurisdictions. DTCC has implemented regulatory disclosure processes using those criteria and urges the same approach for other asset classes going forward.

DTCC hopes that global regulators will eventually recognize the overwhelming advantage of understanding risks globally from a central vantage point, thereby avoiding the data fragmentation, which critically detracts from the management of systemic risk. Preventing the exchange of information between regulators will frustrate efforts to mitigate international financial risk and fragment regulatory oversight on a jurisdiction-by-jurisdiction basis.

As the system for the use of repositories is developed internationally, it is very important for the U.S. to facilitate a result that will place U.S. regulators and foreign regulators on an equal footing in their ability to obtain information from repositories quickly and without barriers. In implementing the Dodd-Frank Act, U.S. standards should be developed to be compatible with those standards still under development in other countries, meeting the needs of both U.S. and foreign regulators. Given the risks to U.S. financial system can be impacted by transactions occurring virtually anywhere in the world, it is essential that the SEC and CFTC's final regulations create SDRs that meet the immediate needs of U.S. regulators and the long-term need of harmonization with the requirements of regulators in Europe and other major financial markets.

One major philosophical and pragmatic question that arises with respect to global cooperation is whether market data should be collected and held by the private sector and made available to regulators on an as-requested basis or, alternatively, whether governments themselves should collect the data and disseminate as a result of treaty and information-sharing agreements.

DTCC urges Congress to consider whether the goal of addressing systemic risk can be reasonably met through the U.S. relying on other governments throughout the world to share information with U.S. regulators. DTCC is skeptical of such an approach, which has been explored by U.S. regulators in the rule-making process. Instead, DTCC recommends that Congress urge U.S. regulators to rely on regulated private sector entities to collect information and disseminate it as appropriate, under a common system that is acceptable to the U.S. and other countries. The experience in the market today supports this approach, as it currently works well at the Warehouse.

Repositories' Role in Promoting Transparency and Reducing Systemic Risk

By aggregating information, repositories collect and compile all relevant data in order to assure appropriate market transparency and effective monitoring of systemic risk. Global repositories have been or are being established for each OTC derivatives asset class, which can provide regulators in the US and around the world real-time access to the data necessary to monitor and safeguard financial markets.

The Dodd-Frank Act has identified SDRs as central to helping U.S. regulators maintain the safety and soundness of derivatives markets. DTCC has urged regulators, and urges this Committee, to focus on three objectives in moving forward with regulations covering SDRs:

1) Enhancing market transparency for regulators and market participants;
2) Reducing systemic risk by ensuring regulators can determine a firm's underlying position and exposure in an integrated fashion; and
3) Promoting coordination and efficiency in the supervision of global capital markets.

DTCC urges Congress, as well as regulators, to think carefully about the implications of fragmenting information about outstanding contracts into different repositories, in different countries, on different continents.

If French regulators have to examine a dozen different trade repositories to determine what kind of credit default swap contracts may be outstanding on French companies, the likelihood is that they will never find all of the contracts, at least not quickly. Contract records could be scattered across repositories in the U.S., in Europe, in Japan, in Dubai, in Hong Kong and elsewhere. Nor is it likely to be apparent to the regulators what they are looking for, since the offsets to contracts residing in one database might be residing elsewhere. A contract could easily have been written between a Swiss financial institution and an Australian financial institution on an underlying French entity, only to be sold or assigned to another party located in Brazil. Even if all of the data is eventually located, a system to verify and analyze it would still be required.

All of the information detailed above is currently collected in the DTCC CDS Warehouse globally, and data is published weekly on all of the contracts held, including a breakdown by currency. DTCC has consistently stated that all interested regulators should have access to the data they need and, for approximately the past year, DTCC has made such data available as appropriate to the regulators involved in accordance with the global criteria adopted by the ODRF. All of this functional transparency will be undermined if regulators move ahead with an approach that does not provide for globally consolidated data.

Global regulators need consolidated reporting across international markets. International regulatory guidance for derivatives regulation has recognized that aggregated data is vital to provide a comprehensive view of derivatives markets. For example, last October, the Financial Stability Board suggested that a beneficial solution to the needs of regulators throughout the world would be the establishment of "a single global data source to aggregate the information from [SDRs]."

The Rule-Making Process

The regulatory implementation of Title VII has been extremely demanding, both on regulators and on market participants. DTCC has filed comments on a number of proposed new rules governing SDRs. Copies of DTCC's comments filed to date are appended to this testimony, and I request that they be entered in full into the hearing record, as they address many technical issues in detail that goes well beyond what is appropriate to cover in this statement.[2] I will cover the highlights of our comments on the major issues that DTCC believes are most likely to be of interest to this Committee, beginning with proposed standards for repositories.

[2]They include comments on the CFTC's Interim Final Rule for Reporting Pre-Enactment Swap Transactions; the CFTC/SEC request for general comments on SDRs and mitigation of conflicts of interest; the CFTC Proposed Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest; the SEC's Proposed Rule on Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies; Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC; the SEC's Interim Final Rule on the Reporting of Security-Based Swap Transaction Data; the SEC Proposed Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information; the FSOC Advance Notice of Proposed Rulemaking Regarding Authority to Designate Financial Market Utilities as Systematically Important; the SEC's Proposed Regulation on Security-Based Swap Repository Regulation, Duties and Core Principles; the OFR Statement on Legal Entity Identification for Financial Contracts, the CFTC Proposed Regulation on Real-time Public Reporting of Swap Transaction Data, and the CFTC Proposed Regulation of Swap Data Recordkeeping and Reporting Requirements.

Proposed Standards for Swap Data Repositories

DTCC has recommended that the regulations implementing Title VII set high standards for SDRs so that they meet the needs of regulators and the markets, serving as an industry utility for both. DTCC also recommends that the rules be refined to only cover entities that are actually acting as repositories, rather than entities merely providing ancillary functions. Some of the major principles include:

Neutrality. DTCC urges regulators to adopt standards for SDRs that foster neutrality and "open access" to all market participants. Regulators must ensure that the public utility function of SDRs is separated from potential commercial uses of the data. SDRs should operate objectively and impartially, with an arms-length and non-discriminatory relationship to any and all clearing, confirmation and execution facilities, affiliated or otherwise.

Round-the Clock Operations. Markets never sleep and neither should repositories. Regulators should require every SDR to operate on a 24/6 basis, process transactions in real-time and maintain redundancy.

Real-Time Processing. Market participants and regulators need repositories to perform their functions without delay in order to facilitate accuracy and the completeness of market information.

At-Cost Fee Structures. Because SDRs operate as utilities, they should be required to maintain non-profit fee structures, with at-cost operating budgets, rather than providing sources of revenue for commercial enterprises.

Redundancy. It is a material weakness for any SDR to fail to maintain adequate redundancy sufficient to protect data bases in light of catastrophic events. Significant and extensive requirements for redundancy for every SDR, consistent with long-established U.S. and global standards for business continuity and resilience, are essential for proper function and mitigation of systemic risk.

No Reductions in Registration Requirements or Performance Requirements. SDRs should be required to meet proposed standards fully, even during the temporary registration phase. The proposed regulations allow for temporary registration for SDRs while regulators assess an SDR's capabilities. To protect safety and soundness, DTCC recommends that appropriate due diligence be conducted during the temporary registration process to ensure that new entrants have adequate operational capabilities, including 24/6 operation, real-time processing, multiple redundancy and robust information security controls.

Phase In for Existing Repositories. Existing repositories, such as the TIW, already provide important transparency to regulators and markets. Final regulations need to ensure that the existing operations of any entity that intends to register as an SDR are not interrupted through the registration process. This can be achieved with phase-in transition arrangements for existing repositories whose services need to be amended to conform to final rules and the effective date of the Dodd-Frank Act.

Regulatory Harmonization. While comprehensive and thoughtful, proposed CFTC and SEC regulations governing repositories are not identical and, in some areas, differ materially. To avoid creating conflicting standards and imposing unnecessary costs, Congress should urge regulators to harmonize the regulations overseeing SDRs.

Implementation Issues

The proposed regulations issued under the Dodd-Frank Act place substantial demands on existing repositories, and those substantial demands apply to anyone who seeks to become a repository.

DTCC recommends that appropriate transitional arrangements be made to avoid market disruption in the implementation process of the proposed regulations. This can be done through a phase-in period for existing service providers like the Warehouse and by allowing a longer period for registration of new service providers who wish to become repositories, enabling them to put in place adequate systems and appropriate controls to meet the Dodd-Frank Act standards.

The implementation of the Dodd-Frank Act also places a significant burden on regulatory agencies. DTCC is merely one participant among a great number of entities consulting regularly with the CFTC and the SEC as these regulators seek to carry out their statutory mission. In meeting with these regulators, it is clear that they feel heavily burdened and are doing their best to meet the demands placed on them by the implementation of this monumental legislation.

Conclusion

Generally, the Dodd-Frank Act established an appropriate framework for the further development and use of repositories in the United States and internationally. DTCC does, however, recommend that Congress review the Act's indemnification requirement. As contemplated, could create substantial problems for the U.S. regulators by giving foreign jurisdictions the incentive to establish separate repositories that operate on a local or national basis, rather than an international standard.

International coordination is critical to achieving the level of transparency necessary to mitigate systemic risk in swaps markets. DTCC also urges that legislators and regulators focus on the use of consolidated repositories, or single repositories by asset class, to counter the risk of fragmentation. Finally, it is critical that in implementing the Dodd-Frank Act, regulators build on existing systems and processes to address the policy goals of the Act. Building on existing systems will result in the most cost-efficient, effective and immediate solutions.

As I stated at the beginning of my testimony, risk mitigation is central to DTCC's mission. As regulators and legislators across the globe write the rules under which the OTC derivatives markets will operate, DTCC is actively engaged in the dialogue. DTCC has a unique perspective to share and appreciates the opportunity to testify before you today.

I look forward to answering any questions the Committee may have.

DTCC

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Via Agency Website & Courier

November 15, 2010

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Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, D.C. 20581

RE: RIN 3038–AD24, Interim Final Rule for Reporting Pre-Enactment Swap Transactions

Dear Mr. Stawick:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("Commission") on its interim final rule for reporting pre-enactment unexpired swap transactions (the "Interim Final Rule").[1] DTCC is supportive of a swap reporting regime that brings increased transparency and oversight to over-the-counter ("OTC") derivatives markets.

Summary of Response

DTCC supports the Commission's efforts to ensure that data from pre-enactment unexpired swap transactions are preserved and retrievable in the future. DTCC respectfully suggests that the reporting of a binding, legal electronic record agreed to by the two counterparties to a pre-enactment unexpired swap should be treated by the Commission as satisfying the Interim Final Rule's reporting requirement and the information and document retention policy suggested by the interpretive note to Rule 44.02(a), as well as certain obligations of swap dealers and major swap participants.[2] Additionally, DTCC provides comments to the scope of information that should be preserved under the Commission's information and documents retention policy, based upon our experience operating the Trade Information Warehouse (the "Warehouse") and the centralized global repository for credit default swaps ("CDS"). Finally, DTCC offers its comments on how the single counterparty reporting obligation set forth in Rule 44.02(b) could result in the fragmentation of swap market data and decrease the utility of

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[1] Interim Final Rule for Reporting Pre-Enactment Swap Transactions, 75 Fed. Reg. 63,080 (Oct. 14, 2010).

[2] *Id.* at 63,085.

the information collected by a swap data repository and on the designation of a consolidated data repository. These comments are preceded by an overview of DTCC and the Warehouse.

Overview of DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives. In addition, DTCC is a leading processor of mutual funds and insurance transactions, linking funds and carriers with their distribution networks. DTCC's depository provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTCC settled more than $1.48 quadrillion in securities transactions.

Overview of the Trade Information Warehouse

Industry Established Trade Information Warehouse to Increase Transparency, Bring Stability

In November 2006, at the initiative of swap market participants, DTCC launched the Warehouse to operate and maintain the centralized global electronic database for virtually all CDS contracts outstanding in the marketplace. The Warehouse has received information with respect to trades executed prior to its inception. During 2007, DTCC back-loaded physical records in the Warehouse with information on over 2.2 million outstanding CDS contracts. Today, data for over 95 percent of all OTC credit derivatives are captured in this automated environment.[3] The Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace, constituting approximately 2.4 million contacts with a notional value of $29.6 trillion ($24.9 trillion electronically "gold" records and $4.7 trillion paper confirmed).

The Warehouse maintains the most current CDS contract details on the official legal, or "gold," record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants single-sided, non-legally binding or "copper," records for CDS transactions to help regulators and market participants gain a clearer and more complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

Warehouse "Gold" Records Are Binding, Legal Electronic Record between Counterparties

Once an executed contract has been matched and confirmed, the trade record is sent to the Warehouse's repository. A "gold" record represents the current legal state of the contract. In fact, each user of the Warehouse's services has signed a binding agreement

[3] For more information about the Warehouse, please see http://www.dtcc.com/products/derivserv/suite/ps_index.php.

that states that, notwithstanding any provisions in any other applicable documentation relating to such transaction, the contracts maintained by the Warehouse represent the definitive record of each transaction and supersede any other documentation or understanding, whether written, oral, or electronic, between the parties. The Warehouse documents are relied upon to resolve any dispute between counterparties and to determine any payments or settlements by the Warehouse.

For "gold" records, DTCC assigns a unique reference identifier to each contract and performs automated recordkeeping to maintain the "current state" contract terms, taking into account post-trade events. The Warehouse also maintains a complete audit trail of the initial trade and every modification or assignment agreed to by the counterparties. These records are updated in real-time and, because the Warehouse is the official legal record of electronically confirmed contracts and centrally processes payments and credit events, counterparties ensure that these files are kept up to date and accurate.

Global regulators are provided information on "gold" and "copper" CDS contracts, as appropriate and upon request. Because contract details are located in a single central location, the Warehouse provides regulators across the globe with the ability to view market exposure on these contracts and assess risk from a central vantage point, which is critical, particularly in times of crisis. The availability of this data is necessary for regulators to identify and address risks to financial markets in a timely fashion.[4] Beginning next year, all credit derivative trade data held in the Warehouse will also be simultaneously held in DTCC Derivatives Repository, Ltd., an FSA regulated subsidiary based in London, in order to help assure regulator access to data across multiple jurisdictions.

Discussion of Interim Final Rule

<u>The Submission and Maintenance of Binding, Legal Electronic Record Should Satisfy the Reporting Requirements for Pre-enactment Unexpired Swaps and also Certain Requirements for Swap Dealers and Major Swap Participants.</u>

Rule 44.01 requires a counterparty to a pre-enactment unexpired swap transaction to report to a registered swap data repository or the Commission by the compliance date established in the reporting rules required under Section 2(h)(5) of the Commodity Exchange Act, or within 60 days after a swap data repository becomes registered with the Commission and commences operations to receive and maintain data related to such swap, whichever occurs first.[5] The purpose of the swap data repository is to "assist the CFTC and SEC in their oversight and market regulation responsibilities."[6]

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[4] As an example, while the Warehouse reported counterparty specific positions to regulators at the time of the AIG insolvency, virtually none of the AIG trades creating the exposure that lead to the company's downfall were registered in the Warehouse. A mandate for all trade activity to be reported into a central swap data repository maintaining all positions would have assisted in identifying risk posed by AIG's market activity and provided an opportunity to reduce the risk promptly.

[5] *See* Interim Final Rule for Reporting Pre-Enactment Swap Transactions, 75 Fed. Reg. at 63,084.

[6] Statement of Sen. Blanche Lincoln. 156 Cong. Rec. S5920 (2010).

Although the Warehouse is not yet a registered swap data repository, DTCC intends to register the Warehouse as a swap data repository upon promulgation of the relevant regulations by the Commission. In the interim, in consultation with the OTC Derivatives Regulators' Forum, the Warehouse makes available its records for regulators and provides aggregated trade data to nearly 30 global regulators and central banks, including the Commission, the Securities and Exchange Commission, the Federal Reserve Bank of New York, the European Central Bank, Banque De France, and the Financial Services Authority.

DTCC respectfully suggests that, in addition to satisfying the filing requirements for pre-enactment unexpired swaps, the submission and maintenance of a binding, legal electronic record on a regular basis should be used to satisfy some of the ongoing obligations of swap dealers and major swap participants. In particular, the entity charged with keeping swap data up to date, as the possessor of this information, could easily report on behalf of a swap dealer or major swap participant regarding its transactions, positions and financial condition,[7] maintain its books and records,[8] and maintain daily trading records of the swaps of the registered swap dealer or major swap participant and all related records (including related cash or forward transactions), as may be required by the Commission and for each swap counterparty.[9]

The designation of the submission and maintenance of a binding, legal electronic record for pre-enactment unexpired swaps within the Interim Final Rule would reduce the burden on counterparties that do not transact frequently in OTC markets and lack the infrastructure for duplicative reporting obligations.[10] Similarly, the value of having one agreed-upon electronic record governing an agreement between counterparties is also recognized by more frequent market participants.[11]

Further, it is inefficient and jeopardizes systemic risk to establish a reporting regime that results in regulators relying on counterparty-reported information that could differ from the binding, legal electronic record maintained at a central location by a neutral third party that the counterparties consider the official record. For asset classes where current

[7] Commodity Exchange Act ("CEA") Section 4r(f)(1)(A).

[8] CEA Section 4r(f)(1)(B)-(D).

[9] CEA Section 4r(g)

[10] *See, e.g.*, Comments from Joseph R. Glace, Chief Risk Officer, Exelon, representing Coalition for Derivatives End-Users, ("The important part for us again is [to] have users who are satisfying the reporting obligations . . so again, you know, to me to have that [reporting] process go on, which is a useful business process, and then to duplicate it again in some other fashion is just an additional cost.") Joint Public Roundtable to Discuss Data for Swaps and Security-Based Swaps, Swap Data Repositories, Security-Based Swap Data Repositories, and Real-Time Public Reporting, September 14, 2010 ("Roundtable Transcript") at 194-195. Available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative18sub091410.pdf.

[11] *See, e.g.*, Comments from John Gidman, Executive Vice President, Loomis, Sayles & Company, representing the Association of Institutional Investors, ("We think the public overall, are much better served by having gold records that we can rely on, particularly at the aggregate level of the market and the markets.") Roundtable Transcript at 227.

market practice dictates reporting and confirmation of trade information to a central repository, establishing a parallel track for regulatory oversight would only duplicate reporting obligations and establish an opportunity for conflicting swap data. Because market participants recognize the value in and currently report and maintain binding, legal electronic records, DTCC suggests that this practice satisfy any additional reporting requirement for pre-enactment unexpired swap transactions.

For these same reasons, DTCC believes the information retention requirements set forth in Rule 44.02(a) for future reporting should be satisfied when trade information has been reported and recognized by the counterparties as the binding, legal electronic record.

Fragmentation of Swap Market Data Caused by Single Party Reporting and Lack of Consolidation of Repository Data Poses Risks

Rule 44.02(b) requires only one party to report pre-enactment unexpired swap transaction data, and depending on the classification of the counterparties as major swap participants[12] or swap dealers,[13] it is possible that the counterparties may select the responsible party.[14] This reporting arrangement differs from current market practice and is inconsistent with the existing repository reporting infrastructure. Currently, the receipt of information from both parties to a swap data repository guarantees reconciliation of the information and confirmation that the information entering into the Warehouse is accurate. Reducing the reporting obligation to only one side leaves open the possibility of incorrect data and jeopardizes the value placed on binding, legal electronic records such as our "gold" records for CDS. Further, a single-reporting regime will confront international legal obstacles, such as domestic privacy laws, which will restrict the reporting party's ability to disclose counterparty information. Bilateral reporting obligations alleviate some of these burdens and produce more valuable, trustworthy information which can be relied upon by counterparties and regulators.

The issue of incorrect or fragmented data presents a second risk that concerns many market participants.[15] DTCC recognizes the value of aggregated reporting to repositories and regulators and strongly urges the Commission to consider consolidation of repository data, either by asset class or across all products.

The Dodd-Frank Act provides authority for the Commission to mitigate the risk posed by fragmented market data caused by multiple swap data repositories. Under section 21 of

[12] CEA Section 1a(33).

[13] CEA Section 1a(49).

[14] *See* Interim Final Rule for Reporting Pre-Enactment Swap Transactions, 75 Fed. Reg. at 63085.

[15] *See, e.g.*, Comments from Athanassos Diplas, Managing Director, Deutsche Bank, ("what regulators have is to have a single report per asset class so that all that information can be contained in one place and we don't have actually information falling through the gaps. Part of the problem in the past has been that information was fragmented and that caused the actual problems.") Roundtable Transcript at 23. *See also* Comments from Bruce Tupper, Director, Market Development ICE eConfirm, ("I think the big question is aggregating the data amongst energy clearing houses and also the OTC data. Is that a responsibility that the Commission wants to have, or is that something of the repository?") Roundtable Transcript at 71.

the CEA, as amended by the Dodd-Frank Act, swap data repositories shall "provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity)."[16] Under this authority, the Commission could designate one swap data repository as the recipient of other swap data repositories' information in order to have consolidation and direct electronic access for the Commission.

Conclusion

We appreciate the opportunity to comment on the Commission's Interim Final Rule and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

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[16] CEA Section 21.

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Via Agency Website & Courier

November 17, 2010

David A. Stawick, Secretary
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RE: RIN 3038–AD01 Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest

Dear Mr. Stawick:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("Commission") on its proposed rules on requirements for derivatives clearing organizations ("DCOs"), designated contract markets ("DCMs") and swap execution facilities ("SEFs") regarding the mitigation of conflicts of interest (the "Proposed Rules").[1] The Proposed Rules contain (i) certain composition and governance requirements on the boards and specified committees of DCOs, DCMs and SEFs (the "Structural Governance Requirements") and (ii) certain limits on the ownership and voting power of members of DCOs, DCMs and SEFs and on enumerated entities[2] (the "Ownership and Voting Limitations").

I. SUMMARY OF RESPONSE

DTCC supports regulations designed to reduce risk, increase transparency and promote market integrity within the financial system. DTCC does not currently operate a DCO, DCM or SEF (each, a "Registered Entity"). However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC"), which has applied to the Commission

[1] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63,732 (Oct. 18, 2010).

[2] "Enumerated entities" is generally defined in the Proposed Rules to mean (i) a bank holding company (as defined in Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841)) with total consolidated assets of $50 billion or more, (ii) a nonbank financial company supervised by the Board of Governors of the Federal Reserve System, (iii) an Affiliate of such bank holding company or nonbank financial company, (iv) a swap dealer, (v) a major swap participant and (vi) an associated person of a swap dealer or major swap participant. *See* proposed regulation 17 C.F.R. § 39.25(b)(1), 75 Fed. Reg. at 63750.

for an order granting registration as a DCO.[3] DTCC is therefore concerned with the potential effect of the Proposed Rules on NYPC (specifically the Structural Governance Requirements) and the potential effect of the Proposed Rules on DTCC and its own shareholders (specifically the Ownership and Voting Limitations). DTCC also offers its comments on the Proposed Rules from its perspective at the center of the financial market as a user-owned and governed, at-cost financial market utility that seeks to reduce systemic risk and ensure financial stability.

- It is DTCC's view that reliance on the proposed Structural Governance Requirements (subject to our further comments below) offers the best solution to meet the stated goals of the Proposed Rules while avoiding the potential negative impact on capital, liquidity and increased systemic risk that could result from the Ownership and Voting Limitations.

- DTCC strongly advocates that the Ownership and Voting Limitations be eliminated in their entirety because the Structural Governance Requirements alone are sufficient to deal with the conflicts of interest identified by the Commission in its notice of proposed rulemaking. DTCC supports the mitigation of conflicts of interest through the imposition of governance requirements designed to ensure an independent perspective on the Boards of Directors and committees of Registered Entities. This approach is supported by various experts, from both the public[4] and private sector,[5] as an appropriate method to mitigate conflicts of interests.

- Should the Commission conclude that ownership restrictions are advisable to mitigate conflicts of interest, DTCC urges the Commission to adopt a definition of "parent" and correlative definition of "subsidiary" which provide that, for purposes of the "Parent Companies" provision of the Ownership and Voting Limitations, a person will only be deemed to be the parent of a subsidiary if such person owns all or a majority of the equity interest in the subsidiary and controls the day-to-day operations of the subsidiary. That is, we suggest that the Commission adopt a definition of parent and correlative definition of subsidiary

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[3] NYSE Euronext owns the other 50% equity interest. Neither DTCC nor NYSE owns a majority of the equity interests in NYPC. NYPC will have its own management team which will control the day to day operations of the company.

[4] *See, e.g.*, Comments from Hal Scott, Harvard Law School, ("[Ownership restrictions are] counterproductive in getting needed capital liquidity into the clearinghouses which, I think, should be our central focus in terms of systemic risk. In my view the potential conflicts should be generally handled by board governance rules and not by ownership restrictions.") Joint Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps, August 20, 2010 ("Roundtable Transcript") at 109-110. Available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative9sub082010.pdf.

[5] *See* Comments from Ms. Lynn Martin, NYSE Euronext, Inc., ("Specifically on the topic of ownership limitations and voting caps, NYSE Euronext opposes specific ownership limitations. We think that a more effective manner in controlling conflicts of interest is around good governance structure at a board level.") Roundtable Transcript at 120-121.

that align with the way the Structural Governance Requirements are proposed to be applied to persons which are parents of Registered Entities.

- If the Commission were to reject this approach to defining the parent/subsidiary relationship, DTCC would, in the alternative, request that the Commission include in the Proposed Rules a general exception from the Parent Companies provision of the Ownership and Voting Limitations for any entity that, like DTCC, is a financial market utility. As a complex user-owned and governed financial market utility with multiple subsidiaries, DTCC is regulated and supervised by banking and securities regulators. Its ownership and corporate governance structures (further described below) are representative of the regulated financial institutions that comprise its user shareholders. Certain of these shareholders may fall directly within the scope of the Proposed Rules and be covered accordingly so that dual coverage should not be necessary; those that are not otherwise subject to the Proposed Rules should not be indirectly regulated merely by virtue of their interests in DTCC. The Ownership and Voting Limitations under the Proposed Rules could adversely destabilize DTCC's structure and governance and conflict with its obligations under other regulatory regimes.

II. OVERVIEW OF DTCC AND ITS WHOLLY-OWNED SUBSIDIARIES

DTCC, through its subsidiaries, provides clearing, settlement, and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives. DTCC is also a leading processor of mutual funds and insurance transactions, linking funds and carriers with their distribution networks.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Securities Exchange Act of 1934, as amended (the "1934 Act"), subject to regulation by the Securities and Exchange Commission (the "SEC"). These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTC is also a limited purpose trust company organized under the New York State Banking Law, subject to regulation by the New York State Banking Department (the "NYSBD"), and a State Member Bank of the Federal Reserve System, subject to regulation by the Federal Reserve Bank of New York ("FRBNY"). As the parent of DTC and another New York limited purpose trust company, DTC is a bank holding company under New York law (but not Federal law), subject to supervision by the NYSBD. Accordingly, DTCC and its clearing agency subsidiaries are collectively subject to the supervision and regulation of both banking and securities regulators.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed-income, mortgage backed and government securities markets. These clearance and settlement services reduce risks for investors and the entire financial system by guaranteeing the completion of stock and bond transactions in the event of a participant default. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year on an at-cost basis.

DTCC believes that its own governance structure may provide a useful model for the Commission as the Commission considers and further develops the Structural Governance Requirements for Registered Entities.

To satisfy the "fair representation" requirements of Section 17A of the 1934 Act applicable to registered clearing agencies, the participants of DTC, NSCC and FICC are required (or, in some cases, permitted but not required) to purchase and own shares in DTCC and are thereby entitled to vote for its directors. The participant community includes domestic and international broker/dealers, custodian, correspondent and clearing banks, mutual fund companies and investment banks. As a financial market utility, DTCC and its clearing agency subsidiaries operate on an "at-cost basis," charging transaction fees for services at levels sufficient to cover the utility's costs and appropriate provisions for necessary reserves. DTCC also has a number of wholly-owned subsidiaries which are not in regulated businesses and, in addition to NYPC, has a 50% equity interest in two other joint venture companies.

The 2010 DTCC Board of Directors is composed of nineteen directors. Thirteen directors are representatives of clearing agency participants, including international broker/dealers, custodian and clearing banks and investment institutions. Three directors are not representatives of participants (also referred to as "independent directors" below). Two directors are designated by DTCC's preferred shareholders, NYSE Euronext and FINRA. The remaining three directors are the Chairman and Chief Executive Officer, President, and Chief Operating Officer of DTCC. The individuals who serve as directors of DTCC also serve as directors of the three clearing agency subsidiaries.

Individuals are nominated for election as directors based on their ability to represent DTCC's diverse base of participants, and DTCC's governance is specifically structured to help achieve this objective. The non-participant board members are individuals with specialized knowledge of financial services, who bring an independent perspective since they are not affiliated with firms that use DTCC services. Board members serve on a variety of board committees with responsibility to oversee aspects of DTCC's operation. In addition, to ensure broad industry representation and expertise on key industry subjects, industry representatives who are non-board members also serve on a number of advisory committees to the board.

As DTCC serves virtually the entire financial industry, from broker/dealers to banks to insurance carriers to mutual funds, its governance structure represents the entirety of the marketplace. DTCC has approximately 330 shareholders and no single shareholder holds more than a 6% interest in the company. Shares are allocated based on usage of the clearing agency subsidiaries. Roughly every three years the shares are reallocated to align ownership with usage. DTCC shares are not traded, so no one firm or group of firms may gain control of the Board of Directors by purchasing shares outside the periodic reallocation.

III. DISCUSSION OF PROPOSED RULES

In describing the conflicts of interest that may confront a DCO, the Commission notes concerns expressed by some market participants, investor advocates, and academics that enumerated entities may have economic incentives to minimize the number of swap contracts subject to mandatory clearing and trading.[6] As stated in the preamble to the Proposed Rules, "[t]hey contend that control of a DCO by the enumerated entities, whether through ownership or otherwise, constitutes the primary means for keeping swap contracts out of the mandatory clearing requirement, and therefore also out of the trading requirement."[7]

As described in greater detail below, DTCC believes that the Ownership and Voting Limitations are an imprecise tool with which to achieve the policy goals of the Commission regarding conflicts of interest. DTCC is concerned that the proposed ownership limitations are more restrictive than necessary to meet the stated goals of the Commission and, at the same time, create the risk of unintended adverse consequences. DTCC takes the view that the policy goals can be best met by the Structural Governance Requirements, by strengthening DCO board governance through the presence of independent board members and the establishment of certain board committees.

A. Structural Governance Requirements

Section II above of this comment letter describes the ownership and governance structure of DTCC. As a user-owned and governed financial market utility that operates on an at-cost basis, DTCC complies with certain statutory requirements of "fair representation," which require that its Board of Directors represent its participant shareholders. In addition, DTCC's governance rules require it to have three independent directors (and, as a practical matter, there are four, including FINRA). DTCC's operations are extremely sophisticated and require its Board and committee members (participant and non-participant alike) to have considerable expertise in financial markets.

Based on our experience with such governance, DTCC sees this approach as a positive model for mitigating conflicts of interest among competing constituencies within the organization. Also, for these reasons and those set forth below, DTCC would respectfully suggest that the Commission recognize the unique circumstances faced by DTCC and other financial market utilities and structure the independence and board requirements in a way that does not jeopardize their ability to identify and mitigate systemic risk while nevertheless addressing the stated concerns for conflicts of interest.

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[6] *See* Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. at 63,734.

[7] *Id.* at 63,734.

i. Independence

The Commission indicates that the Structural Governance Requirements set forth in the Proposed Rules will mitigate conflicts of interest by "introducing a perspective independent of competitive, commercial, or industry considerations to the deliberations of governing bodies (*i.e.* the Board of directors and committees.)"[8] The Commission also notes that conflicts of interest may also be mitigated by providing for fair representation of all constituencies in the governance of a Registered Entity, as fair representation would prevent any one particular interest from dominating the governance of the entity.[9]

As described above, DTCC shareholding and Board representation are determined by the principle of fair representation under the 1934 Act. DTCC's long experience with this composition demonstrates the effectiveness of this approach in affording the industry a forum for the resolution of differing, sometimes competing, interests of the constituent users. At the same time, DTCC greatly values the perspective and contribution of independent board members. Currently, DTCC's Board of Directors includes three non-participant directors who are not affiliated with firms that use DTCC's services as well as a representative of FINRA (as a preferred shareholder). These directors include individuals with specialized knowledge of financial services, including systemic risk, and who bring an independent perspective because they are not customers of DTCC's services.

ii. Board Requirements

1. Composition

The Proposed Rules require the Boards of Directors of Registered Entities be composed of at least 35%, but no less than two, public directors.[10] Further, to prevent dilution of the composition requirements through corporate structuring, the Proposed Rules extend such composition requirements to any committee of the Board of Directors that may exercise delegated authority with respect to the management of the entity.[11] Additionally, the Proposed Rules prohibit Registered Entities from allowing themselves to be "operated" by another entity, unless that entity agrees to adhere to the composition requirements.[12]

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[8] *Id.* at 63,737.

[9] *See id.* at 63,738.

[10] *See id.* at 63,738.

[11] *See id.* at 63,738.

[12] *See id.* at 63,738. "The proposed rule defines 'operate' as 'the direct exercise of control (including through the exercise of veto power) over the day-to-day business operations of' a DCO, DCM, or SEF 'by the sole or majority shareholder of such registered entity, either through the ownership of voting equity, by contract, or otherwise. The term 'operate' shall not prohibit an entity, acting as the sole or majority shareholder of such registered entity, from exercising its rights as a shareholder under any contract, agreement, or other legal obligation." *Id.* at 63,738, fn. 54.

DTCC supports the Commission's objective of reducing conflicts of interest through the imposition of Board of Director and committee composition requirements. However, such requirements should ensure that an entity's governing body represents a broad base of market participants in the relevant markets.

DTCC would urge the Commission to remove the percentage requirement, which may be onerous for a small Board of Directors or start-up initiative. DTCC believes that mandating a 35% independent composition requirement imposes too high a threshold and creates a substantial risk of the dilution of market expertise, especially for entities that have smaller Boards of Directors.

Independent perspectives can provide substantial value to a Board of Directors, but those who do not directly participate in markets may not have sufficient, timely, and comprehensive expertise on those issues critical to the extraordinarily complex financial operations of Registered Entities. These entities require expertise at the Board of Directors level in such diverse areas as strategic planning, risk management, technology, operations, management, finance, audit, government relations, regulatory affairs, compensation and human resources, as well as legal, regulatory, and compliance expertise. Therefore, it is critical for the safety and soundness of Registered Entities that the composition of their Boards of Directors sufficiently incorporates the range of necessary expertise as well as independent judgment. DTCC believes that mandating two public directors is sufficient to introduce an independent perspective and that a percentage requirement is neither necessary nor productive. (Please also refer to our comments below at page 9 regarding the definition of "public director.")

2. Substantive Requirements

In addition to the composition requirements discussed above, the Proposed Rules would impose certain substantive requirements on the Boards of Directors of Registered Entities to enhance the accountability of such Boards of Directors to the Commission. These additional substantive requirements include a clear articulation of the roles and responsibilities of the Board of Directors, annual performance reviews, implementation of member removal procedures, expertise mandates, and certain compensation structure prohibitions.[13]

As a complex financial market utility, DTCC recognizes and supports a regulatory requirement that Board members possess essential characteristics, including integrity, objectivity, sound judgment and leadership. DTCC also recognizes, based on its own experience, that ensuring the safe, sound and efficient oversight of operations requires that Board members also have the requisite expertise and experience.[14]

[13] *See id.* at 63,739.

[14] *See* Comments from Ms. Heather Slavkin, AFL-CIO, ("I think having real experts on the boards of directors is a very important issue. We all saw situations in the last several years where there were boards that were two-thirds independent and made really stupid decisions about risk management. So, we need to make sure that there are people on those boards of directors that really understand the risks that exist within a clearinghouse and are prepared to perceive potential risks that may arise in the system down the road and address them. So they also need to have the personalities to stand up to a board of directors that

iii. Committees

The Proposed Rules set forth requirements for Registered Entities to establish certain committees, including a requirement that these entities establish a Nominating Committee. According to the preamble to the Proposed Rules, "[t]he role of the Nominating Committee would be to: (i) [i]dentify individuals qualified to serve on the Board of Directors, consistent with the criteria that the Board of Directors require and any composition requirement that the Commission promulgates; and (ii) administer a process for the nomination of individuals to the Board of Directors."[15] Under the Proposed Rules, public directors must comprise at least 51% of the Nominating Committee, and a public director must serve as chair of the Committee.[16]

Additionally, the Proposed Rules require that DCOs establish a Risk Management Committee to provide the expertise necessary to manage the risks associated with derivatives instruments, while ensuring the composition of the Committee mitigates potential conflicts of interest.[17] The Proposed Rules require (i) 35% of the Risk Management Committee be composed of public directors, with sufficient expertise in clearing services and (ii) 10% of the Risk Management Committee be composed of customers of clearing members who routinely execute swap contracts and have experience using pricing models for such contracts.[18] Such Risk Management Committees may delegate certain responsibilities to a Risk Management Subcommittee, while maintaining oversight authority over the Subcommittee's decisions.[19] Decisions of the Risk Management Committee and Subcommittee may not be subject to the approval of, or otherwise limited by, any body other than the Board of Directors of a DCO.[20]

Consistent with its position on public directors, DTCC is opposed to the percentage requirements and to the leadership requirements for key committees. DTCC refers to the arguments above regarding the experience and interests of public directors, which are equally applicable to the percentage requirements. While public directors may provide an important counterpoise to interested directors, they may not otherwise have the necessary investment in the success of the enterprise and/or experience to be responsible for such key functions as are proposed.

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may be entrenched and have their own interests that may differ from those that are in the best interests of the systemic stability.") Roundtable Transcript at 77.

[15] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. at 63,740.

[16] *See id.* at 63,740.

[17] *See id.* at 63,740.

[18] *See id.* at 63,740.

[19] *See id.* at 63,741.

[20] *See id.* at 63,741.

However, DTCC supports the policy of requiring the establishment of committees (by whatever name) charged with the responsibility of increasing the quality of representation on Boards of Directors and to manage risk.

iv. Definition of Public Director

The Proposed Rules include a definition of "public director." The Commission requests comments on the proposed definition, asking whether (1) there are other ways the term should be defined, (2) there are other circumstances that should be included in the bright-line materiality test, and (3) there are circumstances that should be removed from such tests.[21]

DTCC agrees that independent directors are a valuable institutional resource and serve to balance the interests of directors who may represent particular constituents on the Board of Directors. The goal of requiring independent directors is to identify individuals of stature, experience and good conscience who will exercise independent judgment in the best interests of the Registered Entity. To this end, DTCC recommends a qualitative definition that stresses positive features of industry knowledge and experience, personal probity and prior service, while specifying a limited and objective set of disqualifications.

DTCC finds the proposed definition of "public director" difficult to construe and, hence, open to misinterpretation. Further, it has the potential to be damaging to critical financial market infrastructures. The definition does not actually state a "bright-line materiality test" because the measures of materiality are illustrative and non-exclusive. DTCC recommends prescriptive guidelines, rather than overbroad and ambiguous regulations which are difficult to apply.

At the core of the definition in the Proposed Rules is the term "material relationship" which is a relationship "that reasonably could affect the independent judgment or decision-making of the director."[22] While DTCC agrees with this general guideline, the manner in which it is measured may be problematic. A definition of "material relationship" which provides a limited objective list of excluded relationships and or safe-harbors would be instructive for market participants. For instance, a provision that limits compensation to a reasonable amount is an example of an objective threshold. The criteria in clause (i) of the definition of material relationship[23] could represent an objective standard, if the terms parent, subsidiary and affiliate were defined as suggested below (please see page 12). Clause (ii) of the definition,[24] excluding members of the Registered Entity and their directors, officers or employees, is also objective, but

[21] *See id.* at 63,734.

[22] *Id.* at 63,747.

[23] "[A]n officer or an employee of the registered entity, or an officer or an employee of its affiliate. In this context, "affiliate" includes parents or subsidiaries of the registered entity or entities that share a common parent with the registered entity…."

[24] *Id.* at 63,747.

extending this to subsidiaries, parents, affiliates and family (as defined) broadens it so far as to be nearly boundless and a challenge to implement.

In complex financial institutions, the interpretation of these exclusions may be difficult enough to determine, and even more so to imagine additional unspecified "material relationships." This over-specificity could have a chilling effect on encouraging independent representation and limit the pool of candidates in a manner adverse to the best interests of the organization.

B. Ownership and Voting Limits

i. Reject Ownership and Voting Limits

The Commission's proposed Ownership and Voting Limitations require that a DCO choose between one of two alternative limitations on ownership of voting equity and the exercise of voting rights.[25] The first alternative limits to 20% the amount of voting equity that any single member (and related persons) may own or vote, directly or indirectly and limits to 40% the amount of voting equity that the enumerated entities (and their related persons) may own in the aggregate or vote, directly or indirectly.[26] The second alternative limits to 5% the voting equity that any DCO member or enumerated entity (whether or not such entity is a DCO member), and the related persons thereof in each case, may own.[27]

The Commission's proposed Ownership and Voting Limitations also would prohibit a member of a DCM or SEF, together with its related persons, from directly or indirectly owning or voting more that 20% of any class of equity interest of the DCM or SEF, as applicable, entitled to vote.

The conflicts of interest provisions in the Proposed Rules are designed to address "a conflict of interest that a DCO may confront when determining (i) whether a swap contract is capable of being cleared, (ii) the minimum criteria that an entity must meet in order to become a swap clearing member, and (iii) whether a particular entity satisfies such criteria."[28]

a. *Hard Ownership Caps Rejected by Congress; European Commission*

DTCC urges that relying upon restrictions on aggregate numerical DCO, DCM and SEF ownership or governance caps on a particular class of market participants is too blunt an approach for these specific market circumstances. DTCC believes that fair representation and governance requirements (other than percentage requirements) are better suited to the achievement of the stated policy goals.

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[25] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. at 63,743.

[26] *See id.* at 63,743.

[27] *See id.* at 63,744.

[28] *See id.* at 63,733.

Further, it is important to recognize that the Commission is proposing hard ownership restrictions which are not specifically required by Section 726 the Dodd-Frank Act.[29] Additionally, as noted by Commissioner O'Malia[30] and Commissioner Sommers,[31] an aggregate ownership cap approach was recently rejected by the European Commission (the "EC"). The language used by the EC in rejecting ownership restrictions is clear, and its logic is compelling. The EC found that there are a number of governance solutions that provide better protections against conflicts of interest than ownership restrictions, and also found that such ownership restrictions risk adverse unintended consequences. As the EC stated in its current proposed rule:

> "[A] CCP must have in place robust governance arrangements. These will respond to any potential conflicts of interest between owners, management, clearing members and indirect participants. The role of independent board members is particularly relevant. The roles and responsibilities of the risk committee are also clearly defined in the Regulation: its risk management function should report directly to the board and not be influenced by other business lines. The Regulation also requires governance arrangements to be publicly disclosed. In addition, a CCP should have adequate internal systems, operational and administrative procedures, and should be subject to independent audits. All of these measures are considered more effective in addressing any potential conflicts of interest that may limit the capacity of CCPs to clear, than any other form of regulation which may have undesirable consequence on market structures (e.g. limitation of ownership, which would need to extend also to so-called vertical structures in which exchanges own a CCP)."[32]

b. <u>*Unintended Consequences of Aggregate Ownership Restrictions*</u>

As a user-owned and governed financial market utility with a cooperative-style ownership structure, DTCC has significant concerns that any proposal which relies upon aggregate ownership restrictions may undermine the safety and soundness of financial markets. An effective prohibition of industry ownership of a market-created initiative

[29] Dodd-Frank Act Section 726 ("The Commodity Futures Trading Commission shall adopt rules which **<u>may include</u>** numerical limits on the control of, or the voting rights with respect to, any derivatives clearing organization." [Emphasis added.])

[30] Concurring statement of Commissioner Scott O'Malia ("With that said, the European Commission released (September 15, 2010) a proposal on financial reform which does not place individual or aggregate ownership limits on DCOs under European Union jurisdiction.")

[31] Dissenting statement of Commissioner Jill Sommers ("I also note that the European Commission explicitly rejected ownership limitations in its proposal for regulating OTC derivatives announced September 15th because such limitations may have negative consequences for market structures. I agree.")

[32] Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories {SEC(2010) 1058} {SEC(2010) 1059}. Available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf.

would have a profound negative impact on the existing clearance and settlement system in the United States, which has served as a source of stability, resiliency and efficiency over the past 35 years and is responsible for mitigating systemic risk, driving down post-trade costs and helping attract global capital to our markets.

DTCC shares Commissioner Sommers' concern that "the proposed limitations on voting equity, especially those proposed for enumerated entities in the aggregate with respect to DCOs, may stifle competition by preventing new DCMs, DCOs, and SEFs that trade or clear swaps from being formed."[33]

ii. Clarify the Application of the Parent Companies Provision

The Ownership and Voting Limitations of the Proposed Rules also contain a provision titled "Parent Companies," which provides that (1) if a Registered Entity is a subsidiary, the Ownership and Voting Limitations shall apply to its parent, whether direct or indirect, in the same manner than they apply to such Registered Entity and (2) if any parent is publicly-listed on a domestic exchange, then such parent must follow the voting requirements promulgated by the SEC or the entity on which such parent is listed.

If the Ownership and Voting Limitations of the Proposed Rules are not eliminated in their entirety as suggested in section II(B)(i) above, then clarity is needed regarding the application of the Parent Companies provision of the Ownership and Voting Limitations.

The term "subsidiary" is not defined in the Proposed Rules. Therefore, it is unclear (1) what types of entities fall within the definition of "subsidiary" and (2) in turn, what types of entities will be deemed to be "parents" subject to the Ownership and Voting Limitations of the Proposed Rules. DTCC suggests that the definition of "subsidiary" in the Parent Companies provision of the Ownership and Voting Limitations be aligned with the application of the Parent Companies provision of the Structural Governance Requirements.

The Structural Governance Requirements of the Proposed Rules also contain a provision titled "Parent Companies." While this provision does not use or define the term "subsidiary," it provides that the Board and committee composition requirements applicable to DCOs, DCMs and SEFs will be applied to any entity that "operates" a Registered Entity. The term "operate" is defined in the Proposed Rules to mean the direct exercise of control (including through the exercise of veto power) over the day-to-day business operations of the Registered Entity by the sole or majority shareholder of such entity, whether through the ownership of voting equity, by contract, or otherwise.

Accordingly, DTCC suggests that the term "subsidiary" for purposes of the Parent Companies provision of the Ownership and Voting Limitations of the Proposed Rules should be defined to mean a wholly-owned or majority-owned entity whose sole or majority shareholder directly exercises control (including through the exercise of veto power) over the day-to-day business operations of such entity, whether through the

[33] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. at 63,753.

ownership of voting equity, by contract or otherwise. Stated differently, a person should be deemed to be the "parent" of a subsidiary only if such person is the sole or majority shareholder of such entity and such person directly exercises control (including through the exercise of veto power) over the day-to-day business operations of such entity, whether through the ownership of voting equity, by contract or otherwise.

iii. Waiver

In the event that the Commission retains the Ownership and Voting Limitations and rejects the approach to parent and subsidiary definitions suggested in Section II(B)(ii)of this comment letter, DTCC would request that the Commission incorporate a general exception in the Parent Companies provision of the Ownership and Voting Limitations of the Proposed Rules for DTCC and other financial market utilities.

The Proposed Rules recognize that "circumstances may exist where neither [DCO ownership restriction] alternative may be appropriate."[34] In such instances, the Commission may grant a DCO a waiver from the limitations if, upon review, the Commission finds that the restrictions are unnecessary or inappropriate to improve the governance of the DCO, mitigate systemic risk, promote competition, mitigate conflicts of interest in connection with a swap dealer's or major swap participant's conduct of business with the DCO with respect to fair and open access and participation and product eligibility, or otherwise accomplish the purposes of the Commodity Exchange Act.

DTCC suggests that, in addition to considering case by case waivers from the Ownership and Voting Limitations of the Proposed Rules, the Commission include in the Proposed Rules a general exception from the Parent Companies provision for financial market utilities which are entirely owned by its members, satisfy the above-referenced governance provisions and meet the factors set forth in the Proposed Rules.[35]

iv. Alternative Approach

In response to the request for comment solicited in the Proposed Rules, DTCC suggests that the Commission consider one alternative approach that addresses the identified conflicts of interest. DTCC's proposal addresses the issue of maximizing the use of DCOs to clear swaps where regulators determine that activity could be accomplished in a safe and sound manner under Section 2(h)(2) of the Commodity Exchange Act.

The Commission could mandate that DCO governance rules require a Board of Directors to include representatives across the broad base of participants in the relevant markets

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[34] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. at 63,743.

[35] *See id.* at 63,751. ("(1) Improve the governance of the derivatives clearing organization; (2) Mitigate systemic risk; (3) Promote competition; (4) Mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with the derivatives clearing organization, including with respect to Section 2(h)(1)(B) and Section 5b(c)(2)(c) of the Act; and (5) Otherwise accomplish the purposes of the Act.")

(i.e., not from only one class of market participants and not representative of any shareholder or management of the DCO), as well as independent directors (i.e., directors who are not associated with market participants). There should also be a means of assuring, through shareholders agreements or through actual shareholding and governance documents, that directors associated with any particular class of market participants are generally acceptable to that class. This type of approach to governance has been used in the past to address the risk of non-alignment of interests among various market participants, for instance in the formation of the Government Securities Clearing Corporation in the late 1980s as an industry owned utility to clear US Government Securities.

DTCC would urge that those involved in the decision making process at DCOs regarding new instruments for clearing (other than the independent directors) be required to bear some financial risk in the event the DCO mismanages the risks associated with clearing these instruments. Otherwise parties with no financial risk could, with impunity, force others to take on risk with no motive to consider the implementation of appropriate risk mitigation.

IV. CONCLUSION

We appreciate the opportunity to comment on the Commission's Proposed Rules and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

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Via Agency Website & Courier

November 26, 2010

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549–1090

RE: RIN 3235–AK74, Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC

Dear Ms. Murphy:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("Commission") on its proposed Regulation MC for security-based swap clearing agencies ("SBSCAs"), security-based swap execution facilities ("SB SEFs") and national securities exchanges that post or make available for trading security-based swaps ("SBS exchanges" and, together with SB SEFs and SBSCAs, collectively, "Registered Entities" and, individually, each a "Registered Entity") regarding the mitigation of conflicts of interest ("Regulation MC").[1] Regulation MC contains (i) certain composition and governance requirements on the Boards and specified committees of Registered Entities (the "Structural Governance Requirements") and (ii) certain limits on the ownership and voting power of members of Registered Entities (the "Ownership and Voting Limitations").

I. SUMMARY OF RESPONSE

DTCC supports regulations designed to mitigate systemic risk, promote competition and mitigate conflicts of interest with respect to Registered Entities. DTCC does not currently operate a Registered Entity. DTCC is, however, concerned with the potential effect that Regulation MC (specifically, the Ownership and Voting Limitations) would have on DTCC and its shareholders if DTCC were to acquire an interest in a Registered

[1] Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC, 75 Fed. Reg. 65,882 (Oct. 26, 2010).

Subsidiaries:
The Depository Trust Company
National Securities Clearing Corporation
Fixed Income Clearing Corporation
DTCC Deriv/SERV LLC
DTCC Solutions LLC

Entity. DTCC also offers its comments on Regulation MC from its perspective at the center of the financial market as a user-owned and governed, at-cost financial market utility that seeks to reduce systemic risk and ensure financial stability.

- It is DTCC's view that reliance on the proposed Structural Governance Requirements (subject to our further comments below) offers the best solution to meet the stated goals of Regulation MC while avoiding the potential negative impact on capital, liquidity and increased systemic risk that could result from the Ownership and Voting Limitations.

- DTCC strongly advocates that the Ownership and Voting Limitations be eliminated in their entirety because the Structural Governance Requirements alone are sufficient to deal with the conflicts of interest identified by the Commission in its notice of proposed rulemaking. DTCC supports the mitigation of conflicts of interest through the imposition of governance requirements designed to ensure an independent perspective on the Boards of Directors and committees of Registered Entities. This approach is supported by various experts, from both the public[2] and private sector,[3] as an appropriate method to mitigate conflicts of interests.

- Should the Commission conclude that the Ownership and Voting Limitations are advisable measures to mitigate conflicts of interest, DTCC urges the Commission to clarify the "direct or indirect" language in the Ownership and Voting Limitations by expressly providing that the Ownership and Voting Limitations will not be applied to ownership or voting interests in a non-Registered Entity which has an ownership or voting interest in a Registered Entity *unless* such non-Registered Entity owns a majority of the equity interest in such Registered Entity and controls (including through the exercise of veto power) the day-to-day operations of such Registered Entity by virtue of such ownership interest, by contract or otherwise.

- Should the Commission conclude that the Ownership and Voting Limitations are advisable and reject DTCC's proposed clarification of the "direct or indirect" language in such Ownership and Voting Limitations, DTCC would, in the alternative, request that the Commission include in Regulation MC a general

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[2] *See, e.g.*, Comments from Hal Scott, Harvard Law School, (''[Ownership restrictions are] counterproductive in getting needed capital liquidity into the clearinghouses which, I think, should be our central focus in terms of systemic risk. In my view the potential conflicts should be generally handled by board governance rules and not by ownership restrictions.") Joint Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps, August 20, 2010 ("Roundtable Transcript") at 109-110. Available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative9sub082010.pdf.

[3] *See* Comments from Ms. Lynn Martin, NYSE Euronext, Inc., ("Specifically on the topic of ownership limitations and voting caps, NYSE Euronext opposes specific ownership limitations. We think that a more effective manner in controlling conflicts of interest is around good governance structure at a board level."). Roundtable Transcript at 120-121.

exception from the Ownership and Voting Limitations, providing that the Ownership and Voting Limitations will not be applied to ownership or voting interests in a non-Registered Entity which has an ownership or voting interest in a Registered Entity if the non-Registered Entity is a financial market utility (such as DTCC). As a complex user-owned and governed financial market utility with multiple subsidiaries, DTCC is regulated and supervised by banking and securities regulators. Its ownership and corporate governance structures (further described below) are designed, under applicable regulations, to be representative of its user shareholders which are also regulated financial institutions. Certain of these shareholders may fall directly within the scope of Regulation MC and be covered accordingly so that dual coverage should not be necessary; those that are not otherwise subject to Regulation MC should not be indirectly regulated merely by virtue of their interests in DTCC. The Ownership and Voting Limitations under Regulation MC could adversely destabilize DTCC's ownership and corporate governance structure and conflict with its obligations under other regulatory regimes.

II. Overview of DTCC and Its Wholly Owned Subsidiaries

DTCC, through its subsidiaries, provides clearing, settlement, and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives. DTCC is also a leading processor of mutual funds and insurance transactions, linking funds and carriers with their distribution networks.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), subject to regulation by the Commission.[4] These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTC is also a limited purpose trust company organized under the New York State Banking Law, subject to regulation by the New York State Banking Department (the "NYSBD"), and a State Member Bank of the Federal Reserve System, subject to regulation by the Federal Reserve Bank of New York ("FRBNY"). DTCC is also a bank holding company under New York law (but not Federal law), subject to supervision by the NYSBD. Accordingly, DTCC and its clearing agency subsidiaries are collectively subject to the supervision and regulation of both banking and securities regulators.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, central counterparty services and a guarantee of

[4] DTCC also has a number of wholly-owned subsidiaries which are not in regulated businesses and has a 50% equity interest in three joint venture companies.

completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage-backed and government securities markets. These clearance and settlement services reduce risks for investors and the entire financial system by guaranteeing the completion of stock and bond transactions in the event of a participant default. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year on an at-cost basis.

DTCC believes that its own governance structure may provide a useful model for the Commission as the Commission considers and further develops the Structural Governance Requirements for Registered Entities.

To satisfy the "fair representation" requirements of Section 17A of the Exchange Act applicable to registered clearing agencies, the participants of DTC, NSCC and FICC are required (or, in some cases, permitted but not required) to purchase and own shares in DTCC and are thereby entitled to vote for its directors. The participant community includes domestic and international broker/dealers, custodian, correspondent and clearing banks, mutual fund companies and investment banks. As a financial market utility, DTCC and its clearing agency subsidiaries operate on an "at-cost basis," charging transaction fees for services at levels sufficient to cover the utility's costs and appropriate provisions for necessary reserves.

The 2010 DTCC Board of Directors is composed of nineteen directors. Thirteen directors are representatives of clearing agency participants, including international broker/dealers, custodian and clearing banks and investment institutions. Three directors are not representatives of participants (also referred to as "non-participant directors" or as "independent directors" below). Two directors are designated by DTCC's preferred shareholders, NYSE Euronext and FINRA. The remaining three directors are the Chairman and Chief Executive Officer, President, and Chief Operating Officer of DTCC. The individuals who serve as directors of DTCC also serve as directors of the three clearing agency subsidiaries. Individuals are nominated for election as directors based on their ability to represent DTCC's diverse base of participants, and DTCC's governance is specifically structured to help achieve this objective. The non-participant directors are individuals with specialized knowledge of financial services, who bring an independent perspective because they are not affiliated with firms that use DTCC services. Board members serve on a variety of Board committees with responsibility to oversee various aspects of DTCC's operation. In addition, to ensure broad industry representation and expertise on key industry subjects, industry representatives who are non-Board members also serve on a number of advisory committees to the Board.

As DTCC serves virtually the entire financial industry, from broker/dealers to banks to insurance carriers to mutual funds, its governance structure represents the entirety of the marketplace. DTCC has approximately 330 shareholders and no single shareholder holds more than a 6% interest in DTCC. DTCC shares are allocated based on usage of the regulated clearing agency subsidiaries. Roughly every three years DTCC shares are reallocated to align ownership with usage. DTCC shares are not traded, so no one firm or group of firms may gain control of the Board of Directors by purchasing shares outside the periodic reallocation.

III. DISCUSSION OF REGULATION MC

In describing the conflicts of interest that may confront an SBSCA, the Commission identifies three key areas where a conflict of interest may present itself: (i) limiting access to an SBSCA, (ii) limiting the scope of products eligible for clearing at the SBSCA and (iii) participants influencing the risk management controls of an SBSCA to reduce the amount of collateral required as margin or a guaranty fund. The Commission also notes that these potential conflicts of interest could undermine the mandatory clearing provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), "thereby affecting transparency, investor protection, risk management, efficiency, and competition in the security-based swaps market."[5]

As described in greater detail below, DTCC believes that the Ownership and Voting Limitations are an imprecise tool with which to achieve the policy goals of the Commission regarding conflicts of interest. DTCC is concerned that the Ownership and Voting Limitations are more restrictive than necessary to meet the stated goals of the Commission and, at the same time, create the risk of unintended adverse consequences. DTCC takes the view that the policy goals can be best met by the Structural Governance Requirements, by strengthening SBSCA Board governance through the presence of independent board members and the establishment of certain Board committees.

A. Structural Governance Requirements

Section II of this comment letter describes the ownership and corporate governance structure of DTCC. As a user-owned and governed financial market utility that operates on an at-cost basis, DTCC complies with certain statutory requirements of "fair representation," which require that its Board of Directors represent its user shareholders. In addition, DTCC's governance rules require it to have three independent directors (and, as a practical matter, there are four, including FINRA). DTCC's extremely sophisticated operations also require its Board and committee members (participant and non-participant alike) to have considerable expertise in financial markets.

Based on DTCC's experience with this governance structure, DTCC believes that such a structure provides a positive model for mitigating conflicts of interest among competing constituencies within the organization. Also, for these reasons and those set forth below,

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[5] *See* Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC, 75 Fed. Reg. at 65,885.

DTCC would respectfully suggest that the Commission recognize the unique circumstances faced by DTCC and other financial market utilities. Accordingly, DTCC would urge the Commission to structure the composition requirements in a way that does not jeopardize the ability of DTCC and other financial market utilities to identify and mitigate systemic risk, while nevertheless addressing the stated concerns for conflicts of interest.

i. Independence

The Commission indicates that the Structural Governance Requirements set forth in Regulation MC will mitigate conflicts of interest because "[t]he presence of a significant number of independent directors on the Board of a security-based swap clearing agency should provide the addition of strong and independent oversight within the security-based swap clearing agency to serve as a potential check against conflicts of interest that could pose a detriment to the security-based swap clearing agency, other firms, or the security-based swaps market generally."[6]

As described above, DTCC's shareholding and Board representation are determined by the principle of fair representation under the Exchange Act. DTCC's long experience with this composition demonstrates the effectiveness of this approach in affording the industry a forum for the resolution of differing, sometimes competing, interests of the constituent users. At the same time, DTCC greatly values the perspective and contribution of independent directors. Currently, DTCC's Board of Directors includes three non-participant directors who are not affiliated with firms that use DTCC's services as well as a representative of FINRA (as a preferred shareholder). These non-participant directors include individuals with specialized knowledge of financial services and key regulatory and market concerns, including systemic risk, who bring an independent perspective because they are not customers of DTCC's services.

ii. Board Requirements

Regulation MC requires that an SBSCA choose between one of two alternative Board composition requirements. The first alternative requires the Board of Directors of an SBSCA to be composed of at least 35% independent directors.[7] The second alternative requires the Board of Directors of an SBSCA to be composed of a majority of independent directors.[8] Regulation MC also requires the Board of Directors of an SB SEF or SBS exchange to be composed of a majority of independent directors.[9] Further,

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[6] *Id.* at 65,896.

[7] *See id.* at 65,930.

[8] *See id.* at 65,931.

[9] *See id.*

Regulation MC extends such composition requirements to any committee of the Board o Directors that has the authority to act on behalf of the Board of Directors.[10]

DTCC supports the Commission's objective of reducing conflicts of interest through the imposition of Board of Director and committee composition requirements. However, such requirements should ensure that an entity's governing body (i) represents a broad base of market participants in the relevant markets and (ii) has the necessary expertise in the relevant markets.

DTCC would urge the Commission to eliminate the specified percentage and majority independent composition requirements. DTCC believes that mandating a 35% or majority independent composition requirement (i) imposes too high a threshold, which may be onerous for start-up initiatives or entities that have smaller Boards of Directors and (ii) creates a substantial risk of dilution of market expertise, especially for entities that have smaller Boards of Directors. DTCC further believes that any regulatory specification of any numerical or percentage requirement is inadvisable because it might discourage start-up initiatives and limit competition.

Independent perspectives can provide substantial value to a Board of Directors, but those who do not directly participate in markets may not have the targeted expertise to exercise timely judgment on issues critical to the complex financial operations of Registered Entities. Registered Entities require expertise at the Board of Directors level in such diverse areas as strategic planning, risk management, technology, operations, management, finance, audit, government relations, regulatory affairs, compensation and human resources, as well as legal, regulatory, and compliance expertise. Therefore, it is essential to the safety and soundness of Registered Entities that the composition of their Boards of Directors sufficiently incorporates the range of necessary expertise as well as independent judgment.

iii. Committee Requirements

Regulation MC sets forth requirements for Registered Entities to establish certain committees, including a requirement for such entities to establish a Nominating Committee for the purpose of identifying individuals qualified to become Board members.[11]

Regulation MC requires that an SBSCA choose between one of two alternative Nominating Committee composition requirements. The first alternative, which correlates with the 35% independent Board composition alternative, requires the SBSCA to establish a Nominating Committee composed of a majority of independent directors.[12]

[10] *See id.* at 65,930-32.

[11] *See id.* at 65,930-31.

[12] *See id.* at 65,930.

The second alternative, which correlates with the majority independent Board alternative, requires an SBSCA to establish a Nominating Committee composed solely of independent directors.[13] Regulation MC also requires the Nominating Committee of an SB SEF and SBS exchange to be composed solely of independent directors.[14]

Consistent with DTCC's position on Board composition requirements, DTCC is opposed to the independent composition requirements for key committees of the Board. DTCC refers to the arguments above regarding the experience and interests of independent directors, which are equally applicable to representation on Board committees.

With respect to governance as it relates to the risk committee of the Board, or its equivalent, DTCC does not support the approach suggested in the discussion in the notice of proposed rulemaking, to provide separate composition requirements applicable only to the risk committee that reflect the highly specialized risk management expertise required of directors serving on that committee. Consistent with DTCC's views expressed above in this comment letter, DTCC believes that the balance of expertise and independent judgment for the Board and its key committees should be the guiding principle. For the reasons set forth above, DTCC would oppose requiring that the risk committee be composed of at least 35% independent directors or any specified percentage, including a majority, (where such committee is delegated authority to act on the Board's behalf). In order to achieve objective balance, guidance might be offered to include other interested persons that are not participants, such as customers of participants, as representatives on the risk committee.

iv. Definition of Independent Director

DTCC agrees that independent directors are a valuable institutional resource and serve to balance the interests of directors who may represent particular constituents on the Board of Directors. The goal of requiring independent directors is to identify individuals of stature, experience and good conscience who will exercise independent judgment in the best interests of the Registered Entity. To this end, DTCC recommends a qualitative definition that stresses positive features of industry knowledge and experience, personal probity and prior service, while specifying a limited and objective set of disqualifications.

DTCC finds the proposed definition of "independent director" to be both over and under-specified. Further, it has the potential to be damaging to critical financial market infrastructures. DTCC recommends prescriptive guidelines which are more clear-cut and, as guidance only, may be applied with greater flexibility to the governance needs of each Registered Entity.

[13] *See id.* at 65,931.

[14] *See id.* at 65,932.

One key element of the definition of "independent director" in Regulation MC is that director shall have no "material relationship" with a list of specified parties.[15] The list of specified parties is very broad and would severely limit the pool of candidates with any industry expertise that might best serve the interest of the Registered Entity, its Board and committees. Moreover, the term "material relationship" is so vaguely defined that the evaluation of any qualified candidate would become an exercise in assessing whether that individual has any relationship, compensatory or otherwise, that reasonably could affect the candidate's independent judgment or decision-making as a director.[16] This makes the process of selecting an independent director potentially onerous for both the Registered Entity and the candidates.

Another key element of the definition of "independent director" is the express exclusion of specified circumstances[17] which are similarly broad-reaching and, hence, overly restrictive. It is also not clear from the drafting whether these "circumstances" should be equated with prohibited "material relationships."

In complex financial institutions, the appropriate implementation of these exclusions may be difficult enough to determine, and even more so to imagine additional unspecified "material relationships." This overly restrictive definition of "independent director" could have a chilling effect on encouraging independent representation and limit the pool of candidates in a manner adverse to the best interests of the Registered Entity. DTCC might instead recommend an approach which relies less on detailed exclusions of the type proposed and more on guiding principles. For instance, a provision that limits compensation to a reasonable amount is an example of an objective determinant. More narrowly drawn exclusions based on direct and material relationships together with "safe harbor" provisions might also ease the compliance burden.

DTCC would also urge the Commission not to adopt a specific (3 year) look-back period within which to determine whether a "material relationship" exists, because of the difficulty of assessing the already vague criteria retrospectively and because this would further narrow the willing pool of candidates.

B. Ownership and Voting Limitations

i. Reject Ownership and Voting Limitations

The Commission's proposed Ownership and Voting Limitations require that an SBSCA choose between one of two alternative limitations on ownership of voting equity and the

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[15] *See id.* at 65,928.

[16] *See id.*

[17] *See id.* at 65,896.

exercise of voting rights.[18] The first alternative, which correlates with the 35% independent Board and majority independent Nominating Committee requirement, limits to 20% the amount of voting equity that any SBSCA participant, either alone or together with its related persons, may, directly or indirectly own or vote, and limits to 40% the amount of voting equity of such SBSCA that SBSCA participants and their related persons may, in the aggregate, directly or indirectly own or vote.[19] The second alternative, which correlates with the majority independent Board and 100% independent Nominating Committee requirement, limits to 5% the amount of voting equity of such SBSCA that any SBSCA participant, either alone or together with its related persons, may, directly or indirectly, own or vote, and does not have an aggregate ownership restriction on all SBSCA participants.[20]

The Commission's proposed Ownership and Voting Limitations also would prohibit a member of an SBS exchange or SB SEF, either alone or together with its related persons, from directly or indirectly owning or voting more than 20% of any class of ownership interest of the SBS exchange or SB SEF, as applicable, entitled to vote.[21]

The conflicts of interest provisions of Regulation MC are designed to meet policy objectives which include "improving governance, mitigating systemic risk, promoting competition, and mitigating conflicts of interest with respect to security-based swap clearing agencies, SB SEFs and SBS exchanges."[22]

a. <u>*Hard Ownership Caps Rejected by Congress; European Commission*</u>

DTCC urges that relying upon proposed numerical ownership or voting caps for Registered Entities is too blunt an approach for these specific market circumstances. DTCC believes that fair representation and governance requirements (other than percentage composition requirements) are better suited to the achievement of the stated policy goals.

Further, it is important to recognize that hard ownership limitations are not specifically required by Section 765 of the Dodd-Frank Act.[23] Additionally, an aggregate ownership cap approach was recently rejected by the European Commission (the "EC"). The

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[18] *See id.* at 65,930.

[19] *See id.* at 65,930.

[20] *See id.* at 65,930.

[21] *See id.* at 65,931.

[22] *Id.* at 65,883

[23] Dodd-Frank Act Section 765 ("The Securities and Exchange Commission shall adopt rules which **<u>may include</u>** numerical limits on the control of, or the voting rights with respect to, any clearing agency that clears security-based swaps, or the control of any security-based swap execution facility or national securities exchange." [Emphasis added.])

language used by the EC in rejecting ownership limitations is clear, and its logic is compelling. The EC found that there are a number of governance solutions that provide better protections against conflicts of interest than ownership limitations, and also found that such ownership limitations create a new risk of adverse unintended consequences. As the EC stated in its current proposed rule:

> "[A] CCP must have in place robust governance arrangements. These will respond to any potential conflicts of interest between owners, management, clearing members and indirect participants. The role of independent board members is particularly relevant. The roles and responsibilities of the risk committee are also clearly defined in the Regulation: its risk management function should report directly to the board and not be influenced by other business lines. The Regulation also requires governance arrangements to be publicly disclosed. In addition, a CCP should have adequate internal systems, operational and administrative procedures, and should be subject to independent audits. All of these measures are considered more effective in addressing any potential conflicts of interest that may limit the capacity of CCPs to clear, than any other form of regulation which may have undesirable consequence on market structures (e.g. limitation of ownership, which would need to extend also to so-called vertical structures in which exchanges own a CCP)."[24]

b. Unintended Consequences of Aggregate Ownership Limitations

As a user-owned and governed financial market utility with a cooperative-style ownership structure, DTCC has significant concerns that any proposal which relies upon aggregate ownership restrictions may undermine the safety and soundness of financial markets. An effective prohibition of industry ownership of a market-created initiative would have (i) a profound negative impact on the existing clearance and settlement system in the United States, which has served as a source of stability, resiliency and efficiency over the past 35 years and is responsible for mitigating systemic risk, driving down post-trade costs and helping attract global capital to our markets and (ii) a chilling effect on new initiatives.

[24] Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories {SEC(2010) 1058} {SEC(2010) 1059}. Available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf.

ii. Clarify the "Direct or Indirect" Language in the Ownership and Voting Limitations

Regulation MC provides that the Ownership and Voting Limitations apply to indirect as well as direct ownership and voting interests in Registered Entities. In the discussion in the notice of proposed rulemaking regarding the application of the Ownership and Voting Limitations to indirect interests in SB SEFs and SBS exchanges (but not in the actual text of Regulation MC), the Commission notes that such Ownership and Voting Limitations would apply to ownership of voting interests in a parent company of an SB SEF or SBS exchange (and provides as an example that if an SB SEF were wholly-owned by a holding company, an SB SEF participant would be prohibited from owning or voting more than the specified limit of voting interest in the parent company).

If the Ownership and Voting Limitations are not eliminated in their entirety as suggested in Section III(B)(i) of this comment letter, then the "direct or indirect" language in such Ownership and Voting Limitations should be made more specific, to make it clear exactly when such Ownership and Voting Limitations will be applied to the ownership or voting interests in a non-Registered Entity which has an ownership or voting interest in a Registered Entity.

DTCC suggests that the "direct or indirect" language in the Ownership and Voting Limitations be clarified to expressly provide that such Ownership and Voting Limitations will not be applied to ownership or voting interests in a non-Registered Entity which has an ownership or voting interest in a Registered Entity *unless* such non-Registered Entity owns all or a majority of the equity interest in such Registered Entity and controls (including through the exercise of veto power) the day-to-day operations of such Registered Entity by virtue of such ownership interest, by contract or otherwise.

iii. Exemptive Authority

Regulation MC recognizes that the Commission "may grant an exemption from any rule or any provision of any rule under Regulation MC."[25] The Commission may generally grant such exemption when "necessary or appropriate in the public interest and consistent with the protection of investors" or when the petitioning entity has "established alternative means to effectively mitigate conflicts."[26]

If the Ownership and Voting Limitations are not eliminated in their entirety as suggested in Section III(B)(i) of this comment letter, and if the clarifying language suggested in

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[25] *See* Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC, 75 Fed. Reg. at 65,912.

[26] *See id.* at 65,913.

Section III(B)(ii) above is not accepted, DTCC would request that the Commission incorporate a general exception from the Ownership and Voting Limitations of Regulation MC providing that such Ownership and Voting Limitations will not be applied to ownership or voting interests in a non-Registered Entity which has an ownership or voting interest in a Registered Entity if the non-Registered Entity is a financial market utility (i.e., an organization which is member-owned) and satisfies the above-referenced governance provisions.

iv. Alternative Approach

In response to the request for comment solicited in Regulation MC, DTCC suggests that the Commission consider one alternative approach that addresses the identified conflicts of interest. DTCC's proposal addresses the issue of maximizing the use of SBSCAs to clear swaps where regulators determine that activity could be accomplished in a safe and sound manner.

The Commission could mandate that SBSCA governance rules require the Board of Directors of an SBSCA to include representatives across the broad base of participants in the relevant markets (i.e., not from only one class of market participants and not representative of any shareholder or management of the SBSCA), as well as independent directors (as discussed above). There should also be a means of assuring, through shareholder agreements or otherwise through actual shareholding and governance documents, that such directors appointed to represent any particular class of market participants be generally acceptable to shareholders of that class. This approach to governance has been used in the past to address the risk of non-alignment of interests among various market participants, for instance in the formation of the Government Securities Clearing Corporation in the late 1980s as an industry owned utility to clear US Government Securities.

DTCC would urge that those involved in the SBSCA decision-making process to introduce new instruments for clearing (other than the independent directors) be required to bear some financial risk in the event the SBSCA mismanages the risks associated with clearing these instruments. Otherwise, parties with no financial risk could, with impunity, force others to take on risk with no incentive for appropriate risk mitigation in the introduction of such new products.

IV. CONCLUSION

We appreciate the opportunity to comment on the Commission's Regulation MC and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

Larry E. Thompson
General Counsel

DTCC

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November 15, 2010

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
1155 21 Street, N.W.
Washington, D.C. 20581

Dear Chairmen Schapiro and Gensler,

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to submit to the U.S. Securities and Exchange Commission ("SEC") and to the U.S. Commodity Futures Trading Commission (the "CFTC" and, collectively with the SEC, the "Commissions") comments for your consideration as you begin to finalize the drafts of proposed rules relating to swap data repositories and security-based swap data repositories (collectively, "SDRs"). We appreciate the efforts of both Commissions to implement regulations under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and we are supportive of steps taken to ensure that regulators have the necessary tools to provide oversight of over-the-counter ("OTC") derivatives markets.

As you and your fellow Commissioners begin to discuss staff proposals for rules governing SDRs, DTCC offers the following comments for your consideration:

- **Swap Data Repository as Single Source for Regulators' Market Data.** DTCC supports a regulatory framework that allows an SDR to provide regulators with a centralized vantage point in this global market to view accurate and complete information for each swap or security-based swap asset class in a timely manner. A registered SDR should be able to provide (i) enforcement agents with necessary information on trading activity; (ii) regulatory agencies with counterparty-specific information about systemic risk based on trading activity; (iii) aggregate trade information for publication on market-wide activity; and (iv) a framework for real-time reporting from swap execution facilities and derivatives clearinghouses.

- **Dodd-Frank Act Provides a Process for the Aggregation of Swap Data to Counter the Risks of Data Fragmentation - Including the Designation of a Particular Swap Data Repository to Serve in Such a Capacity.** The SDR sections in the Dodd-Frank Act include parallel provisions for swap data repositories and security-based swap data repositories that an SDR shall "provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity)."[1] DTCC believes that this language permits both Commissions to designate one SDR as the recipient of the information of other SDRs to ensure the efficient consolidation of data. In order for this arrangement to exist under the forthcoming regulations, the rules should permit each Commission to recognize a single SDR (or one SDR per asset class) (the "Recognized SDR") to receive and aggregate market information and provide regulators with one unified source for real-time electronic data. A Recognized SDR will provide complete and streamlined information to the regulators, reducing the strain on these agencies' limited resources. The Recognized SDR must meet certain threshold requirements that ensure it has the necessary technological and substantive capabilities to perform its responsibilities as a Recognized SDR, as well as the organization and governance structure that is consistent with being a financial market utility serving a vital function to the entire marketplace.

- **Binding, Legal Electronic Records and Asset Servicing Vital for Market Oversight.** In order to maximize the value of an SDR and the vast data stored within it, it must maintain a legally binding electronic record which has been confirmed for accuracy by both counterparties. After each recorded transaction is consummated, the SDR can maintain the validity of the data for that transaction by offering an asset servicing function. This structure would allows the SDR to assist in systemic risk monitoring by providing regulators with regular reports analyzing the data (such as position limit violations or certain identified manipulative trading practices).

- **Conflicts of Interest Can Be Best Addressed through Governance Requirements.** DTCC strongly advocates that ownership and voting limitations for derivatives clearing organizations, security-based swap clearing agencies, designated contract markets, national securities exchanges, swap execution facilities and security-based swap execution facilities be eliminated in their entirety because proposed structural governance requirements sufficiently address the conflicts of interest identified by the Commissions. DTCC further urges the adoption of definitions of "parent" and "subsidiary" that align with proposed structural governance requirements and are consistent between both Commissions. If the Commissions were to reject this approach to defining the parent and subsidiary relationships, DTCC would request the approval of a waiver and general exemption by both Commissions, as contemplated by the CFTC's proposed rule, from the ownership or voting limitations for itself and other user-owned and governed financial market utilities.

- **Indemnification Provisions Threaten Regulators' Ability to Identify and Mitigate Systemic Risk.** Certain provisions of the Dodd-Frank Act require SDRs to make data available to federal and international regulatory agencies on a confidential basis. However, before the SDR is permitted to share the information with such regulators (the "Requesting Entity"), the SDR must receive a written agreement from the Requesting Entity, including any with which the SDR currently shares

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[1] Commodity Exchange Act Section 21(c)(4)(A), as created by Dodd-Frank Act Sections 728, and Securities Exchange Act of 1934 Section 13(n)(5)(D)(i), as created by Dodd-Frank Act Section 763(i).

information, that: (i) the Requesting Entity will abide by confidentiality requirements regarding the provided information; and (ii) the Requesting Entity agrees to indemnify the SDR and regulating Commission for any expenses arising from litigation relating to the information. DTCC remains concerned that regulators are not likely to grant SDRs indemnification in exchange for access to the information and, accordingly, regulators may actually receive less aggregated market data. Such an outcome would result in a reduction of information accessible to regulators on a timely basis both domestically and internationally, which contravenes the purpose of SDRs and jeopardizes market stability. Without an alternative, upon implementation of these provisions, SDRs will be restricted from providing necessary market information to regulators. Until government agencies reach indemnification and confidentiality agreements with SDRs, a regulator's ability to carry out oversight functions will be greatly diminished.

We would like to thank both of you, your fellow Commissioners and the staffs at both agencies for being so willing to consider our opinions and for conducting an open and transparent rulemaking process.

We appreciate the opportunity to share these comments with you and are available to discuss with you and your staffs at any time. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Sincerely,

Larry E. Thompson

Larry E. Thompson
General Counsel

cc: Luis Aguilar, Commissioner, SEC
Kathleen Casey, Commissioner, SEC
Troy Paredes, Commissioner, SEC
Elisse Walter, Commissioner, SEC

Bart Chilton, Commissioner, CFTC
Michael Dunn, Commissioner, CFTC
Scott O'Malia, Commissioner, CFTC
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Via Agency Website & Courier

December 20, 2010

Elizabeth Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

RE: RIN 3235 – AK73 Reporting of Security-Based Swap Transaction Data

Dear Ms. Murphy:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("Commission") on its interim final temporary rule for reporting of security-based swap transaction data (the "Interim Final Temporary Rule").[1] DTCC is supportive of a security-based swap reporting regime that brings increased transparency and oversight to over-the-counter ("OTC") derivatives markets.

Summary of Response

DTCC supports the Commission's efforts to ensure that data from pre-enactment security-based swap transactions are preserved and retrievable in the future. DTCC respectfully suggests that the reporting of a binding, legal electronic record agreed to by the two counterparties to a pre-enactment security-based swap should be treated by the Commission as satisfying the Interim Final Temporary Rule's reporting requirement and the information and document retention policy suggested by the interpretive note to Rule 13Aa-2T, as well as certain obligations of security-based swap dealers and major security-based swap participants.[2] Additionally, DTCC provides comments to the scope of information that should be preserved under the Commission's information and documents retention policy, based upon our experience operating the Trade Information Warehouse (the "Warehouse") and the centralized global repository for credit default swaps ("CDS"). Finally, DTCC offers its comments on how the single counterparty reporting obligation set forth in Rule 13Aa-2T(c) could result in the fragmentation of

[1] *See* Interim Final Temporary Rule for Reporting of Security-Based Swap Transaction Data, 75 Fed. Reg. 64,643 (Oct. 20, 2010).

[2] *See id.* at 64,653-54.

swap market data and decrease the utility of the information collected by a security-based swap data repository and on the designation of a consolidated data repository. These comments are preceded by an overview of DTCC and the Warehouse.

Overview of DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives. DTCC is also a leading processor of mutual funds and insurance transactions, linking funds and carriers with their distribution networks.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), subject to regulation by the Commission. These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTC is also a limited purpose trust company organized under the New York State Banking Law, subject to regulation by the New York State Banking Department (the "NYSBD"), and a State Member Bank of the Federal Reserve System, subject to regulation by the Federal Reserve Bank of New York. DTCC is also a bank holding company under New York law (but not Federal law), subject to supervision by the NYSBD. Accordingly, DTCC and its clearing agency subsidiaries are collectively subject to the supervision and regulation of both banking and securities regulators.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage-backed and government securities markets. These clearance and settlement services reduce risks for investors and the entire financial system by guaranteeing the completion of stock and bond transactions in the event of a participant default. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year on an at-cost basis.

Overview of the Trade Information Warehouse

<u>Industry Established Trade Information Warehouse to Increase Transparency, Bring Stability</u>

In November 2006, at the initiative of swap market participants, DTCC launched the Warehouse to operate and maintain a centralized global electronic database for virtually all CDS contracts outstanding in the marketplace. The Warehouse has received information with respect to trades executed prior to its inception. During 2007, DTCC back-loaded physical records in the Warehouse with information on over 2.2 million outstanding CDS contracts. Today, data for over 95 percent of all OTC credit derivatives are captured in this automated environment.[3] The Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace, constituting approximately 2.4 million contacts with a notional value of $29.6 trillion ($24.9 trillion electronically "gold" records and $4.7 trillion paper confirmed).

The Warehouse maintains the most current CDS contract details on the official legal, or "gold," record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants' single-sided, non-legally binding or "copper," records for CDS transactions to help regulators and market participants gain a clearer and more complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

Warehouse "Gold" Records Are Binding, Legal Electronic Record between Counterparties

Once an executed contract has been matched and confirmed, the trade record is sent to the Warehouse's repository. A "gold" record represents the current legal state of the contract. In fact, each user of the Warehouse's services has signed a binding agreement that states that, notwithstanding any provisions in any other applicable documentation relating to such transaction, the contracts maintained by the Warehouse represent the definitive record of each transaction and supersede any other documentation or understanding, whether written, oral, or electronic, between the parties. The Warehouse documents are relied upon to resolve any dispute between counterparties and to determine any payments or settlements by the Warehouse.

For "gold" records, the Warehouse assigns a unique reference identifier to each contract and performs automated recordkeeping to maintain the "current state" contract terms, taking into account post-trade events. The Warehouse also maintains a complete audit trail of the initial trade and every modification or assignment agreed to by the counterparties. These records are updated in real-time and, because the Warehouse is the official legal record of electronically confirmed contracts and centrally processes payments and credit events, counterparties ensure that these files are kept up to date and accurate.

Global regulators are provided information on "gold" and "copper" CDS contracts, as appropriate and upon request. Because contract details are located in a single central location, the Warehouse provides regulators across the globe with the ability to view

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[3] For more information about the Warehouse, please see http://www.dtcc.com/products/derivserv/suite/ps_index.php.

market exposure on these contracts and assess risk from a central vantage point, which is critical, particularly in times of crisis. The availability of this data is necessary for regulators to identify and address risks to financial markets in a timely fashion.[4] Beginning next year, all credit derivative trade data held in the Warehouse will also be simultaneously held in DTCC Derivatives Repository, Ltd., an FSA regulated subsidiary based in London, in order to help assure regulator access to data across multiple jurisdictions.

Discussion of Interim Final Temporary Rule

The Submission and Maintenance of a Binding, Legal Electronic Record Should Satisfy the Reporting Requirements for Pre-enactment Security-Based Swaps and also Certain Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants

Rule 13Aa-2T requires a counterparty to a pre-enactment security-based swap transaction to report to a registered security-based swap data repository or the Commission by the compliance date established in the reporting rules required under Sections 3C(e) and 13A(a)(1) of the Exchange Act, or within 60 days after a security-based swap data repository becomes registered with the Commission and commences operations to receive and maintain data related to such swap, whichever occurs first.[5] The purpose of the swap data repository is to "assist the CFTC and SEC in their oversight and market regulation responsibilities."[6]

Although the Warehouse is not yet a registered security-based swap data repository, DTCC intends to register the Warehouse as a security-based swap data repository upon promulgation of the relevant regulations by the Commission. In the interim, in consultation with the OTC Derivatives Regulators' Forum, the Warehouse makes available its records for regulators and provides aggregated trade data to nearly 30 global regulators and central banks, including the Commission, the Commodity Futures Trading Commission ("CFTC"), the Federal Reserve Bank of New York, the European Central Bank, Banque De France and the Financial Services Authority.

DTCC respectfully suggests that, in addition to satisfying the filing requirements for pre-enactment security-based swaps, the submission to a security-based swap data repository

[4] As an example, while the Warehouse reported counterparty specific positions to regulators at the time of the AIG insolvency, virtually none of the AIG trades creating the exposure that lead to the company's downfall were registered in the Warehouse. A mandate for all trade activity to be reported into a central swap data repository maintaining all positions would have assisted in identifying risk posed by AIG's market activity and provided an opportunity to reduce the risk promptly.

[5] *See* Interim Final Temporary Rule for Reporting of Security-Based Swap Transaction Data, 75 Fed. Reg. at 64,653.

[6] Statement of Sen. Blanche Lincoln. 156 Cong. Rec. S5920 (2010).

and maintenance of a binding, legal electronic record on a regular basis should be used to satisfy some of the ongoing obligations of security-based swap dealers and major security-based swap participants. In particular, the entity charged with keeping swap data up to date, as the possessor of this information, could easily report on behalf of a security-based swap dealer or major security-based swap participant regarding its transactions, positions and financial condition,[7] maintain its books and records,[8] and maintain daily trading records of the swaps of the registered security-based swap dealer or major security-based swap participant and all related records (including related cash or forward transactions), as may be required by the Commission and for each swap counterparty.[9]

The designation of the submission to a security-based swap data repository and maintenance of a binding, legal electronic record for pre-enactment security-based swaps within the Interim Final Temporary Rule would reduce the burden on counterparties that do not transact frequently in OTC markets and lack the infrastructure for duplicative reporting obligations.[10] Similarly, the value of having one agreed-upon electronic record governing an agreement between counterparties is also recognized by more frequent market participants.[11]

Further, it is inefficient and jeopardizes systemic risk to establish a reporting regime that results in regulators relying on counterparty-reported information that could differ from the binding, legal electronic record maintained at a central location by a neutral third party that the counterparties consider the official record. For asset classes where current market practice dictates reporting and confirmation of trade information to a central repository, establishing a parallel track for regulatory oversight would only duplicate reporting obligations and establish an opportunity for conflicting swap data. Because market participants recognize the value in and currently report and maintain binding,

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[7] *See* Exchange Act Section 15F(f)(1)(A).

[8] *See* Exchange Act Section 15F(f)(1)(B)-(D).

[9] *See* Exchange Act Section 15F(g).

[10] *See, e.g.*, Comments from Joseph R. Glace, Chief Risk Officer, Exelon, representing Coalition for Derivatives End-Users, (''The important part for us again is [to] have users who are satisfying the reporting obligations . . so again, you know, to me to have that [reporting] process go on, which is a useful business process, and then to duplicate it again in some other fashion is just an additional cost.") Joint Public Roundtable to Discuss Data for Swaps and Security-Based Swaps, Swap Data Repositories, Security-Based Swap Data Repositories, and Real-Time Public Reporting, September 14, 2010 ("Roundtable Transcript") at 194-195. Available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative18sub091410.pdf.

[11] *See, e.g.*, Comments from John Gidman, Executive Vice President, Loomis, Sayles & Company, representing the Association of Institutional Investors, (''We think the public overall, are much better served by having gold records that we can rely on, particularly at the aggregate level of the market and the markets.") Roundtable Transcript at 227.

legal electronic records, DTCC suggests that this practice satisfy any additional reporting requirement for pre-enactment security-based swap transactions.

For these same reasons, DTCC believes the information retention requirements set forth in Rule 13Aa-2T(b) for future reporting should be satisfied when trade information has been reported and recognized by the counterparties as the binding, legal electronic record.

Fragmentation of Security-Based Swap Market Data Caused by Single Party Reporting and Lack of Consolidation of Repository Data Poses Risks

Rule 13Aa-2T(c) requires only one party to report pre-enactment security-based swap transaction data, and depending on the classification of the counterparties as major security-based swap participants[12] or security-based swap dealers,[13] it is possible that the counterparties may select the responsible party.[14] This reporting arrangement differs from current market practice and is inconsistent with the existing repository reporting infrastructure. Currently, the receipt of information from both parties to a security-based swap data repository guarantees reconciliation of the information and confirmation that the information entering into the Warehouse is accurate. Reducing the reporting obligation to only one side leaves open the possibility of incorrect data and jeopardizes the value placed on binding, legal electronic records such as our "gold" records for CDS. Further, a single-reporting regime will confront international legal obstacles, such as domestic privacy laws, which will restrict the reporting party's ability to disclose counterparty information. Bilateral reporting obligations alleviate some of these burdens and produce more valuable, trustworthy information which can be relied upon by counterparties and regulators.

The issue of incorrect or fragmented data presents a second risk that concerns many market participants.[15] DTCC recognizes the value of aggregated reporting to repositories and regulators and strongly urges the Commission to consider consolidation of repository data, either by asset class or across all products.

[12] *See* Exchange Act Section 3(a)(67)(A).

[13] *See* Exchange Act Section 3(a)(71)(A).

[14] *See* Interim Final Temporary Rule for Reporting of Security-Based Swap Transaction Data, 75 Fed. Reg. at 64,653-54.

[15] *See, e.g.*, Comments from Athanassos Diplas, Managing Director, Deutsche Bank, ("what regulators have is to have a single report per asset class so that all that information can be contained in one place and we don't have actually information falling through the gaps. Part of the problem in the past has been that information was fragmented and that caused the actual problems.") Roundtable Transcript at 23. *See also* Comments from Bruce Tupper, Director, Market Development ICE eConfirm, ("I think the big question is aggregating the data amongst energy clearing houses and also the OTC data. Is that a responsibility that the Commission wants to have, or is that something of the repository?") Roundtable Transcript at 71.

The Dodd-Frank Act provides authority for the Commission to mitigate the risk posed by fragmented market data caused by multiple security-based swap data repositories. Under Section 13 of the Exchange Act, as amended by the Dodd-Frank Act, security-based swap data repositories shall "provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity)."[16] Under this authority, the Commission could designate one security-based swap data repository as the recipient of information from other security-based swap data repositories in order to have consolidation and direct electronic access for the Commission.

Conclusion

We appreciate the opportunity to comment on the Commission's Interim Final Temporary Rule and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

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General Counsel

[16] *See* Exchange Act Section 13.

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Via Agency Website & Courier

January 18, 2011

Elizabeth Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549–1090

Re: Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information (File Number S7–34–10)

Dear Ms. Murphy:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on proposed Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information ("Proposed Regulation" or "Regulation SBSR") under the Securities Exchange Act of 1934 ("Exchange Act").[1] DTCC's comments are provided with the goal of assisting the Commission in assessing how best to bring increased transparency and oversight to over-the-counter ("OTC") derivatives markets.

SUMMARY OF RESPONSE

DTCC supports the Commission's efforts to establish a comprehensive new framework for the regulation of swaps, including the reporting of all security based swaps ("SBS") to a security-based swap data repository ("SDR").

DTCC urges the Commission and the Commodity Futures Trading Commission ("CFTC") to harmonize their respective regulatory regimes establishing reporting processes for credit and equity derivatives, thereby eliminating the risk and costs associated with developing and maintaining two separate regulatory reporting processes when only a single, comprehensive process is needed. The agencies' current regulatory proposals exhibit significant similarities, but differ in their details, thereby creating potential inconsistencies that could unnecessarily increase risks of inaccurate reporting, as well as operational costs for market participants and SDRs. DTCC urges the SEC and CFTC, when possible, to formulate consistent requirements with respect to data

[1] *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208 (December 2, 2010).

Subsidiaries:
The Depository Trust Company
National Securities Clearing Corporation
Fixed Income Clearing Corporation
DTCC Deriv/SERV LLC
DTCC Solutions LLC

elements, submission of life cycle events, confirmation data and valuation data, the origination of identifiers, reporting party requirements and verification requirements.

DTCC suggests that the Commission reduce the burden of implementation and ongoing performance for reporting parties and enhance the data quality received by SDRs (and available to the Commission) by permitting existing market practices, such as the trade confirmation process, to be used to meet the regulatory reporting requirements, wherever possible. Extracting data for regulatory reporting (as opposed to real-time dissemination) from the confirmation process would be a highly efficient method of information transmission for market participants and provide more effective controls on data quality, with no material impact on the timeliness of regulatory reporting. In certain cases the trade confirmation process is the market participant's trade capture process – in these instances, such processes may also support real-time reporting. As discussed in greater detail below, the regulatory reporting and confirmation of a transaction can be consolidated into one process. A rule authorizing this approach would reduce the burden on reporting entities and strengthen the integrity of the reported data.

DTCC recommends a "phase in" approach for the implementation of the full range of reporting requirements under Regulation SBSR to allow time for the extensive testing and preparation needed to avoid systemic risk and the collection and dissemination of inaccurate information. DTCC's pre-existing operations comply with many of the requirements set forth in the Proposed Regulation. However, the process of developing, implementing, user testing and training industry participants that must follow publication of the final Regulation SBSR will require significant time and effort. Once the final regulations are in place, each SDR will need to revise its operations for compliance, and then educate market participants on the changes, as market participants will only be able to initiate development to meet the reporting requirements once providers have finalized their specifications. For these reasons, described more fully below, DTCC suggests that the Commission consider a "phase in" approach to implementation.

DTCC addresses how regulators and the general public would be best served by the consolidation of data and the enhancement of the availability of aggregate data. Proposed Regulation SBSR outlines a measured approach for achieving standardization of reported data to help facilitate regulatory oversight of trading in and exposures created by SBS markets, as well as meaningful public reporting of data. However, DTCC stresses that good and timely data aggregation is also required. The two most commonly cited manners in which OTC derivatives, particularly credit default swaps, were alleged to have contributed to the financial crisis of 2008 were the general lack of reliable public information about exactly how much exposure to various entities actually existed and the inability of regulators to understand and timely respond to the large one-way trades in credit derivatives on mortgages by companies such as the American International Group, Inc. ("AIG"). As discussed more fully below, neither situation can be appropriately resolved without a competent and fully automated data aggregation process. Standardization alone will not be corrective.

Finally, DTCC also urges the Commission to permit reporting parties to utilize third parties to assist in complying with reporting obligations, facilitating efficient methods of reporting and the provision of higher quality reported data.

DTCC's detailed comments are preceded by a brief overview of DTCC and the Trade Information Warehouse ("TIW" or "Warehouse"), a centralized global repository for trade reporting and post-trade processing of OTC credit derivatives contracts, which is operated by DTCC's wholly-owned subsidiary, The Warehouse Trust Company LLC.

OVERVIEW OF DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities transactions, money market instruments and OTC derivatives. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing agency for derivatives. However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC")[2], which has applied to the CFTC for an order granting registration as a Derivatives Clearing Organization ("DCO").

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Exchange Act, subject to regulation by the Commission. These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, (for some securities) central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year – on an at-cost basis.

[2] NYSE Euronext owns the other 50% equity interest. Neither DTCC nor NYSE owns a majority of the equity interests in NYPC. NYPC will have its own management team which will control the day to day operations of the company.

OVERVIEW OF THE TRADE INFORMATION WAREHOUSE

In November 2006, at the initiative of swap market participants, DTCC launched the Warehouse to operate and maintain the centralized global electronic database for virtually all position data on credit default swap ("CDS") contracts outstanding in the marketplace. Since the life cycle for CDS contracts can extend over five years, in 2007, DTCC "back-loaded" records in the Warehouse with information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 implementation date. Today, data for over 95 percent of all OTC credit derivatives are captured in this automated environment. The Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of $29 trillion ($25.3 trillion electronically confirmed "gold" records and $3.7 trillion paper-confirmed "copper" records).[3]

In addition to repository services (as contemplated by the Commission's proposed rules relating to SDRs, the acceptance and public and regulatory dissemination of data reported by reporting counterparties), the Warehouse provides both legal recordkeeping and central life cycle event processing for all swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details on the official legal or "gold" record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants' single-sided, non-legally binding or "copper" records for CDS transactions to help regulators and market participants gain a clearer and more complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

DTCC's Warehouse is also the first and only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. Various events can occur, such as calculating payments and bilateral netting, settling payments, credit events, early termination and company renames and reorganizations, which require action to be taken by the parties to such CDS contracts. DTCC's Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these functions by the Warehouse distinguishes it from any swap data repository that merely accepts and stores swap data information.

DISCUSSION OF PROPOSED REGULATIONS

Proposed Regulation SBSR, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), identifies the SBS transaction information required to be reported, establishes reporting obligations and specifies the timeframes for reporting and disseminating information. In general, the Proposed Regulation will provide for the reporting of three broad categories of SBS information: (1) information

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[3] Data provided as of December 31, 2010. For more information about the Trade Information Warehouse, please see http://www.dtcc.com/products/derivserv/suite/ps_index.php.

that will be required to be reported to a registered SDR in real-time and publicly disseminated; (2) information required to be reported to a registered SDR or, if there is no registered SDR that will receive such information, to the Commission, but will not be publicly disseminated; and (3) information about "life cycle events" required to be reported as a result of a change to information previously reported for a SBS.

I. WHO MUST REPORT

Using the Confirmation Process for Reporting under Proposed Rules 901(d) and (e)

The trade confirmation process for credit and equity derivatives globally already includes much of the data elements required under Regulation SBSR's Proposed Rules 901(d) and (e). In its existing form, the trade confirmation process is designed to verify all terms of economic value between the parties, including all of the trade terms data required to value the trade. Existing trade confirmation processes also provide a strong audit trail. Given that trade confirmation processes are key to supporting balance sheet verification for market participants, such processes have been developed with a high degree of completeness and accuracy, giving legal certainty to trading positions held by firms. Confirmation processes are designed to identify when economic terms to trades have changed, distinguishing between expected events under an existing confirmation and amendment of economic terms due to the modification of terms. Further, the logic behind these processes supports the identification of price-forming events, as required to be reported in Proposed Rule 901(c). The trade confirmation is a bilateral process in which both parties agree to the confirmation, thereby ensuring any errors in the original data are corrected.

A major distinction between confirmation processes and Proposed Rule 901(d) is timeliness. Proposed Rule 901(d) requires 15 minute, 30 minute or 24 hour submission. In practice, most dealer submissions to the electronic confirmation process for new trades in credit and equity derivatives are made on an intra-day basis on trade date. Actual submission times vary in accordance with the internal practices of each dealer (*e.g.*, real-time versus multi-batch) but are designed to achieve full confirmation as close to the point of trade as possible. Exceptions occur primarily where buy-side firms have not provided allocations for block executions.

More importantly, the electronic confirmation generation process is not significantly different from the trade reporting envisaged by Proposed Rule 901(d), with respect to both trade data content and trade audit trail functionality. Therefore, it may be difficult for reporting parties to provide SDRs with 901(d) data materially faster than the submission process for trade confirmation. (Meaning, generally, any regulatory reporting prior to when firms are able to submit confirm data would likely result in inaccurate submissions.) In that regard, DTCC also notes that, through ongoing commitments made to the global OTC Derivatives Supervisors Group ("ODSG"), the industry has greatly improved timeliness and accuracy of confirm submissions. This has significantly mitigated the operational risk associated with OTC derivatives generally and credit derivatives in particular. It appears, therefore, that linking required regulatory reporting to the electronic confirmation process (where one exists) would provide regulators with a means of further reducing operational risk and improving the timeliness and accuracy of confirmation submissions and regulatory reporting. Specific recommendations in this regard are set forth below under III.A. Reporting Timeframes for Regulatory Information. The alternative approach requires maintenance of separate regulatory submission and electronic confirmation processes that would then necessitate a separate reconciliation process to compare confirmation records against data reported for regulatory purposes.

DTCC believes that regulatory and market confirmation requirements should be aligned to provide for a system that is cost-effective and efficient, integrating the timeliness of Proposed Rules 901(d) and (e) with the confirmation process timeline. This would require the phasing in of the reporting timeliness goals for Proposed Rules 901(d) and (e). While it is difficult to determine how much closer trade confirmation can take place to the point of execution, certain elements of market practice will enable it to occur faster than it does today. For example, certain firms complete a number of data checks internally before issuing confirmations, including, for example, checks to interdealer broker trade confirmations, which can be further automated or will be superseded by electronic execution, enabling more timely submission. As further automation occurs, it is possible that security-based swap execution facility ("SEF") executed trades could be reported within 15 minutes, assuming the existence of automated feeds from the SEF to reporting parties or directly to SDRs acting as agent for the reporting party. Similarly, further streamlining of enterable fields and standardization of required enrichments would help improve submission timeliness and accuracy by the reporting party, bringing confirmation even closer to the point of trade.

For highly structured trades (which would not be electronically confirmable), the current processes for booking the trade and preparing confirmation post-trade execution may not allow for reporting within 24 hours in all instances. Currently, the detailed booking required for full valuation can take a number of days, and a number of points in the confirmation may require clarification and legal drafting prior to confirmation. Still, some reporting of the trade would be possible within 24 hours. Again, DTCC highlights the process of benchmarking improvements over time, as employed by the ODSG, as a model for addressing this issue.

As further background, for credit derivatives, most market participants have the ability to confirm trades electronically, and most credit derivatives trades are stored as electronic, legally binding or "gold" records in the Warehouse. DTCC estimates that over 98% of credit derivatives trades globally are included in the TIW in this form. The initial records are submitted via an electronic confirmation service provider by both parties. In addition, the major dealers and buy-side participants who have made commitments to the ODSG have provided DTCC summary records of trades which are not electronically confirmable to meet their commitment for universal recording. For equity derivatives, the level of electronification of the market is lower, with only 40% of such trades confirmed electronically and no equivalent to the TIW existing.[4]

The trade confirmation process supports all trades. In some cases, where a trade is not electronically confirmed, it is simply rendered as a text-based document and issued by facsimile or emailed PDF, rather than as a structured electronic message. Market participants are working toward increasing the levels of full electronification and, over time, these will increase, enhancing the audit trail, error and correction processes and event controls of the confirmation process.

In its process, TIW receives (through confirmation providers) submission from both parties to the trade – in many cases one party is submitting by affirmation to a trade record submitted by the other party. Certain parties use custodians or outsource providers to perform these activities on their behalf. In addition to the parties to a trade, clearing agents and portfolio compression vendors (when authorized by the trade party) submit updates to trade records directly to TIW.

In certain cases, the trade confirmation process will also be used to facilitate the requirements of Proposed Rule 901(c), where trade capture and confirmation are integrated, such as with MarkitWire. Typically, the seller or payer-party (or an interdealer broker ("IDB")) is responsible for input to this system immediately following execution – an input that involves a minimal number of trade terms. The buyer or receiver reviews these terms and affirms that trade in the system; this then populates the buyer's trade capture system (in the case of IDB input, both parties would review and affirm). Proposed Rule 901(c) reporting would be available from the first input to MarkitWire and, therefore, in certain situations, processes which are part of the trade confirmation process can be used to meet Proposed Rule 901(c) reporting requirements.

Role of Third Parties

DTCC strongly supports the use of third parties to report SBS data on behalf of reporting parties. However, such reporting by third parties should be required to be clearly authorized by the reporting party. The reporting party needs to control the data flow to SDRs to ensure completeness and accuracy of the data. Different firms will wish to have different workflows to support third party reporting, just as they do in the procedures used to undertake confirmation services. For confirmation services, certain firms allow IDBs to book trades into a confirmation service on their behalf, whereas others do not. Similarly, certain firms, where the confirmation service acts by affirmation (one party agreeing to another party's record), accept the other firm's record of the trade following manual review – this books the trade into the internal trade capture system. Other firms

[4] *See* Industry letter to Federal Reserve Bank of New York (June 2, 2009), available at http://www.newyorkfed.org/newsevents/news/markets/2009/060209letter.pdf

book every trade and have built internal matching capabilities to validate records sent to them for affirmation. Finally, certain firms prefer external matching platforms to provide confirmation in order to support independent input, but avoid the full cost of building and maintaining an internal matching engine. DTCC believes it is important that reporting firms with the reporting obligation maintain control over reported positions throughout the life of the contract, with third parties acting for the reporting party in making updates. Otherwise, it is difficult for any party to take responsibility for the accuracy of the resultant position at the SDR.

DTCC believes that the use of third parties will also strengthen the ability of the SDR to fulfill its statutory obligation to confirm the data with both parties.[5] In many cases, the third party will report trade information on behalf of both parties, and, in the absence of an obligation for parties to confirm the data with the SDR, reduce the regulatory burden of the counterparties and ensuring prompt compliance with reporting obligations. DTCC believes that, in many instances, firms will wish to submit every trade to the SDR or have a third party to manage submission to the SDR. Given the complexities related to establishing a new regulatory framework in a global market (particularly with jurisdictions expected to adopt new reporting rules related to SDRs as part of their G20 commitments), there is considerable complexity to devise rules that determine a reporting party's status within a hierarchy based on a counterparty's status or reporting requirements based on the product type.

The Proposed Regulation would require that a U.S. person report transaction data when its counterparty is not a U.S. person. This approach may not be preferred where a U.S. customer is dealing with non-U.S. dealer, and the foreign dealer may wish to offer this as a service to make the actions consistent with those of the customer transaction with U.S. dealers. This type of service by dealers who are not U.S. persons will best promote prompt and accurate reporting, because dealers who are not U.S. persons are better positioned technologically than all but the most advanced of their customers to provide the necessary reporting. Therefore, DTCC urges the Commission to facilitate such arrangements.

II. INFORMATION TO BE REPORTED IN REAL-TIME

Proposed Rule 901 divides the SBS information required to be reported into three broad categories: (1) information that will be required to be reported in real-time; (2) additional information that will be required to be reported but not publicly disseminated; and (3) life cycle event information. Each category has its own respective time deadline for reporting.[6]

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[5] "A security-based swap data repository shall . . . confirm with both counterparties to the security-based swap the accuracy of the data that was submitted." *See* Section 13(n)(5)(B) of the Exchange Act, 15. U.S.C. 78m(n)(5)(B).

[6] *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. at 75,212.

To date, DTCC has looked to regulators and market participants in determining the information which TIW disseminates publicly. The liquidity studies published by DTCC show that credit derivative trading is extremely thin on the majority of roughly 3,000 single name underlyers, and even this data is in aggregate across all maturities for a single reference entity. DTCC's discussions with market participants and regulators prior to publishing data have revealed high levels of sensitivity to disclosing small data samples, particularly from narrow time periods, given that such disclosure may not preserve the anonymity of the trading parties. The Dodd-Frank Act recognized the importance of protecting party anonymity, particularly for trades not subject to mandatory clearing.[7] In addition, the execution model, when combined with public dissemination, may lead to potential unintentional disclosure. For example, a request for quote ("RFQ") process with 5 counterparties will likely enable those parties to link RFQs to executions given there is less than one trade per hour per underlying for the majority of credit derivative underlyings.[8]

The real-time reporting fields set forth in Proposed Regulation SBSR accurately represent the key economic terms. Full terms should not be reported for timely submission, as only the most technically sophisticated recipients would be able to interpret the additional published data. However, publicly disseminated data for trades with a non-standard feature flag activated will be of limited usefulness and could be misleading. As a general mater, it is difficult to compare price data across transactions that are non-standard and have different terms. As a result, publication of only price (or other limited) transaction data for non-standard transactions is unlikely to benefit market participants and may, in fact, be confusing or misleading. DTCC believes that any dissemination of information with respect to highly structured trades should be phased in, if required at all, and that no dissemination for these products should occur until an analysis is conducted as to the impact and potential for misleading the investing public.

The Proposed Regulation defines "real-time" to mean (with respect to the reporting of SBS transaction information), "as soon as technologically practicable, but in no event later than 15 minutes after the time of execution of the SBS transaction."[9] DTCC believes that reporting within 15 minutes may be possible, but its experience with new industry-wide processes indicates there will likely be a "shakeout" period during which any number of problems with reported data will be discovered. The Commission should take this into account and provide a means of assuring that publicly disseminated

[7] "With respect to the rule providing for the public availability of transaction and pricing data for security-based swaps . . . , the rule promulgated by the Commission shall contain provisions . . . to ensure such information does not identify the participants." *See* Section 15(m)(1)(E) of the Exchange Act, 15. U.S.C. 78m(m)(1)(E).

[8] *See* Core Principles and Other Requirements for Swap Execution Facilities; Proposed Rules ("Proposed Rule" or "Proposed Regulation") 76 Fed. Reg. 1214 (Jan. 7, 2011).

[9] *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. at 75,284.

information is of high quality before dissemination is permitted. In this regard, DTCC understands that TRACE was initially introduced with a reporting deadline of more than an hour, which was tightened over a period of 18 months. DTCC would advocate a similar approach in this case, starting with a similar deadline and tightening over a similar period to TRACE.

III. Additional Reporting of Regulatory Information

Proposed Regulation SBSR requires reporting, within specified timeframes, of certain SBS transaction information that will not be publicly disseminated. The information required under Proposed Rule 901(d) is in addition to the publicly disseminated information required under the real-time reporting requirements set forth in Proposed Rule 901(c).[10]

For detailed market supervision, including understanding of pricing, regulators will need all economic attributes of a trade and execution time of the trade. Proposed Rule 901(d) appropriately captures the data elements necessary to determine the market value of the transaction and the execution time. Prudential regulators may need detailed information, which allows them to understand the detailed business activity of firms they oversee, but also more aggregate data on positions held by firms. Similarly, central banks will have an interest in more aggregate data. In these cases, aggregate trade valuations, including counterparty exposures and information as to collateral positions, are important for measuring risk exposures. Proposed Regulation SBSR is not clear as to the approach for obtaining this data. DTCC understands that firms expend considerable resources in valuing trades. It would be costly and difficult, if not impossible, for an SDR to replicate this activity across the multiplicity of products and contracts. Therefore, DTCC urges the Commission to adopt an approach whereby reporting firms submit their mark-to-market valuations.

For collateral information, while certain required collateral is assessed at trade level (for example, an independent amount or a reduced collateral requirement based on a trading strategy), collateral agreements typically operate with respect to a master agreement as a whole, and margin calls are made and collected on a net basis. Therefore, collateral is held against a portfolio and not attributable at trade level and any reporting needs to occur at that level.

Given that Proposed Rule 901(d)(v) requires the data elements necessary for a person to determine the market value of the transaction, Proposed Rule 901(d)(iii) appears duplicative and, further, Proposed Rule 901(d)(iii) is unclear as to the proposed form of the "description of the terms and contingencies of the payment streams" required. DTCC expects only the full terms as laid out in the trade confirmation should be reportable, as under Proposed Rule 901(d)(v).

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[10] *See id.* at 75,217.

DTCC is concerned that the requirements to include master agreement dates and credit support agreement dates at trade level is onerous, as these operate at portfolio level, in hierarchical structures and generally are not directly incorporated into current trade level messages. Rather, they are typically incorporated by reference to one applicable agreement. Therefore the level of change required to incorporate these into individual trade messages is excessive and may be better supported by a portfolio level approach to such issues, if required at all. The trade level reference should follow the current process, which references the lowest level governing document, which document itself will in turn permit identification of all other relevant documents.

Further, DTCC does not advocate requiring the reporting of trader or desk IDs, as the effort to maintain such information in an SDR may exceed its usefulness given that desk structures are changed relatively frequently and personnel rotate often and often transfer from firm to firm. Moreover, such information should be available directly from firms' own audit trails for the occasions when needed.

DTCC understands that SWIFT's Bank Identification Code ("BIC") is an ISO standard for counterparty identifiers and that SWIFT is interested in supporting the provision of unique identification codes ("UICs"). DTCC is supportive of SWIFT acting in this capacity, but expects the SDR will be largely agnostic as to the form of identifier and believes any form of identifier could be adopted and function appropriately. DTCC believes that, minimally, the UIC should be used in communication between the SDR and regulators and will be readily convertible from other formats by the SDR – rather than requiring immediate adoption by all parties in the reporting process. DTCC expects that each market participant will acquire its UIC directly from the internationally recognized standards-setting body ("IRSB") and that the IRSB will make a level of data publicly available, without charge, to allow market participants to correctly identify the UIC, including the legal entity name and the registration location of that legal name.

The TIW currently uses proprietary codes to identify parties to trades, at a legal entity level, not at a subunit level. DTCC does not believe it complex or difficult to develop a mapping table to a UIC for reporting to regulators.

A. Reporting Timeframes for Regulatory Information

Pursuant to Proposed Regulation SBSR, the Commission believes SBS transaction information should be reported within a reasonable time following the time of execution (*i.e.*, the point at which the counterparties to a SBS become irrevocably bound under applicable law), rather than waiting until the time a transaction is confirmed. For purposes of Proposed Regulation SBSR, the time a transaction is confirmed means the production of a confirmation that is agreed to by the parties to be definitive and complete and that has been manually, electronically, or by some other legally equivalent means, signed.[11] The Proposed Regulation requires a reporting party to submit the regulatory information required under Rule 901(d) "promptly" and, in no event, later than:

- 15 minutes after the time of execution for a SBS that is executed and confirmed electronically;
- 30 minutes after the time of execution for a SBS that is confirmed electronically but not executed electronically; or
- 24 hours after execution for a SBS that is not executed or confirmed electronically.[12]

As noted above, DTCC believes that there are direct similarities between the reporting requirement of Proposed Rules 901(d) and (e) and the confirmation process. The current confirmation process is not as timely as Proposed Rule 901(d). DTCC's experience suggests that electronically executed trades could be confirmed within 15 minutes, but it would require straight through processes for all reporting parties, which may be cost prohibitive for some low volume users. In addition, DTCC's experience suggests that orally executed, but electronically confirmable, trades can be submitted in a relatively short timeframe, but likewise require a level of automation and investment in electronic trade processing. Placing the reporting burden on swap dealers and major swap participants would facilitate achieving implementation of this proposed requirement; as such entities are more likely to get net benefits from the investment in automation. DTCC recommends that the electronically executed trade deadline be set at 30 minutes and the deadline for an electronically confirmable trade be set at 2 hours. To provide for a transition period to enable reporting parties to develop appropriate capabilities, these deadlines should be subject to phase in, initially starting closer to current market capability for electronically confirmable at 24 hours.

Manually confirmed trades are not currently subject to the same processes for all types of trades. Some trades are confirmed relatively quickly, with more standard contract confirmation generated by automated processes (*e.g.,* by delivery by facsimile or a PDF in email). Other trade confirmations are only issued after extensive legal drafting (required to describe economic terms) and validation against termsheets and internal trade bookings. Some trade confirmations may run to over 50 pages of terms. Trade booking into risk systems for certain complex trades, with appropriate controls over accuracy of input, can take a number of days. In addition, the submission for these trades may be heavily text-based. In light of these practices, it will be difficult for these trades to consistently be reported within 24 hours. Therefore, Proposed Regulation SDSR should be modified to permit a record without full terms to be sent within 24 hours, followed by the full terms, when available, but no later than 5 days.

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[11] *See id.* at 75,219.
[12] *See id.* at 75,219.

B. REPORTING OF LIFE CYCLE EVENTS

Proposed Regulation SBSR requires the reporting of certain "life cycle event" information. A "life cycle event" is defined as any event resulting in a change in the information required to be reported to an SDR under Proposed Rule 901. This definition includes a counterparty change resulting from an assignment or novation; a partial or full termination of the SBS; a change in the cash flows originally reported; for a SBS that is not cleared, any change to the collateral agreement; or a corporate action affecting a security or securities on which the SBS is based (*e.g.*, a merger, dividend, stock split or bankruptcy).[13]

Many life cycle events are price-forming or significantly change the exposures under a trade; for example, novation, early termination, exercise, knock-out or knock-in. The current definition supports reporting of these events, which is necessary for detailed markets regulation and, where independent valuation is considered an important capability from SDR data, for prudential and central bank regulation. Life cycle events are best reported in standard market forms (*e.g.,* for novation and early termination by trade confirmation; for exercise by exercise notice).

TIW has determined solutions to a number of complex issues for credit derivatives and can support life cycle event reporting processes. Based on this experience, DTCC believes that solutions can be developed for the life cycle event reporting required under Proposed Rule 901(e). In a number of cases, the life cycle event reporting timeliness will likely follow the initial reporting timeliness, particularly in the case of price-forming events subject to confirmation. However, requiring that this reporting occur "promptly" is appropriate since it also serves to recognize that certain life cycle events will result from other processes (*e.g.,* corporate actions or credit events), where many trades will be impacted simultaneously and processing may be manual or automated, requiring a varied amount of time. DTCC believes that it would be helpful for the Commission to provide greater clarity around its understanding of the term "promptly," as the term, without further explanation, may be interpreted by reporting parties differently for similar events and processes, particularly in a market where certain processes have historically taken a number of days to effect.

C. ADDITIONAL REQUIREMENTS APPLICABLE TO REGISTERED SDRS OR PARTICIPANTS

Proposed Regulation SBSR contains a set of rules that mandate the use of standardized reporting formats and identifiers for SBS information reported to a registered SB SDR. DTCC recognizes that standardization of reporting generally and counterparty information specifically, as well as identification of parents and affiliates, is critical to providing regulators with a comprehensive view of the swaps markets and assuring that

[13] *See id.* at 75,220.

publicly reported data is accurate and meaningful. However, such standardization alone is not sufficient to permit prompt and accurate regulatory assessments of either risky and unsafe position taking or manipulative and abusive trading practices. Nor will standardization assure meaningful public reporting of relevant market information.

DTCC has several years experience in operating the only global repository for an entire swap asset class (the TIW for credit derivatives) that has regularly and publicly reported key global market information, including net open interest and turnover information for the top 1,000 names traded worldwide, and regularly reported to relevant regulators worldwide key position risk and trade detail information. It is demonstrable that were the data publicly reported in aggregate by the TIW fragmented and reported by separate entities (*i.e.*, multiple repositories) the net open interest and net turnover information publicly reported would have been inaccurate and misleading in that it would have been almost always overstated, in many instances significantly.

In a presentation provided to regulators in July 2010, DTCC reviewed the net notional associated with the most liquid, on-the-run index (CDX.NA.IG.14) current at that time. The net open interest, as of July 9, 2010 was $33,035,116,000 at the clearinghouse and the bilateral, non-cleared net open interest was $69,231,897,351. This could have lead to an erroneous determination that the aggregate net open interest totaled $102,267,013,351. However, the cleared positions for a given counterparty often offset the bilateral net position. When the bilateral and cleared positions of each counterparty were netted together and then totaled, the net open interest for the marketplace was $46,906,650,518. This example illustrates that even for the most liquid contracts, fragmented reporting can indicate overall exposures of more than double what they actually are. This exemplifies the problems inherent in the dissaggregation of any positions, whether cleared vs. non-cleared or cleared at different clearinghouses.

In general this is unacceptable, but it is particularly so during times of crisis when overstated public reporting of net open interest/net exposures could contribute to unnecessary, severe market reactions. During the Lehman Brothers ("Lehman") crisis, when the TIW was able to assure markets that the net amount of credit default swaps written on Lehman was no greater than $6 billion (actual net settlements on credit default swaps written on Lehman were approximately $5.2 billion), as opposed to the hundreds of billions of dollars speculated, this principle for providing information for market surety was demonstrated. Had the credit default swaps on Lehman been reported to multiple repositories at the time, the net exposure to Lehman could have been reported to have been as high as $72 billion, an amount that would have been off by a factor of greater than ten.

It has been alleged that the lack of accurate public information about firms' exposures in the credit default swap market was a significant contributor to the financial crisis of 2008. Unless regulators maintain the public reporting of net open interest based on the entire market rather than various portions of it, that situation will continue and this particular contributing cause to the 2008 financial crisis will not have been adequately addressed.

The other circumstance in which the credit default swap market was viewed as contributing to the financial crisis of 2008 revolved around the large one-way trades put on by AIG in mortgage related credit derivatives. Those trades were not reported to the TIW at the time (they have since been backloaded to the TIW). Importantly, if AIG had chosen to try to hide these trades by reporting to multiple repositories, these systemically risky positions would not have been discovered absent a "super repository" that aggregated the trade level data of the various reporting repositories in a manner as to detect the large one-way aggregate positions.

Unless data fragmentation can be avoided, the primary lessons of the 2008 financial crisis, as related to OTC derivatives trading, will not have been realistically or adequately taken into account. Nevertheless, standardization is also necessary and a precondition to avoid fragmentation. Specific comments on standardization and related issues are set forth below.

Transaction ID and Unique Identification Code

A transaction ID would likely be essential to identify the trade to which Proposed Rules 901(d) and (e) data and any corrections relate. This can be achieved by consistent use of a common ID assigned by any party and mapping to other proprietary standards where appropriate. In the current TIW model, DTCC assigns a unique transaction ID, which is sent back by electronic message to submitting firms. This unique transaction ID or the firm's proprietary reference is used in subsequent submissions relating to that trade to TIW and is used by submitting firms in periodic full population reconciliation against TIW.

Transaction IDs would also likely be useful to counterparties, providing a shared identifier for both parties to the trades, which would serve to improve efficiency of any processes where mutual recognition is needed and where, otherwise, some level of bilateral reconciliation would be required before processing. This is particularly important in situations where the reporting party may change during the life of a contract. For example, upon trade assignment the reporting party may change, and the remaining party to the trade is in the best place to communicate with both the transferor and transferee in the trade. In addition, transaction IDs also may be of use to agents who act for one party in communicating with the other party.

SDRs can assign unique transaction IDs, as can other service providers. The SDR could provide the reference back to the reporting party as part of a message confirming first receipt of the submission. This is the current model with the TIW and DTCC recommends that this responsibility be retained, as opposed to transferring it to other providers (for example, SEFs). SDRs are better placed to establish consistent protocols to deal with these transformations without loss of relevant information for regulatory use. Keeping this responsibility with SDRs may also eliminate any unintentional disclosure issues which stem from linking a trade to a specific SEF, potentially increasing the instances of unintended identification of the trade parties. TIW currently assigns a DTCC TRI (transaction reference identifier), which is unique to each trade, and messages this back to both parties electronically.

UICs for both counterparties will be necessary for regulators to accurately track exposures between counterparties to SBSs – a primary driver for the creation of SDRs. Proposed Rule 906(a) would achieve the population of necessary UICs and would assist the SDR in fulfilling its obligation to confirm the submission with both parties. Ideally, this process would be supported electronically (*e.g.,* by electronic messaging to the parties, or by retrieving it from the SDR's website). In addition, use of third party services – for example, bilateral confirmation services – should meet this requirement.

A primary issue with UICs will be the initial issuance and adoption of UIC information, given that these may not be available from a standards body at the onset of reporting.

Financial Products Markup Language ("FpML") ™ is broadly used as a standard in the OTC derivatives markets and should be the basis for reporting to an SDR. At times, SDRs will need to develop their own FpML tags, as often product development is ahead of formal market FpML development, and SDRs should have the discretion to do so. However, SDR-unique FpML tags should be converted to the market standard FpML in a reasonable time period. FpML has good coverage of trade terms, but will need to be extended to cover some of the data elements required in Proposed Rule 901.

DTCC believes market standard forms of data should be used, rather than a newly created set of reference data codes. New codes will need ongoing maintenance and require that specific processes be developed for reporting purposes, likely resulting in poorer quality data submissions. Currently, Markit Reference Entity Database ("RED")™ codes are widely used in trade confirmations for credit derivatives, and Reuters Instrument Codes ("RIC") are used in electronic messages for equity derivatives. These are subject to licensed use. DTCC supports the ongoing usage of licensed codes (with the provision that these codes be made available to small volume players at appropriately reduced costs).

The alternative generally results in difficulties for the SDR. For example, DTCC must recognize a number of variations in the name of a reference entity in its public reporting, because without RED codes the description of the reference entity in submitted data can vary, even in relatively minor ways (*e.g.*, punctuation used in abbreviations). Such issues are difficult for an SDR to systemically resolve, as it requires correctly identifying cases of difference while correctly aggregating the cases of similarity. Finally, as with counterparties, it would be possible for the SDR to use market data vendors to map data into different formats without the need for imposition all data submissions.

Parent and Affiliate Information

Parent and affiliate information helps to illustrate the full group level exposures of firms and the impact of the failure of any participant. The SDR should have the power to obtain this information from firms. DTCC envisions that the SDR will likely look to a data vendor to provide this information, allowing market participants to review and approve such data. DTCC understands that data vendors specialize in this type of data service. Such vendors have suggested that often another market participant drives timely updates to the data, rather than the direct party impacted due to the many parties using the data. Therefore, use of such a vendor may improve the accuracy of data in the SDR.

Time Stamp

With respect to the additional requirements of SDRs, the SDR could readily time stamp information upon receipt. DTCC's TIW can support recording both message arrival time and processing times.

D. REPORTING OF DATA FOR HISTORICAL SBSS

The Commission proposes to limit the reporting of SBSs entered into prior to the date of enactment ("pre-enactment SBSs"). The rule permits further flexibility by requiring a reporting party to report this historical SBSs data only to the extent that such information is available.[14]

Historical SBS records should be included in the SDR to allow accurate exposure monitoring. For this purpose, only open contracts should be reported and only their current state should need to be reported, without additional information like execution time. (If information, such as execution time, is needed for a particular transaction, the relevant regulator could request such information from the relevant counterparties.) For trades that are in the TIW, for which the TIW record is the official legal record, this record could populate the SDR with all of the information required for the initial population.

IV. PUBLIC DISSEMINATION OF SECURITY-BASED SWAP TRANSACTION INFORMATION

The Proposed Regulations relating to the post-trade transparency of block trades take into account the possibility that public disclosure required under the Dodd-Frank Act could materially reduce market liquidity for SBSs of large notional size. The Proposed Regulations are designed to balance the benefits of post-trade transparency against the potential harm that could be done to market participants, with particular focus on fiduciary investment managers, who could face higher costs in transferring or hedging a

[14] *See id.* at 75,244.

large risk position after other market participants learn of the execution of a block trade.[15]

DTCC views the SDR role as supporting the reporting required by the Commission and would be happy to provide data under its existing framework for reporting to regulators to assist in studying issues of liquidity. DTCC has already published quarterly reports on liquidity and publishes weekly aggregate activity in the top 1,000 reference entities (top 1,000 by open interest).

A. Registered SDRs as Entities With Duty to Disseminate

The Dodd-Frank Act identifies four types of SBSs and requires real-time public reporting for such SBS transactions. In implementing the requirements of the Dodd-Frank Act, the Commission believes that the best approach is to require registered SDRs to disseminate SBS transaction information and to require other market participants to report such information to a registered SDR in real-time, so that the registered SDR can in turn provide transaction reports to the public in real-time. Under this approach, market participants and regulators will not have to obtain SBS market data from other potential sources of SBS transaction information – such as SEFs, clearing agencies, brokers or the counterparties themselves – to obtain a comprehensive view of the SBS market.[16]

SDRs should be able to disseminate data effectively and should be the sole source of data dissemination. Allowing other entities to disseminate data may add to the processes by which counterparties are required to submit data and further complicate the rules for market participants. If multiple disseminators are involved, it may be unclear to subscribers where data is duplicated in dissemination. In addition, the block trade rules require a full data set to determine the appropriate levels, requiring a means to obtain such data. Direct dissemination by SEFs will potentially achieve timely dissemination but may be localized and conflict with a SEFs own commercial interest in the data. Also, for SDRs to effectively consolidate the data, the rules must ensure that the SDR receives each instance of the record, from real-time reporting through confirmation, to ensure accuracy and validity of the data.

For real-time reporting, there must be consistent block trade definitions and thresholds across the entire market globally. These should be representative of the entire market and reflective of market depth and liquidity – rather than localized subsets, based on narrow reporting populations, such as those defined by components of market infrastructure, counterparty location or fragmentation of reported information by reporting of trade executions to multiple SDRs. A localized block trade definition will provide participants with a potential means to avoid or delay public dissemination. Therefore, the

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[15] *See id.* at 75,224.
[16] *See id.* at 75,227.

Commission needs to determine how to establish consistent block trade rules and thresholds across the market.

B. SBS INFORMATION THAT WILL NOT BE DISSEMINATED

Under the Commission's Proposed Regulations, a registered SDR will be prohibited from disseminating the identity of either counterparty to a SBS. A registered SDR is also prohibited from disseminating any information disclosing the business transactions and market positions of any person with respect to a SBS that is not cleared, but has been reported to that registered SDR. Finally, a registered SDR is prohibited from publicly disseminating any SBS information reported under the pre-enactment and transitional SBS rules.[17]

Currently, DTCC does not report credit default swap information beyond the top 1,000 names, because regulators and market participants have expressed concerns with respect to unintentional disclosure of parties as a result of low trading activity levels. Consistent with the Dodd-Frank Act, Proposed Rule 901(c) should not require SDRs to make disclosures that could cause the unintentional disclosure of counterparty information.[18] DTCC urges the Commission to consider this issue fully in determining the phase-in and scope of public dissemination.

C. OPERATING HOURS OF REGISTERED SDRS

The Proposed Rule will require a registered SDR to design its systems to allow for continuous receipt and dissemination of SBS data, except that a registered SDR will be permitted to establish "normal closing hours." Such normal closing hours may occur only when, in the estimation of the registered SDR, the U.S. markets and other major markets are inactive. In addition, a registered SDR will be permitted to declare, on an ad hoc basis, special closing hours to perform routine system maintenance, subject to certain requirements.[19]

DTCC believes that SDRs should operate 24/6, allowing for continuous access to data by regulators, including during period where individual exchanges or other trading platforms are closed. Requiring such operating hours recognizes the global nature of trading in derivatives markets and the round-the-clock participation in these markets by U.S. persons. One of the primary issues reporting to a repository is designed to address

[17] *See id.* at 75,234.

[18] "With respect to the rule providing for the public availability of transaction and pricing data for security-based swaps . . . , the rule promulgated by the Commission shall contain provisions . . . to ensure such information does not identify the participants." *See* Section 15(m)(1)(E) of the Exchange Act, 15. U.S.C. 78m(m)(1)(E).

[19] *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. at 75,235.

is the analysis of the consequential impact of the failure of an institution, an event not limited to U.S.-based standard hours.

V. Policies and Procedures of Registered SDRs

A registered SDR will be required to establish and maintain certain policies and procedures, which must: (1) enumerate the specific data elements of SBS or life cycle event that a reporting party must report; (2) specify one or more acceptable data formats, connectivity requirements, and other protocols for submitting information; (3) promptly correct information in its records discovered to be erroneous; (4) determine whether and how life cycle events and other SBSs that may not accurately reflect the market should be disseminated; (5) assign or obtain certain unique identifiers; (6) receive information concerning a participant's ultimate parent and affiliated entities; and (7) handle block trades. A registered SDR also will be required to make its policies and procedures required by proposed Regulation SBSR publicly available on its website.[20]

A registered SDR should have flexibility to specify acceptable data formats, connectivity requirements and other protocols for submitting information. Market practice, including structure of confirmation messages and detail of economic fields, evolve over time, and the SDR should have the capability to adopt and set new formats. In addition, the SDR will need to support an appropriate set of connectivity methods; the Commission should not, however, require SDRs to support all connectivity methods, as the costs to do so would be prohibitive.

The data formats of the SDR should be publicly available, and the SDR should publish Application Program Interfaces ("APIs") to permit direct submission by reporting parties and their agents (with appropriate validations by the SDR). The SDR is well positioned to establish standards for certain reporting attributes where these are not defined elsewhere.

With respect to policies concerning dissemination, all price forming events should be disseminated. For portfolio compression activities, which in most cases are risk neutral, an exact pricing at individual trade level between parties is not meaningful and, therefore, these transactions should not be disseminated. Normal terminations should be fully price-forming and reported. Further, the SDR should not have discretion to determine public dissemination of real-time price activity, as it is unlikely that the SDR will have sufficient information from Proposed Rule 901(c) to make such a determination.

[20] *See id.* at 75,236.

VI. JURISDICTIONAL MATTERS

This rule is designed to clarify the application of proposed Regulation SBSR to cross-border SBS transactions and to non-U.S. persons.

A. WHEN IS A SBS SUBJECT TO REGULATION SBSR?

The Proposed Regulation requires a SBS to be reported if the SBS: (1) has at least one counterparty that is a U.S. person; (2) was executed in the United States or through any means of interstate commerce; or (3) was cleared through a registered clearing agency having its principal place of business in the United States. In addition, any SBS that is required to be reported to a registered SDR will also be required to be publicly disseminated by the registered SDR.[21] A SBS will have to be reported pursuant to proposed Regulation SBSR – even if both counterparties are not U.S. persons – if the SBS was transacted in the U.S. or cleared through a clearing agency having its principal place of business in the United States.

It is DTCC's understanding that U.S. Persons may be restricted from complying with Proposed Rule SBSR where they act outside the U.S. For example, DTCC understands that the London branch of a U.S Person will require their counterparty's consent to identify that party under U.K. law. This consent could be obtained through terms of business between the parties, but in many cases may have already been obtained by service offerings that may connect to an SDR, such as the trade confirmation process. The value of these service offerings can be further illustrated by considering a parallel example executed by a Paris branch, where DTCC understands that, under French law, consent is required each time a report is made identifying the counterparty and, therefore, cannot be resolved by changes to the firm's terms of business. Again, confirmation service providers have resolved this issue through bilateral submission of confirmations. (These issues relate to the location of trading and, therefore, apply equally to any non-U.S dealer wanting to report on behalf of its U.S. customers.) DTCC's experience indicates that there is public interest in net open position and level of trading activity in underlyings. In addition, the OTC Derivatives Regulators' Forum ("ODRF") has provided guidance indicating that regulators should receive information according to regulatory responsibilities. This information is expected to vary by regulator type. For example, central banks may receive information, including aggregate market information and more detailed information on large financial institutions in their jurisdiction, whereas markets regulators may receive information on trades conducted by parties in their jurisdiction and trades written on underlyings for which they have a regulatory responsibility.

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[21] *See id.* at 75,239.

B. WHEN IS A COUNTERPARTY TO A SBS SUBJECT TO REGULATION SBSR?

The Proposed Regulation provides that, notwithstanding any other provision of Regulation SBSR, no counterparty to a SBS will incur any obligation under Regulation SBSR unless it is: (1) a U.S. person; (2) a counterparty to a SBS executed in the United States or through any means of interstate commerce; or (3) a counterparty to a SBS cleared through a clearing agency having its principal place of business in the United States. The Commission preliminarily believes that, if a U.S. person executes a SBS anywhere in the world, that U.S. person should become subject to Regulation SBSR.

Aggregate Data

Proposed Rule 908 is a positive recognition of the international complexities of SDRs. DTCC believes there is strong desire amongst regulators for relatively few SDRs providing largely global data. Without this, the value of the introduction of trade repositories is considerably reduced, becoming more like the existing regulatory regime. At present, regulators can access the data of their regulatees, but otherwise have to form colleges or access data under MoUs. Additionally, regulators must perform their own aggregation of the resultant data, being careful to avoid double counting of trades where the data does not relate to a regulatee. This aggregation is not simple to perform accurately, as different jurisdictions will define reportable trade populations differently and require different timing for reporting. As a result, in the absence of global or aggregate solutions, the burden of accurate aggregation will fall on each interested regulator.

Each of the key events in the financial crisis which led to the call for OTC derivatives trade repositories suggests the need for global aggregate data: (i) the assessment of the impact of a financial institution's failure on other institutions requires immediate availability of full global exposures; (ii) the identification of a participant with large exposures in a particular market requires accurate aggregation of all exposures in that market; and (iii) the evaluation of the impact of derivatives market activity to the pricing of government debt requires cross jurisdictional data aggregates.

DTCC believes that, of the data that it publishes each week, the two key data sets are the reporting of net open interest for a reference entity and the trading activity for a reference entity. This data, particularly the net open interest, is very difficult to replicate from fragmented data sets, making the issue of fragmentation, both domestically and internationally, of significant concern.

Proposed Rule 908 recognizes the scope of application and goes some way to address sensitivity to unequal access rights to data in SDRs between regulators. This concern was reflected in the guidance ODRF agreed upon amongst its 43 members and gave to TIW. This guidance included the guiding principle that "the scope of data access should be comparable for similarly situated authorities…..The primary regulator would not generally access participant specific data for trades where both counterparties are outside of its supervisory jurisdiction." The provision could be strengthened by limiting direct access by the Commission to trades within Proposed Rules 908(a)(1)-(3) and removal of indemnification requirements for those trades within the direct ambit of the requesting regulator.

Not addressing this issue will lead to further fragmentation of data and the loss of key information, such as net open interest, to the market. DTCC notes that in addressing these issues and in considering deferral of the implementation timeline described below, there will be a reduction in time lag between implementation in various jurisdictions given that reporting OTC derivatives to a repository is a G20 commitment. This will also reduce the possibility for regulatory arbitrage.

VII. Fair and Non-Discriminatory Access to SBS Market Data

Currently, TIW provides public data at no charge. DTCC envisions this continuing for both the weekly and periodic reporting available at www.dtcc.com and any real-time price reporting required by the Proposed Regulations. TIW considers the data reported to it through agreement with supervisors (and pursuant to regulation, after implementation of Regulation SBRS) to be that of the market participants, not TIW's own, and provides additional services only as approved by its user board of directors, or where contractually required, to the individual customers themselves. It is good public policy that the aggregating entity not itself use the data for commercial purposes, particularly where data is required to be reported to an aggregator serving a regulatory purpose, and make such data available to value added providers on a non-discriminatory basis, consistent with restrictions placed on the data by the data contributors themselves. DTCC operates the TIW on an at-cost basis and believes this is an appropriate model for the operation of an SDR given the central role SDRs play in supporting regulator surveillance generally.

VIII. Implementation Timeframes

The Commission is proposing a phased-in compliance schedule, with respect to an SDR that registers with the Commission, as follows:[22]

- **Reporting of pre-enactment SBSs, no later than January 12, 2012:** The Proposed Rule will require reporting parties to report to an SDR any pre-enactment SBSs subject to the reporting rules no later than January 12, 2012 (180 days after the effective date of the Dodd-Frank Act). The Proposed Rule defines pre-enactment SBS to mean any SBS executed before July 21, 2010 (the date of enactment of the Dodd-Frank Act), the terms of which had not expired as of that date.

[22] *See id.* at 75,242.

- **Phase 1, six months after the registration date (i.e., the effective reporting date):** Reporting parties will begin reporting all SBS transactions executed on or after the effective reporting date; reporting parties also will report to the registered SDR any transitional SBSs

- **Phase 2, nine months after the registration date:** Wave 1 of public dissemination; registered SDRs must comply with Proposed Rules 902 and 905 (with respect to dissemination of corrected transaction reports) for 50 SBS instruments.

- **Phase 3, twelve months after the registration date:** Wave 2 of public dissemination; registered SDRs must comply with Proposed Rules 902 and 905 (with respect to dissemination of corrected transaction reports) for an additional 200 SBS instruments.

- **Phase 4, eighteen months after the registration date:** Wave 3 of public dissemination; all SBSs reported to registered SDRs will be subject to real-time public dissemination.

Deferral

DTCC believes the current schedule is aggressive, primarily because of the time necessary to promulgate final rules. Since final rules will not likely be available until Q2 2011, SDRs that apply for registration in July 2011 will do so largely having developed functionality based on the Proposed Rule, with a view to broad compliance as the priority over efficient usage and, therefore, with a potentially sub-optimal burden on reporting parties. Based on the final rules, SDRs and third party service providers will further enhance their offering. However, due to the complexity of and the precision demanded from the processes involved, a relatively long lead time should be expected – for example, a minimum of six-months. A six month period seems appropriate, since systems typically require extensive periods for the creation of functional specifications (usually 4 weeks or more), technical specifications (also typically 4 weeks or more), actual development (8-10 weeks or more), regression testing (4-6 weeks), and user acceptance testing (generally 6-8 weeks or more) – that is, cumulatively, 26-32 weeks.

Further, given this implementation would have to be market-wide, market-wide testing periods and design periods are likely to be even longer than these estimates, as market-wide initiatives need wide co-ordination. In that regard, DTCC notes that when it developed the TIW, in conjunction with market participants and the ODSG, systemic risk considerations dictated that it be implemented in phases:

- Year 1, design and build basic trade loading and storage capacity, with particular focus on data quality and inventory control. At the end of Year 1 all electronically confirmed new trades were automatically maintained in the Warehouse. To coordinate this effort across the industry globally, one of the "big 4" accounting firms was engaged and expended considerable resources.

- Year 2, back load all legacy inter-dealer transactions and implementation of automated payment calculation and central settlement through CLS bank. The back loading effort itself was a separately managed effort lead by the "big 4" accounting firm, which remained as program coordinator for the overall effort. Design of life-cycle event processing agreed.

- Year 3, back load dealer-to-customer trades, begin reporting of non-electronically confirmed trades and central processing of life-cycle events.

While much of this infrastructure can form the core of the processes required by the Proposed Regulation, it is inevitable that substantial new industry-wide processes will have to be implemented, particularly (though not exclusively) around real-time reporting. These new processes will take substantial coordination, testing and development, as noted above, and this will ultimately depend on the adoption of the final rule.

Reporting parties' development would have to follow the publication of final specifications by the SDR and ideally that of third party vendors. These dependencies make it unlikely that the first reporting could be implemented much before an April 1, 2012 implementation date; April 1 would still be an early target, but DTCC believes it could be a realistic date for the first reporting, with July 1, 2012 more suitable for mandatory market-wide adoption. Imposing an earlier deadline may lead reporting parties to have to develop solutions ahead of this, which may later be replaced by enhanced functionality at the SDR or third party vendors. In addition, credit products are more reporting-ready than equities products, because credit products' current operational processes show higher levels of automation.

The phasing proposals for public dissemination limits the initial information in the public domain to the most traded contracts, which may enable a better understanding of the impact of public dissemination of less liquid contracts. However, this does not serve as a mitigant for delivery risk for the reporting processes, as all processes have to be fully functional for the first reporting period. From a market integrity perspective, the waves of public dissemination may be too expeditious to fully assess impact of dissemination on the market.

IX. GENERAL REQUEST FOR COMMENT

The CFTC is adopting rules related to the reporting of swaps and the public dissemination of swap transaction, pricing, and volume data, as required under Sections 723, 727, and 729 of the Dodd-Frank Act. Understanding that the Commission and the CFTC regulate different products and markets and, as such, appropriately may be proposing alternative regulatory requirements, the Commission requests comment on the impact of any differences between the Commission and CFTC approaches to the regulation of the reporting of swaps and SBSs and the public dissemination of swap and SBS transaction, pricing, and volume information. Further, the Commission requests comment generally on the impact of any differences between the Commission's proposed approach to the reporting and public dissemination of SBSs and that of any relevant foreign jurisdictions.[23]

Harmonization

Currently, the reporting requirements between the CFTC and the Commission differ with respect to some key process steps. Specifically, the CFTC proposes to require some verification of trade data prior to submission of additional data, whereas the Commission does not. While the CFTC proposes to require the SEF and clearing agency to perform certain reporting tasks, the Commission's proposal retains a single reporting party for a trade. Additionally, the CFTC's proposal calls for valuation data, confirmation data and contract intrinsic data for credit and equities products.

To illustrate the narrow distinction between swaps and SBS, consider the possibility of certain equity basket trades moving between narrow and broad based index intra-day, with stock price movements changing the constituent weightings under the current definition of broad and narrow (*e.g.,* when the determinant of narrow is that five securities comprise more than 60% of the weighting). It would be beneficial to treat all credit and equity trades in a single process, utilizing the same reporting party and SDR, with all data available to the appropriate regulator, without building routines in reporting to test for market pricing, which may be required to determine index weightings, particularly when there are continuous price changes to the components.

DTCC believes these differences are meaningful enough to add complexity into the reporting processes and lead to omission or erroneous reporting, although there is a common goal in both processes with minimal differences. Where DTCC has made process recommendations that, in its view, will most likely achieve the shared policy goals, DTCC advocates that both the SEC and CFTC adopt these recommendations. With respect to differences between the SEC and CFTC's proposed rules regarding reporting and dissemination responsibilities, DTCC would expect certain third parties to report to the SDR, as they do to the TIW today, and foresees reporting by SEFs, clearing agents and portfolio compression services directly to the SDR. However, DTCC supports leaving ultimate responsibility for these arrangements with the reporting counterparty, who remains fully accountable for the representation of the trade in the SDR.

[23] *See id.* at 75,246.

X. COST-BENEFIT CONSIDERATIONS

TIW has approximately 1,700 customers, operating 17,000+ accounts for the global CDS market. Well over half of these are located in the U.S. and regularly transact business through dealers who are not U.S. persons. Unless the Commission encourages arrangements through which dealers who are non-U.S. persons can act as submitting parties for their U.S. customers, the costs of implementation are likely to impose significant burdens and costs on U.S. money managers, which are, in turn, likely to be passed through to U.S. consumers, such as individual investors, pension funds and state and local governments.

DTCC believes the current TIW model is efficient because it reuses data from the confirmation process, it ensures the quality of that data by performing asset servicing on the data and its users have agreed that the record in TIW has legally binding status. The asset servicing and legal status ensures that customers actively reconcile their internal data to TIW's data on an ongoing basis. This process occurs in place of multiple bilateral portfolio and trade level reconciliations and creates a more efficient model. In addition, for market events and updates, TIW has the benefit of multiple participants reviewing the calculations performed by DTCC processes, and the users appoint third party data servicers to act on their behalf while they retain the responsibility to maintain the most up-to-date record of the trade in TIW. This approach strengthens the quality of data in the TIW, but would not be available to a stand-alone, reporting-only solution.

CONCLUSION

We appreciate the opportunity to comment on the Commission's Proposed Rule and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

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Via Agency Website & Courier

January 20, 2011

Mr. Alastair Fitzpayne
Deputy Chief of Staff and Executive Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Financial Stability Oversight Council Advance Notice of Proposed Rulemaking Authority to Designate Financial Market Utilities as Systemically Important

Dear Mr. Fitzpayne:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Financial Stability Oversight Council (the "Council") on the Advance Notice of Proposed Rulemaking ("ANPR") issued by the Council regarding its authority to designate a Financial Market Utility (an "FMU") as systemically important.[1]

DTCC, through its subsidiaries, provides clearing, settlement, and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives. In particular, DTCC owns and operates three U.S. registered clearing agencies, The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"), and also The Warehouse Trust Company LLC, a centralized global electronic database for position data on credit default swap contracts outstanding in the marketplace.

Based upon this unique market perspective, DTCC supports the enhancements to regulation and supervision of all systemically important FMUs contemplated by Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), recognizes that identification of systemically important FMUs is a vital first step in that process,[2] and is

[1] *See* Financial Stability Oversight Council Authority to Designate Financial Market Utilities as Systemically Important, 75 Fed. Reg. 79, 982 (December 21, 2010).

[2] Section 803(6) of the Dodd-Frank Act defines "financial market utility" to mean "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."

supportive of the Council's careful deliberations regarding the designation of systemically important FMUs.

When making these important designations, the Council should consider not only the quantitative and qualitative information about particular FMUs in its deliberations, but also ensure that the designation of certain entities as systemically important operates to establish consistency in oversight and regulation of FMUs so that the legislative intent of Title VIII is fulfilled by the Council's designations.

OVERVIEW OF DTCC

For more than four decades, DTCC and its subsidiaries have helped automate, centralize, standardize and streamline the processes that are critical to the safety and soundness of the capital markets. DTCC has long been in the business of managing risk on behalf of the industry – and views it as a core competency. That role has never been more important and more central to DTCC's mission or the industry than it is today.

DTCC was established in 1999 as a market-neutral, user-owned and governed holding company for DTC and NSCC. DTCC later brought in and consolidated two additional registered clearing agencies for fixed income securities, Government Securities Clearing Corporation and MBS Clearing Corporation which now operate as divisions of FICC.

DTC provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. NSCC provides clearing, risk management, central counter-party services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counter-party services for U.S. Treasury and Agency securities in the mortgage backed and government securities markets. Through these subsidiaries, DTCC cleared and settled more than $1.48 quadrillion in securities transactions in 2009. DTCC is user-owned and governed and operates on an at-cost basis, with a fee structure based on cost recovery.

PRINCIPLES TO CONSIDER IN MAKING SYSTEMICALLY IMPORTANT DESIGNATION

Section 802 of the Dodd-Frank Act sets forth the purpose of Title VIII, which is "to mitigate systemic risk in the financial system and promote financial stability" by providing the Board of Governors of the Federal Reserve (the "Board") with additional powers. Specifically, Section 802 authorizes the Board to promote uniform standards for risk management and conduct and provides the Board with an enhanced supervisory role for systemically important utilities. Those FMUs that are designated as systemically significant will be subject to additional supervision and requirements to comply with newly adopted risk management and conduct standards. For example, Section 805 authorizes the Commodity Futures Trading Commission and the Securities Exchange Commission to prescribe regulations containing risk management standards governing the operations of designated clearing entities.

Section 803(9) of the Dodd-Frank Act defines the term "systemically important" as a "situation where the failure of or disruption of a financial market utility or the conduct of a payment, clearing, or settlement activity could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States." To identify systemic importance, the statute sets forth certain enumerated factors that the Council must consider. These factors include the monetary value of transactions processed; exposure to counterparties; the relationship, interdependencies, or other interactions of the FMUs or payment clearing or settlement activity with other FMUs; and the effect that the failure of or disruption to the FMU would have on critical markets, financial institutions, or the broader financial system.[3]

DTCC recognizes that identifying how large or how interconnected an FMU must be to be systemically important is a difficult task in which judgment must be brought to bear, based on prior experience and market insight. Because it may be difficult in advance to discern bright line criteria, and there is not always a necessary correlation between size and risk, DTCC suggests that the Council focus instead on the function of the FMU in its market and the particular market or markets the FMU serves. The Council should be sensitive in its designations of FMUs so as not to create competitive advantages or disadvantages.

As noted above, Title VIII provides that all designated FMUs will be subject to uniform standards for risk management and enhanced supervision by the Board. DTCC strongly supports efforts to create uniform and effective standards for the management of risks for systemically important FMUs and recognizes that the imposition of these standards on FMUs will be significant to the business models adopted by designated FMUs.

It is critical that all FMUs serving the same participants, markets or instruments (i.e., all FMUs within the same class) should be subject to the same rules, without exception. Consistency in standards is one of the stated purposes of Title VIII and the Council's determinations should serve that purpose. Failure to achieve consistency could result in a "race to the bottom" if some competing FMUs of the same class are allowed to serve the same function without being subject to the rigorous oversight contemplated by Title VIII. As the Council considers which FMUs to designate as systemically important, it should be guided by the principle that, by such designation of an FMU, it does not afford a competitive advantage to other FMUs that serve the same function or market and are not so designated.

[3] *See* Section 804 (a) (2) of the Dodd-Frank Act.

CONCLUSION

We appreciate the opportunity to comment on the Council's ANPR and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

Larry E. Thompson
General Counsel

cc: Timothy F. Geithner, Secretary of the Treasury and Chairperson of the Financial Stability Oversight Council
Sheila Bair, Chairperson, Federal Deposit Insurance Corporation
Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System
Edward DeMarco, Acting Director, Federal Housing Finance Agency
Gary Gensler, Chairman, Commodity Futures Trading Commission
Debbie Matz, Chairman, National Credit Union Administration
Mary Schapiro, Chairman, Securities and Exchange Commission
John Walsh, Acting Comptroller of the Currency
William Haraf, Commissioner, California Department of Financial Institutions
John Huff, Director, Missouri Department of Insurance, Financial Institutions, and Professional Registration
David Massey, Deputy Securities Administrator, North Carolina Department of the Secretary of State, Securities Division

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Via Agency Website & Courier

January 24, 2011

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549–1090

RE: Security-Based Swap Data Repository Registration, Duties, and Core Principles RIN 3235–AK79, File No. S7-53-10

Dear Ms. Murphy:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or the "Commission") on its proposed new rules under the Securities Exchange Act of 1934 ("Exchange Act") governing the security-based swap data repository ("SDR") registration process, duties, and core principles (the "Proposed Rule" or "Proposed Regulation").[1] Imposing requirements on security-based swap data repositories would promote safety and soundness for all U.S. markets by bringing increased transparency and oversight to over-the-counter ("OTC") security-based swap ("SBS") markets, an important component of the reforms sought by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2]

Summary of Response

DTCC supports the Commission's efforts to establish a comprehensive new framework for the regulation of SBSs, including the implementation of registration, duties, and core principles for SDRs. Key points from DTCC's response are highlighted below.

All SBSs, whether cleared or uncleared, must, by statute, be reported to swap data repositories.[3] The primary purposes of this mandate are to provide regulators with complete transparency into the previously unregulated SBS markets and to assure public dissemination of SBS information as required by statute or as determined by regulators

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[1] *See* Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. 77,306 (December 10, 2010).

[2] Public Law 111–203, 124 Stat. 1376 (2010).

[3] *See* Exchange Act Section 13(m)(1)(G) ("Each security-based swap (whether cleared or uncleared) shall be reported to a registered security-based swap data repository.").

Subsidiaries:
The Depository Trust Company
National Securities Clearing Corporation
Fixed Income Clearing Corporation

to be otherwise necessary for efficient and fair functioning of markets (subject to confidentiality considerations set forth in the Dodd-Frank Act and applicable regulations). These requirements make SDRs unique among the various parts of the market infrastructure for SBSs contemplated by the Dodd-Frank Act, in that all counterparties to all SBS transactions will have the details of each of their transactions reported to an SDR.

The mandatory reporting regime creates an opportunity for the SDR to improperly commercialize the information it receives. It is important that regulators ensure that the public utility function of SDRs, which operate as aggregators and collectors of swap and SBS data to support regulatory oversight and supervisory functions, as well as regulator-mandated public reporting, is separated from potential commercial uses of the data. The principle of user control over the data for non-regulatory purposes must also be scrupulously maintained, and care should be taken to assure that SDRs maintain an arms-length and non-discriminatory relationship with other parts of the market infrastructure (i.e., clearing, confirmation, and execution facilities) and that these other parts of the infrastructure maintain similar relationships with SDRs. It is important, however, that SDRs themselves be allowed to enter into partnerships or coordinated programs in order to better provide aggregate views of data to regulators, to better assure that global regulatory requirements are met, or to promote other public purposes.

Related specific points deserving of more detailed consideration include:

- In order to assure that non-regulatory uses of mandatorily reported data remain in the hands of the counterparties, SDRs should be, broadly speaking, "user-governed." This should include a board of directors that is broadly representative of market participants and that incorporates voting safeguards designed to prevent non-regulatory uses of data of a particular class of market participants that are objectionable to that class. In addition, no communication of data (other than to, or as required by, applicable regulators) that could have the result of disclosing the actual positions or specific business or trading activity of a counterparty should be permitted without the consent of that counterparty.

- SDRs should not engage in the commercialization of data reported to them and should demonstrate strict impartiality in making data available to, or receiving data from, other providers, including affiliates of SDRs. This is best achieved by following objective, public standards and by assuring that dealings with affiliates (other than cooperating regulated repositories) and competitors of affiliates be subject to oversight by members of the SDR's board of directors who are not engaged in the governance or oversight of either the affiliates or their competitors. These same objective standards should be used for other providers, such as clearing, confirmation, and execution providers, in their dealings with SDRs.

- SDR fee structures should reflect an at-cost operating budget. Further, since even smaller, non-reporting counterparties will legitimately want to interact with SDRs, if only to verify what has been reported, SDRs should have the flexibility to facilitate such access by not charging, or charging only nominal amounts, for such interaction.

Additional points discussed by DTCC include the following:

- DTCC relies upon the direction provided by the OTC Derivatives Regulators' Forum ("ODRF"), whose membership includes the SEC and the Commodity Futures Trading Commission ("CFTC"). DTCC's Trade Information Warehouse (the "Warehouse" or "TIW") has followed the ODRF's guidance, recognizing that broad agreement among global regulators is difficult to achieve. DTCC is committed to complying with the policies adopted by the regulators and working with the Commission in this regard. DTCC urges the SEC, in its regulation of SDRs, to aim for regulatory comity both as it has already been agreed to by the ODRF and as it may be further agreed to by such other international bodies as the Committee on Payment and Settlement Systems ("CPSS") and the International Organization of Securities Commission ("IOSCO").

- DTCC supports the Commission in requiring robust operational capabilities of an SDR, and specifically recommends that SDR infrastructure should operate on a 24/6 basis, given the global nature of where these products are traded. SDRs should also process transactions in real-time and maintain multiple levels of operational redundancy. Given the importance of SDRs to the regulatory and systemic risk oversight of the financial markets and the important role they will play in providing market transparency, a lack of robust resiliency and redundancy in operations should disqualify an entity from registering as an SDR. Also paramount to service provision is a strong ability to maintain information security. Assessment of these core capabilities should form part of any registration process, including a temporary registration process.

- DTCC recommends that appropriate transitional arrangements be made to avoid market disruption by the implementation of the Proposed Rule. The TIW is a centralized global repository for trade reporting and post-trade processing of OTC credit derivatives contracts, operated by DTCC's wholly-owned subsidiary, The Warehouse Trust Company LLC. The TIW is an integral part of the credit default swap ("CDS") market. Restrictions to its operation could introduce significant operational risks to market participants. DTCC recommends that the final rules be subject to a phase-in period to allow an adequate period for existing service providers like the TIW to make necessary changes to their service offerings. In the alternative, DTCC requests the Commission provide specific transitional arrangements for existing infrastructures.

- To avoid creating conflicts between standards, as well as unnecessary costs, the Commission and the CFTC should harmonize the regimes that oversee SDRs. DTCC believes that harmonization is a more important priority than the exact nature of the consistent standard, as SDRs can adjust to meet a single standard but not multiple, inconsistent standards. The CFTC, in its proposed rule related to swap data recordkeeping and reporting requirements,[4] has specifically taken the position that life cycle event processing and legal recordkeeping services are "ancillary" services and not part of core SDR functions.[5] DTCC agrees with the CFTC that these services, which are valuable to market participants and provide a vital function, do not necessarily need to be considered as part of the core role to be performed by an SDR.

DTCC also makes a number of detailed observations addressing specific points and the questions posed in the Proposed Rule. These comments are preceded by a brief overview of DTCC and the Warehouse.

Overview of DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities transactions, money market instruments and OTC derivatives. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing agency for derivatives. However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC")[6], which has applied to the CFTC for an order granting registration as a Derivatives Clearing Organization ("DCO").

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Exchange Act, subject to regulation by the Commission. These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

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[4] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574 (December 8, 2010).

[5] *See id.* at 76, 592 fn. 67. ("The Commission does not believe that Dodd-Frank precludes an SDR from accepting and maintaining swap data from both counterparties to a swap. For example, an SDR or its affiliate performing the ancillary service of maintaining the single binding legal record of a swap, such as the ''gold'' record maintained by the Depository Trust & Clearing Corporation (''DTCC'') for credit swaps, would not be barred from receiving dual reporting in that connection.").

[6] NYSE Euronext owns the other 50% equity interest. Neither DTCC nor NYSE owns a majority of the equity interests in NYPC. NYPC will have its own management team which will control the day to day operations of the company.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. Through its subsidiaries, DTCC processes huge volumes of transactions – more than 30 billion a year – on an at-cost basis. For example, in 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, (for some securities) central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets.

Overview of the Trade Information Warehouse

In November 2006, at the initiative of swap market participants, DTCC launched the Warehouse to operate and maintain the centralized global electronic database for virtually all position data on CDS contracts outstanding in the marketplace. As the life cycle for CDS contracts may extend five years or more, in 2007, DTCC "back-loaded" records in the Warehouse to incorporate information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 implementation date. Today, data for over 95 percent of all OTC credit derivatives are captured in this automated environment. The Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of $29 trillion ($25.3 trillion electronically confirmed "gold" records and $3.7 trillion paper-confirmed "copper" records).[7]

In addition to repository services, such as those activities contemplated by the Proposed Rule (*e.g.*, the acceptance and public and regulatory dissemination of data reported by reporting counterparties), the Warehouse provides both legal recordkeeping and central life cycle event processing for all swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details for both cleared and bilaterally-executed CDS transactions in its "gold" records, which are the official and legal records of those transactions. The repository also stores key information on other CDS transactions, those involving market participants' single-sided, non-legally binding or "copper" records, helping regulators and market participants gain a clearer and more complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

DTCC's Warehouse was the first and remains the only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. As various events occur regarding CDS contracts, such as calculating payments and bilateral netting, settling payments, credit events, early termination and company renames and reorganizations, DTCC's Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these

[7] Data provided as of December 31, 2010. For more information about the Trade Information Warehouse, please see http://www.dtcc.com/products/derivserv/suite/ps_index.php.

functions by the Warehouse distinguishes it from any SDR that merely accepts and stores swap data information.

General Discussion of the Proposed Rule

Proposed Rules 13n–1 to 13n–11 under the Exchange Act govern the SDR registration process, duties, and core principles, including duties related to data maintenance and access by relevant authorities and those seeking to use the SDR's repository services. The Proposed Rule would require SBS transaction information to be: (1) provided to SDRs in accordance with uniform data standards; (2) verified and maintained by SDRs, which serve as secure, centralized recordkeeping facilities that are accessible by relevant authorities; and (3) publicly disseminated in a timely fashion by SDRs.[8]

DTCC requests that the Commission provide clear guidance as to the scope of the entities covered within the definition of SDR in the Dodd-Frank Act. The statutory duties required of an SDR are extensive and can form a business in their own right. The requirements of an SDR should not be imposed upon service providers looking to provide targeted solutions to specific processes, as opposed to providers looking more broadly to fulfill the role of an SDR. All third party service providers have to perform a level of recordkeeping and often retain data previously submitted by customers to offer services efficiently. This should not transform them into an SDR unless there is a corresponding policy reason for doing so. In fact, there is a strong policy reason to exclude them, the goal of countering the risk of fragmentation in data collection and dissemination on a global basis.

The CFTC, in its proposed rule related to swap data recordkeeping and reporting requirements,[9] has specifically taken the position that life cycle event processing and legal recordkeeping services are "ancillary" services and not part of core SDR functions.[10] DTCC agrees with the CFTC that these services, which are valuable to market participants and provide a vital function, should not necessarily be considered part of the core role to be performed by an SDR.

The Commission's proposed required practices are generally consistent with those of the Warehouse. The Warehouse currently receives event-based records and, based upon those records, maintains positions and publishes CDS market data. It also currently makes data available to regulators upon request. To date, the Warehouse has received SBS data on a service-based basis, rather than due to a regulatory mandate, offering its

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[8] *See* Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. at 77,307.

[9] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,574.

[10] *See id.* at 76, 592 fn. 67. ("The Commission does not believe that Dodd-Frank precludes an SDR from accepting and maintaining swap data from both counterparties to a swap. For example, an SDR or its affiliate performing the ancillary service of maintaining the single binding legal record of a swap, such as the ''gold'' record maintained by the Depository Trust & Clearing Corporation (''DTCC'') for credit swaps, would not be barred from receiving dual reporting in that connection.").

customers legal record-keeping, position updates, and life cycle event services (such as messaging and updating for successor and credit events, payment amount determination, and net settlement calculations and processing). The Warehouse continues to benefit customers by providing a single operational process and single platform for reconciliation for customers, rather than providing merely separate series of bilateral event, settlement, trade, and portfolio processes and reconciliations. The Warehouse does not currently perform real-time price dissemination activities, nor does it obtain certain trade attributes requested by the Commission in Proposed Rule SBSR.[11] These processes would need to be adjusted to support these functions. The existing TIW regulatory reporting process provides direct access for relevant regulators to information in the furtherance of their regulatory responsibilities, including a number of standard reports recommended by the ODRF. These processes, which have been extensively relied upon by regulators, would also need to be modified in light of the Proposed Rule.

The Warehouse keeps records of SBS transactions in electronic format. These records are updated to reflect life cycle events and preserve a complete audit trail. Certain repositories, including DTCC's OTC equity derivatives repository, take only a periodic upload of open position data in electronic form, and would be required to undergo extensive changes to comply with the Proposed Rule.

The Proposed Rule should require the retention of electronic records of transactions, including life cycle events. These should be maintained for the life of the contract in order to provide an audit trail to positions and for a reasonable retention period thereafter. An SDR's records should be in an electronically readable format (where available) that allows for application and analysis. SBS transaction data retained as electronic images of paper documents is cumbersome and will frustrate regulatory oversight efforts.

The SDR's documents should be relied upon by regulators to complement the records retained by SBS counterparties and should not be seen as a replacement for SBS counterparty record retention requirements. Further, certain aggregate data should be maintained beyond the maturity of contracts to provide public availability of time series data. With respect to an industry standard format for SBS information and records, definitions and standards published by the International Swaps and Derivative Association ("ISDA") are widely accepted by the industry and relied upon by market participants.

Further, the Proposed Rule may have the consequence of unintentionally disclosing participant identity, by overly detailed public dissemination, due to the low volume of activity in certain instruments. The possibility of inadvertent disclosure should be considered in conjunction with the execution model, for example information transferred in a request-for-quote process could be linked to actual executions published by the SDR.

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[11] *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208 (December 2, 2010).

There appear to be relatively narrow differences between the Commission and the CFTC's approaches to the regulation of SDRs. However, because SDRs will operate in both the swaps and SBS markets, particularly in equities and credit asset classes, SDRs are likely to register with both the Commission and the CFTC. For that reason, it is vitally important that there not be any conflict in regulatory regimes between the two agencies. DTCC believes that harmonization is a more important priority than the exact nature of the consistent standard, as SDRs can adjust to meet a single standard but not multiple, inconsistent standards.

In determining whether an entity decides to operate an SDR, it must consider its corporate strategy and positioning. Generally, entities best positioned to operate an SDR are financial market utilities that can provide a broad utility service to the market, data companies who seek to enhance commercial data services, or commercial market infrastructure providers seeking to capture flow and increase barriers to entry for their competitors.

Likely investors in or providers of capital for new SDRs must be aware of the uncertainty of market share or volume of SBS transaction processing for a new SDR in contrast with the certain significant investment necessary to establish the robust and detailed technological systems required for the operation of a successful SDR.

Finally, DTCC believes that there is a significant advantage to the market if SDRs are required to provide basic services on an at-cost or utility model basis, as it avoids the potential abuse or conflict of interest related to a relatively small number of service providers in the SDR industry.

Registration of SDRs

Proposed New Form SDR

The Commission is proposing Rule 13n–1, which establishes the procedures by which an SDR may apply to the Commission for registration.[12] The Proposed Rule requires that the application for registration be filed electronically in a tagged data format on proposed new Form SDR.[13] The information provided on Form SDR would enable the Commission to determine whether to grant or deny an application for registration. Form SDR would require an SDR to indicate the purpose for which it is submitting the form (*i.e.*, application for registration, amendment to an application, or amendment to an effective registration) and provide information in seven categories: (1) general information, (2) business organization, (3) financial information, (4) operational capability, (5) access to services and data, (6) other policies and procedures, and (7) legal opinion.[14]

[12] *See* Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. at 77,366.

[13] *See id.*

[14] *See id.* at 77,310.

If the applicant is a non-resident SDR, then the signer of Form SDR would also be required to certify that the SDR can, as a matter of law, provide the Commission with prompt access to the SDR's books and records and that the SDR can, as a matter of law, submit to onsite inspection and examination by the Commission.[15]

With respect to operational capabilities, it is essential that proposed Form SDR request information related to the SDR's operating schedule, real-time processing, existence of multiple redundant infrastructures for continuity, strong information security controls, and robust reporting operations (including direct electronic access by the Commission). Because an SDR provides important utility services to regulators and market participants, such resiliency and redundancy should be evaluated in light of the significant policies and procedures for establishing such redundancy, including several backup locations in different geographic regions that DTCC and other market utilities have already developed, implemented, and tested. DTCC has developed and enhanced such efforts for its entire operations in the aftermath of the September 11, 2001 attacks to ensure continuous operations during times of crisis.

DTCC would not support reduced registration requirements for non-resident SDRs at this time. The current European repositories offer periodic position-based data and do not currently meet the requirements of the Proposed Rule related to the reporting and dissemination of SBS information. The regulatory regimes outside the U.S. with respect to OTC derivatives trade repositories are in an early phase of development and not yet supported by international standards, with only draft considerations issued by CPSS-IOSCO to date.

The proposed Regulation SBSR contemplates that an SDR would be required to register with the Commission as a securities information processor ("SIP") and submit an application for registration as an SIP on Form SIP. As the Commission notes, the reporting and recordkeeping burden of Form SDR and Form SIP are not insignificant.[16] Because of the duplicative nature of the information required by Form SDR and Form SIP, DTCC requests that the Commission combine Form SDR and Form SIP such that an SDR would register as an SDR and an SIP using only one form. In the alternative, DTCC suggests that one form (either Form SDR or Form SIP) be permitted for an application for registration as both an SDR and an SIP.

[15] *See id.* at 77,366.

[16] See *id.* at 77,348 ("[T]he Commission estimates that it would take an SDR approximately 400 hours to complete the initial Form SDR with the information required and in compliance with these proposals.") See also *id.* at 77,348 fn. 208 ("The Commission calculated in 2008 that Form SIP takes 400 hours to complete. 73 FR 34060 (June 16, 2008) (outlining the most recent Commission calculations regarding the PRA burdens for Form SIP).").

Temporary Registration

Proposed Rule 13n-1(d) would provide a method for SDRs to register temporarily with the Commission, to enable both the SDR and the Commission to comply with the Dodd-Frank Act upon its effective date (*i.e.,* the later of 360 days after the date of its enactment or 60 days after publication of the final rule implementing Exchange Act Section 13(n)) despite any unexpected issues with the use of Form SDR.[17] The temporary registration would expire on the earlier of: (1) the date that the Commission grants or denies registration of the SDR; or (2) the date that the Commission rescinds the temporary registration of the SDR.[18] The Commissions emphasize that SDRs registered on a temporary registration basis must demonstrate that they have the capacity and resources to comply with their regulatory obligations on an ongoing basis as their business evolves.[19]

DTCC is concerned that the SEC's proposed implementation schedule for reporting to SDRs is heavily compressed and, when coupled with the temporary registration regime, may lead to compromised solutions, including operational and security compromises. Potential SDRs are incented to enter the market early to capture market share, as initial trade reporting obligates further reporting on that trade, and the long tenors of the trades will make switching SDRs onerous for reporting parties. However, potential SDRs are unlikely to be able to offer fully robust or efficient solutions for early registration, given that the final rules will be available relatively shortly before the effective date.

DTCC recommends that appropriate due diligence is conducted with respect to the temporary registration process and that those diligence findings are either used to support transition of existing infrastructure or used for new entrants who can demonstrate that their infrastructure supports key operational capabilities, including 24/6 operation, real-time processing, multiple redundancy, and robust information security controls.

DTCC respectfully urges the Commission to ensure that the registration process does not interrupt current operation of existing trade repositories who intend to register as SDRs. This can be achieved as a phase-in for existing SDRs where services will need to be amended to conform with the final rules given the compressed time period between the publication of the final rules and the effective date of the Dodd-Frank Act. It is important that the Commission ensure both the continuation of counterparty reporting and the ability of the trade repository to receive and maintain current trade information on an ongoing basis. The continuation of these activities is imperative for effective oversight of systemic risk and the availability of relevant trade information to the Commission, as well as the continuance of the operational services to market participants. Transitional arrangements, including temporary registration, may be required to ensure these activities continue without interruption.

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[17] *See id.* at 77,314.

[18] *See id.* at 77,366.

[19] *See id.* at 77,314.

Duties and Core Principles of SDRs

Section 763(i) of the Dodd-Frank Act requires an SDR to comply with the requirements and core principles described in Exchange Act Section 13(n), as well as any requirement that the Commission prescribes by rule or regulation, in order to be registered and maintain registration as an SDR with the Commission.[20]

The Warehouse, as a centralized global repository, serves as an important source of regulatory information for the Commission and other appropriate regulators. However, DTCC believes that the value of the information provided by an SDR will be limited if data reporting becomes too fragmented. If the Commission receives pieces of information from many sources, and not one full picture from any source, the Commission's ability to monitor systemic risk in the marketplace in a timely and global manner will be severely limited.

DTCC expects that normal market forces will result in the provision of aggregate data to the Commission. However, to the extent that such aggregation does not occur as SDRs develop, the Commission should consider designating one SDR as the consolidator of market information (for example, by asset class) responsible for providing the Commission with direct electronic access.[21] The role of an aggregating SDR is significant in that it ensures regulators efficient, streamlined access to consolidated data, reducing the strain on limited agency resources. International financial regulators have identified this approach as a valuable one, noting that:

> "Authorities should ensure that [SDRs] are established that provide aggregate global coverage of the global derivatives market and that the data collected can be aggregated so as to provide a comprehensive view of the market. The establishment of uniform data standards and functional requirements for data exchange will be a necessary condition for authorities to have a timely and consistent global view for assessing and analysing the OTC derivatives markets. One beneficial solution would be to establish a single global data source to aggregate the information from [SDRs] [emphasis added]."[22]

With regard to regulatory access, DTCC's understanding of the Commission's access provisions are not in accordance with the guidance issued by the ODRF. DTCC believes that regulators want direct electronic access to data in SDRs where that data is needed to fulfill regulatory responsibilities. DTCC supports regulators' access to regular reports from SDRs that are scheduled temporally or triggered by certain events, including certain

[20] *See id.* at 77,317.

[21] *See* Exchange Act Section 13(n)(5) ("An SDR shall...provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity).").

[22] Financial Stability Board, *Implementing OTC Derivatives Market Reforms*. October 25, 2010. *Available at*: http://www.financialstabilityboard.org/publications/r_101025.pdf.

concentration levels, rather than by request, with notice to another regulatory authority or requiring indemnification. Finally, the regulatory model should be location agnostic, without preferential access for the prudential regulator, except to perform its prudential duties.

The indemnification provisions should not apply in situations where regulators are carrying out regulatory responsibilities, acting in a manner consistent with international agreements and maintaining the confidentiality of data. However, recognizing that the indemnity provision is mandated by the Dodd-Frank Act, DTCC believes that the Commission should provide model indemnity language to be used by all SDRs in arrangements with regulators. Ensuring consistent application of this legislative mandate will minimize any disruption to the global repository framework. Further, DTCC believes that any indemnity should be limited in scope to minimize the potential reduction in value of registered SDRs to the regulatory community.

An important issue that U.S. and global regulators will need to address, particularly as the implementation of the Dodd-Frank Act results in the growth of SDRs globally, is how to best handle data collected by an SDR where the trade would not be reportable under the statute to U.S. regulators by virtue of where it took place or the counterparties involved. In this regard, DTCC points to the guidance in a letter from the ODRF membership[23] related to global regulator access to TIW data.[24] The ODRF letter contemplates that the SEC receives data from the TIW that goes beyond the scope of information proposed by the Dodd-Frank Act or the Proposed Rule, such as data related to overseas transactions entered into by non-U.S. persons on U.S. underlyings. Today, the TIW routinely provides this transaction data to U.S. regulators (and conversely, routinely provides data related to transactions in the U.S. by U.S. persons on European underlyings to European regulators), as contemplated by the ODRF letter. As the Commission knows, it is important to preserve this spirit of cooperation and coordination between regulators around the world. Without such cooperation, the SEC's ability to routinely receive details of purely European transactions written on U.S. underlyings would be frustrated.

DTCC is concerned that the current asymmetry in the Proposed Rule, when compared to existing international standards, will lead to fragmentation along regional lines and prohibit global services and global data provision, which will weaken the introduction of trade repositories as a financial markets reform measure. Further, because of the onerous standards imposed on SDRs compared to the regulatory framework of other competitive jurisdictions, the U.S. will be less attractive than other locations for the purpose of storing full global data where SDRs are actively looking to service the global regulatory community.

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[23] Authorities Currently Involved in the OTC Derivatives Regulators' Forum. *Available at*: http://www.otcdrf.org/about/members.htm.

[24] *See* letter from OTC Derivatives Regulators' Forum to the Warehouse Trust Company, dated June 18, 2010. *Available at*: http://www.dtcc.com/downloads/legal/imp_notices/2010/derivserv/tiw044.zip.

DTCC strongly supports the use of third party service providers to report SBS data on behalf of reporting parties (*e.g.*, counterparties, security-based swap execution facilities). However, such reporting should be required to be clearly authorized by the reporting parties. The reporting parties need to control the data flow to SDRs to ensure completeness and accuracy of the data. Different firms will wish to have different workflows to support third party service providers' reporting, just as they do in the procedures used to undertake confirmation services. It is important that firms with the reporting obligation maintain control over reported positions throughout the life of the contract, even when third party service providers act on behalf of the reporting party. Otherwise, it is difficult for any party to take responsibility for the accuracy of the resultant position at the SDR.

The use of third party service providers will also strengthen the ability of the SDR to fulfill its statutory obligation to confirm the data with both parties.[25] In many cases, the third party service provider will report trade information on behalf of both counterparties to a trade. Allowing such an arrangement will reduce the regulatory burden of the counterparties, and ensure prompt compliance with reporting obligations. DTCC believes that, in many instances, firms will wish to submit every trade to the SDR or have a third party service provider manage their submissions to the SDR. Given the complexities related to establishing a new regulatory framework in a global market (particularly with jurisdictions expected to adopt new reporting rules related to SDRs as part of their G-20 commitments), there is considerable complexity to replicate in a firm's technology systems the rules that will determine the reporting party or the reporting requirements based on the product type.

In addition to the recognized value inherent in relying upon third party service providers to carry out certain functions on behalf of reporting parties, DTCC urges the Commission to ensure that third party service providers do not "bundle" services to include the SDR function. To ensure accurate, timely information for regulatory oversight and to mitigate potential conflicts of interest, an SDR must be free from conflict with the operation and pricing of other market services (*e.g.*, clearing and trade execution). Allowing bundling of obligations undertaken by third party service providers with an SDR will detract from the SDR's utility function and jeopardize the value of SDRs to regulators and the market.

With respect to whether the Commission should require SDRs to establish automated systems for monitoring, screening, and analyzing SBS data or provide the data for the Commission to perform these functions, DTCC believes monitoring, screening, and analysis should be performed centrally by an SDR, as it would promote efficiency in the system. The data maintained by the SDR should then be made available to potentially impacted regulators. Concentration data would be especially disposed to this approach as it requires aggregate market wide data.

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[25] *See* Exchange Act Section 13(n)(5)(B) ("A security-based swap data repository shall . . . confirm with both counterparties to the security-based swap the accuracy of the data that was submitted.").

Implementation of Core Principles

Each SDR is required, under Exchange Act Section 13(n)(7), to comply with core principles relating to: (1) market access to services and data, (2) governance arrangements, and (3) conflicts of interest.[26]

First Core Principle: Market Access to Services and Data

The first core principle is intended to protect investors and to maintain a fair, orderly, and efficient SBS market. Proposed Rule 13n-4(c)(1) is designed to ensure that any dues or fees are, on a case-by-case basis, fair, reasonable, do not unreasonably discriminate and are applied consistently across all similarly situated users of the SDR's services. The Proposed Rule would also require each SDR to permit market participants to access specific services offered by the SDR separately, such as ancillary matching and confirmation services. Further, each SDR must permit fair, open, and not unreasonably discriminatory access to its services offered and the data it maintains.

DTCC's perspective is that access to data is a key issue relating to SDRs. DTCC supports open access to data by other service providers, based on the consent of the parties for that provider to receive the data. DTCC believes this is an important principle for allowing development of automation and efficient operational processing in the market, while preserving the parties' control over confidential information. The Warehouse currently provides access to many vendors, including trade confirmation and trade messaging providers, central counterparties, portfolio reconciliation service providers, portfolio compression services, custodians and outsource providers. A corollary of this sort of independence is that third party service providers should be barred from bundling their services with those of any SDR. Open access and neutral dealing with other providers should be a two-way street.

With respect to fees, the TIW's current model operates on an at-cost basis, charges the dealers for services, and operates at no cost to the buy-side and end-users. This model has been successful in an industry-led voluntary regime as market participants have been able to benefit from cost savings from operational efficiencies, while also encouraging broad-based usage. It is also important to ensure that all counterparties to trades reported to an SDR should, as a matter of principle, have access to all data relating to trades to which they are a counterparty. This access should be made available to smaller, lower volume market participants, as necessary, through the reduction or waiver of certain fees.

In addition, the fees for certain services should reflect the specific costs of the related service. For example, if a reporting party uses a third party service provider for trade submission, which fulfils the SDR's requirement to confirm the trade with both parties, this report would potentially be charged at a lower cost than a direct report to the SDR, requiring the SDR itself to confirm with the other party.

[26] *See* Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. at 77,320.

The TIW offers certain services at no extra cost, currently charging a position-based fee. In some cases, third party costs incurred by TIW are charged directly to the consuming customer rather than spread evenly across all users, where these costs only apply to certain types of trade. In many cases, the marginal cost of operating the additional services are very low. DTCC supports this approach because it incentivizes the adoption of automation and electronic processing, such as the central settlement service and triggering for restructuring credit events, bringing reduced risk to the market. Customer reception to these services is very positive. However, it is important to recognize that current usage of TIW is on a voluntary basis. Therefore, an appropriate option would be to permit customers with two (or more) services options: one that fulfils the minimum regulatory reporting process, and a suite of other services to compliment the mandatory reporting function.

Second Core Principle: Governance Arrangements

Proposed Rule 13n-4(c)(2) would require each SDR to establish governance arrangements that are well defined and include a clear organizational structure with effective internal controls, including fair representation of market participants. The Proposed Rule would further require each SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the SDR's senior management and each member of the board or committee that has the authority to act on behalf of the board possess requisite skills and expertise to fulfill their responsibilities in the management and governance of the SDR, to have a clear understanding of their responsibilities, and to exercise sound judgment about the SDR's affairs. Finally, the Commission could, but has not proposed, minimum requirements pertaining to board composition or impose ownership restrictions.

DTCC believes that the use of ownership and voting limitations would be an imprecise tool with which to achieve the policy goals of the Commission regarding conflicts of interest. These policy goals can best be met by structural governance requirements. In the specific case of an SDR, governance by market participants is appropriate, given that most potential conflicts of interest are dealt with directly in the Proposed Rule and will be overseen directly by the regulator.

The SDR is not defining the reporting party, timeliness or content for public dissemination, and similarly the SDR is not defining the reporting party, content or process for regulatory access. Therefore, the SDR does not have significant influence over the inclusion or omission of information in the reporting process, nor does it control the output of the process. This position is significantly different from other market infrastructures, where these infrastructures may have the ability to influence participation in a service (*e.g.* execution, clearing membership, portfolio compression), or completeness of product offering (where it is proposed that all trades in an asset class are accepted).

DTCC suggests that the Commission focus on ensuring the SDR open access provisions described above are in place. To support these requirements, the SDR needs governance that has independence from its affiliates and which is representative of users who are the beneficiaries of choice in service providers. The TIW has a separate board, consisting of fee-paying users, which acts independently from the DTCC parent company board, though the Warehouse must ensure its actions do not damage the financial strength or reputation of its parent. DTCC, as the parent company, does not direct the strategy of the TIW nor promote its interests within the TIW.

Furthermore, in order to assure that non-regulatory uses of mandatorily reported data remain in the hands of the counterparties, SDRs should be broadly speaking "user-governed". This should include a board of directors that is broadly representative of market participants and that incorporates voting safeguards designed to prevent non-regulatory uses of data of a particular class of market participants that are objectionable to that class. In addition, no communication of data (other than to or as required by applicable regulators) that could have the result of disclosing the actual positions or specific business or trading activity of a counterparty should be permitted without the consent of that counterparty.

Independent perspectives can provide value to a board of directors, but those who do not directly participate in markets may not have sufficient, timely, and comprehensive expertise on those issues critical to the extraordinarily complex financial operations of SDRs. These entities require industry expertise at the board level and it is critical for the safety and soundness of SDRs that the composition of their boards sufficiently incorporates the range of necessary expertise as well as independent judgment.

Third Core Principle: Rules and Procedures for Minimizing and Resolving Conflicts of Interest

Each SDR is statutorily required to establish and enforce written policies and procedures reasonably designed to minimize and resolve conflicts of interest in the SDR's decision-making process.[27] Based on information provided by industry representatives regarding how SDRs will likely operate, the Commission preliminarily believes that a small number of dealers could control SDRs, which may require SDR owners to balance competing interests.[28] Owners of an SDR could derive greater revenues from their non-repository activities in the SBS market than they would from sharing in the profits of the SDR in which they hold a financial interest.[29] In addition, there may be a tension between an SDR's statutory obligations and its own commercial interests or those of its owners.[30]

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[27] *See id.* at 77,369.

[28] *See id.* at 77,324.

[29] *See id.*

[30] *See id.*

The Commission notes that a few entities that presently provide or anticipate providing repository services have identified conflicts of interest that could arise at an SDR.[31] First, owners of an SDR could have commercial incentives to exert undue influence to control the level of access to the services offered and data maintained by the SDR and to implement policies and procedures that would further their self-interests to the detriment of others by impeding competition.[32] Second, an SDR could favor certain market participants over others with respect to the SDR's services and pricing for such services.[33] Third, an SDR could require that services be purchased on a "bundled" basis.[34] Finally, an SDR could misuse or misappropriate data reported to the SDR for financial gain.[35]

The TIW recognizes that market access by service providers to an SDR could be a potential source for conflicts of interest, but strongly supports the principle of open access, having established many vendor connections. The Warehouse operates at-cost, rebates any excess revenues, and charges only dealers for its services. The reporting rules for SDRs are highly prescriptive, and the primary consumers of this data are regulators, leaving limited room for conflicts involving regulatory or public data access. Access for other service providers is a key requirement for efficiency and strongly supported by a user-governed organization.

Data Collection and Maintenance

The Commission is proposing Rule 13n-5 under the Exchange Act to specify the data collection and maintenance requirements applicable to SDRs.

DTCC believes that there should be a common definition for the products within each asset class that is used by all SDRs to ensure that reporting counterparties know where to report trade information. The requirement for an SDR to support all trades in an asset class is also important to reduce the complexity for reporting parties. Given the need for reporting parties to report life cycle events and potentially report valuation data to the SDR that originally received the trade, these processes can be burdensome. In addition, the requirement to support all trades in an asset class discourages an SDR from only servicing high volume products within an asset class to maximize profit, and leaving more complex (and less frequently traded) transactions to be reported by reporting parties directly to the Commission.

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[31] *See id.*

[32] *See id.*

[33] *See id.* at 77,325.

[34] *See id.*

[35] *See id.*

Definitions

DTCC does not feel that the definition of "asset class" needs further definition for SBS. DTCC does think the distinction between loan-based and credit asset classes is unnecessary, and notes products like CDS on loans, while loan-based, are currently reported alongside other CDS products to the TIW.

Requirements

Transaction Data

The Proposed Rule would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed for the reporting of transaction data to the SDR, and would require the SDR to accept all transaction data that is reported to the SDR in accordance with such policies and procedures under proposed Rule 13n–5(b)(1)(i).[36] Further, proposed Rule 13n–5(b)(1)(ii) would require an SDR, if it accepts any SBS in a given asset class, to accept all SBSs in that asset class that are reported to it in accordance with its policies and procedures required by paragraph (b)(1) of the Proposed Rule.[37] Finally, proposed Rule 13n–5(b)(1)(iii) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the transaction data that has been submitted to the SDR is accurate.[38] This is in accordance with Exchange Act Section 13(n)(5)(B), which requires an SDR to "confirm with both counterparties to the security-based swap the accuracy of the data that was submitted."[39]

As noted above, DTCC believes that the Commission should require an SDR to accept all SBSs of a given asset class. In general, equity and credit derivatives will be easy to classify, although it is possible that certain transactions could be mixed and more difficult to classify. DTCC considers classification difficulties are more likely to occur between a swap and an SBS, rather than between SBS asset classes. For example, trades may be constructed based on the correlation between commodities and equities. The Commission can further mitigate this potential problem by combining the loan-based asset class with credit derivatives, and allowing an SBS to be reported to either the equity or credit SDR if there is any uncertainty of a product's asset class. In practice, SDRs will need to evolve to accept new products and variations in product structures, so this requirement should not impose a significant burden on an SDR in receiving such an SBS.

[36] *See id.* at 77,369.

[37] *See id.*

[38] *See id.*

[39] *See id.* at 77,327.

SDRs should not have additional duties with respect to verifying the accuracy of submission, as there is limited data available to the SDR. The SDR may carry out certain routine functions to identify trades which may indicate erroneous data (*e.g.* based on size), but in general, the primary responsibility for accuracy of reported information should remain with the reporting party.

From a systemic risk oversight perspective, it is imperative that all SBSs are recorded by registered SDRs and that the trade information is accurately and promptly made available for regulators.

Position Data

The Commission's proposed Rule 13n–5(b)(2) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to calculate positions for all persons with open SBSs for which the SDR maintains records.[40] Position data is required to be provided by an SDR to certain entities pursuant to Exchange Act Section 13(n)(5)(G).[41] In order for the positions to be calculated accurately, the SDR will need to promptly incorporate recently reported transaction data and collected unreported data.[42]

DTCC believes that position data is most valuable when aggregated among all SDRs to accurately reflect a counterparty's true position in a timely manner. Allowing each SDR to calculate positions will result in inaccurate, fragmented reporting to regulators. To this end, DTCC would suggest that one SDR should be given the responsibility to aggregate and maintain the consolidated position data for regulatory purposes.

The Warehouse currently maintains policies and procedures, including technical specifications where automated routines are used, to support position calculation processes. It is DTCC's opinion that where market values are required, they should be provided by firms. Firms invest considerable resources in valuing trades, including personnel, data feeds and capital to assess valuation levels. It would be difficult for an SDR to replicate these activities for all trades, including model selection, trade parameterization to the model, market data sourcing and transformation to model input, and valuation testing. An SDR could contract with a market valuation service to provide some values and this would provide some independent valuation, but this will not readily extend to illiquid or structured products.

Mark-to-market values would be of some use to regulators without collateral information, as regulators may be able to better understand some of the market risk exposures and marking disputes with access to this information. Mark-to-market values would also readily fulfill portfolio reconciliation functions. However, the values would not be useful in assessing counterparty risk exposures without collateral information.

[40] *See id.* at 77,369.

[41] *See id.* at 77,326.

[42] *See id.* at 77,329.

Many collateral agreements are structured at the portfolio level, so the reporting regime should reflect this, rather than attempt to arbitrarily attribute collateral holdings to individual trades.

Maintain Accurate Data

Proposed Rule 13n–5(b)(3) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the transaction data and positions that it maintains are accurate. Maintaining accurate records is a core function of an SDR.[43] The Commission believes it is important that an SDR has policies and procedures to ensure reasonably the accuracy of the transaction data and positions that it maintains.[44] These policies and procedures could include portfolio reconciliation.[45]

In the current TIW model, the onus is on the customers to ensure the accuracy of the data, and this ensures their records are synchronized with the life cycle event processing and asset servicing offered by the TIW. This model formed the basis of the value proposition of the TIW, namely that the multiple bilateral reconciliations performed between the parties to a trade throughout the life of a trade (and often on an ad hoc basis or only following a dispute), could be replaced by one single reconciliation framework with a shared central record, increasing both operating efficiency as well as reducing operational risks. The Commission's suggestion for portfolio reconciliation seems well aligned with this, and this would give the direct benefit of improved bilateral portfolio reconciliation processes between the parties.

Controls to Prevent Invalidation

Proposed Rule 13n–5(b)(5) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to prevent any provision in a valid SBS from being invalidated or modified through the procedures or operations of the SDR.[46]

DTCC supports the approach that records are not invalidated by the actions of the SDR. Changes to records must be agreed upon between the bilateral parties via the confirmation service platform or via a centralized life cycle event processer. The SDR should be able to offer life cycle event processing and asset servicing activities and these may lead to an update or modification to the records in the SDR. This role is currently supported by the customer contracts of the TIW and is akin to a legal agreement as a third party service provider to the reporting party. DTCC believes that an SDR should be able to act as a provider of additional services to reporting parties and thus, should be able to update a record with the consent of both parties.

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[43] *See id.* at 77,369.

[44] *See id.* at 77,329.

[45] *See id.* at 77,330.

[46] *See id.* at 77,369.

Dispute Resolution Procedures

Proposed Rule 13n–5(b)(6) would require every SDR to establish procedures and provide facilities reasonably designed to effectively resolve disputes over the accuracy of the transaction data and positions maintained by the SDR.[47] The Commission believes this is necessary because the data maintained by the SDR will be used by regulators to make assessments about counterparties, such as whether the counterparty is a major SBS participant.[48] Further, the counterparties also will use this data, and in some cases the data maintained by the SDR may be considered by the counterparties to be the legal record of the SBS.[49]

DTCC recognizes the importance of accurate data at the SDR and believes that an SDR should be in a position to identify disputes or unconfirmed data as part of its process to confirm the data with both parties. However, only the parties to a transaction can resolve any dispute as to the terms of the trade. In many situations, trade reporting will take place through a third party service provider, which act directly as an affirmation, confirmation or verification platform and already utilizes dispute resolution workflows.

For that reason, resolution by the third party service provider will result in updated records being reported to the SDR. DTCC does not support a Proposed Rule that would require that the SDR building processes to replicate these services. It is not the primary role of an SDR to be a matching service, as other service providers act in this capacity, which services should not be bundled with SDR services. Instead, an SDR can make the quality of the data or disputed trades visible to a firm's prudential regulator and this would act as an incentive to timely resolution.

Automated Systems

<u>Requirements for SDRs' Automated System</u>

The Proposed Rule provides standards for SDRs with regard to their automated systems' capacity, resiliency, and security, based upon the Commission's current Automation Review Policy ("ARP") program. Proposed Rule 13n–6 would require an SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security; and submit to the Commission annual reviews of its automated systems, systems outage notices, and prior notices of planned system changes.

DTCC believes that the operating hours of an SDR should be 24/6, that processing should be real-time, and that business continuity provisions should include multiple redundant systems. Due to its key position in the financial services industry, DTCC has always placed a high priority on maintaining business resiliency. DTCC has in place

[47] *See id.*

[48] *See id.* at 77,329.

[49] *See id.*

multiple fully staffed data and operations centers in diverse regions of the country, each capable of handling DTCC's entire business. This infrastructure, when combined with a highly resilient network, allows DTCC to recover from a regional incident and be back in operation within two hours. DTCC performs both data center and operational failover tests every year. Datacenter recovery tests are performed at least six times a year in various configurations, and there are more than two dozen operational failover tests each year, ranging from a single department failover, to an operational recovery involving more than 400 staff. These capabilities are fundamental to any registration as an SDR.

Reports to be Provided to the Commission

The Commission is proposing Rule 13n–8 under the Exchange Act to specify certain reports that the SDR would have to provide to the Commission.[50] Proposed Rule 13n–8 would require an SDR to "promptly report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the [Exchange] Act."[51]

DTCC currently makes information available directly to regulators, having created a web portal for access to scheduled reports, and providing extracts from the TIW's database based on parameters set by regulators. These reports are available in electronic formats. Through this system, DTCC expects to be able to offer acceptable access to the Commission.

Privacy of SBS Transaction Information

In order to fulfill the requirements of the Dodd-Frank Act, the Commission is proposing to require each SDR to establish, maintain, and enforce written policies and procedures reasonably designed to protect the privacy of any and all SBS transaction information that the SDR receives from an SBS dealer, counterparty, or any registered entity.[52] Each SDR must establish and maintain safeguards, policies, and procedures reasonably designed to prevent the misappropriation or misuse, directly or indirectly, of: (1) any confidential information received by the SDR, including, but not limited to, trade data, position data, and any nonpublic personal information about a market participant or any of its customers; (2) material, nonpublic information; and/or (3) intellectual property, such as trading strategies or portfolio positions, by the SDR or any person associated with the SDR for their personal benefit or the benefit of others. Such safeguards, policies, and procedures shall address, without limitation, (a) limiting access to such confidential information, material, nonpublic information, and intellectual property, (b) standards pertaining to the trading by persons associated with the SDR for their personal benefit or the benefit of others, and (c) adequate oversight to ensure compliance of this

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[50] *See id.* at 77,338.

[51] *See id.*

[52] *See id.* at 77,339.

provision.[53] Under the Warehouse's Operating Procedures, users are responsible for adhering to the security procedures promulgated by the Warehouse.

DTCC fully supports the Commission's efforts to protect the privacy of any and all SBS transaction information received by an SDR. Currently, the Warehouse has published Operating Procedures requiring it to treat as confidential (both during and after the termination of a User's access to the System) all confidential information, including transaction data, specified in records received by the Warehouse, any data, reports, summaries or payment amounts which may be produced as a result of processing such transaction data, and the identity of any entity a User uses to settle obligations. DTCC may not transfer or disclose this information to any non-affiliated third party or use information except as expressly contemplated under the Warehouse's Operating Procedures, or as reasonably deemed necessary to provide the services or system, or in response to, for example, subpoenas or regulatory requests.[54]

Disclosure to Market Participants

Proposed Rule 13n–10 would provide that before accepting any SBS data from a market participant or upon a market participant's request, each SDR shall furnish to the market participant a disclosure document that contains the following written information: (1) the SDR's criteria for providing others with access to services offered and data maintained by the SDR; (2) the SDR's criteria for those seeking to connect to or link with the SDR; (3) a description of the SDR's policies and procedures regarding its safeguarding of data and operational reliability to protect the confidentiality and security of such data; (4) a description of the SDR's policies and procedures reasonably designed to protect the privacy of any and all SBS transaction information that the SDR receives from an SBS dealer, counterparty, or any registered entity; (5) a description of the SDR's policies and procedures regarding its noncommercial and/or commercial use of the SBS transaction information that it receives from a market participant, any registered entity, or any other person; (6) a description of the SDR's dispute resolution procedures involving market participants; (7) a description of all the SDR's services, including any ancillary services; (8) the SDR's updated schedule of any dues, unbundled prices, rates, or other fees for all of its services (including any ancillary services); any discounts or rebates offered, and the criteria to benefit from such discounts or rebates; and (9) a description of the SDR's governance arrangements.[55]

DTCC recognizes the importance of providing market participants with disclosure documents outlining the SDR's policies regarding member participant criteria and the safeguarding and privacy of data submitted to the SDR. The Warehouse ensures that its

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[53] *See id.*

[54] *See* Warehouse Trust Company Operating Procedures, *available at:* http://www.dtcc.com/customer/membership/derivserv/derivserv.php.

[55] *See* Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. at 77,340.

users are provided these relevant documents, and makes available copies of its policies to its users on its website.

Chief Compliance Officer of Each SDR

The Commission is proposing Rule 13n-11, which would incorporate the duties of an SDR's chief compliance officer ("CCO") that are enumerated in Exchange Act Section 13(n)(6) and impose additional requirements.[56]

Enumerated Duties of Chief Compliance Officer

Each SDR must identify on Form SDR a person who has been designated by the board to serve as the CCO of the SDR.[57] The CCO would be responsible for, among other things, keeping the board or the SDR's chief executive officer apprised of significant compliance issues and advising the board or chief executive officer of needed changes in the SDR's policies and procedures.[58] The Commission specifies that he or she must be competent and knowledgeable regarding the federal securities laws and must be empowered with full responsibility and authority to develop and enforce appropriate policies and procedures for the SDR.[59] To meet his or her statutory obligations, a CCO should also have a position of sufficient seniority and authority within the SDR to compel others to adhere to the SDR's policies and procedures.[60]

DTCC agrees with the Commission that a robust internal compliance function plays an important role in facilitating an SDR's monitoring of, and compliance with, the requirements of the Exchange Act (and rules thereunder) applicable to SDRs. Requiring a CCO is an appropriate way to further this goal.

DTCC currently has an established compliance infrastructure for its businesses, including the Warehouse, which includes processes for establishing and implementing required compliance policies and procedures and overseeing adherence to those procedures and a mechanism for reporting, tracking, remediating and closing compliance issues whether self-identified or identified through internal or external examinations. DTCC expects to build on this existing operation in establishing the compliance function for an SDR. In light of this experience, DTCC would like to make certain suggestions as to the proposed rules in this area and the implementation of the chief compliance officer requirement. While DTCC fully supports the principles underlying the proposed role and functions of a chief compliance officer, it believes that some of the enumerated responsibilities of that role require clarification in order to avoid an overly broad reading of those duties.

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[56] *See id.* at 77,341.

[57] *See id.*

[58] *See id.*

[59] *See id.*

[60] *See id.*

As provided in the Proposed Rule, each CCO shall: (1) report directly to the board or to the chief executive officer of the SDR; (2) review the compliance of the SDR with respect to the requirements and core principles described in Exchange Act Section 13(n); (3) in consultation with the board or the SDR's chief executive officer, resolve any conflicts of interest that may arise; (4) be responsible for administering each policy and procedure that is required to be established pursuant to Exchange Act Section 13; (5) ensure compliance with the rules and regulations under the Exchange Act relating to SBSs, including each rule prescribed by the Commission under Exchange Act Section 13; (6) establish procedures for the remediation of noncompliance issues identified by the CCO through any (a) compliance office review, (b) look-back, (c) internal or external audit finding, (d) self-reported error, or (e) validated complaint; and (7) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.[61]

As noted above, DTCC believes that some of the descriptions of the CCO's responsibilities may be too broad and could be read to encompass responsibilities beyond those traditionally understood to be part of a compliance function (*i.e.*, those issues that can as a matter of competence, and typically would be, handled by a compliance department). In DTCC's view, the CCO should be responsible for establishing relevant compliance procedures, and monitoring compliance with those procedures and other applicable legal requirements. The CCO should also participate in other aspects of the SDR's activities that implicate compliance or regulatory issues. However, the CCO cannot be, and should not be, required to be responsible for the overall operation of the SDR's business. Accordingly, DTCC believes that such requirements as "administering each policy and procedure that is required to be established under" Exchange Act Section 13(n) should be understood in this light.

Similarly, the Commission should recognize that oversight of certain aspects of SDR activities are principally (and, as a practical matter, need to be) within the purview of risk management and operations personnel. Although there may be a regulatory component to whether an SDR is meeting its operational readiness, service level or data security responsibilities for example, oversight of those aspects of the SDR business should remain with the relevant business areas, subject of course to oversight by senior management and ultimately the board of directors. While a CCO may have an important role to play in overall oversight and remediation of any problems, the Commission's rules should not be interpreted to impose on CCOs responsibility outside of their traditional core competencies.

With respect to the requirement to resolve conflicts of interest, DTCC believes that the Commission should clarify what types of conflict of interest should be within the CCO's purview. Some issues, such as permissibility of dealings with related parties or entities, are properly within the CCO's functions. Other issues, such as restrictions on ownership and access, may be fundamental for the board of directors and senior management to address. Furthermore, to the extent that the Proposed Rule requires consultation with the

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[61] *See id.*

board or senior management, some materiality threshold would be appropriate, as not every potential conflict of interest that might be addressed by a CCO (or his or her subordinates) would need such consultation. The determination of materiality is something currently within the CCO's purview to determine based on factors such as nature and scope of the issue and potential exposure.

In addition, in DTCC's view, the Commission should also clarify that the CCO's specific responsibilities related to conflicts are limited to compliance with the provisions of Exchange Act Section 13(n) and the final rules thereunder as they relate to the SBS operations of an SDR. The Commission should not mandate compliance responsibilities with respect to other regulatory requirements to which an SDR may be subject; those responsibilities should be specified by the regulator imposing the other requirements.

Points Raised in the Proposed Rule

In response to the Commission's specific questions in the release, DTCC believes, as a general matter, that the Commission does not need to be overly prescriptive as to the specific compliance responsibilities of the CCO and that SDRs should have some flexibility to implement the required compliance procedures in ways consistent with their structure and business. The SBS markets are continuing to evolve, and will likely change significantly as a result of the introduction of SDRs and other requirements under the Dodd-Frank Act. In light of this ongoing development, DTCC believes SDRs are best suited to determine the most effective way to implement the general requirements of Exchange Act Section 13(n) and Rule 13n-11.

With respect to the question about potential incremental costs, DTCC believes that it is difficult to assess at this time. As noted above, DTCC has an established compliance infrastructure, but it is likely that the new requirements of Rule 13n-11 will entail additional costs, potentially including additional personnel and systems. DTCC also believes that compliance responsibilities in an SDR will evolve (and likely increase) as the scope of transactions reported to that SDR increase, which may also result in additional incremental costs.

In terms of the proposed requirement in Rule 13n-11 for the CCO of an SDR to prepare an annual report as to compliance, DTCC would suggest several clarifications and modifications. First, DTCC believes that any such report should be limited to compliance with the requirements of the Exchange Act and the policies and procedures of the SDR that relate to its activities as such with respect to SBSs (as opposed to policies and procedures that may address other regulatory requirements).

In addition, DTCC does not believe it is appropriate to require the report to include a discussion of recommendations for material changes to the policies and procedures of the SDR as a result of the annual review (as well as the rationale for such recommendations and whether the policies or procedures will be modified as a result of such recommendations). DTCC believes that the inclusion of a description of any material changes to the SDR's policies and procedures, and any material compliance matters identified both since the date of the preceding compliance report, provide comprehensive information. In DTCC's view, requiring the CCO to detail every recommendation (whether or not accepted) may chill open communication between the CCO and other SDR management (including the board of directors) regarding improvements to the compliance policies and procedures. Such an approach could have the undesirable effect of making it less likely for CCOs to propose improvements to compliance policies and procedures.

As noted above, DTCC also believes that it is not appropriate to place the principal responsibility on a CCO to review such business matters as service levels, cost, pricing and operational reliability for purposes of preventing anticompetitive behavior. DTCC believes that other personnel teams, particularly in the risk management, operational or business areas, are best positioned to perform these functions. Of course, a CCO should be involved in remedying any noncompliance issues discovered during such review.

DTCC firmly believes the annual report should be kept confidential by the Commission. Given the level of disclosure expected to be required, DTCC believes that the report will likely contain confidential and proprietary business information. Such information should not be made available to the public or market participants generally.

DTCC fully supports Commission efforts to require the highest standards of regulatory compliance at SDRs, and believes requiring each SDR to have a CCO is an effective way to ensure compliance.

Conclusion

We appreciate the opportunity to comment on the Commission's Proposed Rule and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

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Via Federal eRulemaking Portal & Courier

January 31, 2011

Mr. Lewis Alexander
Counselor to the Secretary
U.S. Treasury Department
Office of Financial Research
Washington, D.C. 20581

RE: Statement of Policy on Legal Entity Identification for Financial Contracts

Dear Mr. Alexander:

The Depository Trust & Clearing Corporation ("DTCC") is pleased to submit comments to the Office of Financial Research ("OFR") in connection with its Statement on Legal Entity Identification for Financial Contracts and Request for Comment ("Statement").[1] DTCC supports the OFR's efforts to develop a universal standard for identifying parties to financial contracts by creating a unique Legal Entity Identifier (an "LEI") for each institution, and to adopt a standard that is established and implemented by private industry and other relevant stakeholders through an "LEI Utility" created for this purpose. DTCC, as a centrally positioned financial market utility that is user-owned and operated on an at-cost basis, looks forward to participating significantly in these initiatives as they evolve.

Overview of DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. domestic equities, corporate and municipal bond, U.S. government securities and mortgage-backed securities transactions, money market instruments and over-the-counter (OTC) derivatives. DTCC, through its subsidiaries, is also a leading processor of mutual fund and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Securities Exchange Act of 1934, as amended: The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC"), and the Fixed Income Clearing Corporation ("FICC"), all of which are subject to regulation by the Securities and Exchange Commission (the "SEC"). DTC, as

[1] *See* Statement of Policy with Request for Comment, 75 Fed. Reg. 74,146 (November 30, 2010).

Subsidiaries:
The Depository Trust Company
National Securities Clearing Corporation
Fixed Income Clearing Corporation
DTCC Deriv/SERV LLC
DTCC Solutions LLC

a New York limited purpose trust company and State member bank of the Federal Reserve System, is also subject to regulation by the New York State Banking Department and the Federal Reserve System.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2010, DTC settled nearly $1.66 quadrillion in securities transactions. NSCC provides clearing, risk management, central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets. Thus, DTCC, through its subsidiaries, processes more than 30 billion transactions a year on an at-cost basis. Among DTCC's core competencies are ensuring that markets operate securely, efficiently, and with confidence. DTCC's Networked Community links virtually all trading parties through one network for data exchange; a network that is highly resilient, self-healing and can be managed from multiple locations. DTCC's Business Continuity Program provides full redundancy of operating and data centers thousands a mile apart, with data capture asynchronously down under 30 seconds.

Outside the U.S. DTCC operates The European Central Counterparty Limited (EuroCCP), a U.K.-based CCP that is a recognized clearing house regulated by the Financial Services Authority (FSA). EuroCCP currently provides pan-European clearing services for equity transactions in 19 markets and in 9 currencies.

DTCC also operates a global trade repository for over-the-counter credit default swaps (CDS), through its wholly owned subsidiary Warehouse Trust Company LLC. Warehouse Trust holds data on more than 98% of CDS trades worldwide. In addition, DTCC operates the global reporting repository for the OTC equity derivatives market through its European-based DTCC Derivatives Repository Ltd. subsidiary, a UK-FSA regulated service company.

DTCC's subsidiaries have maintained their own identification and numbering systems for legal entities since their inception several decades ago. But more recently (and particularly relevant to the OFR Statement), in July 2010, DTCC purchased a UK-based company called Avox Limited ("Avox") that specializes in this area. Avox is a provider of entity identification services to the global financial community, counting among its customers many of the largest, global financial institutions, and having an entity database of over 800,000 records.

DTCC's multifaceted role in the global financial markets provides it with a unique perspective and position to support the initiatives proposed in the Statement.

Universal Standardization of a Legal Entity Identifier is Imperative

DTCC agrees with the Statement that "precise and accurate identification of legal entities engaged in financial transactions is important to private markets and government regulation."[2]

For each financial institution, "precise and accurate identification" of the entities with whom it interacts (as transaction counterparties or otherwise) involves a variety of tasks – determining the identity of a particular entity, verifying detailed information about it, understanding its relationship to other related entities (e.g., that may be part of the same corporate group), periodically re-verifying all of this information, and, at the simplest level, establishing a means – some type of identification code – of denoting that entity both within the financial institution's own systems and with other systems (trading markets, payment, clearing or settlement systems) in which the financial institution may transact with this other entity. This many-faceted process of "precise and accurate identification" is inordinately expensive – a recent study conducted by the Aite Group found that financial services firms spend over $250 million annually on this entire process of cleansing and maintaining entity information.[3]

Further complicating this process is the reality that virtually all financial institutions today perform these processes on their own, and each market infrastructure maintains its own LEI identification system. This results in the use of individualized, proprietary alpha-numeric coding systems to identify financial market participants and counterparties by virtually all financial institutions – there is no standardized, common system among these institutions.

While there would be many benefits from the creation of a standardized, common system to identify legal entities, the lack of such a uniform LEI system across geographies and markets certainly means that determining the aggregate exposure of any single entity would be, at minimum, extremely difficult, requiring linking together data using multiple proprietary identification codes, a time-consuming and complex process that, at best, would be severely error-prone. In truth, DTCC believes that this likely would be virtually impossible.

DTCC strongly agrees that there would be regulatory reporting benefits in the use of a single global industry LEI as the Statement proposes. In the view of DTCC, the universal standardized LEI is the most effective way – it may be the only practical way – to ensure data consistency across the industry and reduce the cost of systemic risk monitoring for regulators. LEI standardization will allow regulators to conduct analyses across markets, products, and regions, identifying trends and emerging risks.

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[2] *See id.* at 74,147.

[3] Aite Group, LLC. Shortcuts to Customer and Counterparty Data Management: Vendors and Capabilities for Legal Entity Data, December, 2006. *Available at* http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=304.

DTCC believes that the criteria set forth in the Statement are not only appropriate, but achievable in the near-term. Over the last six months, DTCC has been actively engaged with other financial industry participants and regulators in the U.S. and abroad to develop a series of proposals that we have enhanced in response to the feedback from these discussions. DTCC has also reached out to several potential collaborators that could play an important role in developing a global solution, and DTCC's Board has approved the commitment of resources toward the development of such a proposed solution.

DTCC has a Unique Blend of Capabilities that can be Leveraged Toward Creating an LEI Utility Solution

1. DTCC has Core Competencies to Create and Maintain a Database of Legal Entity Identifiers on Behalf of Financial Firms

Although DTCC's other subsidiaries have decades of experience in this area, DTCC's Avox subsidiary has nearly ten years of experience in collecting and validating legal entity information from over 200 jurisdictions, and currently maintains a database of 800,000 legal entity records. The complexities of establishing and maintaining a database of this size are considerable, and the vast amount of knowledge and experience that DTCC can leverage to support the LEI Utility is unique in the industry. Some examples of the expertise that DTCC can bring to bear include:

a. Supporting various methodologies to populate the database:

    i. Allowing systemically important financial institutions and other entities with transaction and position reporting requirements to submit a bulk list of entities (e.g., all of their counterparties) for validation and LEI assignment (the more common case, used by financial market professionals); or

    ii. Accepting and validating a submission directly from an entity that is seeking an LEI for itself. (This latter method is important for collection of information that is either not in the public domain or not available from a reliable electronic source.)

b. Tapping into a comprehensive database of rules, policies, procedures and definitions for validating legal entity reference data. This business intelligence represents a significant investment over many years and enables analysts who are validating legal entity records to consistently apply -- on a jurisdiction-by-jurisdiction basis -- the authoritative sources, the non-authoritative sources, address standards, legal form variations, exception management processes and other resources to ensure the highest level of accuracy and thoroughness possible.

c. Leveraging the public database of hundreds of thousands of legal entity data records that Avox already makes publicly available at no charge over the Internet.

d. Incorporating the "challenge functions" currently used by Avox that help keep legal entity records accurate and up to date. These include accepting information from the entity itself as a "self certification," and allowing other firms or users of the public database to challenge specific field values within a record that Avox will then research and, if necessary, correct. Through information and news provided by a global community of financial institutions, Avox is able to obtain information about changes to legal entities that may have been reported to authoritative sources but may not have yet been reflected in their public databases or not yet reported. Avox staff brings this to the attention of those sources and confirms the change before updating the Avox record. Very often, it is the case that if one firm's view of a legal entity data record conflicts with the consensus view, that firm's information is the most recent and therefore most up to date/correct view. The only way to capture these types of exceptions is by proactively soliciting the feedback of all users of the data. Every exception is thoroughly researched before any change is applied to the database.

e. Incorporating corporate action feeds to identify when a corporate action (e.g., a merger) changes information about an entity. DTCC itself is one of several principal sources of corporate action information to the markets (e.g., issuing approximately 8.6 million announcements of such information globally in 2010); and

f. Extensive experience with the annual re-verification needed to ensure that this information remains up to date.

2. <u>DTCC has the Appropriate Governance Structure and Operating Infrastructure</u>

As a participant-owned utility, operated on an at-cost basis, DTCC's mandate is to standardize and reduce the costs and risks associated with its products and services for the benefit of its user-owners. These include the systemically important financial institutions which will be directly affected by the proposal. DTCC's participation in developing and maintaining a global LEI Utility is consistent with this mandate.

For the heightened protection of data required to support the LEI Utility, DTCC can establish a governance structure that can provide the opportunity for those bearing much or all of the ultimate cost of the LEI Utility (the systemically important firms) to have input into how it is operated. Senior executives with broad experience and domain experts in enterprise data management and reference data would be included in governance. DTCC's own governance offers an example of how this can be done, with DTCC's Board comprised of both industry experts and non-industry members representing the interests of the public and the broader markets.

In addition, DTCC can leverage the security and redundancy of its operating systems and infrastructure that settled nearly $1.66 quadrillion worth of transactions in 2010 to ensure that the LEI Utility meets service levels, security requirements, redundancy and disaster recovery requirements.

3. DTCC can Provide a Complete Solution that is Global in Nature

While DTCC would leverage its core competencies to collect, validate and make available the legal entity record in the Utility, DTCC is not itself a Registration Authority of an international standard identifier. Over the past several months, DTCC has had many conversations with Registration Authorities, and those conversations have progressed furthest with the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"). SWIFT, a trusted European-based utility, is a member-owned cooperative used by more than 9,000 banking organizations, securities institutions, and corporate customers, and regulators in 209 countries. As a global Registration Authority, SWIFT has assigned Business Identification Codes ("BICs")[4], an International Organization for Standardization (ISO) standard, to companies for more than 30 years while developing and refining a robust registration and maintenance process that is a cornerstone of SWIFT's operations. During the industry consultation conducted over the past several months, SWIFT has modified the proposed BIC LEI Solution (separate and apart from the current BIC used for addressing messages on the SWIFT network and identifying counterparties within those messages) to meet industry and OFR requirements. The combination of DTCC and SWIFT would create a truly global solution responsive to the needs of global firms and regulators alike.

DTCC's Solution Meets OFR Criteria in the Statement

The capabilities of DTCC, combined with the capabilities of a Registration Authority like SWIFT, directly responds to the requirements articulated by the OFR. DTCC notes the following with respect to the criteria for the LEI Utility as set forth in the Statement:

(1) *Be based on a standard developed and maintained via an international "voluntary consensus standards body," . . . such as the International Organization for Standardization.*

DTCC agrees that the LEI itself should be selected by the industry and must be recognized globally, especially by the government or regulatory agencies charged with the responsibility of monitoring systemic risk, as well as those financial institutions deemed to be systemically important and those which will have significant transaction and position reporting obligations.

[4] BIC is an established International Standard (ISO 9362) used by financial entities around the world as a network address and as an LEI.

While DTCC's capabilities to gather and validate legal entity records can be used with any numbering solution selected – DTCC itself has one of the industry's several commercial legal entity identifiers (the "AVID") – DTCC strongly endorses the need for a global ISO standard identifier to achieve the highest degree of global consensus. While we are open to working with any Registration Authority and numbering methodology selected by the industry and regulatory community, we are encouraged that SWIFT will modify its BIC to create an LEI for use in the LEI Utility. The BIC is an ISO standard (ISO 9362) that is widely used in more than 200 countries as a network address and entity identifier. Using an ISO standard will reduce costs, eliminate inefficiencies, and increase automation.

(2) *Be unique for each legally distinct entity, where each legal entity is assigned only one LEI which cannot be reassigned.*

The current database maintained by Avox assigns and maintains the Avox identifier, or AVID, as noted in this requirement. Should the BIC LEI be selected as the LEI Utility standard, each BIC LEI would be unique, used in perpetuity and never reassigned to another entity. In the event that an entity ceases to operate, a field in the database will reflect this status but the BIC LEI assigned to that entity will never be reassigned to another entity.

(3) *Persist over the life of an entity regardless of corporate actions or other business or structural changes.*

The current database maintained by Avox assigns and maintains the AVID as the Statement requires. Should the BIC LEI be selected as the LEI Utility standard, the BIC LEI would have no built-in intelligence linking the composition of the BIC number itself to some feature of the entity (e.g., its country/state of incorporation). Therefore corporate actions and other events that do not change the identity of the entity will not change the BIC LEI.

(4) *Include minimal information about the entity in the identifier itself.*

We agree that the LEI Utility Record must be composed of two elements – minimum identifying information about the entity and the actual identifier (in our proposal, the BIC LEI). We agree that the actual BIC LEI should not contain information about the legal entity itself. Further, we propose that the LEI Utility database core record should initially contain only minimal information necessary to identify an entity uniquely, and that the information should be able to be validated using publicly available sources. We believe these fields include Registered Name, Operational Address and Jurisdiction of Registration (plus, of course, the identification code under the scheme that is selected); however, DTCC has the ability to support whatever the information regulators and the industry ultimately decide to be the core fields. Other fields such as Record Creation Date, Last Update or Review Date, Expiry Date, and Status are control fields that should be included and are currently made available by Avox. Over time, and with the agreement of the industry and regulators, additional information can be added to the public record. In addition, the LEI Utility could collect additional information as required, such as Immediate Parent and Ultimate Parent, and provide that information to regulators and others the regulators specify, but not make it available in the public LEI database.

(5) *Accommodate growth in the number of legal entities that need to be identified in the full range of reporting systems and to potential industry and regulatory innovations.*

DTCC estimates that the LEI Utility would need to create and maintain approximately 2.5 million LEIs over the next two to three years. Because Avox already has 800,000 legal entity data records which it manages for over 30 global financial institutions today, the expansion of the database to 2.5 million records and beyond within this timeframe can be achieved readily. (Most numbering solutions, including the BIC, can readily scale to have tens of millions of unique numbers.)

(6) *Be available for all eligible markets participants, including but not limited to all financial intermediaries, all companies that issue stock or debt listed on exchange, all companies that trade stock or debt, infrastructure providers, all entities subject to financial regulation, and firms affiliated with such entities.*

The Avox database currently contains information on over 200,000 issuers. Issuers, guarantors, fund managers, counterparties, obligors and others can be (as they are already) added to the database either through the bulk submissions by large firms or by self-registration as described above. Those agencies that currently assign numbers to issues and issuers in large quantities, such as CUSIP and other National Numbering Agencies, can submit their entity information into the LEI Utility in bulk for number assignment and inclusion into the public database, just as large banks and broker/dealers can submit their lists of entities of interest.

(7) *Not be contractually restricted in use.*

Currently, the core legal entity information contained in the Avox database is publicly available free of charge and has limited usage restrictions placed on it. The LEI Utility would have neither any usage restrictions placed on the use or distribution of the content nor would there be any user/license/distribution fees. We propose to allow the LEI Utility database to have search and download capabilities. We anticipate the utility will be operated on a not-for-profit basis and that the costs would need to be recovered via a cost recovery model developed in consultation with the OFR, regulators and the industry. No fees would be placed on the consumers of the public database including vendors who may redistribute the content with or without their own value-added services.

(8) *Where possible, be compatible with existing systems, work across various platforms, and not conflict with other numbering or identification schemes.*

DTCC's creation and maintenance of the LEI Utility database would be based on current Avox capabilities which utilize standard technologies. The ability for the LEI Utility to accept a bulk submission of counterparties from a single client indexed by its own internal identifiers enables it to append the selected LEI to each of the client's records, creating the mapping the client needs to report to regulators with minimal (if any) internal development or ad hoc mapping required. Any systems development by the client would be limited to translation in reporting interfaces rather than in a significant number of internal applications. This procedure greatly lowers the costs and increases the speed of compliance by the industry.

(9) *Be readily accessible using secure and open standards.*

DTCC and SWIFT are industry-owned cooperatives whose interest, through strong corporate governance, is to operate for the good of the financial markets at large and not to maximize profit. DTCC has proven capabilities to communicate with financial institutions, and to process transactions and payments using a secure, redundant infrastructure. DTCC will leverage its infrastructure for the LEI Utility, and work with the financial community and other interested parties to develop input and output specifications (which could be based on the current Avox specifications). At the same time, DTCC will make publicly available the LEI Utility database through a standard website with standard search and downloading functions.

(10) *Be reliable and secure against corruption and misuse.*

DTCC urges that information security should be a paramount feature of the LEI Utility and the supporting system. DTCC itself has considerable experience in this respect. For example, DTCC treats all of its data processing sites, networks, control centers and business sites as a unified complex that is always accessible and, where feasible, actively operates across multiple sites and environments. In support of DTCC's businesses, DTCC has multiple data center locations, including in-region and out-of-region sites with state-of-the-art data replication technologies. All of DTCC's US-regulated subsidiaries (DTC, NSCC and FICC) meet the standards set forth in the "Interagency Paper on Sound Practices to Strengthen the Resiliency of the U.S. Financial System" (the "Interagency Paper") that was published by the Federal Reserve, the Office of the Comptroller of the Currency and the SEC in 2003. DTCC departments involve staff, including Internal Audit, to verify the transaction data integrity and recovery of DTCC's broad suite of data applications. DTCC participates in industry-wide business continuity tests, which involve the major financial institutions, as well as its own business continuity and recovery exercises, conducted six times each year. DTCC has an outstanding reputation for having strong governance standards, the highest levels of integrity, a superior reliability record, and proven techniques that are time-tested to guard against corruption and misuse of its services and facilities. DTCC would leverage these capabilities as part of its solution.

(11) *Be capable of becoming the single international standard for unique identification of legal entities in the financial sector.*

DTCC agrees that the LEI standard should be global, used by systemically important financial institutions in every jurisdiction in the world to report transactions and positions. In addition, as many of the systemically important financial institutions are global firms operating in all leading market centers and across all asset classes, having different solutions geographically or by asset class could place an undue burden on them and would, at the least, significantly impair and delay systemic risk monitoring across borders.

The governance structure of the selected organization(s) must provide the opportunity for the financial institutions bearing much or all of the ultimate cost of the LEI Utility (the systemically important firms) to have input into how it is operated.

DTCC and SWIFT are headquartered in the U.S. and Europe, respectively, and have close working relationships with the financial institutions, many of whom participate directly in the governance of the two utilities, and the regulators in both regions. The support of these governing financial institutions and regulators will aid greatly in achieving global consensus on the single international standard.

Avox originated in the United Kingdom and still has its core operations center there. Avox has major clients in countries including Japan, Singapore, South Africa, Australia, Germany, Canada, the United Kingdom and the United States. These clients will assist with the proliferation of the LEI.

Conclusion

The need for a universal LEI is clear. The inability of regulators to be able to quickly, confidently and consistently identify parties to transactions across all the markets hinders their ability to evaluate systemic risk and take appropriate corrective steps. Going forward, regulators will be charged with gathering data originating from markets and processing systems that are geographically dispersed, and assessing the risks to specific firms and to the financial markets more generally.

DTCC has the capabilities, the governance, the operating scale and the desire to become an integral part of creating and maintaining a global LEI Utility. For the past six months, DTCC has been meeting with regulators, industry groups, subject matter experts, and financial firms to help shape its approach for a global solution that will be acceptable to regulators and financial firms. Behind the highlights outlined in this response are more in-depth plans on how the LEI Utility could be established, operated, funded, and governed. We have begun to share many of these in-depth ideas with industry participants and are committed to a process of further development based on industry feedback. We look forward to participating in all future discussions about this initiative.

We appreciate the opportunity to comment on the Statement and provide the information set forth above. Should you wish to discuss these comments further, please contact me at (212) 855-2727 or whodash@dtcc.com.

Regards,

William Hodash

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Via Agency Website & Courier

February 7, 2011

David A. Stawick, Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Swap Data Recordkeeping and Reporting Requirements (RIN 3038-AD19)

Dear Mr. Stawick:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC" or "Commission") on its proposed regulation regarding swap data recordkeeping and reporting ("Proposed Regulation" or "Proposed Rule") under the Commodity Exchange Act ("CEA").[1] DTCC's comments are provided with the goal of assisting the Commission in assessing how best to bring increased transparency and oversight to over-the-counter ("OTC") derivatives markets.

SUMMARY OF RESPONSE

DTCC supports the Commission's efforts to establish a comprehensive framework for the regulation of swaps, including the reporting of all swaps to a swap data repository ("SDR"). DTCC also commends the Commission's staff for addressing a very technical and complicated subject in a thorough and thoughtful manner and appreciates the invitation to comment.

One of the primary purposes of SDRs and the statutory requirement that all swaps be reported to SDRs is to assure that the Commission has complete and timely transparency into the U.S. swap markets, as well as the global swap trading activity of U.S. persons. As evidenced by past performance, DTCC fully supports this goal and is committed to assuring that the Commission achieves this transparency through SDRs that maintain complete and accurate data on all swaps throughout their respective transaction lives. DTCC currently offers such transparency to the Commission for credit default swaps.

[1] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574 (December 8, 2010).

As the global repository for credit default swaps (containing over 95% of all such swaps worldwide, capturing over 98% of all current global trading activity and centrally processing life cycle events for the bulk of these transactions), DTCC has worked closely with U.S. and non-U.S. authorities, at their request, to provide credit default swap information. DTCC has (i) responded to over 100 requests globally from 23 different regulators and other authorities, and (ii) established an on-line regulator portal, currently "live" with 19 regulators and other authorities globally, permitting queries of data to which the regulator is entitled pursuant to the guidelines developed by the global OTC Derivatives Regulators Forum ("ODRF") on which the Commission sits. (DTCC is also developing additional electronic interfaces with other U.S. and non-U.S. authorities.) The DTCC credit default swap repository data includes both detailed transaction level data for all swaps in the repository and the resulting position data. Regulators and other authorities using the data have viewed it as complete and accurate for purposes of market surveillance and risk oversight functions. DTCC offers the Commission a standing invitation to take advantage of current services and to further discuss additional electronic interfaces.

There is a significant concern that the Proposed Regulations have the potential to inadvertently frustrate the public purpose of regulatory reporting under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] Specifically, DTCC is concerned that in going beyond specifying ***what*** data needs to be reported by ***when*** and setting forth ***standards*** for data maintenance – but also specifying ***how*** such data should be reported and by ***whom*** – the Commission risks a number of unintended, adverse results, including:

- receiving an incomplete set of data on swaps over their transaction lives, such incompleteness could adversely affect the Commission's market surveillance function, among others;
- receiving lesser quality (*i.e.*, less reliable) data when higher quality (*i.e.*, more reliable) data is readily available; and
- imposing unnecessary costs and burdens on reporting entities, as well as their non-reporting counterparties, such as fiduciary money managers and end users, with whom SDRs are obligated to confirm the accuracy of reported data.[3]

This potential for unintended, adverse results is exhibited in several aspects of the Proposed Regulations, discussed in further detail below. As a general matter, however, it is important to note that, as an industry governed utility with both buy- and sell-side firms represented on its governing bodies, DTCC is aware that market participants, who are statutorily responsible for all swap data reporting to SDRs,[4] have only just begun to

[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

[3] *See* CEA Section 21(c)(2).

[4] *See* CEA Section 2(a)(13)(F).

analyze the safest, most efficient and most accurate means to report the required data.[5] It is prudent to avoid prescribing reporting methods based upon current practice that may or may not be relevant after implementation of all of the provisions of the Dodd-Frank Act or upon assumptions about future market infrastructure under the Dodd-Frank Act that may or may not turn out be accurate.

In order to fulfill its regulatory obligations, the Commission is best served by SDRs that maintain complete and accurate up-to-date (if not up to the minute) swap data that includes (with some very minor exceptions noted herein) all of the information set forth in the appendices to the Proposed Rule, and the regulatory steps taken must assure this occurs. Attempting at this early stage in the implementation process to set forth the precise manner in which this should be accomplished (and who should report) when the matter has not yet been fully considered by those with the statutory responsibility to report, risks a flawed solution. Alternatively, the Commission could require that any SDR demonstrate in its registration process that the reporting procedure contemplated by the SDR will result in timely reporting and proper maintenance of the data required by the CEA and the Proposed Regulations. Further, the integrity of the processes should be reviewed periodically.

It is important to note that the overly specific proposals to require certain methods of reporting data about swaps over their transaction lives (referred to in the Proposed Rule as continuation data) are in conflict with the increased automation of the swap markets. Post-trade processing is becoming increasingly automated for all swaps, and further automation is both a regulatory and supervisory goal to continue to eliminate operational and other risk in these markets.[6] Moreover, it is generally acknowledged that the most accurate and complete data with respect to any swap is the data generated by automated confirmation (including confirmable life cycle events) and centralized non-confirmable life cycle event processing, where that is also automated. This data will be readily available to SDRs without any further processes necessary on the part of the swap counterparties, other than authorization of these service providers to report the data to SDRs as their agents. It is expected that these providers will include DCOs, automated

[5] At the direction of the board of directors of DTCC's U.S. user governed cooperative repository, the Warehouse Trust Company (a New York based subsidiary servicing the global credit derivative market), we held a follow-up informal meeting with board members and their senior staffs on January 25, 2011 to specifically address concerns around how the industry would comply with swap data reporting requirements generally for all asset classes under both the SEC and CFTC proposed rules. These discussions are ongoing and involve senior representatives (generally, but not exclusively, heads of derivative operations) from global dealers, as well as from buy-side firms on both sides of the Atlantic appointed for such purpose by the major recognized buy-side trade associations.

[6] *See* Preamble to Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,574. *See also* Press Release, Federal Reserve Bank of New York, New York Fed Welcomes Further Industry Commitments on Over-the-Counter Derivatives (March 1, 2010) *available at:* http://www.newyorkfed.org/newsevents/news/markets/2010/ma100301.html and Letter from the ODSG to the Honorable William Dudley, President, Federal Reserve Bank of New York (Mar. 1, 2010) *available at:* http://www.newyorkfed.org/newsevents/news/markets/2010/100301_letter.pdf.

confirmation facilities, SEFs, DCMs or entities providing central legal recordkeeping or central asset servicing. According to the most recent quarterly survey published by Markit,[7] automated confirmation (including automated confirmation of life cycle events) exists today for approximately 98% of the global credit derivative market, 85% of the global OTC interest rate derivative market (where the vast majority of actually occurring life cycle events are confirmable) and 40% of the global OTC equity derivative market. While current quarterly data for the global FX and commodities markets is not available, recent benchmarking studies indicate that automated confirmation exists for 54% of the global OTC FX derivative market and 65% of the global OTC commodity derivative market.[8] These usage percentages will only grow over time.

Complete data sets for almost all of the OTC rates and credit derivatives asset classes, as well as significant portions of the other asset classes, already exist today in automated form. Further, the industry considers it best practice to reconcile to this data; this data is easily available to SDRs (as it is already produced on an automated basis in standardized form); and virtually all of the data content is in any event required to be reported to SDRs by the Dodd-Frank Act, the SEC and the CFTC.[9] Where complete electronic data sets already exist for swaps, given this data is both the highest quality and most readily available data, SDRs should leverage these to the maximum extent possible.[10] Additional reporting on these swaps that does not add any new pertinent information, and could potentially introduce less accurate data, should be discouraged.

There are specific and unintended potential adverse consequences that could result from being overly specific about prescribing certain reporting obligations to entities other than the counterparties executing the transaction. The CEA is specific that the "[p]arties to a swap (including agents of the parties to a swap) shall be responsible for reporting swap transaction information to the appropriate registered entity in a timely manner as may be

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[7] *See* Markit Quarterly Survey, *available at:* http://www.markit.com/en/products/research-and-reports/metrics/metrics.page.

[8] 2010 ISDA Operations Benchmarking Survey, *available at:* http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf.

[9] The SEC proposed rule does not specifically require reporting of confirmation data, but this data is essentially the same data as the primary economic terms that the SEC requires to be reported in Proposed Rule 242.901(d), which includes the data elements necessary for a person to determine the market value of the transaction, and actual electronic confirmation records is the best evidence of this information. It also comprises almost all of the data that the OTC Derivatives Regulators Forum recommends to be reported to repositories as best practices (again, reporting of actual confirmations is not part of the recommendations, but reporting of essentially the same information as contained in confirmations).

[10] It may be noted that the current global repositories for both rates (operated by TriOptima) and equities (operated by DTCC in London) do not leverage this data where it exists. This is because the industry organizations sponsoring these repositories specifically did not require that trade level detail be maintained in repositories, but rather addressed the narrower need for exposure information relating to swap dealers and not full market surveillance data or exposure information relating to other entities. This position is now superseded by both the Dodd-Frank Act and the current position of the OTC Derivatives Regulators Forum.

prescribed by the Commission."[11] In DTCC's experience, the value of third party providers acting as reporting agents has been proven, but the entities with the statutory reporting responsibility should be able to determine for themselves which agents are best used for what reporting. This is an instance where the CFTC and the Securities and Exchange Commission ("SEC") proposed rules on data reporting are not consistent. DTCC would urge that this difference be resolved by adopting the SEC approach under which the reporting responsibility stays with the applicable market participants who may then engage the appropriate third parties as agents to facilitate the process. This will accommodate not only current circumstances, but also future developments that cannot be anticipated at this time.

Additional comments include:

- The establishment of a separate collateral repository to ensure that complete exposure information is available to regulators; which repositories would hold information as to the collateral held and a valuation for that collateral under each collateral agreement. This information cannot be collected or recorded against individual trades or even particular asset classes, given that most collateral agreements apply to a portfolio of trades across all asset classes, and collateral is called and held against the net exposure of the portfolio – not attributable at trade level.
- Support, on an individual trade level, for the aspect of the Proposed Rule effectively requiring that all information with respect to a particular swap be reported to the same SDR. This appears to be required by the CEA,[12] and it is sound public policy. It will already be difficult for the Commission to aggregate data from swaps reported to multiple repositories without also considering the reconstruction of data relating to a single swap from multiple repositories.
- Support for the aspect of the Proposed Rule requiring that SDRs be able to accommodate all swaps and all swap data with respect to any particular asset class for which it proposes to act as an SDR. (This promotes sound public policy for several reasons. For example, such a requirement will discourage "cherry picking" only those swaps that are easy-to-process – a practice which contributes unnecessarily to data fragmentation and could undermine any economic case for taking the hard-to-process swaps (in turn causing such hard-to-process swaps to fall on the Commission, which results in an unnecessary monetary burden on taxpayer resources).[13] Harmonization of the regulatory regimes for reporting between the

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[11] *See* CEA Section 2(a)(13)(F).

[12] *See* CEA Section 2(a)(13)(G) ("**Each** swap (whether cleared or uncleared) shall be reported to a registered swap data repository.") (emphasis added).

[13] While DCOs will provide an important role as a data source, it is fairly straightforward for DCOs who do not wish to serve as repositories for all potential swaps in a particular asset class to report their information to registered SDRs that meet this requirement. Such reporting would impose no additional burden on DCO users, as DCOs already can accommodate this (in fact, it may avoid some duplicated costs between the SDR and DCO in establishing reporting for all regulator types as countenanced by the ODRF).

Commission and the SEC will tend to eliminate risk of errors and costs associated with two complementary, but conflicting reporting regimes.

- Use of existing practices, such as the trade confirmation process, to meet regulatory reporting requirements, due to the similarity of process requirements and content and the resulting high quality that this would ensure.
- 'Phase-in' of the implementation to allow for the extensive testing and preparation required to ensure that the processes lead to accurate data. The data will be relied upon for systemic risk control and price transparency purposes and must be of suitable quality and not mislead regulators or the public.
- The importance of aggregate data to fulfill the intended purpose of SDRs and avoid the inability of regulators to understand and timely respond to the buildup of concentrated exposures, such as the mortgage credit derivatives exposures of American International Group, Inc. ("AIG").
- Use of third-parties in the reporting model to allow reporting parties the appropriate flexibility to report efficiently.

DTCC's detailed comments are preceded by a brief overview of DTCC and the Trade Information Warehouse ("TIW" or "Warehouse"), a centralized global repository for trade reporting and post-trade processing of OTC credit derivatives contracts, which is operated by DTCC's wholly-owned subsidiary, The Warehouse Trust Company LLC.[14]

OVERVIEW OF DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities transactions, money market instruments and OTC derivatives. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing agency for derivatives. However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC")[15], which has been granted registration as a derivatives clearing organization ("DCO") by the CFTC.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Securities Exchange Act of 1934 ("Exchange Act"), subject to regulation by the SEC.

It will ensure that the full trade lifecycle is recorded from point of execution, not just from point of clearing, and enable ready analysis of exceptions to clearing.

[14] DTCC filed a separate letter with the Commission on February 7, 2011 addressing Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140 (December 7, 2010). DTCC believes there is significant overlap of the issues addressed in the two letters and urges Commission staff to consider both sets of comments.

[15] NYSE Euronext owns the other 50% equity interest. Neither DTCC nor NYSE owns a majority of the equity interests in NYPC. NYPC has its own management team which controls the day to day operations of the company.

These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, (for some securities) central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year – on an at-cost basis.

OVERVIEW OF THE TRADE INFORMATION WAREHOUSE

In November 2006, at the initiative of swap market participants, DTCC launched the Warehouse to operate and maintain the centralized global electronic database for virtually all position data on credit default swap ("CDS") contracts outstanding in the marketplace. Since the life cycle for CDS contracts can extend over five years, in 2007, DTCC "back-loaded" records in the Warehouse with information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 implementation date. Today, data for over 95 percent of all OTC credit derivatives are captured in this automated environment. The Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of $29 trillion ($25.3 trillion electronically confirmed "gold" records and $3.7 trillion paper-confirmed "copper" records).[16]

In addition to repository services (as contemplated by the proposed rules relating to SDRs, the acceptance and public and regulatory dissemination of data reported by reporting counterparties), the Warehouse provides both legal recordkeeping and central life cycle event processing for all swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details on the official legal or "gold" record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants' single-sided, non-legally binding or "copper" records for CDS transactions to help regulators and market participants gain a clearer and more complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

[16] Data provided as of December 31, 2010. For more information about the Trade Information Warehouse, please see http://www.dtcc.com/products/derivserv/suite/ps_index.php.

DTCC's Warehouse is also the first and only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. Various events can occur, such as calculating payments and bilateral netting, settling payments, credit events, early termination and company renames and reorganizations, which require action to be taken by the parties to such CDS contracts. DTCC's Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these functions by the Warehouse distinguishes it from any swap data repository that merely accepts and stores swap data information.

DISCUSSION OF PROPOSED REGULATIONS

Pursuant to Title VII of the Dodd-Frank Act, the Proposed Regulations establish swap data recordkeeping and reporting requirements for registered entities and counterparties involved in swaps.

I. Recordkeeping Requirements

The Proposed Regulations establish recordkeeping requirements for all designated contract markets ("DCMs"), derivatives clearing organizations ("DCOs"), futures commission merchants ("FCMs"), introducing brokers ("IBs") and members of contract markets.[17] Each such entity is required to keep full and complete records of all activities relating to the business of the entity subject to the Commission's authority.[18] All such records must be kept for a period of five years from the date of the record and must be readily accessible during the first two years of the five-year period.[19] Copies of all records must be provided, at the expense of the entity required to keep the records, upon request by any representative of the Commission or the Department of Justice.[20]

Further, the Commission's Proposed Regulations require that all DCOs, DCMs, swap execution facilities ("SEFs"), swap dealers ("SDs") and major swap participants ("MSPs") keep full, complete and systematic records of all activities relating to the business of such entities with respect to swaps, including records of all data required to be reported in connection with any swap.[21] The Proposed Regulations require that all records required to be kept by DCOs, DCMs, SEFs, SDs, MSPs and non-SD/MSP counterparties be kept throughout the existence of the swap and for five years following final termination of the swap.[22] Records required to be kept by DCOs, DCMs, SEFs, SDs and MSPs must be readily accessible by the registered entity via real time electronic

[17] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,579.

[18] *See id.*

[19] *See id.*

[20] *See id.*

[21] *See id.*

[22] *See id.*

access throughout the life of the swap, for two years following the final termination of the swap and retrievable within three business days through the remainder of the required retention period.[23] Non-SD/MSP counterparties, including counterparties who qualify as end user counterparties, will be required to keep full, complete and systematic records with respect to each swap in which they are a counterparty.[24] Each record will be required to be retrievable by the counterparty within three business days during the required retention period.[25]

The Proposed Regulations require that all records required to be maintained by SDRs be kept throughout the existence of the swap and for five years following final termination or expiration of the swap, during which time the records must be readily accessible by the SDR and available to the Commission via real time electronic access.[26] Thereafter, for a period determined by the Commission, all such records must be maintained in archival storage from which they are retrievable by the SDR within three business days.[27]

The Proposed Rule should require the retention of electronic records of transactions, including life cycle events. These should be maintained for the life of the contract in order to provide an audit trail to positions and for a reasonable retention period thereafter. An SDR's records should be in an electronically readable format (where available) that allows for application and analysis. Swap transaction data retained as electronic images of paper documents is cumbersome and will frustrate regulatory oversight efforts.

II. Swap Data Reporting

The Proposed Regulations require swap data reporting to include data from two stages of a swap's existence: (1) the creation of the swap and (2) the continuation of the swap over its existence until its final termination or expiration.[28]

A. Swap Creation Data

The Proposed Regulation calls for reporting two sets of data generated in connection with the creation of a swap: (1) primary economic terms data and (2) confirmation data.[29]

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[23] *See id.*

[24] *See id.*

[25] *See id.*

[26] *See id.*

[27] *See id.*

[28] *See id.* at 76,580.

[29] *See id.*

The primary economic terms of a swap include all of the terms of the swap verified or matched by the counterparties at or shortly after the execution of the swap.[30] Such terms can differ not only for swaps in different swap asset classes, but also for standardized versus non-standardized swaps.[31] For swaps executed on a SEF or DCM, the primary economic terms will be those specified in the contract listed on the platform in question. For non-standardized or bespoke swaps executed bilaterally, primary economic terms are typically far less standardized.[32] However, counterparties verify the primary or essential economic terms of their swap with each other in some fashion following execution in the case of every swap.[33] The Proposed Regulation requires that all of the terms of the swap verified by the counterparties be reported to an SDR.[34]

Confirmation data, the second set of data generated in connection with the creation of a swap, constitutes all of the terms of a swap matched and agreed upon by the counterparties in confirming the swap.[35] As with primary economic terms data, the Proposed Regulations require confirmation data to be reported to an SDR.[36]

Under the Proposed Regulations, determination of who must report swap creation data is based on two criteria.[37] The first criterion is whether the swap is (1) executed on a SEF or DCM and cleared on a DCO; (2) executed on a SEF or DCM but not cleared; (3) not executed on a SEF or DCM but cleared on a DCO; or (4) not executed on a SEF or DCM and not cleared.[38] The second criterion is whether the reporting counterparty is an SD or MSP or, instead, a non-SD/MSP counterparty.[39]

The Proposed Regulations specify the timeframes for reporting swap creation data to an SDR.[40] The applicable timeframes are based on several criteria, including the reporting counterparty, whether the swap is executed on a SEF or DCM and whether the swap is cleared by a DCO.[41]

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[30] *See id.* at 76,598.

[31] *See id.* at 76,580.

[32] *See id.*

[33] *See id.*

[34] *See id.* at 76,600.

[35] *See id.* at 76,598.

[36] *See id.* at 76,600.

[37] *See id.* at 76,581.

[38] *See id.*

[39] *See id.*

[40] *See id.* at 76,600.

[41] *See id.*

Using the Confirmation Process for Reporting under Proposed Regulation 45.3

The trade confirmation process for credit and equity derivatives globally already includes much of the data elements required under Proposed Regulation 45.3.[42] In its existing form, the trade confirmation process is designed to verify all terms of economic value between the counterparties, including all of the trade terms data required to value the trade. Existing trade confirmation processes also provide a strong audit trail.

Given that trade confirmation processes are key to supporting balance sheet verification for market participants, such processes have been developed with a high degree of completeness and accuracy, giving legal certainty to trading positions held by firms. Confirmation processes are designed to identify when economic terms to trades have changed, distinguishing between expected events under an existing confirmation and amendment of economic terms due to the modification of terms. Further, the logic behind these processes supports the identification of price-forming events, as required to be reported under Part 43. The trade confirmation is a bilateral process in which both parties agree to the confirmation, thereby ensuring any errors in the original data are corrected.

A major distinction between confirmation processes and Proposed Regulation 45.3 is timeliness. Proposed Regulation 45.3 requires 15 minute, 30 minute and 24 hour submission. In practice, most dealer submissions to the electronic confirmation process for new trades in credit and equity derivatives are made on an intra-day basis on trade date. Actual submission times vary in accordance with the internal practices of each dealer (*e.g.*, real-time versus multi-batch) but are designed to achieve full confirmation as close to the point of trade as possible. Exceptions occur primarily where buy-side firms have not provided allocations for block executions.

In addition, given that the electronic confirmation generation process is not significantly different from the trade reporting envisaged by Proposed Regulation 45.3, with respect to both trade data content and trade audit trail functionality, it may be difficult for reporting parties to provide SDRs with the data contemplated in Proposed Regulation 45.3 materially faster than provided via the submission process for trade confirmation. Firms are incented to issue and match confirms as soon as possible, as this leads directly to the identification of booking errors and enables recognition, managing previously unrecognized market and credit risk.

Through ongoing commitments made to the global OTC Derivatives Supervisors Group, the industry has greatly improved the timeliness and accuracy of confirmation submissions. This development has significantly mitigated the operational risk associated with OTC derivatives, particularly credit derivatives. It appears, therefore, that linking required regulatory reporting to the electronic confirmation process reduces operational

[42] *See id.*

risk and, at the same time, improves the timeliness and accuracy of confirmation submissions and regulatory reporting. The alternative approach would require maintenance of separate regulatory submission and electronic confirmation processes that would require a reconciliation process to compare confirmation records against data reported for regulatory purposes.

DTCC believes that the regulatory reporting and trade confirmation requirements should be consistent to best provide for a cost-effective and efficient system that integrates the timeliness of Proposed Regulation 45.3 with the confirmation process timeline. This organizational structure would require a phased-in implementation of Proposed Regulation 45.3. While it is difficult to determine how much closer trade confirmation can take place to the point of execution, certain elements of market practice will enable it to occur faster than it does today. For example, certain firms complete a number of data checks internally before issuing confirmations, including checks to interdealer broker trade confirmations, which can be further automated or will be superseded by electronic execution, enabling more timely submission. As further automated processes are used, it is possible that SEF executed trades could be reported within 15 minutes, assuming the existence of automated feeds from the SEF to reporting parties or directly to SDRs acting as agents for the reporting party. Similarly, further streamlining of enterable fields and standardization of required enrichments would help improve submission timeliness and accuracy by the reporting party, bringing confirmation even closer to the point of trade.

For credit derivatives, most market participants have the ability to confirm trades electronically, and most credit derivatives trades are stored as electronic, legally binding or "gold" records in the Warehouse. DTCC estimates that over 98% of credit derivatives trades globally are included in the TIW in this form. The initial records are submitted via an electronic confirmation service provider by both parties. For trades which would not be electronically confirmable, the current processes for booking the trade and preparing post-trade confirmation may not always allow for reporting within 24 hours. Currently, the detailed booking required for full valuation can take a number of days, and a number of points in the confirmation may require clarification and legal drafting prior to confirmation. These terms are generally not related to pricing, but reflect fallback procedures for certain future events and addressing ambiguities. Accelerating this to occur pre-execution will increase the burden on end users as they will have to incur additional legal costs to negotiate with all quoting dealers. While these details are pending, the reporting of certain fields is possible within 24 hours, and DTCC recommends the process of benchmarking improvements over time, as employed by the OTC Derivatives Supervisors Group ("ODSG"), as a model for addressing this issue.

Who Must Report

While noting the Commission's stated intent to select the reporting entity based on the ready availability of the information required to be reported, DTCC believes that market participants are still in the fledgling stages of examining how best to establish the most efficient and accurate reporting processes.[43] Therefore, DTCC suggests that the Commission consider permitting alternative reporting parties if doing so would result in more accurate reporting. For example, because SDs and MSPs are obligated to undertake certain reporting responsibilities, it may be more efficient and less technologically risky to require such entities to assume consolidated reporting responsibilities, particularly when certain information is not readily available to the prescribed reporting party (*e.g.*, SEFs). Further, providing counterparties a single point of reconciliation (*i.e.*, reconciling to an SDR) promotes efficiency and greater accuracy in reporting.

In addition, certain processes operate message data schemes that are order dependent because they are used to affect change to the full open notional at a point in time and, therefore, reports out of the correct sequence can lead to erroneous resultant positions. For example, for a trade that is partially terminated and then fully terminated, if the full termination message is received prior to the partial termination, the effective notional calculated in the position may appear as a negative. The sequencing issues are more difficult to control with multiple parties possessing the ability to update a position. DTCC developed procedures to manage these issues for credit derivatives with direct input from market participants.

At the direction of counterparties, data held by SDRs should be able to be used for purposes other than regulatory and public reporting. To ensure that these processes are properly performed, counterparties must maintain accurate data over the information they control. The Proposed Rule's assignment of reporting obligations to multiple parties precludes clear, singular responsibility for data accuracy and creates ambiguity in assigning responsibility to verify and correct reported data, particularly when subsequent events cause changes to the previously reported trade information. In such instance, a correction by one party may not lead to a consistent correction by another for the subsequent event. As such, the assignment of multiple reporting parties may not be efficient. In addition, parties to the trade may wish to use additional services offered by the SDR or third party vendors accessing this data, and additional data may need to be configured in the SDR to support this. For these reasons, trade counterparties should remain in control of the data in SDRs and agree which third party service providers act on their behalf.

As indicated previously, the CEA specifies that the "[p]arties to a swap (including agents of the parties to a swap) shall be responsible for reporting swap transaction information to the appropriate registered entity in a timely manner as may be prescribed by the

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[43] *See id.* at 76,581.

Commission."[44] While the value of third party providers acting as reporting agents has been proven, the entities with the statutory reporting responsibility will, in all likelihood, determine for themselves which agents are best used for what reporting. DTCC also notes that this is an instance where the CFTC and SEC proposed rules on data reporting are not consistent. In light of the above considerations, DTCC would urge that this difference be resolved by adopting the SEC approach under which the reporting responsibility stays with the applicable market participants who may then engage the appropriate third parties as agents to facilitate the process. This will best accommodate not only the current situation, but also potential future developments that cannot be anticipated at this time.

Reporting Timeframes

As noted above, DTCC believes that there are direct similarities between the reporting requirement of Proposed Regulation 45.3 and the confirmation process. The current confirmation process is not as timely as Proposed Regulation 45.3. DTCC's experience suggests that electronically executed trades could be confirmed within 15 minutes, but it would require straight through processes for all reporting parties, which may be cost prohibitive for some low volume users. In addition, DTCC's experience suggests that orally executed, but electronically confirmable, trades can be submitted in a relatively short timeframe, but likewise require a level of automation and investment in electronic trade processing. DTCC recommends that the electronically executed trade deadline be set at 30 minutes and the deadline for an electronically confirmable trade be set at 2 hours. To provide for a transition period to enable reporting parties to develop appropriate capabilities, these deadlines should be subject to phase in, initially starting closer to current market capability for electronically confirmable at 24 hours.

Manually confirmed trades are not currently subject to the same processes for all types of trades. Some trades are confirmed relatively quickly, with more standard contract confirmation generated by automated processes (*e.g.*, by delivery by facsimile or a PDF in email). Other trade confirmations are only issued after extensive legal drafting (required to describe economic terms) and validation against term sheets and internal trade bookings. Some trade confirmations may run to over 50 pages of terms. Trade booking into risk systems for certain complex trades, with appropriate controls over accuracy of input, can take a number of days. In addition, the submission for these trades may be heavily text-based. In light of these circumstances, it will be difficult for these trades to consistently be reported within 24 hours. Therefore, DTCC respectfully suggests that the Proposed Regulation be modified to permit a record without full terms to be sent within 24 hours, followed by the full terms, when available, but no later than 5 days.

[44] *See* CEA Section 2(a)(13)(F).

B. Swap Continuation Data

The Proposed Regulations call for reporting of four sets of data generated in connection with the continuation of a swap: (1) life cycle data for credit swaps and equity swaps; (2) contract-intrinsic data for credit swaps and equity swaps; (3) daily state data for interest rate swaps, currency swaps and other commodity swaps; and (4) valuation data for swaps in all five swap asset classes.[45] Under the Proposed Regulations, determination of who must report required swap continuation data is based on two criteria: (1) whether the swap is cleared on a DCO and (2) whether the reporting counterparty is a SD or MSP or, instead, a non-SD/MSP counterparty.[46]

For credit swaps and equity swaps, whether cleared or uncleared, the Proposed Regulations require that life cycle event data be reported on the same day in which any life cycle event occurs, while contract-intrinsic event data must be reported on the same day in which any contract-intrinsic event occurs.[47] For interest rate swaps, currency swaps, and other commodity swaps, whether cleared or uncleared, the Proposed Regulations require that all required state data for the swap be reported daily through the existence of the swap until its final termination or expiration.[48]

For each swap (regardless of asset class) cleared on a DCO, the Proposed Regulations require the DCO to report all valuation data in its possession on a daily basis.[49] Where the reporting counterparty for such a swap is an SD or MSP, the Proposed Regulations will require the SD or MSP to report all valuation data in its possession on a daily basis.[50] Where the reporting counterparty for such a swap is a non-SD/MSP counterparty, the Proposed Regulations call for the reporting counterparty to report all valuation data in its possession at times to be determined by the Commission prior to its adoption of final swap data reporting regulations.[51]

Flexibility in Data Collection Process

As noted above and repeated here, there is a significant concern that the Proposed Regulations have the potential to inadvertently frustrate the public purpose of regulatory reporting under the Dodd-Frank Act. Specifically, DTCC is concerned that in going beyond specifying ***what*** data needs to be reported by ***when*** and setting forth ***standards***

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[45] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,601.

[46] *See id.*

[47] *See id.*

[48] *See id.*

[49] *See id.*

[50] *See id.*

[51] *See id.*

for data maintenance – but also specifying ***how*** such data should be reported and by ***whom*** – the Commission risks a number of unintended, adverse results, including:

- receiving an incomplete set of data on swaps over their transaction lives, such incompleteness could adversely affect the Commission's market surveillance function, among others;
- receiving lesser quality (*i.e.*, less reliable) data when higher quality (*i.e.*, more reliable) data is readily available; and
- imposing unnecessary costs and burdens on reporting entities, as well as their non-reporting counterparties, such as fiduciary money managers and end users, with whom SDRs are obligated to confirm the accuracy of reported data.[52]

This potential for unintended, adverse results is exhibited in several aspects of the Proposed Regulations, discussed in further detail below. As a general matter, however, it is important to note that, as an industry governed utility with both buy- and sell-side firms represented on its governing bodies, DTCC is aware that market participants, who are statutorily responsible for all swap data reporting to SDRs,[53] have only just begun to analyze the safest, most efficient and most accurate means to report the required data.[54] It is prudent to avoid prescribing reporting methods based upon current practice that may or may not be relevant after implementation of all of the provisions of the Dodd-Frank Act or upon assumptions about future market infrastructure under the Dodd-Frank Act that may or may not turn out be accurate.

In order to fulfill its regulatory obligations, the Commission is best served by SDRs that maintain complete and accurate up-to-date (if not up to the minute) swap data that includes (with some very minor exceptions noted herein) all of the information set forth in the appendices to the Proposed Rule, and the regulatory steps taken must assure this occurs. Attempting at this early stage in the implementation process to set forth the precise manner in which this should be accomplished (and who should report) when the matter has not yet been fully considered by those with the statutory responsibility to report, risks a flawed solution. Alternatively, the Commission could require that any SDR demonstrate in its registration process that the reporting procedure contemplated by the SDR will result in timely reporting and proper maintenance of the data required by the CEA and the Proposed Regulations. Further, the integrity of the processes should be reviewed periodically.

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[52] *See* CEA Section 21(c)(2).

[53] *See* CEA Section 2(a)(13)(F).

[54] At the direction of the board of directors of DTCC's U.S. user governed cooperative repository, the Warehouse Trust Company (a New York based subsidiary servicing the global credit derivative market), we held a follow-up informal meeting with board members and their senior staffs on January 25, 2011 to specifically address concerns around how the industry would comply with swap data reporting requirements generally for all asset classes under both the SEC and CFTC proposed rules. These discussions are ongoing and involve senior representatives (generally, but not exclusively, heads of derivative operations) from global dealers, as well as from buy-side firms on both sides of the Atlantic appointed for such purpose by the major recognized buy-side trade associations.

As discussed in greater above, the daily snapshot approach is particularly unsuited to the credit and rates markets, where the degree of automated, electronic processing is high, and complete life cycle records are already available in most cases. However, for very complex swaps (which are generally not electronically confirmable and which exist in each asset class), it may indeed be the case that even reporting of confirm data associated with confirmable life cycle events would not catch all changes in trade economics.[55] It remains undetermined, however, whether reporting daily snapshots of all primary economic terms would be more or less burdensome on the industry. That being said, reporting only daily snapshots would lead to an inferior data set, than would a procedure under which life cycle events are reported. Mere reporting of daily snapshots leaves out the ***reason*** for any reported change. This is particularly problematic where the reasons for change have little to do with real economic trading, such as portfolio compression, allocating block trades, prime-broker give-up, etc. The Commission simply would not know whether the termination of a trade or the sudden appearance of a new trade was the result of real economic trading or of a different process such as compression. It would appear that this would hinder the market surveillance function of any market regulator.[56] It is important to note that under the daily snapshot model, errors are potentially indistinguishable from price-forming or life cycle events and, therefore, offer limited comparison.

DTCC's experience may be instructive with regard to the relative merits of the use of the daily snapshot model and one that requires reporting life cycle events (or, where this is not practical, at least reporting the changes in the previously reported primary economic terms).[57] DTCC has for years offered a payment reconciliation service for OTC derivatives under which submitters have the option of submitting all deals or just those

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[55] It appears from a combined reading of proposed Parts 43 and 45 that all confirmable life cycle events effectively have to be reported as "confirmation data." It would be helpful for the Commission to clarify that this is the case. If so, the distinction between reporting daily snapshots and life cycle events would appear to be relevant only with respect to non-confirmable events that changed the economics of the trade or where the full description of the event would be missing if merely the related confirmation was reported.

[56] The DTCC repository has worked with the ODRF to implement processes by which confirmation data associated with events such as compressions or prime-broker give-ups are electronically tagged through various means. This data may then be reflected in publications of real economic trading activity and information provided to regulators for market surveillance purposes. This process is not peculiar to the credit derivative markets and may be generally applicable to all asset classes. With respect to non-electronically confirmed transactions, it may be argued that these types of events would not be reported under Part 43, as they are not price forming events and, thus, it could be inferred that they were not relevant for market surveillance. This, however, ignores the fact that regulatory reporting serves as a check on compliance with Part 43 reporting and would be a much less effective check if the reason for trade terminations or the appearance of new trades due to life cycle events was unknown.

[57] The Commission notes that it may be difficult to enumerate the life cycle events for certain types of swaps. Assuming that this observation is correct, it does not support the argument that reporting daily snapshots is more accurate or less burdensome than reporting changes in the terms constituting the daily snapshot itself.

where the basic economic terms (*i.e.*, those necessary to determine payments) changed. DTCC found that some firms preferred one method, while some preferred another, with no appreciable difference in the data quality. Thus, it may be worth further study to determine whether one method or the other produces better data. DTCC would add that the incidence of relevant non-confirmable (and even confirmable) life cycle events in the rates, FX and commodities asset classes is relatively rare, particularly when compared with the frequency of these events in the credit and equity asset classes. It appears, therefore, more burdensome, rather than less, to require daily snapshots with respect to those asset classes given the requirements of CEA Section 21(c)(2) that SDRs confirm submitted data with both parties to the trade. Where exceptions are rare, exception processing is efficient – just report the exception; where exceptions are frequent, it is more problematic.

DTCC believes, therefore, that counterparties and SDRs should be given the flexibility to devise the most efficient, least error prone method of providing the Commission with the *complete* set of data that it needs to fulfill its regulatory obligations. The methods should not be prescribed *a priori* (when there is little experience to support the superiority of one method over another) except perhaps to state the principle that higher data quality is always to be preferred over lower data quality when it is available.

Similar concerns arise with respect to the Proposed Rule's specifications of who should report what data. This applies to both creation data and continuation data (as defined in the Proposed Rule). Although the Dodd-Frank Act clearly makes the counterparties (and agents) responsible for all reporting to registered entities (which include SDRs), the Commission in its Proposed Rules aims to "streamline and simplify" the approach by tying the reporting obligations to those entities that have easiest and/or earliest access to the data.[58] DTCC applauds the approach but is concerned that the understandings and assumptions upon which the Proposed Rule is based in this regard may turn out to be incorrect. To note just a few examples:

- Feedback DTCC has received from our users is that it is not likely that SEFs will be able to report all primary economic terms (as contemplated by the proposed rule) and that therefore the parties to the swap will have to report these terms. In that event, it is far easier for the reporting counterparty to report all such terms than just those not reported by the SEF (which may vary from SEF to SEF). If both report, then the SDR will have to incorporate its own matching and reconciliation process. In this case, the counterparty itself should be given the reporting responsibility (with the ability to use third parties as agents to report some or all of the data). Fortunately there are "middleware" solutions in the market today that take trading platform data and either enrich it using standing data provided by the counterparties themselves or permit the counterparties to correct and enrich the data. In the case of interest rates swaps, this process is well developed and takes an average of 8 minutes from the

[58] See Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,581.

point of execution. If counterparties themselves have the reporting responsibility, they can take advantage of these middleware providers to quickly validate and enrich the data originated by SEFs in order to meet these reporting requirements.

- In many cases DCOs leverage central life cycle event processors to manage asset servicing of cleared contracts. This is particularly important to market participants when there are multiple clearers and all clearers and bilateral counterparties must process life cycle events in exactly the same way.[59] In these cases, it would appear that the central life cycle event processor is in fact best situated to be the reporting entity. Again, this can be accomplished if the responsibility for reporting is left to the actual market participant counterparties who can then engage the appropriate third party as agent to fulfill the reporting obligation.
- For cleared trades, it is hard to ascertain the relevance of daily snapshot data. If the DCO maintains the official trade records (allowing for adequate performance of the requisite risk management), either by itself or through the engagement of a legal recordkeeping service, such as the TIW, a complete picture of the state of all cleared trades will be maintained by the DCO, which will also track changes on an automated basis. Reporting this data to SDRs should be sufficient. Separate reporting of daily snapshots by the market counterparties will only lead to confusion in data reporting.

The CFTC and SEC proposed rules on data reporting are not consistent. In this instance, in light of the above considerations, DTCC suggests that this difference should be resolved by adopting the SEC approach under which the reporting responsibility remains with the applicable market participants who may then engage the appropriate third parties as agents to facilitate the process. This will best accommodate not only present circumstances, but also potential future developments that cannot be anticipated at this time.

Reporting of Life Cycle Events

Many life cycle events are price-forming or significantly change the primary economic terms for a trade (examples of the latter category include novation, early termination, exercise, knock-out or knock-in). The Proposed Rule's definition supports reporting of these events, which is necessary for detailed markets regulation and for prudential and central bank regulation. Life cycle events are best reported in standard market forms (*e.g.*, for novation and early termination by trade confirmation; for exercise by exercise notice).

The TIW has developed solutions to a number of complex issues for credit derivatives and can support life cycle event reporting processes. Based on this experience, DTCC believes that solutions can be developed for the life cycle event reporting required under

[59] Thus, all but one of the credit default swap clearers in the United States and Europe leverage DTCC's Trade Information Warehouse to process life cycle events.

the Proposed Rule. In a number of cases, the life cycle event reporting timeliness will likely follow the initial reporting timeliness, particularly in the case of price-forming events subject to confirmation.

The requirements for contract intrinsic data for credit and equities trades appear too detailed. These are low level data elements of limited value to regulators, but onerous to capture and maintain. The rationale for requiring them in credit and equities, but not other asset classes, is unclear. The risk sensitivities to small price movements of observation sources of trades in other asset classes can be significantly greater than those in credit and equities due to the average notional sizes and tenors, notably in rates products. DTCC respectfully suggests that the requirement for contract intrinsic data in credit and equities is removed from the reporting requirements of the Proposed Rule.

Mixed Swaps and Multi-Asset Class Swaps

Mixed swaps that are subject to regulation by the Commission should be reported one time to an SDR registered with the Commission. For swaps subject to joint SEC-CFTC regulation, the trade information should be reported to an SDR operating in an applicable asset class registered with both the SEC and the Commission. Only when a dually-registered SDR does not exist for that asset class should the trade be reported to two SDRs. Duplicative reporting will diminish the value of aggregate data, and notably impacts counterparty based reporting of exposures and concentrations. Because of these potential risks, mixed swaps in repositories not registered with both the SEC and the Commission will need explicit identification by the repository.

Equity swaps and credit total return swaps, as examples, which involve a standard funding component, should be recognized as equity and credit products, respectively. These products should not be classified as mixed swaps.

Requirement for an SDR to Confirm Trades with Both Parties

The ODRF supports that the quality of data in SDRs be of the highest quality and involve confirmation or paired records. DTCC expects that third-party service providers, such as confirmation matching vendors, will be able to provide high quality data directly to the SDR, and the ability for reporting parties to appoint agents to fulfill their reporting obligations will be important for efficiency. DTCC notes that certain forms of confirmation are relatively inaccessible (*e.g.*, certain structured trades will have confirmation records only stored as electronic image files without electronically readable data elements, or electronically readable files but which are difficult to interrogate electronically without sophisticated text recognition software), and these will be poor sources of such data. In these cases, the SDR may be better served by primary economic data that is verified by the counterparty. This may also be true where confirmations have been executed by exchange rather than attestation to a single document. Where electronically matched confirmations records are available, these are the highest quality sources, but the SDR will need not just the confirmation but the match status.

Collateral Management

Collateral information is important to understanding counterparty exposures and is therefore key to systemic risk monitoring. Any reporting of collateral information should be required at a portfolio level. Proposals that require collateral information at a trade level are less instructive, as most collateral agreements operate across a portfolio of trades, and the collateral is called on a net exposure basis. For those reasons, any attribution at trade level is meaningless. Trades held in trade SDRs can be referenced to collateral data by establishing a collateral repository (in effect making collateral a further asset class) and on trade submission to the trade SDR including an indicator to show whether they are collateralized, and linked to the appropriate credit support agreement. This can be done by static data held at the SDR and where necessary the appropriate master agreement or master confirmation agreement reference. The mark-to-market of trades would be maintained within the trade SDR, and exposures would be calculated from aggregated trade valuations and collateral valuations.

Primary Economic Terms and All Confirmation Data

DTCC is concerned that any requirement to include master agreement dates and credit support agreement dates at trade level is onerous, as these operate at portfolio level, in hierarchical structures and generally are not directly incorporated into current trade level messages. Rather, they are typically incorporated by reference to one applicable agreement. Therefore the level of change required to incorporate these into individual trade messages is excessive and may be better supported by a portfolio level approach to such issues, if required at all. The trade level reference should follow the current process, which references the lowest level governing document, which document itself will in turn permit identification of all other relevant documents.

The Commission should clarify its intent with respect to whether "all confirmation data" in Proposed Rule 45.3 includes contractual changes to a trade (*e.g.*, novation, early termination, and other amendments to the trade documented by confirmation), as the preamble to the Proposed Regulation includes discussion of confirmation data only within the context of creation data; however it does not refer to it in the discussion of continuation data. DTCC's reading of Proposed Rule 45.3 is that it supports reporting of confirmation data for continuation events, and DTCC supports such treatment (*i.e.*, absent this requirement the reported confirmation data would be of limited usefulness as would not describe the open trade).[60]

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[60] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,578.

DTCC believes that OTC derivatives cannot be mapped readily to futures contracts in many cases. While futures market equivalents are used in risk management, the analysis as a futures contract equivalent involves a decomposition of the product and term structure and can involve choice as to futures to which to map and the use of synthetic futures contracts that do not exist on any exchange. In addition, it is a risk management approach that does not focus on product specific basis risks. This data will not necessarily be able to be meaningfully aggregated, is point in time based, and may be of limited use.

III. Unique Identifiers

The Commission proposes requiring use of unique identifiers to facilitate aggregation of transaction and position data for the purpose of conducting market and financial risk surveillance, enforcing position limits, analyzing market data, enforcing Commission regulations, monitoring systemic risk and improving market transparency.[61]

A. Unique Swap Identifiers

The Proposed Regulations require a Unique Swap Identifier ("USI") to be created and assigned to a swap at the time it is executed and used to identify that particular swap transaction throughout its existence.[62] For a swap executed on a trading platform, the USI will be created and assigned by the SEF or DCM involved.[63] For a swap executed bilaterally, the USI will be created and assigned by the SD or MSP required to report concerning the swap, or in the case of a swap between non-SD/MSP counterparties will be created by the SDR to which the swap is reported.[64]

A USI will likely be essential to identify the trade to which the Proposed Regulation's data reporting and corrections relate.[65] This can be achieved by consistent use of common identifier assigned by any third party and mapping the identifier to other proprietary standards, where appropriate. In the current TIW model, DTCC assigns a unique transaction ID, which is sent back by electronic message to submitting firms. This unique transaction ID or the firm's proprietary reference is used in subsequent submissions relating to that trade to the TIW and is used by submitting firms in periodic full population reconciliation against the TIW's records. USIs will also likely be useful to counterparties. Providing a shared identifier for both parties to the trades would improve efficiency of any processes where mutual recognition is needed and where some level of bilateral reconciliation would be required before processing.

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[61] *See id.* at 76,587.

[62] *See id.* at 76,602.

[63] *See id.*

[64] *See id.* at 76,587.

[65] *See id.*

SDRs and other service providers can assign unique transaction IDs. The SDR could provide the reference back to the reporting party as part of a message confirming receipt of the first submission. The TIW and DTCC recommend that this responsibility be retained by the SDR, as opposed to transferring it to other market participants. SDRs are better situated to establish consistent protocols to deal with these transformations without losing relevant information for regulatory use, as explained further below. Keeping this responsibility with SDRs may also eliminate any unintentional disclosure issues which stem from linking a trade to a specific execution platform, potentially increasing the instances of unintended identification of the trade parties. Currently, the TIW assigns a DTCC transaction reference identifier ("TRI"), which is unique to each trade, and messages this information back to both parties electronically.

USIs need very careful implementation. Swaps themselves do not remain unique, as they can split into more than one contract, merge, and even transform on a many-to-many basis. DTCC believe the most value is derived from being able to understand these events and recognize how a contract transforms through its life (*e.g.,* maintain an audit trail) and having an identifier for the trade be available at all times.

For a bilateral trade with limited post-trade activity, the application is relatively straightforward, as there is a one-to-one mapping with transactions. For example, if Client 1 executes a $10 million notional 5-year CDS with Bank 1, and after 6 months, terminates that trade, the result would that there is one transaction (the original 5-year CDS), with two trading events which require reporting by the bank, and can be reported with the same USI.

The situation becomes more complex when one transaction transfers to multiple parties. For example, Client 1 executes a $10 million notional 5-year CDS with Bank 1, and after six months, partially assigns $5 million of the trade to Bank 2. Bank 1 now has two open positions of $5 million, one with Client 1 and one with Bank 2. Reporting by Bank 1 of these trades using the same USI no longer uniquely identifies the record, and if Client 1 later terminated the residual $5 million, this update would need to be applied to the correct record in the reporting process to ensure accurate data.

There are a number of similar instances in which this occurs, both price-forming events (*e.g.,* partial assignment) and non price-forming events (*e.g.*, allocation, give up to a prime broker, or clearing). There are also instances where, after a creation event, there is some form of aggregation of separate trades. This is typical in portfolio compression and will be important in clearing netting. In this case, many creation trades are replaced with a single replacement trade representing the collective positions. Aggregation can be done by full termination of all the trades and the simultaneous creation of new trades, or by full termination of many trades and partial termination or upsizing of a select number from within that portfolio. In the latter case, preservation of a single USI is very difficult as it is a many-to-many relationship. Repeated application, which will be prevalent in clearing, will result in open trades which were derived from many thousands of prior trades, and hence arguably many thousands of USIs would be applicable to the open trade.

The importance of issues related to trade identification increases with the snapshot approach, as the snapshot approach needs to correctly reflect the number of trades, and will struggle to present any strong audit trail where multiple trades are impacted by a single event. In determining the optimal approach, the solution will likely be best informed by the purpose of the USI.

If the purpose is an audit trail, then a USI is not the real solution. Rather, the appropriate solution would require that events are stored with an audit trail in the SDR showing the trade identifiers and mapping of trade identifiers both before and after the life cycle event. The SDR could then link these events into event chains, providing a full audit trail from creation, which would be accessible to regulators. If the purpose is to support identification between parties and infrastructures (for participants and oversight), then common references are needed at the point in time when the interactions occur. A single USI through the life of the trade will not be sufficient for mapping between all venues as the trades transform through their life, and in effect the USI can become non unique. Rather, it will require common identifiers at a unique level at each usage (each point in time), but this identifier being allowed to change through the life of a trade. This is strongly linked to event processing and event based USI updates.

In either case, the USI does not look like a sufficient solution when compared with an event based solution. The event based solution can be first touch, or applied by the SDR and the arguments remain similar for each. In the first touch model, the references can be subscribed to with the transmission of the event form the vendor by all recipients. In the SDR model, the application of the identifier by the SDR serves to control reporting (a confirmation of a successful report), achieves standardization in processing identifier changes, reduces connectivity points for identifier updates, and preserves vendor anonymity in subsequent unrelated events. These characteristics are important and hence DTCC favors a model in which the SDR assigns identifiers. In such a model the SDR should not be precluded from being able to agree that execution and life cycle event processing platforms update these of its behalf for certain events. This will allow immediate establishment of unique identifiers and control by the SDR.

B. Unique Counterparty Identifiers

The Proposed Regulations mandate that each counterparty in any swap subject to the Commission's jurisdiction and executed after the effective date of the Commission's final swap data reporting regulations must be identified in all recordkeeping and reporting by means of a single Unique Counterparty Identifier ("UCI") having the characteristics specified by the Commission.[66]

[66] *See id.* at 76,602.

The Proposed Regulations require each swap counterparty to report all of its corporate affiliations into a confidential, non-public corporate affiliations reference database, designated by the Commission.[67] Data contained in the corporate affiliations reference database will be available only to the Commission and to other financial regulators via the same data access procedures applicable to data in SDRs for regulatory purposes.[68] The corporate affiliation information reported will be required to be sufficient to disclose parent-subsidiary and affiliate relationships, such that each legal entity within or affiliated with the corporate hierarchy or ownership group to which the counterparty belongs will be separately identified.[69] Each counterparty will also be required to report to the corporate affiliations reference database all changes to the information previously reported concerning the counterparty's corporate affiliations to ensure that the corporate affiliation information recorded in the corporate affiliations reference database remains current and accurate at all times.[70]

The Commission indicates that the corporate affiliations reference database will need to be accessible to both national and international financial regulators in order to make the identification system involving UCIs fully effective for regulatory purposes.[71] Further, the Commission believes a single corporate affiliations reference database, maintained by a single organization in a single location, will be optimal to ensure the availability of comprehensive and accurate information.[72]

Parent and affiliate information helps to illustrate the full group level exposures of firms and the impact of the failure of any participant. SDRs should possess the authority to obtain this information from firms for the purpose of use in reporting to regulators. SDRs should be able to provide netted data aggregates directly to regulators, as opposed to the underlying data and requiring each regulator to perform this aggregation itself. This is supported by ODRF Guidance to the Warehouse Trust Company LLC and the ODRF Functionality Outline, and reduces infrastructural requirements and costs for regulators.

DTCC envisions that SDRs will likely look to data vendors to provide this information, allowing market participants to review and approve such data. DTCC understands that data vendors specialize in this type of data service. Such vendors have suggested that other market participants often drive timely updates to the data, rather than the party directly impacted, due to the many parties using the data. Therefore, use of such a vendor may improve the accuracy of data in the SDR.

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[67] *See id.*

[68] *See id.*

[69] *See id.*

[70] *See id.*

[71] *See id.* at 76,591.

[72] *See id.*

DTCC understands that SWIFT's Bank Identification Code ("BIC") is an ISO standard for counterparty identifiers and that SWIFT is interested in supporting the provision of UCIs. DTCC is supportive of SWIFT acting in this capacity, but expects the SDR will be largely agnostic as to the form of identifier and believes any form of identifier could be adopted and function appropriately. DTCC believes that, minimally, the UCI should be used in communication between the SDR and regulators and will be readily convertible from other formats by the SDR – rather than requiring immediate adoption by all parties in the reporting process. DTCC expects that each market participant will acquire its UCI directly from the internationally recognized standards-setting body ("IRSB") and that the IRSB will make a level of data publicly available, without charge, to allow market participants to correctly identify the UCI, including the legal entity name and the registration location of that legal name.

The TIW currently uses proprietary codes to identify parties to trades, at a legal entity level, not at a subunit level. DTCC does not believe it complex or difficult to develop a mapping table to a UIC for reporting to regulators.

The Commission proposes to use its rulemaking authority to require the use of UCIs in all swap data reporting subject to its jurisdiction.[73] The Commission prefers to have its swap data reporting regulations prescribe use of a universally-available UCI that is part of an identification system created on an international basis through an international "voluntary consensus standards body," and intends to promulgate final regulations to that effect if such an identification is available sufficiently prior to the implementation date included in the Commission's final swap data reporting regulations.[74] However, the Commission will prescribe its own method for creation of UCIs to be used in swap data reporting subject to the Commission's regulations if no such internationally-accepted identification system acceptable to the Commission is available prior to the implementation date of the final regulations.[75] The Commission anticipates that a system for publication of UCIs meeting the requirements of the Proposed Regulations may be developed through an international voluntary consensus body and be available as of the implementation date for the UCI requirement.[76] The Proposed Regulations set forth principles that govern the identification system used to establish UCIs for swap counterparties.[77]

UCIs for both counterparties will be necessary for regulators to accurately track exposures between counterparties to swaps – a primary driver for the creation of SDRs.

[73] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,591.

[74] *See id.*

[75] *See id.*

[76] *See id.*

[77] *See id.*

The Proposed Regulation promotes the development of necessary UCIs. However, a primary issue with UCIs will be the initial issuance and adoption of UCI information, as these may not be available from a standards body at the onset of reporting.

C. Unique Product Identifiers

The Unique Product Identifier ("UPI") called for by the Proposed Rules will be used for categorization of swaps with respect to the underlying products referenced in them. While the UPI will be assigned to a particular level of the taxonomy of the asset class or sub-asset class in question, the Commission indicates that its existence will enable aggregation of transactions at various taxonomy levels based on the type of product underlying the swap.[78]

DTCC does not believe there is particular utility in aggregation based on a separate product taxonomy relative to aggregation based on primary economic terms data. Defining taxonomy levels with practical utility is a substantial undertaking and will require ongoing maintenance as products evolve and emphasis as to attributes of primary interest changes. The greatest flexibility will be achieved through the retention of full electronic data records (*i.e.*, electronic confirmation) and classification performed by the SDR based on a set of defined attributes by the regulator at the time of request. This view reflects the experience of firms that have used taxonomies and found that different users prefer different taxonomies (*e.g.*, a financial accountant will classify products based on accounting policy, while a market risk controller will want a classification based on risk attributes). While these classifications change in response to usage change, they must be applied retrospectively to open contracts. In the prior examples, the accountant would be responsive to accounting policy change, and the risk controller would be responsive to exposure levels requiring discrete market risk recognition on a gross or net basis. A parallel could be drawn in this case, if one expected use is for block trade thresholds, the liquidity distinctions between products change over time, and hence fixed categorization is not a useful tool to drive analysis for block trade groupings.

The Proposed Regulation contains a set of rules that mandate the use of standardized reporting formats and identifiers for swap information reported to a registered SDR.[79] DTCC recognizes that standardization of reporting generally and counterparty information specifically, as well as identification of parents and affiliates, is critical to providing regulators with a comprehensive view of the swaps markets and assuring that publicly reported data is accurate and meaningful. However, such standardization alone is not sufficient to permit prompt and accurate regulatory assessments of either risky and unsafe position taking or manipulative and abusive trading practices. Nor will standardization assure meaningful public reporting of relevant market information.

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[78] *See id.* at 76,592.

[79] *See id.* at 76,602.

DTCC has several years experience in operating the only global repository for an entire swap asset class (the TIW for credit derivatives) that has regularly and publicly reported key global market information, including net open interest and turnover information for the top 1,000 names traded worldwide, and regularly reported to relevant regulators worldwide key position risk and trade detail information. It is demonstrable that were the data publicly reported in aggregate by the TIW fragmented and reported by separate entities (*i.e.*, multiple repositories) the net open interest and net turnover information publicly reported would have been inaccurate and misleading in that it would have been almost always overstated, in many instances significantly.

In a presentation provided to regulators in July 2010, DTCC reviewed the net notional associated with the most liquid, on-the-run index (CDX.NA.IG.14) current at that time. The net open interest, as of July 9, 2010 was $33,035,116,000 at the clearinghouse and the bilateral, non-cleared net open interest was $69,231,897,351. This could have lead to an erroneous determination that the aggregate net open interest totaled $102,267,013,351. However, the cleared positions for a given counterparty often offset the bilateral net position. When the bilateral and cleared positions of each counterparty were netted together and then totaled, the net open interest for the marketplace was $46,906,650,518. This example illustrates that even for the most liquid contracts, fragmented reporting can indicate overall exposures of more than double what they actually are. This exemplifies the problems inherent in the disaggregation of any positions, whether cleared vs. non-cleared or cleared at different clearinghouses.

In general this is unacceptable, but it is particularly so during times of crisis when overstated public reporting of net open interest/net exposures could contribute to unnecessary, severe market reactions. During the Lehman Brothers ("Lehman") crisis, when the TIW was able to assure markets that the net amount of credit default swaps written on Lehman was no greater than $6 billion (actual net settlements on credit default swaps written on Lehman were approximately $5.2 billion), as opposed to the hundreds of billions of dollars speculated, this principle for providing information for market surety was demonstrated. Had the credit default swaps on Lehman been reported to multiple repositories at the time, the net exposure to Lehman could have been reported to have been as high as $72 billion, an amount that would have been off by a factor of greater than ten.

It has been alleged that the lack of accurate public information about firms' exposures in the credit default swap market was a significant contributor to the financial crisis of 2008. Unless regulators maintain the public reporting of net open interest based on the entire market rather than various portions of it, that situation will continue and this particular contributing cause to the 2008 financial crisis will not have been adequately addressed.

The other circumstance in which the credit default swap market was viewed as contributing to the financial crisis of 2008 revolved around the large one-way trades put on by AIG in mortgage related credit derivatives. Those trades were not reported to the TIW at the time (they have since been backloaded to the TIW). Importantly, if AIG had chosen to try to hide these trades by reporting to multiple repositories, these systemically risky positions would not have been discovered absent a "super repository" that aggregated the trade level data of the various reporting repositories in a manner as to detect the large one-way aggregate positions.

Unless data fragmentation can be avoided, the primary lessons of the 2008 financial crisis, as related to OTC derivatives trading, will not have been realistically or adequately taken into account. Nevertheless, standardization is also necessary and a precondition to avoid fragmentation. Specific comments on standardization and related issues are set forth below.

IV. Determination of Which Counterparty Must Report

The Proposed Regulations require reporting of confirmation data for all swaps as a means of verification of the accuracy of the data submitted in connection with each swap.[80] The Proposed Regulations establish a mechanism for counterparties to follow in choosing the counterparty to report in situations where both counterparties have the same hierarchical status, in order to prevent confusion or delay concerning this choice.[81] Where both counterparties are SDs, or both are MSPs, or both are non-SD/MSP counterparties, the Proposed Regulations require the counterparties to agree as one term of their swap transaction which counterparty will fulfill reporting obligations with respect to that swap.[82] The Proposed Regulations also provide that, where only one counterparty to a swap is a U.S. person, the U.S. person should be the reporting counterparty.[83]

As stated above, DTCC supports the use of confirmation records in fulfilling the obligation of the SDR to confirm data submissions with both parties.

DTCC expects reporting parties to desire to operate under clear, consistent standards, avoiding excessive complexity in the reporting process with respect to determining the reporting party or reporting requirements. Such issues will be magnified at the international level, as many jurisdictions will look to apply the G20 commitment to report all OTC derivatives to trade repositories. Middleware and messaging providers will look to provide services to reduce this complexity.

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[80] *See id.* at 76,581.

[81] *See id.* at 76,593.

[82] *See id.* at 76,604.

[83] *See id.*

As detailed above, DTCC believes the reporting party should be a party to the trade and should be responsible for contracting with any third party to fulfill this obligation.

As a further note, it is DTCC's understanding that U.S. persons may be restricted from complying with the Proposed Rule where they act outside the U.S. For example, DTCC understands that the London branch of a U.S person will require their counterparty's consent to identify that party under U.K. law. This consent could be obtained through terms of business between the parties, but in many cases may have already been obtained by service offerings that may connect to an SDR, such as the trade confirmation process. The value of these service offerings can be further illustrated by considering a parallel example executed by a Paris branch, where DTCC understands that, under French law, consent is required each time a report is made identifying the counterparty and, therefore, cannot be resolved by changes to the firm's terms of business. Again, confirmation service providers have resolved this issue through bilateral submission of confirmations. (These issues relate to the location of trading and, therefore, apply equally to any non-U.S dealer wanting to report on behalf of its U.S. customers.)

V. Third Party Facilitation of Swap Data Reporting

The Proposed Regulations explicitly recognize that registered entities and counterparties required to report under Part 45 may contract with third-party service providers to facilitate reporting, but, nonetheless, remain fully responsible for reporting as required by the Proposed Regulations.[84]

DTCC strongly supports the use of third parties to report swap data on behalf of reporting parties. However, such reporting by third parties should be required to be clearly authorized by the reporting party. The reporting party needs to control the data flow to SDRs to ensure completeness and accuracy of the data. Different firms will wish to have different workflows to support third party reporting, just as they do in the procedures used to undertake confirmation services. For confirmation services, certain firms allow interdealer brokers to book trades into a confirmation service on their behalf, whereas others do not. Similarly, certain firms, where the confirmation service acts by affirmation (one party agreeing to another party's record), accept the other firm's record of the trade following manual review – this books the trade into the internal trade capture system. Other firms book every trade and have built internal matching capabilities to validate records sent to them for affirmation. Finally, certain firms prefer external matching platforms to provide confirmation in order to support independent input, but avoid the full cost of building and maintaining an internal matching engine. DTCC believes it is important that reporting firms with the reporting obligation maintain control over reported positions throughout the life of the contract, with third parties acting for the reporting party in making updates. Otherwise, it is difficult for any party to take responsibility for the accuracy of the resultant position at the SDR.

[84] *See id.*

DTCC believes that the use of third parties will also strengthen the ability of the SDR to fulfill its statutory obligation to confirm the data with both parties.[85] In many cases, the third party will report trade information on behalf of both parties and, in the absence of an obligation for parties to confirm the data with the SDR, reduce the regulatory burden of the counterparties and ensure prompt compliance with reporting obligations. DTCC believes that, in many instances, firms will wish to submit every trade to the SDR or have a third party to manage submission to the SDR. Given the complexities related to establishing a new regulatory framework in a global market (particularly with jurisdictions expected to adopt new reporting rules related to SDRs as part of their G20 commitments), there is considerable complexity to devise rules that determine a reporting party's status within a hierarchy based on a counterparty's status or reporting requirements based on the product type.

As noted above, the CEA indicates that the "[p]arties to a swap (including agents of the parties to a swap) shall be responsible for reporting swap transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission."[86] Although the value of third party providers acting as reporting agents has been proven, the entities with the statutory reporting responsibility should determine for themselves which agents are best used for what reporting obligations. DTCC's Warehouse currently provides access to many vendors, including trade confirmation and trade messaging providers, central counterparties, portfolio reconciliation service providers, portfolio compression services, custodians and outsource providers. These third-parties are continually refining their service offerings and looking to service their customers, and can contribute to an efficient and accurate reporting regime.

The Proposed Regulation, being applicable to U.S. persons, would require that a U.S. person report transaction data when its counterparty is not a U.S. person. This approach may not be preferred where a U.S. customer is dealing with non-U.S. dealer, and the foreign dealer may wish to offer this as a service to make the actions consistent with those of the customer transaction with U.S. dealers. This type of service by dealers who are not U.S. persons will best promote prompt and accurate reporting, because dealers who are not U.S. persons are better positioned technologically than all but the most advanced of their customers to provide the necessary reporting. Therefore, DTCC urges the Commission to facilitate such arrangements.

VI. Reporting to a Single SDR

The Proposed Regulations require that all swap data for a given swap be reported to a single SDR, which must be the SDR to which required primary economic terms data for

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[85] *See* CEA Section 24(c)(2) ("A swap data repository shall – confirm with both counterparties to the swap the accuracy of the data that was submitted.").

[86] *See* CEA Section 2(a)(13)(F).

that swap is first reported.[87] The Proposed Regulations also provide that the SDR receiving this initial report transmit its own identity, together with the USI for the swap to each counterparty to the swap, to the SEF or DCM, if any, on which the swap was executed, and to the DCO, if any, to which the swap is submitted for clearing.[88] Thereafter, the Proposed Regulations require that all data reported for the swap by any registered entity or any counterparty to the swap, and all corrections of errors and omissions in previously reported data, be reported to that same SDR (or to its successor in the event that it ceases to operate).[89]

Where the initial report of required primary economic terms data is made by the SEF or DCM on which a swap is executed, or by an SD or MSP counterparty in the case of a swap not executed on a SEF or DCM, the Proposed Regulations provide that the choice of the SDR to receive the initial report must be made in a manner to be determined by the Commission prior to adoption of its final swap data reporting regulations.[90] Where the initial report of required primary economic terms data is made by a non-SD/MSP counterparty, the Proposed Regulations provide that the non-SD/MSP counterparty making that report must choose the SDR to which the report is made.[91]

If all swap data for a given swap is not reported to the same SDR, a significant burden will fall on the Commission to aggregate data in furtherance of its markets regulator responsibilities. In addition, as described above, the issues of swaps transforming through their life and the inability of a swap to maintain the same USI throughout its life, may render this impossible. Any subsequent report for a swap should be made to the same SDR.

With respect to choice, this should reside with the initial party to the trade responsible for reporting. The burden of responsibility for reporting should be on this party, including ongoing control or portfolio reconciliation to the SDR. The choice of an SDR for initial reporting will determine the recipient of many subsequent reports. This will also determine the ancillary services available to that trade, without replication in another SDR. The economics of that decision should remain with the initial party and be aligned with the bearing of the costs.

Replication or duplication should be avoided due to risks of misreporting and issues of public data availability, as part of the public policy objectives for the framework for SDRs.

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[87] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76,604.

[88] *See id.*

[89] *See id.*

[90] *See id.*

[91] *See id.*

These issues are further exacerbated on an international level; DTCC believes there is strong desire amongst regulators for relatively few SDRs providing largely global data. Without this, the value of the introduction of trade repositories is considerably reduced, becoming more like the existing regulatory regime. At present, regulators can access the data of their regulatees, but otherwise have to act in concert with their global counterparts or access data under memorandums of understanding ("MoUs"). Additionally, regulators must perform their own aggregation of the resultant data, being careful to avoid double counting of trades where the data does not relate to a regulatee. This aggregation is not simple to perform accurately, as different jurisdictions will define reportable trade populations differently and require different timing for reporting. As a result, in the absence of global or aggregate solutions, the burden of accurate aggregation will fall on each interested regulator.

Each of the key events in the financial crisis which led to the call for OTC derivatives trade repositories suggests regulators' need for global aggregate data: (i) the assessment of the impact of a financial institution's failure on other institutions requires immediate availability of full global exposures; (ii) the identification of a participant with large exposures in a particular market requires accurate aggregation of all exposures in that market; and (iii) the evaluation of the impact of derivatives market activity to the pricing of government debt requires cross jurisdictional data aggregates.

DTCC believes that, of the data that it publishes each week, the two key data sets are the reporting of net open interest for a reference entity and the trading activity for a reference entity. This data, particularly the net open interest, is very difficult to replicate from fragmented data sets, making the issue of fragmentation, both domestically and internationally, of significant concern.

The rule that requires ongoing reporting to the same SDR is important in responding to this, as are measures to ensure that international access to data is unencumbered.

VII. Data Reporting for Swaps in Asset Classes not Accepted by any Swap Data Repository

Situations could arise where a novel product does not fit into any existing asset class or no SDR yet accepts swap data for any swap in an existing asset class. In such situations, the CEA and the Proposed Regulations require the reporting counterparty to report to the Commission all swap data required by Part 45 to be reported to an SDR where one is available.[92] This report will be required to be made at a time and in a form and manner determined by the Commission.[93]

[92] *See id.*

[93] *See id.*

DTCC agrees that an SDR should be required to accept data for all swaps in an asset class, as this minimizes complexity for reporting parties and ensures that SDRs are positioned to aggregate a wide set of data for a market, which, if fragmented, may be misleading. The alternative of permitting SDRs to accept subsets of an asset class will significantly increase the difficulty for reporting parties in understanding trade admission criterion to a specific SDR, and require them to connect to many SDRs adding further to their difficulty in controlling the resulting position at any SDR.

The subsets accepted by the SDR in this case, will be based on specific business interests rather than a public policy objective and will likely leave the Commission with a tail of complex products being directly reported to it.

VIII. Required Data Standards

The Proposed Regulations require an SDR to maintain all swap data reported to it in a format acceptable to the Commission and to transmit all swap data requested by the Commission in an electronic file in a format acceptable to the Commission.[94] The Proposed Regulations require reporting entities and counterparties to use the facilities, methods or data standards provided or required by an SDR to which they report data, but also allow an SDR to permit reporting via various facilities, methods or data standards, provided that its requirements in this regard enable it to maintain swap data and transmit it to the Commission as the Commission requires.[95] The Proposed Regulations delegate to the Director of the Division of Market Oversight the ability to accommodate the needs of different communities of users and to provide the flexibility to adapt to changing circumstances and evolving data standards.[96]

Financial Products Markup Language ("FpML") ™ is broadly used as a standard in the OTC derivatives markets and should be the basis for reporting to an SDR. At times, SDRs will need to develop their own FpML tags, as often product development is ahead of formal market FpML development, and SDRs should have the discretion to do so. However, SDR-unique FpML tags should be converted to the market standard FpML in a reasonable time period. FpML has good coverage of trade terms, but will need to be extended to cover some of the data elements required in the Proposed Regulation.

Therefore, a registered SDR should have flexibility to specify acceptable data formats, connectivity requirements and other protocols for submitting information. Market practice, including structure of confirmation messages and detail of economic fields, evolve over time, and the SDR should have the capability to adopt and set new formats. In addition, the SDR will need to support an appropriate set of connectivity methods; the

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[94] *See id.*

[95] *See id.*

[96] *See id.* at 76,605

Commission should not, however, require SDRs to support all connectivity methods, as the costs to do so would be prohibitive.

The data formats of the SDR should be publicly available, and the SDR should publish Application Program Interfaces ("APIs") to permit direct submission by reporting parties and their agents (with appropriate validations by the SDR). The SDR is well positioned to establish standards for certain reporting attributes where these are not defined elsewhere.

DTCC believes market standard forms of data should be used, rather than a newly created set of reference data codes. New codes will need ongoing maintenance and require that specific processes be developed for reporting purposes, likely resulting in poorer quality data submissions. Currently, Markit Reference Entity Database ("RED")™ codes are widely used in trade confirmations for credit derivatives, and Reuters Instrument Codes ("RIC") are used in electronic messages for equity derivatives. These are subject to licensed use. DTCC supports the ongoing usage of licensed codes (with the provision that these codes be made available to small volume players at appropriately reduced costs).

IX. Cost-Benefit Considerations

TIW has approximately 1,700 customers, operating 17,000+ accounts for the global CDS market. Well over half of these are located in the U.S. and regularly transact business through dealers who are not U.S. persons. Unless the Commission encourages arrangements through which dealers who are non-U.S. persons can act as submitting parties for their U.S. customers, the costs of implementation are likely to impose significant burdens and costs on U.S. money managers, which are, in turn, likely to be passed through to U.S. consumers, such as individual investors, pension funds and state and local governments.

DTCC believes the current TIW model is efficient because it reuses data from the confirmation process, it ensures the quality of that data by performing asset servicing on the data and its users have agreed that the record in TIW has legally binding status. The asset servicing and legal status ensures that customers actively reconcile their internal data to TIW's data on an ongoing basis. This process occurs in place of multiple bilateral portfolio and trade level reconciliations and creates a more efficient model. In addition, for market events and updates, TIW has the benefit of multiple participants reviewing the calculations performed by DTCC processes, and the users appoint third party data servicers to act on their behalf while they retain the responsibility to maintain the most up-to-date record of the trade in TIW. This approach strengthens the quality of data in the TIW, but would not be available to a stand-alone, reporting-only solution.

X. Proposed Effective Date

The Commission understands that, after the date on which the Commission promulgates its final swap data reporting regulations, the industry will need a reasonable period of time to implement the requirements of those regulations.[97] Time may be required for entities to register as SEFs, DCMs, DCOs, or SDRs (or to update current registrations as DCMs or DCOs) pursuant to new Commission regulations concerning such entities.[98] Time may also be needed for registered entities and potential swap counterparties to adapt or create automated systems capable of fulfilling the requirements of Commission regulations concerning swap data reporting.[99] Accordingly, it may be appropriate for the Commission's final swap data reporting regulations to establish an effective date for the requirements contained in those regulations that is later than the date of their promulgation.[100]

DTCC believes the Commission should allow for an implementation date that is later than the date of promulgation of the final rules. Since final rules will not likely be available until Q2 2011, SDRs that apply for registration in July 2011 will do so largely having developed functionality based on the Proposed Rule, with a view to broad compliance as the priority over efficient usage and, therefore, with a potentially sub-optimal burden on reporting parties. Based on the final rules, SDRs and third party service providers will further enhance their offering. However, due to the complexity of, and the precision demanded from, the processes involved, an appropriate lead time should be anticipated to ensure systems are developed and implemented consistent with the intent of the regulation. Based on our experience in the development of similar systems, the time frame expected for the creation of functional specifications (4-6 weeks), technical specifications (4-6 weeks), actual development (8-10 weeks), regression testing (4-6 weeks), and user acceptance testing (6-8 weeks) – can be between 26-36 weeks.

Further, given this implementation would have to be market-wide, market-wide testing periods and design periods are likely to be even longer than these estimates, as market-wide initiatives need wide co-ordination. In that regard, DTCC notes that when it developed the TIW, in conjunction with market participants and the ODSG, systemic risk considerations dictated that it be implemented in phases:

- Year 1, design and build basic trade loading and storage capacity, with particular focus on data quality and inventory control. At the end of Year 1 all electronically confirmed new trades were automatically maintained in the Warehouse. To

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[97] *See id.* at 76.597.

[98] *See id.*

[99] *See id.*

[100] *See id.*

coordinate this effort across the industry globally, one of the "big 4" accounting firms was engaged and expended considerable resources.

- Year 2, back load all legacy inter-dealer transactions and implementation of automated payment calculation and central settlement through CLS bank. The back loading effort itself was a separately managed effort lead by the "big 4" accounting firm, which remained as program coordinator for the overall effort. Design of life cycle event processing agreed.

- Year 3, back load dealer-to-customer trades, begin reporting of non-electronically confirmed trades and central processing of life cycle events.

While much of this infrastructure can form the core of the processes required by the Proposed Regulation, it is inevitable that substantial new industry-wide processes will have to be implemented, particularly (though not exclusively) around real-time reporting, as required under Part 43. These new processes will take substantial coordination, testing and development, as noted above, and this will ultimately depend on the adoption of the final rule.

Reporting parties' development would have to follow the publication of final specifications by the SDR and ideally that of third party vendors. These dependencies make it unlikely that the first reporting could be implemented prior to the April 1, 2012 implementation date. April 1 would still be an early target, but DTCC believes it could be a realistic date for the first reporting, with a later date consistent with the time frame discussed above more suitable for mandatory market-wide adoption. Imposing an earlier deadline may lead reporting parties to have to develop solutions ahead of this, which may later be replaced by enhanced functionality at the SDR or third party vendors. In addition, credit products are more reporting-ready than equities products, because credit products' current operational processes show higher levels of automation.

XI. General Comments

DTCC urges the Commission to consider the importance of harmonizing its regulations with those of the SEC. Currently, the reporting requirements between the CFTC and the SEC differ with respect to some key process steps. Specifically, the Commission proposes to require some verification of trade data prior to submission of additional data, whereas the SEC does not. While the Commission proposes to require the SEF and clearing agency to perform certain reporting tasks, the SEC's proposal retains a single reporting party for a trade. Additionally, the CFTC's proposal calls for valuation data, confirmation data and contract intrinsic data for credit and equities products.

To illustrate the narrow distinction between swaps and security-based swaps, consider the possibility of certain equity basket trades moving between narrow and broad based index intra-day, with stock price movements changing the constituent weightings under the current definition of broad and narrow (*e.g.,* when the determinant of narrow is that five securities comprise more than 60% of the weighting). It would be beneficial to treat all credit and equity trades in a single process, utilizing the same reporting party and SDR, with all data available to the appropriate regulator, without building routines in reporting to test for market pricing, which may be required to determine index weightings, particularly when there are continuous price changes to the components.

DTCC believes these differences are meaningful enough to add complexity into the reporting processes and lead to omission or erroneous reporting, although there is a common goal in both processes with minimal differences. Where DTCC has made process recommendations that, in its view, will most likely achieve the shared policy goals, DTCC advocates that both the CFTC and the SEC adopt these recommendations. With respect to differences between the CFTC and SEC's proposed rules regarding reporting responsibilities, DTCC would expect certain third parties to report to the SDR, as they do to the TIW today, and foresees reporting by SEFs, clearing agents and portfolio compression services directly to the SDR. However, DTCC supports leaving ultimate responsibility for these arrangements with the reporting counterparty, which remains fully accountable for the representation of the trade in the SDR.

CONCLUSION

We appreciate the opportunity to comment on the Commission's Proposed Rule and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

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Via Agency Website & Courier

February 7, 2011

David A. Stawick, Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Real-Time Public Reporting of Swap Transaction Data (RIN 3038-AD08)

Dear Mr. Stawick:

The Depository Trust & Clearing Corporation ("DTCC") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC" or "Commission") on its proposed regulation regarding real-time public reporting of swap transaction data ("Proposed Regulation" or "Proposed Rule") under the Commodity Exchange Act ("CEA" or "Act").[1] DTCC's comments are provided with the goal of assisting the Commission in assessing how best to bring increased transparency and oversight to over-the-counter ("OTC") derivatives markets.

SUMMARY OF RESPONSE

DTCC supports the Commission's efforts to establish a comprehensive new framework for the regulation of swaps, including regulations that provide for the public availability of swap transaction and pricing data in real-time to enhance price discovery. As an industry utility that currently plays an important role in providing transparency to the derivatives market, as well as other markets, DTCC brings a unique perspective to the dialogue concerning the implementation of real-time public reporting requirements. In general, DTCC believes that the Commission's Proposed Rule should be fashioned in a way to ensure that the improvements to transparency and operations that have been achieved in the past few years are not lost, but rather built upon as new processes and systems are developed.

[1] *See* Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140 (December 7, 2010).

Subsidiaries:
The Depository Trust Company
National Securities Clearing Corporation
Fixed Income Clearing Corporation
DTCC Deriv/SERV LLC
DTCC Solutions LLC

Importantly, DTCC urges the Commission and the Securities and Exchange Commission ("SEC") to harmonize their respective regulatory regimes establishing reporting processes for credit and equity derivatives, thereby eliminating the risk and costs associated with developing and maintaining two separate regulatory reporting processes when only a single, comprehensive process is needed. The agencies' current regulatory proposals exhibit significant similarities, but differ in the details, creating potential inconsistencies that could increase risks of inaccurate reporting, as well as operational costs for market participants and swap data repositories ("SDRs"). DTCC urges the CFTC and SEC, when possible, to formulate consistent requirements with respect to data elements, reporting parties and reportable price-forming events.

It is important to aggregate data across the market, and the Commission should set and apply consistent thresholds for block trades in public dissemination by both SDRs and any market operators who directly disseminate information. The level of public transparency from mandatory regulatory reporting should not vary, whether based on the choice of the SDR to which a trade is reported or the market over which it is traded. DTCC believes that there should be relatively few asset classes defined, as this drives an increased aggregation of service provision, reducing the risks of duplication or omission in public dissemination, limits the possibility of erroneous consolidation by the public of available data, and reduces the burden on market participants to connect and reconcile to multiple SDRs. In this regard, DTCC strongly supports the proposals for acceptance of all swaps in an asset class. This action promotes sound public policy. For example, such a requirement will discourage potential SDRs from cherry picking only those swaps that are considered "easy" - a practice which contributes to data fragmentation and could undermine any economic case for taking the "hard" swaps. The net effect would lead to "hard" swaps falling to the Commission, resulting in an unnecessary monetary burden and wasted taxpayer resources.

While DTCC generally supports the Commission's approach that allows third party service providers to support reporting parties in fulfilling their reporting obligations, there is concern that the proposed rules will cause confusion for reporting parties. The Commission's proposal allows unregulated, non-SDRs to accept data reporting from swap markets and to serve the function as a real-time disseminator to fulfill the public reporting requirements under Part 43. DTCC questions whether an unregulated entity should be fulfilling the Commission's dissemination requirements, when SDRs are created by the statute to collect the very same data for regulatory and reporting purposes. If such third party dissemination by a non-SDR were to be allowed under the final rule, it is important to clarify that reporting trade data to such a third party real-time disseminator specifically does not fulfill the reporting requirements that counterparties to transactions must meet under Part 45. DTCC intends to comment further on these issues in its comment letter in response to Part 49 dealing with SDR registration and duties.

It is DTCC's view that the responsibility for reporting should be required of a principal to the trade, (most commonly the swap dealer), with the ability to appoint an agent to perform the reporting on the principal's behalf. In addition, DTCC encourages the use of existing standard business processes to support the reporting obligations, as the use of existing processes will enhance the accuracy of the reported data, improving error and omission controls and reducing the costs involved in the creation of entirely new reporting and compliance systems and procedures. DTCC also calls for the extension of the application of Proposed Rule 45.7, reporting to a single SDR, to include real-time reporting.[2] This will increase the integrity of reporting and appropriately align the relationship through all subsequent reporting to the SDR. This sound public policy appears to be consistent with the requirements of the CEA.[3]

After the final rules are adopted, market participants must be given adequate time to develop and implement appropriate reporting and compliance systems and procedures. Once these systems are fully tested and operational, real-time public reporting requirements should be implemented gradually to avoid market disruptions as the market reacts to the increased transparency. A phased-in public reporting protocol, beginning with reporting requirements for the most liquid centrally cleared contracts, will allow the Commission to study the impact of transparency on the market, and if necessary, make adjustments to both the timing of the dissemination and the data that should be disseminated.

DTCC's detailed comments are preceded by a brief overview of DTCC and the Trade Information Warehouse ("TIW" or "Warehouse"), a centralized global repository for trade reporting and post-trade processing of OTC credit derivatives contracts, which is operated by DTCC's wholly-owned subsidiary, The Warehouse Trust Company LLC.[4]

OVERVIEW OF DTCC

DTCC, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities transactions, money market instruments and OTC derivatives. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing agency for derivatives. However,

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[2] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574, 76,604 (December 8, 2010).

[3] *See* CEA Section 2(a)(13(G) ("**Each** swap (whether cleared or uncleared) shall be reported to **a** registered swap data repository.") (emphasis added).

[4] DTCC filed a separate letter with the Commission on February 7, 2011 addressing Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574. DTCC believes there is significant overlap of the issues addressed in the two letters and urges Commission staff to consider both sets of comments.

DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC ("NYPC")[5], which has been granted registration as a derivatives clearing organization ("DCO") by the CFTC.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Securities Exchange Act of 1934 ("Exchange Act"), subject to regulation by the SEC. These three clearing agency subsidiaries are The Depository Trust Company ("DTC"), National Securities Clearing Corporation ("NSCC") and Fixed Income Clearing Corporation ("FICC"). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost $34 trillion. In 2009, DTC settled more than $1.48 quadrillion in securities transactions. NSCC provides clearing, risk management, (for some securities) central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year – on an at-cost basis.

OVERVIEW OF THE TRADE INFORMATION WAREHOUSE

In November 2006, at the initiative of swap market participants, DTCC launched the Warehouse to operate and maintain the centralized global electronic database for virtually all position data on credit default swap ("CDS") contracts outstanding in the marketplace. Since the life cycle for CDS contracts can extend over five years, in 2007, DTCC "back-loaded" records in the Warehouse with information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 implementation date. Today, data for over 95 percent of all OTC credit derivatives are captured in this automated environment. The Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of $29 trillion ($25.3 trillion electronically confirmed "gold" records and $3.7 trillion paper-confirmed "copper" records).[6]

In addition to repository services (as contemplated by the proposed rules relating to SDRs, the acceptance and public and regulatory dissemination of data reported by reporting counterparties), the Warehouse provides both legal recordkeeping and central

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[5] NYSE Euronext owns the other 50% equity interest. Neither DTCC nor NYSE owns a majority of the equity interests in NYPC. NYPC has its own management team which controls the day to day operations of the company.

[6] Data provided as of December 31, 2010. For more information about the Trade Information Warehouse, please see http://www.dtcc.com/products/derivserv/suite/ps_index.php.

life cycle event processing for all swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details on the official legal or "gold" record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants' single-sided, non-legally binding or "copper" records for CDS transactions to help regulators and market participants gain a clearer and complete snapshot of the market's overall risk exposure to OTC credit derivatives instruments.

DTCC's Warehouse is also the first and only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. Various events can occur, such as calculating payments and bilateral netting, settling payments, credit events, early termination and company renames and reorganizations, which require action to be taken by the parties to such CDS contracts. DTCC's Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these functions by the Warehouse distinguishes it from any swap data repository that merely accepts and stores swap data information.

DISCUSSION OF PROPOSED REGULATIONS

Pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Proposed Regulation establishes a framework for the public availability of swap transaction and pricing data in real-time.[7] Under Section 2(a)(13)(A) of the CEA, the definition of "real-time public reporting" means reporting "data relating to a swap transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed."[8]

The Proposed Rule applies to all swaps, including: (i) swaps subject to the mandatory clearing requirement (including those swaps that may qualify for a non-financial end-user exception from the mandatory clearing requirement); (ii) swaps not subject to the mandatory clearing requirement but cleared at a registered DCO; (iii) swaps not cleared at a registered DCO and reported to a registered SDR or to the Commission; and (iv) swaps "determined to be required to be cleared" under the CEA but not cleared.[9]

The Proposed Rule sets out the framework for: (i) the entities or persons that must be responsible for reporting swap transaction and pricing data; (ii) the entities or persons that must be responsible for publicly disseminating such data; (iii) the data fields and guidance on the appropriate order and format for data to be reported to the public in real-

[7] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

[8] *See* Real-Time Public Reporting of Swap Transaction Data 75 Fed. Reg. at 76,140.

[9] *See id.* at 76,141.

time; (iv) the appropriate minimum size and time delay for block trades and large notional swaps; and (v) the proposed effective date and implementation schedule for the Proposed Rule.[10]

The Need for Harmonized Regulation

While DTCC strongly supports the development of thoughtful regulations regarding real-time trade reporting, it is important to put the Commission's Proposed Regulation in the context of the larger changes to the infrastructure of the OTC derivatives markets. With regard to real-time trade reporting, both this Commission and the SEC have proposed lengthy rulemakings. While these proposals are similar, they diverge in several respects, requiring market participants to address such differences when building out technology systems to handle reporting requirements. DTCC does not believe that the underlying differences between swaps and securities-based swaps necessitate differing regulatory treatment from a transaction reporting perspective.

DTCC urges the Commission and the SEC to harmonize their respective regulatory regimes establishing reporting and dissemination processes. A more cohesive approach would eliminate the risk and costs associated with developing and maintaining two separate regulatory reporting regimes when only a single, comprehensive framework is necessary. Moreover, the differing details in the two proposals create potential inconsistencies that could unnecessarily increase risks of inaccurate reporting and dissemination, as well as operational costs for market participants and SDRs. DTCC urges the CFTC and SEC to formulate a unified implementation schedule for real-time reporting with consistent requirements with respect to reporting transaction and pricing data, public dissemination of such data, specific data fields, and the calculation and reporting of block trades.

The Need for Aggregate and Consolidated Data

For real-time reporting, there must be consistent block trade definitions and thresholds across the global market. These should be representative of the entire market and reflective of market depth and liquidity for a given product – rather than reflective of localized subsets, based on narrow reporting populations, such as those defined by components of market infrastructure, counterparty location or fragmentation of reported information by reporting of trade executions to multiple SDRs. A localized block trade definition will provide participants with a potential means to avoid or delay public dissemination. Therefore, the Commission needs to determine how to establish consistent block trade rules and thresholds across the market.

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[10] *See id.*

DTCC believes that the dissemination function under this rule should be performed by a registered SDR. Allowing other entities to fulfill the regulatory requirements of real-time dissemination may add to the processes by which counterparties are required to submit data and further complicate the rules for market participants. Furthermore, the rules and core principles that will govern SDRs will help ensure that such dissemination is carried out in a manner consistent with the public utility function that is being provided. Also, reliance on an unregistered and unregulated third party real time disseminator to fulfill regulatory dissemination requirements fails to provide an oversight mechanism for the Commission to ensure the accuracy and completeness of the data disseminated.

As DTCC will discuss in its Part 49 comment letter, SDRs should not own or commercialize the data. However, the issue here is the regulatory requirements of dissemination, not commercialized or value added services. The contributors of the data should retain the rights and ownership of such commercialized services after the real time reporting requirements are fulfilled.

Furthermore, having the SDR provide the dissemination function will streamline reporting and avoid any confusion that reporting to a third party non-SDR disseminator is somehow fulfilling a counterparty's reporting requirements under Section 45.

DTCC believes that there should be relatively few asset classes defined, as this drives increased aggregation of service provision, reducing the risks of duplication or omission in public dissemination, or erroneous consolidation by the public of available data, and reduces the burden on market participants to connect and reconcile among multiple SDRs.

DTCC strongly supports Proposed Rule 43.3(c)(2), which requires the acceptance of all swaps in an asset class. There is limited difference between offerings within an asset class, and a partial service offering will limit the provision of a consolidated public record, increase complexity and costs in reporting (with reporting parties having to maintain additional relationship and support additional rules in their systems), weaken the error correction process (introducing additional routing logic to this), and leave some swaps without a provider or process for real-time dissemination.

Service Providers and Swap Dealer Reporting

DTCC believes that the burden of reporting should mostly fall to dealers, who generally will have more highly automated systems and connectivity capabilities than many customers. Most importantly, DTCC believes the reporting party should be a party to the trade, and they should be responsible for contracting with any third party to fulfill any reporting obligation to the SDR on their behalf. DTCC's rationale for this arises from the benefits of unambiguous accountability for data quality in an SDR and the recognition that in reporting all events to an SDR, the parties will need to operate reconciliation and control process to reconcile individual reports and the cumulative portfolio position against the SDR.

Furthermore, given that initial reporting will determine the SDR to which all subsequent data is reported, the initial reporting decision will need to align with a determination of the full cost burden and availability of services from the chosen SDR. DTCC believes this decision should be with the party who will bear this cost (*i.e.,* a party to the contract rather than an execution venue).

TIW has approximately 1,700 customers, operating 17,000+ accounts for the global CDS market. Well over half of these are located in the U.S. and regularly transact business through dealers who are not U.S. persons. Unless the Commission encourages arrangements through which dealers who are non-U.S. persons can act as submitting parties for their U.S. customers, the costs of implementation are likely to impose significant burdens and costs on U.S. money managers, which are, in turn, are likely to be passed through to U.S. consumers, such as individual investors, pension funds and state and local governments.

Efficiency and Integrity in Reporting

Pursuant to the CEA, SDRs shall have reasonable discretion in complying with the core principles outlined in Section 21 of the Act.[11] Accordingly, in order to avoid placing unreasonable and unnecessarily costly compliance burdens on regulated entities, DTCC encourages the Commission to adopt regulations that allow SDRs flexibility in determining the best reporting methods to promote complete, timely and accurate swap data is available to the Commission.

Reporting parties do not want to face excessive complexity in the reporting process. Issues with respect to determining the reporting party or the reporting requirements increase when considering that further regulations will need to be issued by other G20 countries to comply with the reporting requirements for all OTC derivatives to trade repositories. It should, however, be noted that many of these services can be fully integrated into existing business processes by middleware providers, as trade capture and confirmation services often are today.

DTCC believes the current TIW model is efficient because it reuses data from the confirmation process. Further, the TIW model ensures the quality of that data by performing asset servicing on the data and its users have agreed that the record in TIW has legally binding status. The asset servicing and legal status encourages customers to actively reconcile their internal data to TIW's data on an ongoing basis. This process

[11] *See* CEA Section 21(a)(3)(B) ("Unless otherwise determined by the Commission by rule or regulation, a swap data repository . . . shall have reasonable discretion in establishing the manner in which the swap data repository complies with the core principles described in [Section 21 of the CEA].").

replaces multiple bilateral portfolio and trade level reconciliations and creates a more efficient model. In addition, for market events and updates, TIW has the benefit of multiple participants reviewing the calculations performed by DTCC processes, and the users appoint third party data servicers to act on their behalf while they retain the responsibility to maintain the most up-to-date record of the trade in TIW. This approach strengthens the quality of data in the TIW, but would not be available for a stand-alone, reporting-only solution.

While real-time reporting is limited to price-forming events, it will also benefit from strong linkage to existing business processes, particularly linkage to trade capture and middleware or confirmation services. In some cases, the confirmation process is driving the booking of the trade into firms trade capture and risk systems and therefore represents the earliest point for feeding to a real-time reporting process. Real-time reporting would also benefit from additional integrity to error and omission reporting processes, with strong integration with existing business processes and subsequent reporting.

Therefore DTCC recommends that the Commission extend the reporting to a single SDR in Proposed Rule 45.7 to include real-time reporting.[12] DTCC believes this is required by the CEA[13] and will result in increased integrity of reporting, which is sound public policy. Furthermore, the Commission should not try to develop a specific nomenclature for real-time reporting, as it adds further complexity and inconsistency to usage of terms in the market.

Financial Products Markup Language ("FpML") ™ is broadly used as a standard in the OTC derivatives markets and should be the basis for reporting to an SDR. At times, SDRs will need to develop their own FpML tags, as often product development is ahead of formal market FpML development, and SDRs should have the discretion to do so. However, SDR-unique FpML tags should be converted to the market standard FpML in a reasonable time period. FpML has good coverage of trade terms, but will need to be extended to cover some of the data elements required in the Proposed Regulation.

Therefore a registered SDR should have flexibility to specify acceptable data formats, connectivity requirements and other protocols for submitting information. Market practice, including the structure of confirmation messages and detail of economic fields, evolve over time, and the SDR should have the capability to adopt and set new formats. In addition, the SDR will need to support an appropriate set of connectivity methods; the Commission should not, however, require SDRs to support all connectivity methods, as the costs to do so would be prohibitive.

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[12] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,604.

[13] *See* CEA Section 2(a)(13)(G) ("**Each** swap (whether cleared or uncleared) shall be reported to **a** registered swap data repository.") (emphasis added).

The data formats of the SDR should be publicly available, and the SDR should publish Application Program Interfaces ("APIs") to permit direct submission by reporting parties and their agents (with appropriate validations by the SDR). The SDR is well positioned to establish standards for certain reporting attributes in situations where these standards are not defined elsewhere.

DTCC believes market standard forms of data should be used, including reference data codes, rather than a newly created set of reference data codes. New codes will need ongoing maintenance and require that specific processes be developed for reporting purposes, likely resulting in poorer quality data submissions. Currently, Markit Reference Entity Database ("RED")™ codes are widely used in trade confirmations for credit derivatives, and Reuters Instrument Codes ("RIC") are used in electronic messages for equity derivatives. These are subject to licensed use. DTCC supports the ongoing usage of licensed codes (with the provision that these codes be made available to small volume players at appropriately reduced costs).

Phase-in and Implementation Timeline

Since final rules will not likely be available until Q2 2011, SDRs that apply for registration in July 2011 will do so largely having already developed functionality based on the Commission's proposed regulations, with a view to broad compliance as the priority over efficient usage and, therefore, with a potentially sub-optimal burden on reporting parties. Based on the final rules, SDRs and third party service providers will further enhance their offering. However, due to the complexity of, and the precision demanded from, the processes involved, a relatively long lead time should be expected – for example, a minimum of six months. Based on the final rules, SDRs and third party service providers will further enhance their offering. However, due to the complexity of, and the precision demanded from, the processes involved, an appropriate lead time should be anticipated to ensure systems are developed and implemented consistent with the intent of the regulation. Based on our experience in the development of similar systems, the time frame expected for the creation of functional specifications (4-6 weeks), technical specifications (4-6 weeks), actual development (8-10 weeks), regression testing (4-6 weeks), and user acceptance testing (6-8 weeks) – can be between 26-36 weeks.

Further, given that this implementation would have to be market-wide, market-wide testing periods and design periods are likely to be even longer than these estimates, as market-wide initiatives need wide co-ordination. In that regard, DTCC notes that when it developed the TIW in conjunction with market participants and the OTC Derivatives Supervisors Group ("ODSG"), systemic risk considerations dictated that it be implemented in phases:

- Year 1, design and build basic trade loading and storage capacity, with particular focus on data quality and inventory control. At the end of Year 1 all electronically confirmed new trades were automatically maintained in the Warehouse. To coordinate this effort across the industry globally, one of the "big 4" accounting firms was engaged and expended considerable resources.

- Year 2, back load all legacy inter-dealer transactions and implementation of automated payment calculation and central settlement through CLS bank. The back loading effort itself was a separately managed effort lead by the "big 4" accounting firm, which remained as program coordinator for the overall effort. Additionally in year 2, the design of life-cycle event processing was agreed.

- Year 3, back load dealer-to-customer trades, begin reporting of non-electronically confirmed trades and central processing of life-cycle events.

While much of this infrastructure can form the core of the processes required by the Commission's proposed regulations, it is inevitable that substantial new industry-wide processes will have to be implemented, particularly (though not exclusively) around real-time reporting. These new processes will take substantial coordination, testing and development, as noted above, and this will ultimately depend on the adoption of the final rules.

Reporting parties' development would have to follow the publication of final specifications by the SDR and ideally that of third party vendors. These dependencies make it unlikely that the first reporting could be implemented prior to the April 1, 2012 implementation date. April 1 would still be an early target, but DTCC believes it could be a realistic date for the first reporting, with a later date consistent with the time frame discussed above more suitable for mandatory market-wide adoption. Imposing an earlier deadline may lead reporting parties to have to develop solutions ahead of this, which may later be replaced by enhanced functionality at the SDR or third party vendors. In addition, credit products are more reporting-ready than equities products, because credit products' current operational processes show higher levels of automation.

The phasing proposals for public dissemination limits the initial information in the public domain to the most traded contracts, which may enable a better understanding of the impact of public dissemination of less liquid contracts. However, this does not mitigate the delivery risk for the reporting processes, as all processes have to be fully functional before the first reporting period.

DTCC experience with new industry-wide processes indicates there will likely be a "shakeout" period during which any number of problems with reported data will be discovered. The Commission should take this into account and provide a means of assuring that publicly disseminated information is of high quality before dissemination is permitted. In this regard, DTCC understands that TRACE was initially introduced with a reporting deadline of more than an hour, which was tightened over a period of 18 months. DTCC would advocate a similar approach in this case, starting with a similar deadline and tightening over a similar period to TRACE.

The Need to Preserve Liquidity and Protect Anonymity

To date, DTCC has looked to regulators and market participants in determining the information which TIW disseminates publicly. The liquidity studies published by DTCC show that credit derivative trading is extremely thin on the majority of roughly 3,000 single name underlyers, and even this data is in aggregate across all maturities for a single reference entity.[14] In addition, the proposed execution model, when combined with public dissemination, may lead to potential unintentional disclosure. For example, a request for quote ("RFQ") process with 5 counterparties will likely enable those parties to link RFQs to specific executions, given that there is less than one trade per hour per underlying for the majority of credit derivative underlyings.[15]

DTCC's discussions with market participants and regulators prior to publishing data have revealed high levels of sensitivity to disclosing small data samples, particularly from narrow time periods, given that such disclosure may not preserve the anonymity of the trading parties. Currently, DTCC does not report credit default swap information beyond the top 1,000 names, because regulators and market participants have expressed concerns with respect to unintentional disclosure of parties as a result of low trading activity levels. Consistent with the Dodd-Frank Act, the Proposed Regulation should not require SDRs to make disclosures that could cause the unintentional disclosure of counterparty information.[16] DTCC urges the Commission to consider this issue fully in determining the phase-in period and the scope of public dissemination.

With respect to non-standardized swaps, it is difficult to compare price data across transactions that are non-standard and have different terms, particularly when only limited information as to the non standard feature (as presented by an indicator only) is available. As a result, publication of only price (or other limited) transaction data for non-standard transactions is unlikely to benefit market participants and may, in fact, be confusing or misleading. DTCC does not think that further trade attributes should be reported, as only the most technically sophisticated recipients would be able to interpret the additional published data. DTCC believes that any dissemination of information with respect to highly structured trades should be phased in, if required at all, and that no

[14] TOP 1000 SINGLE NAMES: AGGREGATED TRANSACTION DATA BY REFERENCE ENTITY, http://www.dtcc.com/products/derivserv/suite/ps_index.php.

[15] *See* Core Principles and Other Requirements for Swap Execution Facilities 76 Fed. Reg. 1214 (Jan. 7, 2011).

[16] *See* CEA Section 2(a)(13)(E)(i) ("With respect to the rule providing for the public availability of transaction and pricing data for swaps . . . , the rule promulgated by the Commission shall contain provisions . . . to ensure such information does not identify the participants.").

dissemination for these products should occur until an analysis is conducted as to the impact and potential for misleading the investing public.

Hours of Operation; Recordkeeping and Fees

DTCC believes that SDRs should operate 24/6, allowing for continuous access to data by regulators, including during periods where individual exchanges or other trading platforms are closed. Requiring such operating hours recognizes the global nature of trading in derivatives markets and the round-the-clock participation in these markets by U.S. persons. One of the primary issues that reporting to a repository is designed to address is the analysis of the consequential impact of the failure of an institution, an event which is not limited to U.S.-based standard hours.

DTCC's believes that real-time data should be retained for an appropriate period from the date of the price-forming event to allow re-publication of historic price data, and support the error correction process. As a practical matter, SDRs may need to hold all data to maturity of the contract. This will allow participants to complete any error correction processes, given that detection of an error may only be triggered by a subsequent event on that trade and recognition of an erroneous previous report at that stage.

Currently, TIW provides public data at no charge. DTCC envisions this practice continuing for both the weekly and periodic reporting available at www.dtcc.com and any real-time price reporting required by the Proposed Regulation. TIW considers the data reported to it through agreement with supervisors (and pursuant to regulation, after implementation of the Commission's final rules) to be that of the market participants, not TIW's own, and provides additional services only as approved by its user board of directors, or where contractually required, to the individual customers themselves. It is good public policy that the aggregating entity not itself use the data for commercial purposes, particularly where data is required to be reported to an aggregator serving a regulatory purpose. The data may then be made available to value added providers on a non-discriminatory basis, consistent with restrictions placed on the data by the data contributors themselves. DTCC operates the TIW on an at-cost basis and believes this is an appropriate model for the operation of an SDR, given the central role SDRs play in supporting regulator surveillance generally.

CONCLUSION

We appreciate the opportunity to comment on the Commission's Proposed Rule and provide the information set forth above. Should you wish to discuss these comments further, please contact me at 212-855-3240 or lthompson@dtcc.com.

Regards,

Larry E. Thompson

Larry E. Thompson
General Counsel

TESTIMONY
OF
TERRENCE A. DUFFY
EXECUTIVE CHAIRMAN
CME GROUP INC.
BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE

FEBRUARY 15, 2011

Chairman Bachus, Ranking Member Frank, members of the committee, thank you for the opportunity to testify respecting implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, July 21, 2010) ("DFA"). I am Terry Duffy, Executive Chairman of CME Group, which is the world's largest and most diverse derivatives marketplace. CME Group includes four separate exchanges—Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX") (together "CME Group Exchanges"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME also includes CME Clearing, a derivatives clearing organization and one of the largest central counterparty clearing services in the world; it provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter ("OTC") derivatives transactions through CME Clearing and CME ClearPort®.

The CME Group Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions. In addition, CME Group distributes real-time pricing and volume data through a global distribution network of approximately 500 directly connected vendor firms serving approximately 400,000 price display subscribers and hundreds of thousands of additional order entry system users. CME's proven high reliability, high

availability platform coupled with robust administrative systems represent vast expertise and performance in managing market center data offerings.
The financial crisis focused well-warranted attention on the lack of regulation of OTC financial markets. We learned a number of important lessons and Congress crafted legislation that, we hope, reduces the likelihood of a repetition of that near disaster. However, it is important to emphasize that regulated futures markets and futures clearing houses operated flawlessly. Futures markets performed all of their essential functions without interruption and, despite failures of significant financial firms, our clearing house experienced no default and no customers on the futures side lost their collateral or were unable to immediately transfer positions and continue managing risk.

We support the overarching goals of DFA to reduce systemic risk through central clearing and exchange trading of derivatives, to increase data transparency and price discovery, and to prevent fraud and market manipulation. Unfortunately, DFA left many important issues to be resolved by regulators with little or ambiguous direction and set unnecessarily tight deadlines on rulemakings by the agencies charged with implementation of the Act. In response to the urgent schedule imposed by DFA, the Commodity Futures Trading Commission ("CFTC" or "Commission") has proposed hundreds of pages of new or expanded regulations.

In our view, many of the proposals are inconsistent with DFA, not required by DFA, and/or impose burdens on the industry that require an increase in CFTC staff and expenditures that could never be justified if an adequate cost/benefit analysis had been performed. In the view of many experienced derivative industry professionals, the CFTC has been selectively reading DFA to implement a policy that is likely to defeat the real goals of DFA.

We realize that the Commission is under immense pressure to complete many rulemakings within a very short time period. Put simply, DFA set forth an unrealistic rulemaking schedule. And even more problematically, many of the rulemakings required by DFA are interrelated. That is, DFA requires many intertwined rulemakings with varying deadlines. Entities such as CME often cannot fully anticipate the meaning of a proposed rule when that proposed rule is reliant on another rule that is not yet in its final form. As a result, interested parties are unable to comment on the proposed rules in a meaningful way, because they cannot know the full effect of the proposed rules.

For example, rules addressing the definitions of "swap," "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant" and "security-based swap agreement" are absolutely fundamental to the Commission's regulatory scheme under DFA. As such, they must be established before interested parties can meaningfully address other proposed rules. Nonetheless, the Commission just proposed rules regarding these definitions on December 21, 2010, and the comment period for those proposed rules does not even close until February 22, 2011. *See* 75 Fed. Reg. 80174. Meanwhile, the Commission has proposed many other rules, and many comment periods have closed without commentators having the benefit of clarity on these essential definitions.

This Congress can mitigate some of the problems that have plagued the CFTC rulemaking process by extending the rulemaking schedule so that professionals, including exchanges, clearing houses, dealers, market makers, and end users can have their views heard and so that the CFTC will have a realistic opportunity to assess those views and measure the real costs imposed by its new regulations. Otherwise, the unintended adverse consequences of those ambiguities and the rush to regulation will impair effective exchange innovation and stifle the most important growth paths in our industry, including the clearing of OTC transactions. Indeed, the threat of such policies has already driven major customers to move business off U.S. markets.

Several Commissioners clearly recognize this issue and have been forthright in suggesting that the CFTC temper its ambitions. For example, in her recent statement opposing proposed rules in the area of position limits, Commissioner Sommers expressed concern regarding the lack of analysis performed before proposal of the rules. She specifically noted that she was troubled by the lack of analysis of swap markets and of whether the proposal would "cause price discovery in the commodity to shift to trading on foreign boards of trade," and that "driving business overseas remains a long standing concern." Further, Commissioner Sommers noted that, in any case, the Commission did not have the capacity to enforce the proposed rule.[1] Commissioner Dunn has echoed our

[1] In full, Commissioner Sommers stated:"I oppose the proposal before us today because I believe it is flawed in a number of respects. First, I believe we should conduct a complete analysis of the swap market data before we determine the appropriate formula to propose. We have not done that. Second, without data on swap market positions, the spot month limits we are proposing are not enforceable. I think it is bad policy to propose regulations that the agency does not have the capacity to enforce. Third, in Section 4a(a)(1) of the Commodity Exchange Act, Congress specifically authorized the Commission to consider different limits on different groups or classes of traders. This language was added in Section 737 of Dodd-Frank. The proposal before us today does not analyze, or in any way consider, whether different limits are appropriate for different groups or classes of traders. Finally, Section 737 of Dodd-Frank states that the Commission shall strive to ensure that position limits will not cause price discovery in the commodity to shift to trading on foreign boards of trade. This proposal does not contain any analysis of how the

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concerns regarding the lack of CFTC funding and the potential detrimental effects of a prescriptive, rather than principles-based, regime upon the markets. More specifically, he expressed concern that if the CFTC's "budget woes continue, [his] fear is that the CFTC may simply become a restrictive regulator. In essence, [it] will need to say "No" a lot more . . . No to anything [it does] not believe in good faith that [it has] the resources to manage" and that "such a restrictive regime may be detrimental to innovation and competition."[2] Commissioner O'Malia has likewise expressed concern regarding the effect of proposed regulations on the markets. More specifically, the Commissioner has expressed concern that new regulation could make it "too costly to clear." He noted that there are several "changes to [the] existing rules that will contribute to increased costs." Such cost increases have the effect of "reducing the incentive of futures commission merchants to appropriately identify and manage customer risk. In the spirit of the Executive Order, we must ask ourselves: Are we creating an environment that makes it too costly to clear and puts risk management out of reach?"[3]

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proposal attempts to accomplish this goal. In fact, the proposal does not even mention this goal. Driving business overseas is a long standing concern of mine, and that concern remains unaddressed."
Commissioner Jill E. Sommers, Opening Statement, Open Meeting on the Ninth Series of Proposed Rulemakings under the Dodd-Frank Act, (January 13, 2011) http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement011311.html

[2] Commissioner Dunn stated: "Lastly, I would like to speak briefly about the budget crisis the CFTC is facing. The CFTC is currently operating on a continuing resolution with funds insufficient to implement and enforce the Dodd-Frank Act. My fear at the beginning of this process was that due to our lack of funds the CFTC would be forced to move from a principles based regulatory regime to a more prescriptive regime. If our budget woes continue, my fear is that the CFTC may simply become a restrictive regulator. In essence, we will need to say "No" a lot more. No to new products. No to new applications. No to anything we do not believe in good faith that we have the resources to manage. Such a restrictive regime may be detrimental to innovation and competition, but it would allow us to fulfill our duties under the law, with the resources we have available." Commissioner Michael V. Dunn, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act (January 13, 2011) http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement011311.html

[3] In Facing the Consequences: "Too Costly to Clear," Commissioner O'Malia stated: "I have serious concerns about the cost of clearing. I believe everyone recognizes that the Dodd-Frank Act mandates the clearing of swaps, and that as a result, we are concentrating market risk in clearinghouses to mitigate risk in other parts of the financial system. I said this back in October, and unfortunately, I have not been proven wrong yet. Our challenge in implementing these new clearing rules is in not making it 'too costly to clear.' Regardless of what the new market structures ultimately look like, hedging commercial risk and operating in general will become more expensive as costs increase across the board, from trading and clearing, to compliance and reporting."

"In the short time I have been involved in this rulemaking process, I have seen a distinct but consistent pattern. There seems to be a strong correlation between risk reduction and cash. Any time the clearing rulemaking team discusses increasing risk reduction, it is followed by a conversation regarding the cost of compliance and how much more cash is required."

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We are concerned that many of the Commission's rulemakings to date would unnecessarily convert the regulatory system for the futures markets from the highly successful principles-based regime that has permitted U.S. Futures markets to prosper as an engine of economic growth for this nation, to a restrictive, prescription-based regime that will stifle growth and innovation. This could have a detrimental affect on the competitiveness of U.S. exchanges as well as job creation and the U.S. economy as a whole. We are also concerned that many of the Commission's proposed rulemakings go beyond the specific mandates of DFA, and do not comply with the Administrative Procedure Act's requirements that rulemakings be legitimately grounded in evidence and strong economic theory. I will now address, in turn, several proposed rules issued by the Commission that illustrate these problems.

1. Proposed Rulemaking on Position Limits[4]

One example of this is the Commission's proposal to impose broad, fixed position limits for all physically delivered commodities. The Commission's proposed position limit regulations ignore the clear Congressional directives, which DFA added to section 4a of the Commodity Exchange Act, to set position limits "as the Commission finds are necessary to diminish, eliminate, or prevent" "sudden or unreasonable fluctuations or unwarranted changes in the price of" a commodity.[5] Without any basis to make this finding, the Commission instead justified its position limit proposal as follows:

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"For example, there are several changes to our existing rules that will contribute to increased costs, including more stringent standards for those clearinghouses deemed to be systemically significant. The Commission staff has also recommended establishing a new margining regime for the swaps market that is different from the futures market model because it requires individual segregation of customer collateral. I am told this will increase costs to the customer and create moral hazard by reducing the incentive of futures commission merchants to appropriately identify and manage customer risk. In the spirit of the Executive Order, we must ask ourselves: Are we creating an environment that makes it too costly to clear and puts risk management out of reach?" Commissioner Scott D. O'Malia, *Derivatives Reform: Preparing for Change, Title VII of the Dodd-Frank Act: 732 Pages and Counting*, Keynote Address (January 25, 2011) http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-3.html

[4] 76 Fed. Reg. 4752 (proposed Jan. 26, 2011) (to be codified at 17 C.F.R. pts. 1, 150-51)

[5] My December 15, 2010, testimony before the Subcommittee On General Farm Commodities and Risk Management of the House Committee on Agriculture includes a more complete legal analysis of the DFA requirements.

> The Commission is not required to find that an undue burden on interstate commerce resulting from excessive speculation exists or is likely to occur in the future in order to impose position limits. Nor is the Commission required to make an affirmative finding that position limits are necessary to prevent sudden or unreasonable fluctuations or unwarranted changes in prices or otherwise necessary for market protection. Rather, the Commission may impose position limits prophylactically, based on its reasonable judgment that such limits are necessary for the purpose of "diminishing, eliminating, or preventing" such burdens on interstate commerce that the Congress has found result from excessive speculation. 76 Federal Register 4752 at 4754 (January 26, 2011), Position Limits for Derivatives.

At the December 15, 2010, hearing of the General Farm Commodities and Risk Management Subcommittee of the House Agriculture Committee on the subject of the implementation of DFA's provisions respecting position limits, there was strong bipartisan agreement among the subcommittee members with the sentiments expressed by Representative Moran:

> Despite what some believe is a mandate for the commission to set position limits within a definite period of time, the Dodd-Frank legislation actually qualifies CFTC's position-limit authority. Section 737 of the Dodd-Frank act amends the Commodity Exchange Act so that Section 4A-A2A states, "The commission shall, by rule, establish limits on the amount of positions as appropriate." The act then states, "In subparagraph B, for exempt commodities, the limit required under subparagraph A shall be established within 180 days after the date of enactment of this paragraph." When subparagraphs A and B are read in conjunction, the act states that when position limits are required under subparagraph A, the commission shall set the limits within 180 days under paragraph B. Subparagraph A says the position-limit rule should be only prescribed when appropriate.
>
> Therefore, the 180-day timetable is only triggered if position limits are appropriate. In regard to the word "appropriate," the commission has three distinct problems. First, the commission has never made an affirmative finding that position limits are appropriate to curtail excessive speculation. In fact, to date, the only reports issued by the commission or its staff failed to identify a connection between market trends and excessive speculation. This is not to say that there is no

> connection, but it does say the commission does not have enough information to draw an affirmative conclusion.

"The second and third issues relating to the appropriateness of position limits are regulated to adequacy of information about OTC markets. On December 8, 2010, the commission published a proposed rule on swap data recordkeeping and reporting requirements. This proposed rule is open to comment until February 7, 2011, and the rule is not expected to be final and effective until summer at the earliest. Furthermore, the commission has yet to issue a proposed rulemaking about swap data repositories. Until a swap data repository is set up and running, it is difficult to see how it would be appropriate for the commission to set position limits." CME group is not opposed to position limits and other means to prevent market congestion; we employ limits in most of our physically delivered contracts. However, we use limits and accountability levels, as contemplated by the Congressionally-approved Core Principles for Designated Contract Markets ("DCMs"), to mitigate potential congestion during delivery periods and to help us identify and respond in advance of any threat to manipulate our markets. CME Group believes that the core purpose that should govern Federal and exchange-set position limits, to the extent such limits are necessary and appropriate should be to reduce the threat of price manipulation and other disruptions to the integrity of prices. We agree that such activity destroys public confidence in the integrity of our markets and harms the acknowledged public interest in legitimate price discovery and we have the greatest incentive and best information to prevent such misconduct.

We don't want to lose sight of the real economic cost of imposing position limits that are unwarranted. For the last 150 years, modern day futures markets have served as the most efficient and transparent means to discover prices and manage exposure to price fluctuations. Regulated futures exchanges operate centralized, transparent markets to facilitate price discovery by permitting the best informed and most interested parties to express their opinions by buying and selling for future delivery. Such markets are a vital part of a smooth functioning economy. Futures exchanges allow producers, processors and agribusiness to transfer and reduce risks through bona fide hedging and risk management strategies. This risk transfer means producers can plant more crops. Commercial participants can ship more goods. Risk transfer only works because speculators are prepared to provide liquidity and to accept the price risk that others do not. Futures exchanges and speculators have been a force to reduce price volatility and mitigate risk. Overly inclusive position limits adversely impact legitimate trading and impair the ability of producers to hedge. Worse, the drive certain classes of speculators into physical markets and distort the physical supply chain and prices.

Similarly troubling is the fact that the CFTC's proposed rules in this and other areas affecting market participants are not in harmony with international regulators. That is, international regulators, such as the EU, are far from adopting an approach as prescriptive of the CFTC's proposal in this and other areas. This creates an incentive for market participants to move their business to international exchanges where they may be subject to less prescriptive regimes, negatively impacting the global leadership of the U.S. financial market. The Commission should be careful not to adopt restrictions that tilt the competitive playing field in favor of overseas markets. Such a tilt threatens to export the price discovery process to overseas exchanges, resulting in both a loss of jobs in the U.S. and less cost-efficient hedging for persons in business in the U.S. As an example, consider the two major price discovery indexes in crude oil: West Texas Intermediate, which trades on NYMEX, and Brent Oil, which trades overseas. If the Commission places heavy restrictions in areas such as position limits on traders in the U.S., traders in crude oil, and with them the price discovery process, is likely to move to overseas markets.

2. Proposed Rulemaking on Mandatory Swaps Clearing Review Process[6]

Another example of a rule proposal that raises concerns and could produce consequences counter to the fundamental purposes of DFA is the Commission's proposed rule relating to the process for review of swaps for mandatory clearing. The proposed regulation treats an application by a derivatives clearing organization ("DCO") to list a particular swap for clearing as obliging that DCO to perform due diligence and analysis for the Commission respecting a broad swath of swaps, as to which the DCO has no information and no interest in clearing. In effect, a DCO that wishes to list a new swap would be saddled with the obligation to collect and analyze massive amounts of information to enable the Commission to determine whether the swap that is the subject of the application and any other swap that is within the same "group, category, type, or class" should be subject to the mandatory clearing requirement.

This proposed regulation is one among several proposals that impose costs and obligations whose effect and impact are contrary to the purposes of Title VII of

[6] 75 Fed. Reg. 667277 (proposed Nov. 2, 2010) (to be codified at 17 C.F.R. pts. 1, 150, 151)

DFA. The costs in terms of time and effort to secure and present the information required by the proposed regulation would be a massive disincentive to DCOs to voluntarily undertake to clear a "new" swap. The Commission lacks authority to transfer the obligations that the statute imposes on it to a DCO. The proposed regulation eliminates the possibility of a simple, speedy decision on whether a particular swap transaction can be cleared—a decision that the DFA surely intended should be made quickly in the interests of customers who seek the benefits of clearing—and forces a DCO to participate in an unwieldy, unstructured and endless process to determine whether mandatory clearing is required. Regulation section 39.5(b)(5) starkly illustrates this outcome. Every simple request to clear a swap is converted into a marathon that is likely to kill the runner before Athens is in sight. No application is deemed complete until all of the information that the Commission needs to make the mandatory clearing decision has been received. The Commission is the sole judge of completion and the only test is its unfettered discretion. Only then does the 90 day period begin to run. This turns DFA on its head.

3. Conversion from Principles-Based to Rules-Based Regulation[7]

Some of the CFTC's rule proposals are explained by the ambiguities created during the rush to push DFA to a final vote. For example, Congress preserved and expanded the scheme of principles-based regulation by expanding the list of core principles and granting self regulatory organizations "reasonable discretion in establishing the manner in which the [self regulatory organization] complies with the core principles." Congress granted the Commission the authority to adopt rules respecting core principles, but did not direct it to eliminate principles-based regulation.

The agency's prescriptive regulatory approach would convert its role from an oversight agency, whose role is to assure compliance with sound principles, to a front line decision maker that imposes its business judgments on every operational aspect of derivatives trading and clearing. This role reversal will require doubling of the Commission's staff and budget and impose astronomical costs on the industry and the end users of derivatives. Yet there is no evidence that this interpretation of Congressional intent behind DFA is necessary or will be beneficial to the public or to the functioning of the markets. This approach will also unnecessarily deplete the agency's limited resources. In keeping with the

[7] *See*, 75 Fed. Reg. 80747 (proposed Dec. 22, 2010) (to be codified at 17 C.F.R. pts. 1, 16, 38)

President's Executive Order to reduce unnecessary regulatory cost, the CFTC should be required to reconsider each of its proposals with an eye toward performing those functions that are clearly mandated by DFA.

Prior to DFA, the Commodity Exchange Act ("CEA"), as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"), prohibited the CFTC from mandating exclusive means of compliance with the Core Principles applicable to regulated entities. *See* CEA 5c(a)(2). The CFTC set forth "[g]uidance on, and Acceptable Practices in, Compliance with Core Principles," but these statements operated only as guidance or as a safe harbor for compliance—not as requirements.

Changes to the CEA made by DFA gave the Commission discretion to, where necessary, step back from this principles-based regime. That is, they changed the language of the CEA to state that boards of trade "shall have reasonable discretion in establishing the manner in which they comply with the core principles, unless otherwise determined by the Commission by rule or regulation. *See, e.g.*, DFA § 735(b), amending Section 5(d)(1)(B) of the CEA. To begin, this language assumes that the principles-based regime will remain in effect and that, as such, regulated entities will have reasonable discretion as to the manner with which they comply with the Core Principles except in limited circumstances in which more specific rules addressing compliance with a core principle are necessary. The Commission has used this change in language, however, to propose specific requirements for multiple Core Principles—almost all Core Principles in the case of DCMs—and effectively eviscerate the principle-based regime that has fostered success in CFTC-regulated entities for the past decade.

The principles-based regime of the CFMA has facilitated tremendous innovation and allowed U.S. exchanges to compete effectively on a global playing field. Principles-based regulation of futures exchanges and clearing houses permitted U.S. exchanges to regain their competitive position in the global market. U.S. futures exchanges are able to keep pace with rapidly changing technology and market needs by introducing new products, new processes and new methods by certifying compliance with the CEA and thereby avoiding stifling regulatory review. Indeed, U.S. futures exchanges have operated more efficiently, more economically and with fewer complaints under this system than at any time in their history.

(a) Proposed Rulemaking under Core Principle 9 for DCMs

One example of the Commission's unnecessary and problematic departure from the principles-based regime is its proposed rule under Core Principle 9 for DCMs – Execution of Transactions, which states that a DCM "shall provide a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market" but that "the rules of a board of trade may authorize . . . (i) transfer trades or office trades; (ii) an exchange of (I) futures in connection with a cash commodity transaction; (II) futures for cash commodities; or (III) futures for swaps; or (iii) a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if that contract is reported, recorded, or cleared in accordance with the rules of the contract market or [DCO]."

Proposed rule 38.502(a) would require that 85% or greater of the total volume of any contract listed on a DCM be traded on the DCM's centralized market, as calculated over a 12 month period. The Commission asserts that this is necessary because "the price discovery function of trading in the centralized market" must be protected. 75 Fed. Reg. at 80588. However, Congress gave no indication in DFA that it considered setting an arbitrary limit as an appropriate means to regulate under the Core Principles. Indeed, in other portions of DFA, where Congress thought that a numerical limit could be necessary, it stated so. For example, in Section 726 addressing rulemaking on Conflicts of Interest, Congress specifically stated that rules "may include numerical limits on the control of, or the voting rights" of certain specified entities in DCOs, DCMs or Swap Execution Facilities ("SEFs").

Congress did not sanction arbitrary proscriptions by the Commission, and the 85% exchange trading requirement is completely arbitrary. That is, the Commission justifies the requirement only with its observations as to percentages of various contracts traded on various exchanges—it provides no support for a position that the 85% requirement provides or is necessary to provide a "competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade," as is required under Core Principle 9. Further, Core Principle 9, as noted above, expressly permits DCMs to authorize off-exchange transactions including for exchanges to related positions pursuant to their rules.

The Commission does not assert in its proposal that the 85% exchange trading requirement has any regulatory benefit for either it or market participants. Indeed, there is no such benefit. The Commission does not receive any additional information regarding the market through the proposed 85% requirement. That is, if an instrument is not traded on an exchange, it will in many cases simply be traded on an SEF or in the OTC market as a swap. Following DFA, the swap and OTC markets, like the futures market, is regulated by the Commission. Thus, the Commission will receive the same information for use in regulation regardless of whether the instrument is traded in the centralized market or not.

Moreover, imposition of the proposed 85% exchange trading requirement will have extremely negative effects on the industry. The 85% requirement would significantly deter the development of new products by exchanges like CME. This is because new products generally initially gain trading momentum in off-exchange transactions. Indeed, it takes years for new products to reach the 85% exchange trading requirement proposed by the Commission. For example, one now popular and very liquid foreign exchange product developed and offered by CME would not have met the 85% requirement for four years after it was initially offered. The product's on-exchange trading continued to increase over ten years, and it now trades only 2% off exchange. Under the proposed rule, CME would have had to delist this product.[8]

Imposition of an 85% exchange trading requirement would also have adverse effects on market participants. If instruments that are most often traded off-exchange are forced onto the centralized market, customers will lose cross-margin efficiencies that they currently enjoy and will be forced to post additional cash or assets as margin. For example, customers who currently hold open positions on CME Clearport® will be required to post a total of approximately $3.9 billion in margin (at the clearing firm level, across all clearing firms).

(b) Proposed Comparable Fee Structures under Core Principle 2 for DCMs

In the case of certain proposed fee restrictions to be placed on DCMs, the Commission not only retreats needlessly from principles-based regulation but also greatly exceeds its authority under DFA. DCM Core Principle 2, which appears in DFA Section 735, states, in part, that a DCM "shall establish, monitor, and enforce compliance with rules of the contract market including . . . access requirements." Under this Core Principle, the Commission has proposed rule 38.151, which states that a DCM "must provide its members, market participants and independent

[8] More specifically, the product traded 32% off-exchange when it was first offered in 2000, 31% off exchange in 2001, 25 % in 2002, 20% in 2003, finally within the 85% requirement at 13% off-exchange in 2004, 10% in 2005, 7% in 2006, 5% in 2007, 3% in 2008, and 2% in 2009 and 2010.

software vendors with impartial access to its market and services including . . . comparable fee structures for members, market participants and independent software vendors receiving equal access to, or services from, the [DCM]."

The CFTC's attempt to regulate DCM member, market participant and independent software vendor fees is unsupportable. The CFTC is expressly authorized by statute to charge reasonable fees to recoup the costs of services it provides. 7 U.S.C. 16a(c). The Commission may not bootstrap that authority to set or limit the fees charged by DCMs or to impose an industry-wide fee cap that has the effect of a tax. *See Federal Power Commission v. New England Power Co.*, 415 U.S. 345, 349 (1974) ("[W]hole industries are not in the category of those who may be assessed [regulatory service fees], the thrust of the Act reaching only specific charges for specific services to specific individuals or companies."). In any event, the CFTC's overreaching is not supported by DFA. Nowhere in the CEA is the CFTC authorized to set or limit fees a DCM may charge. To the extent the CFTC believes its authority to oversee impartial access to trading platforms may provide a basis for its assertion of authority, that attempt to read new and significant powers into the CEA should be rejected.

3. Provisions Common to Registered Entities[9]

The CFMA streamlined the procedures for listing new products and amending rules that did not impact the economic interests of persons holding open contracts. These changes recognized that the previous system required massive, worthless paper pushing efforts by exchanges and by the CFTC's staff. It slowed innovation and offered no demonstrable public benefit. Our ability to compete on a global scale, which had been progressively eroded by the disparity between the U.S. process and the rules under which foreign competitors operated, was restored.

Under current rules, before a product is self-certified or a new rule or rule amendment is proposed, DCMs and DCOs conduct a due diligence review to support their conclusion that the product or rule complies with the Act and Core Principles. The point of the self-certification process that Congress retained in DFA is that registered entities that list new products have a self-interest in making sure that the new products meet applicable legal standards. Breach of this certification requirement potentially subjects the DCM or DCO to regulatory liability. In addition, in some circumstances, a DCM or DCO may be subject to litigation or other commercial remedies for listing a new product, and the

[9] 75 Fed. Reg. 67282 (proposed Nov. 2, 2010) (to be codified at 17 C.F.R. pt. 40)

avoidance of these costs and burdens is sufficient incentive for DCMs and DCOs to remain compliant with the Act.

Nothing in the last decade of self-certification suggests that this concept is flawed or that registered entities have employed this power recklessly or abusively. During 2010, CME launched 438 new products and submitted 342 rules or rule amendments to the Commission. There was no legitimate complaint respecting the self-certification process during this time. Put simply, the existing process has worked, and there is no reason for the Commission to impose additional burdens, which are not required by DFA, to impair that process.

Section 745 of DFA merely states, in relevant part, that "a registered entity may elect to list for trading or accept for clearing any new contract, or other instrument, or may elect to approve or implement any new rule or rule amendment, by providing to the Commission a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with this Act (including regulations under this Act)." To be sure, DFA in no way directs the Commission to require the submission of all documents supporting such a certification nor to require a review of the legal implications of the product or rule with regard to laws other than DFA. Essentially, it requires exactly what was required prior to the passage of DFA—a certification that the product, rule or rule amendment complies with the CEA. Nonetheless, the Commission has taken it upon itself to impose these additional and burdensome submission requirements upon registered entities.

The new requirements are likely to significantly impair the speed and value of innovation by U.S. exchanges and clearing houses, which will be required to watch their innovations, brought to market by foreign competitors while the U.S. agency checks boxes to insure that filings are complete. Moreover, given the volume of filings required by the Notice of proposed rulemaking, the Commission will require significant increases in staffing and other resources. The Commission's resources should be better aligned with the implementation of the goals of DFA rather than "correcting" a well-functioning and efficient process.

The proposed rules greatly and unnecessarily increase the documentation burden associated with this submission process, and it seems inevitable that they will greatly slow the process of new rule and product introduction. First, a registered entity must submit "all documentation" relied upon to determine whether a new product, rule or rule amendment complies with applicable Core Principles. This requirement is, to begin with, vague, and thus is likely to result in the submission of unnecessary and non-useful information. More importantly, this requirement imposes an additional burden on both registered entities, which must compile and produce all such documentation, and the Commission, which must review it. The benefits, if any, to be gathered by this requirement are significantly outweighed by the costs imposed both on the marketplace and the Commission.

Second, the proposed rules require registered entities to examine potential legal issues associated with the listing of products and include representations related to these issues in their submissions. Specifically, a registered entity must provide a certification that it has undertaken a due diligence review of the legal conditions, including conditions that relate to contractual and intellectual property rights. The imposition of such a legal due diligence standard is clearly outside the scope of DFA and is unnecessarily vague and impractical, if not impossible, to comply with in any meaningful manner. An entity, such as CME, involved in product creation and design is always cognizant of material intellectual property issues that might arise. This amorphous and potentially vast legal diligence requirement could require that registered entities expand what could reasonably be considered to be a material or colorable intellectual property analysis and undertake extensive intellectual property analysis, including patent, copyright and trademark searches in order to satisfy the regulatory mandates. This would greatly increase the cost and timing of listing products without providing any true corresponding benefit to the marketplace. Indeed, the Commission itself admits in its NOPR that these proposed rules will increase the overall information collection burden on registered entities *by approximately 8,300 hours per year*. 75 Fed. Reg. at 67290.

Further, these rules steer the Commission closer to the product and rule approval process currently employed by the SEC, about which those regulated by the SEC complained at the CFTC-SEC harmonization hearings. Indeed, William J. Brodsky of the Chicago Board of Options Exchange testified that the SEC's approval process "inhibits innovation in the securities markets" and urged the adoption of the CFTC's certification process.

4. Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding Mitigation of Conflicts of Interest[10]

The Commission's proposed rules regarding the mitigation of conflicts of interest in DCOs, DCMs and SEFs ("Regulated Entities") also exceed its rulemaking authority under DFA and impose constraints on governance that are unrelated to

[10] 75 Fed. Reg. 63732 (proposed October 18, 2010) (to be codified at 17 C.F.R. pts. 1, 37, 38, 39, 40)

the purposes of DFA or the CEA. The Commission purports to act pursuant to Section 726 of DFA but ignores the clear boundaries of its authority under that section, which it cites to justify taking control of every aspect of the governance of those Regulated Entities. Section 726 conditions the Commission's right to adopt rules mitigating conflicts of interest to circumstances where the Commission has made a finding that the rule is "necessary and appropriate" to "improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest *in connection with a swap dealer or major swap participant's conduct of business with*, a [Regulated Entity] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment." (emphasis added) The "necessary and appropriate" requirement constrains the Commission to enact rules that are no more intrusive than necessary to fulfill the stated Congressional intent—in other words, the regulations must be narrowly-tailored to minimize their burden on the industry. The Commission failed to make the required determination that the proposed regulations were "necessary and proper" and, unsurprisingly, the proposed rules are not narrowly-tailored but rather overbroad, outside of the authority granted to it by DFA and extraordinarily burdensome.

The Commission proposed governance rules and ownership limitations that affect all Regulated Entities, including those in which no swap dealer has a material debt or equity investment and those that do not even trade or clear swaps. Moreover, the governance rules proposed have nothing to do with conflicts of interest, as that term is understood in the context of corporate governance. Instead, the Commission has created a concept of "structural conflicts," which has no recognized meaning outside of the Commission's own declarations and is unrelated to "conflict of interest" as used in the CEA. The Commission proposed rules to regulate the ownership of voting interests in Regulated Entities by any member of those Regulated Entities, including members whose interests are unrelated or even contrary to the interests of the defined "enumerated entities." In addition, the Commission is attempting to impose membership condition requirements for a broad range of committees that are unrelated to the decision making to which Section 726 was directed.

The Commission's proposed rules are most notably overbroad and burdensome in that they address not only ownership issues but the internal structure of public corporations governed by state law and listing requirements of SEC regulated national securities exchanges. More specifically, the proposed regulations set requirements for the composition of corporate boards, require Regulated Entities to have certain internal committees of specified compositions and even propose a new definition for a "public director." Such rules in no way relate to the conflict of interest Congress sought to address through Section 726. Moreover, these proposed rules improperly intrude into an area of traditional state sovereignty. It is well-established that matters of internal corporate governance are regulated by the states, specifically the state of incorporation. Regulators may not enact rules that intrude into traditional areas of state sovereignty unless federal law compels such an intrusion. Here, Section 726 provides no such authorization.

Perhaps most importantly, the proposed structural governance requirements cannot be "necessary and appropriate," as required by DFA, because applicable state law renders them completely unnecessary. State law imposes fiduciary duties on directors of corporations that mandate that they act in the best interests of the corporation and its shareholders—not in their own best interests or the best interests of other entities with whom they may have a relationship. As such, regardless of how a board or committee is composed, the members must act in the best interest of the exchange or clearinghouse. The Commission's concerns—that members, enumerated entities, or other individuals not meeting its definition of "public director" will act in their own interests—and its proposed structural requirements are wholly unnecessary and impose additional costs on the industry—not to mention additional enforcement costs—completely needlessly.

5. Prohibition on Market Manipulation[11]

The Commission's proposed rules on Market Manipulation, although not representing as clear an overstepping of its boundaries under DFA, are also problematic because they are extremely vague. The Commission has proposed two rules related to market manipulation: Rule 180.1, modeled after SEC Rule 10b-5 and intended as a broad, catch-all provision for fraudulent conduct; and Rule 180.2, which mirrors new CEA Section 6(c)(3) and is aimed at prohibiting price manipulation. *See* 75 Fed. Reg. at 67658. Clearly, there is a shared interest among market participants, exchanges and regulators in having market and regulatory infrastructures that promote fair, transparent and efficient markets and that mitigate exposure to risks that threaten the integrity and stability of the market. In that context, however, market participants also desire clarity with respect to the rules and fairness and consistency with regard to their enforcement.

As to its proposed rule 180.1, the Commission relies on SEC precedent to provide further clarity with respect to its interpretation and notes that it intends to

[11] 75 Fed.Reg. 67657-62 (proposed Nov. 3, 2010) (to be codified at 17 C.F.R. pt. 180)

implement the rule to reflect its "distinct regulatory mission." However, the Commission fails to explain how the rule and precedent will be adapted to reflect the differences between futures and securities markets. *See* 75 Fed. Reg. at 67658-60. For example, the Commission does not provide clarity as to if and to what extent it intends to apply insider trading precedent to futures markets. Making this concept applicable to futures markets would fundamentally change the nature of the market, not to mention all but halting participation by hedgers, yet the Commission does not even address this issue. Rule 180.1 is further unclear as to what standard of scienter the Commission intends to adopt for liability under the rule. Rule 180.2 is comparably vague, providing, for example, no guidance as to what sort of behavior is "intended to interfere with the legitimate forces of supply and demand" and how the Commission intends to determine whether a price has been affected by illegitimate factors.

These proposed rules, like many others, have clearly been proposed in haste and fail to provide market participants with sufficient notice of whether contemplated trading practices run afoul of them. Indeed, the proposed rules are so unclear as to be subject to constitutional challenge. That is, due process precludes the government from penalizing a private party for violating a rule without first providing adequate notice that conduct is forbidden by the rule. In the area of market manipulation especially, impermissible conduct must be clearly defined lest the rules chill legitimate market participation and undermine the hedging and price discovery functions of the market by threatening sanctions for what otherwise would be considered completely legal activity. That is, if market participants do not know the rules of the road in advance and lack confidence that the disciplinary regime will operate fairly and rationally, market participation will be chilled because there is a significant risk that legitimate trading practices will be arbitrarily construed, post-hoc, as unlawful.

6. Antidisruptive Practices Authority Contained in DFA[12]

Rules regarding Disruptive Trade Practices (DFA Section 747) run the risk of being similarly vague and resulting in chilling of market participation. At this juncture, the Commission has issued only an Advance notice of proposed rulemaking ("ANPR") on this issue, and the ANPR demonstrates the Commission's understanding that it must provide clarity beyond that provided by DFA. Still, it is worthy of note that Section 747 of DFA, which authorizes the Commission to promulgate additional rules if they are reasonably necessary to

[12] 75 Fed. Reg. 67301 (proposed November 2, 2010) (to be codified at 17 C.F.R. pt. 1)

prohibit trading practices that are "disruptive of fair and equitable trading," is exceedingly vague as written and does not provide market participants with adequate notice as to whether contemplated conduct is forbidden. Hasty rulemaking resulting in vague rules in the area of disruptive trade practices will have the same effect as such rulemaking in the area of market manipulation—participation in the market and the hedging and price discovery functions of the market will be chilled due to uncertainty among participants as to whether their contemplated conduct is acceptable.

7. Effects on Existing Derivatives Contracts

DFA's overhaul of the regulatory framework for swaps creates uncertainty about the status and validity of existing swap contracts, and the Commission's failure thus far to address, in particular, the definition of "swap" or other provisions for dealing with currently effective swaps will serve to exacerbate the effects of this uncertainty. Today, under provisions enacted in 2000, swaps are excluded or exempt from the CEA under Sections 2(d), 2(g) and 2(h) of the CEA. These provisions allow parties to enter into swap transactions without worrying about whether the swaps are illegal futures contracts under CEA section 4(a). DFA repeals those exclusions and exemptions effective July 16, 2011. At this time, it is unclear what if any action the CFTC plans to take or legally could take to allow both swaps entered into on or before July 16 and those swaps entered into after July 16 from being challenged as illegal futures contracts. To address this concern, Congress and the CFTC should consider some combination of deferral of the effective dates of the repeal of sections 2(d), 2(g) and 2(h), exercise of CFTC exemptive power under section 4(c) or other appropriate action. Otherwise swap markets may be hit by a wave of legal uncertainty which the statutory exclusions and exemptions were designed in 2000 to prevent. This uncertainty may, again, chill participation in the swap market and impair the ability of market participants, including hedgers, to manage their risks.

The above are merely a few examples of instances in which CME believes the Commission has proposed rules inconsistent with DFA or that impose unjustified costs and burdens on both the industry and the Commission. We ask this Congress to extend the rulemaking schedule under DFA to allow time for industry professionals of various viewpoints to fully express their views and concerns to the Commission and for the Commission to have a realistic opportunity to assess and respond to those views and to realistically assess the costs and burdens imposed by the new regulations. We urge the Congress to ensure that implementation of DFA is consistent with the Congressional directives in the Act and does not unnecessarily harm hedging and risk transfer markets that U.S. companies depend upon to reduce business risks and increase economic growth.

TESTIMONY OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

BEFORE THE

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

WASHINGTON, DC

February 15, 2011

Good morning Chairman Bachus, Ranking Member Frank and members of the Committee. I thank you for inviting me to today's hearing on implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act. I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC). I also thank my fellow Commissioners for their hard work and commitment on implementing the legislation.

I am honored to appear at today's hearing alongside fellow regulators with whom we are working so closely to implement the Dodd-Frank Act. I am particularly happy to appear here with Chairman Schapiro, with whom I have a strong working relationship. I believe that this is the eighth time that we have testified together. We have consulted and coordinated closely with the SEC, Federal Reserve and other regulators on rulemakings to oversee the swaps markets. Throughout this process, interagency cooperation has been extraordinary and has improved our proposed rulemakings.

Before I move into the testimony, I want to congratulate Chairman Bachus on becoming Chairman of the Committee. I look forward to working with you and all Members of the Committee.

The Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Act. The Act amended the Commodity Exchange Act (CEA) to establish a comprehensive new regulatory framework for swaps and security-based swaps. Title VII of the Act, which relates to swaps, was enacted to reduce risk, increase transparency and promote market integrity within the financial system by, among other things:

1. Providing for the registration and comprehensive regulation of swap dealers and major swap participants;
2. Imposing clearing and trade execution requirements on standardized derivatives products;
3. Creating robust recordkeeping and real-time reporting regimes; and
4. Enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

The reforms mandated by Congress will reduce systemic risk to our financial system and bring sunshine and competition to the swaps markets. Markets work best when they are transparent, open and competitive. The American public has benefited from these attributes in the futures and securities markets since the great regulatory reforms of the 1930s. The reforms of Title VII will bring similar features to the swaps markets. Lowering risk and improving transparency will make the swaps markets safer and improve pricing for end-users.

Implementation

The Dodd-Frank Act is very detailed, addressing all of the key policy issues regarding regulation of the swaps marketplace. To implement these regulations, the Act requires the CFTC and SEC, working with our fellow regulators, to write rules generally within 360 days. At the CFTC, we initially organized our effort around 30 teams who have been actively at work. We have recently added another team. We had our first meeting with the 30 team leads the day before the President signed the law.

The CFTC is working deliberatively and efficiently to promulgate rules required by Congress. The talented and dedicated staff of the CFTC has stepped up to the challenge and has recommended thoughtful rules – with a great deal of input from each of the five Commissioners – that would implement the Act. Thus far, the CFTC has approved 39 notices of proposed rulemaking, two interim final rules, four advanced notices of proposed rulemaking and one final rule.

The CFTC's process to implement the rulemakings required by the Act includes enhancements over the agency's prior practices in five important areas. Our goal was to provide the public with additional opportunities to inform the Commission on rulemakings, even before official public comment periods. I will expand on each of these five points in my testimony.

1. We began soliciting views from the public immediately after the Act was signed and prior to approving proposed rulemakings. This allowed the agency to receive input before the pens hit the paper.
2. We hosted a series of public, staff-led roundtables to hear ideas from the public prior to considering proposed rulemakings.
3. We engaged in significant outreach with other regulators – both foreign and domestic – to seek input on each rulemaking.
4. Information on both staff's and Commissioners' meetings with members of the public to hear their views on rulemakings has been made publicly available at cftc.gov.
5. The Commission held public meetings to consider proposed rulemakings. The meetings were webcast so that the Commission's deliberations were available to the public. Archive webcasts are available on our website as well.

Two principles are guiding us throughout the rule-writing process. First is the statute itself. We intend to comply fully with the statute's provisions and Congressional intent to lower risk and bring transparency to these markets.

Second, we are consulting heavily with both other regulators and the broader public. We are working very closely with the SEC, the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and other prudential regulators, which includes sharing many of our memos, term sheets and draft work product. CFTC staff has had 376 meetings with other regulators on implementation of the Act.

Specifically, our rule-writing teams are working with the Federal Reserve in several critical areas: swap dealer regulation, clearinghouse regulation and swap data repositories, though we are consulting with them on a number of other areas as well. With the SEC, we are working on the entire range of rule-writing, including those previously mentioned as well as trading requirements, real time reporting and key definitions. So far, we have proposed two joint rules with the SEC as required by Congress.

In addition to working with our American counterparts, we have reached out to and are actively consulting and coordinating with international regulators to harmonize our approach to swaps oversight. As we are with domestic regulators, we are sharing many of our memos, term sheets and draft work product with international regulators as well. Our discussions have focused on clearing and trading requirements, clearinghouses more generally and swaps data reporting issues, among many other topics.

Specifically, we have been consulting directly and sharing documentation with the European Commission, the European Central Bank, the UK Financial Services Authority and the new European Securities and Markets Authority. We also have shared documents with the Japanese Financial Services Authority and consulted with Members of the European Parliament and regulators in Canada, France, Germany and Switzerland.

Through this consultation, we are working to bring consistency to regulation of the swaps markets. In September of last year, the European Commission released its swaps proposal. As we had in the Dodd-Frank Act, the E.C.'s proposal covers the entire derivatives marketplace – both bilateral and cleared – and the entire product suite, including interest rate swaps, currency swaps, commodity swaps, equity swaps and credit default swaps. The proposal includes requirements for central clearing of swaps, robust oversight of central counterparties and reporting of all swaps to a trade repository. The E.C. also is considering revisions to its existing Markets in Financial Instruments Directive (MiFID), which includes a trade execution requirement, the creation of a report with aggregate data on the markets similar to the CFTC's Commitments of Traders reports and accountability levels or position limits on various commodity markets.

We also are soliciting broad public input into the rules. On July 21st, we listed the 30 rule-writing teams and set up mailboxes for the public to comment directly. We determined it would be best to engage the public as broadly as possible even before publishing proposed rules. We have received 2,851 submissions from the public through the email inboxes as well as 1,111 official comments in response to notices of proposed rulemaking.

We also have organized nine roundtables to hear specifically on particular subjects. We have coordinated the majority of our roundtables with the SEC and have joined with the Federal Reserve on several of them as well. These meetings have allowed us to hear directly from investors, market participants, end-users, academics, exchanges and clearinghouses on key topics including governance and conflicts of interest, real time reporting, swap data recordkeeping and swap execution facilities, among others. The roundtables have been open to the public, and we have established call-in numbers for each of them so that anyone can listen in.

Additionally, many individuals have asked for meetings with either our staff or Commissioners to discuss swaps regulation. To date, we have had more than 500 such meetings. We are now posting on our website a list of all of the meetings CFTC staff and I have with outside organizations, as well as the participants, issues discussed and all materials given to us.

We began publishing proposed rulemakings at our first public meeting to implement the Act on October 1, 2010. We have sequenced our proposed rulemakings over 11 public meetings thus far. Our next meeting is scheduled for February 24.

Public meetings have allowed us to discuss proposed rules in the open. For the vast majority of proposed rulemakings, we have solicited public comments for a period of 60 days. On a few occasions, the public comment period lasted 30 days. As part of seeking public comment on each of the individual rules, we also have asked a question within many of the proposed rulemakings relating to the timing for the implementation of various requirements under these rules. In looking across the entire set of rules and taking into consideration the costs of cumulative regulations, public comments will help inform the Commission as to what requirements can be met sooner and which ones will take a bit more time.

We have thus far proposed rulemakings in 26 of the 30 areas established last July. We still must propose rules on capital and margin requirements, product definitions (jointly with the

SEC) and the Volcker Rule. We also are considering comments received in response to advanced notices of proposed rulemaking with regard to disruptive trading practices and segregation of funds for cleared swaps.

A number of months ago we also set up a 31st rulemaking team tasked with developing conforming rules to update the CFTC's existing regulations to take into account the provisions of the Act.

End-User Margin

One of the rules on which the CFTC is working closely with the SEC, the Federal Reserve and other prudential regulators will address margin requirements for swap dealers and major swap participants.

Congress recognized the different levels of risk posed by transactions between financial entities and those that involve non-financial entities, as reflected in the non-financial end-user exception to clearing. Transactions involving non-financial entities do not present the same risk to the financial system as those solely between financial entities. The risk of a crisis spreading throughout the financial system is greater the more interconnected financial companies are to each other. Interconnectedness among financial entities allows one entity's failure to cause uncertainty and possible runs on the funding of other financial entities, which can spread risk and economic harm throughout the economy. Consistent with this, proposed rules on margin requirements should focus only on transactions between financial entities rather than those transactions that involve non-financial end-users.

Existing Derivatives Contracts

Congress provided for the legal certainty for swaps entered into prior to the date of enactment of the Dodd-Frank Act. Questions also have been raised regarding the clearing mandate and margin requirements. With respect to the clearing requirement and margin, I believe that the new rules should apply on a prospective basis only as to transactions entered into after the rules take effect.

Definition of Swap Dealer and Major Swap Participant

The CFTC and the SEC in December proposed a joint rule to further define the terms "swap dealer" and "major swap participant." The proposed swap dealer definition closely follows the criteria laid out by Congress. This includes whether an entity makes a market in swaps, holds itself out as a swap dealer, is commonly referred to as a swap dealer or regularly enters into swaps as an ordinary course of its business. The major swap participant definition relies on Congress's three-prong test, and the category is very clearly limited to encompass only those entities that have risk large enough to pose a threat to the U.S. financial system. We anticipate that the major swap participant category will be comprised of only a handful of entities. The comment period on this proposal is open until February 22. To the extent that members of the public have comments on other rules that apply to swap dealers and major swap participants and have not yet submitted them, they may include those comments within their submissions on this rule. The CFTC will use its discretion to include those in the comment files and consider them for the related rules.

Position Limits

Last month, the CFTC issued a proposed rule to establish position limits on futures contracts and some swaps in agriculture, energy and metals markets. The proposed rule covers 28 commodities and includes one position limits regime for the spot month and another for single-month and all-months combined. Under the proposal, spot month limits would be set based on deliverable supply. Single-month and all-months-combined limits would be set using a formula based on data to be collected on the total size of the swaps and futures market. We look forward to reviewing the public's comments on this proposal.

Conclusion

Before I close, I will briefly address the resource needs of the CFTC. The futures marketplace that the CFTC currently oversees is approximately $40 trillion in notional amount. The swaps market that the Act tasks the CFTC with regulating has a notional amount roughly seven times the size of that of the futures market and is significantly more complex. Based upon figures compiled by the Office of the Comptroller of the Currency, the largest 25 bank holding companies currently have $277 trillion notional amount of swaps.

The CFTC's current funding is far less than what is required to properly fulfill our significantly expanded mission. Though we have an excellent, hardworking and talented staff, we just this past year got back to the staff levels that we had in the 1990s. To take on the challenges of our expanded mission, we will need significantly more staff resources and – very importantly – significantly more resources for technology. Technology is critical so that we can be as efficient as an agency as possible in overseeing these vast markets.

The CFTC currently is operating under a continuing resolution that provides funding at an annualized level of $169 million. The President requested $261 million for the CFTC in his proposed fiscal year (FY) 2011 budget. This included $216 million and 745 full-time equivalent employees for pre–reform authorities and $45 million to provide half of the staff estimated at that time needed to implement the Act. Under the continuing resolution, the Commission has operated in FY 2011 at its FY 2010 level. In the budget released yesterday, the President requested $308 million for the CFTC for FY 2012 that would provide for 983 full-time equivalent employees.

Given the resource needs of the CFTC, we are working very closely with self regulatory organizations, including the National Futures Association, to determine what duties and roles they can take on in the swaps markets. Nevertheless, the CFTC has the ultimate statutory authority and responsibility for overseeing these markets. Therefore, it is essential that the CFTC have additional resources to reduce risk and promote transparency in the swaps markets.

Thank you, and I'd be happy to take questions.

Testimony

Before
The House Committee on Financial Services

On

Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act

February 15, 2011

J. Christopher Giancarlo,
Executive Vice President,
GFI Group Inc.
Board Member, WMBAA

Testimony of
J. Christopher Giancarlo
February 15, 2011

Introduction.

Thank you Chairman Bachus, Ranking Member Frank and members of the Committee for providing this opportunity to participate in today's hearing. I am Chris Giancarlo, Executive Vice President of GFI Group Inc., a global wholesale broker of swaps and other financial products[1]. I am also a member of the Board and former Chairman of the Wholesale Markets Brokers Association, Americas (the "WMBAA")[2]. I welcome this opportunity to discuss with you implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or "DFA") from the perspective of the primary intermediaries of over-the-counter swaps operating today here in the United States and across the globe.

In my testimony today, I will contend that:

- Wholesale brokers are today's central marketplaces in the global swaps markets and, as such, are the prototype of swap execution facilities or "SEFs".
- Wholesale brokers are experts in fostering liquidity and transparency in global swaps markets by utilizing trade execution methodologies that feature a hybrid blend of knowledgeable brokers and sophisticated electronic technology.
- Liquidity in today's swaps markets is fundamentally different than liquidity in futures and equities markets and naturally determines the optimal mode of market transparency and trade execution.

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[1] GFI Group Inc. (NYSE: GFIG) is a leading provider of wholesale brokerage, clearing services, electronic execution and trading support products for global financial markets. GFI Group Inc. provides brokerage services, market data, trading platform and analytics software products to institutional clients in markets for a range of fixed income, financial, equity and commodity instruments. Headquartered in New York, GFI was founded in 1987 and employs more than 1,900 people with additional offices in London, Paris, Hong Kong, Seoul, Tokyo, Singapore, Sydney, Cape Town, Santiago, Dubai, Dublin, Tel Aviv, Calgary, Los Angeles, Bogota, Englewood (NJ) and Sugar Land (TX). GFI Group Inc. provides services and products to over 2,400 institutional clients, including leading investment and commercial banks, corporations, insurance companies and hedge funds. Its brands include GFI℠, GFInet®, CreditMatch®, GFI ForexMatch®, EnergyMatch®, FENICS®, Starsupply®, Amerex®, Trayport® and Kyte®.

[2] The WMBAA is an independent industry body representing the largest inter-dealer brokers ("IDBs") operating in the North American wholesale markets across a broad range of financial products. The WMBAA and its member firms have developed a set of *Principles for Enhancing the Safety and Soundness of the Wholesale, Over-The-Counter Markets*. Using these *Principles* as a guide, the WMBAA seeks to work with Congress, regulators, and key public policymakers on future regulation and oversight of institutional markets and their participants. By working with regulators to make wholesale markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets. The five founding members of the WMBAA are BGC Partners; GFI Group; ICAP; Tradition and Tullett-Prebon. More about the WMBAA can be found at: www.WMBAA.org.

- Wholesale brokers' trading methodologies for price dissemination and trade execution are specifically tailored to the unique liquidity characteristics of particular swaps markets.

- It is critical that regulators gain a thorough understanding of the many modes of swaps trade execution currently deployed by wholesale brokers and accommodate those methods and trading practices in their SEF rulemaking.

- Too many of the SEC's and CFTC's Title VII proposals are based off rules governing the equities and futures markets and are ill-suited for the fundamentally different liquidity characteristics of today's swaps markets.

- Three critical elements that regulators need to get right under Title VII are:
  - SEFs must not be restricted from deploying the many varied and beneficial trade execution methodologies and technologies successfully used today to execute swaps transactions;
  - The "goal" of pre-trade transparency must be realized through means that do not destroy market liquidity for market participants and end users; and
  - Regulators need to carefully structure a public trade reporting regime that is not "one size fits all", but rather takes into account the unique challenges of fostering liquidity in the diverse range of swaps markets.

- As the WMBAA has proposed[3], a block trade standards advisory board (the "Swaps Standards Advisory Board") should be established and made up of recognized experts and representatives of registered SDRs and SEFs to make recommendations to the SEC and CFTC for appropriate block trade thresholds for swaps and security based swaps.

- Congress can assist with technical corrections to Dodd-Frank and, crucially, by providing regulators with adequate time and resources to thoroughly understand the challenges and current solutions to garnering trading liquidity in the swaps markets.

- Taking adequate time to get the Title VII regulations right will expedite the implementation of the worthy goals of Dodd-Frank: central counterparty clearing and effective trade execution by regulated intermediaries in order to provide end users with more competitive pricing, increased transparency and deeper trading liquidity for their risk management needs.

[3] *See* Comment Letter from WMBAA (January 18, 2011) (" 1/18/11 WMBAA Letter").

Background on GFI and Wholesale Brokers.

My firm, GFI Group, is a US publicly-traded company listed on the New York Stock Exchange with almost two thousand employees in four US cities and over 16 countries. We provide a marketplace for institutional buyers and sellers of OTC financial products where their trading needs can be matched with sophisticated counterparties having reciprocal interests in a transparent, yet anonymous, environment. To persons unfamiliar with our business, I often describe GFI as something as a virtual trading floor where large financial institutions buy and sell financial products that rarely trade on an exchange.

As we sit here today, GFI and its competitors are facilitating the execution of hundreds of thousands of OTC trades corresponding to an average of $5 trillion in size across the range of foreign exchange, interest rate, Treasury, credit, equity and commodity asset classes in both cash and derivative instruments. We are wholesale brokers (sometimes called "inter-dealer" brokers). WMBAA member firms account for over 90% of intermediated swaps transactions taking place around the world today. Our industry does not serve household or retail customers. Rather, we operate at the center of the global wholesale financial markets by aggregating and disseminating prices and fostering trading liquidity for financial institutions around the world. The roots of our industry go back over a century in the world's major financial centers. Our activities in many of the markets we serve today are highly regulated. GFI businesses are subject to oversight in the United States by the SEC, NASD, FINRA and CFTC, in the UK by the FSA and globally by regulatory agencies in France, Singapore, Hong Kong, Japan and Korea. In fact, our sister trade association in London was formed several decades ago by request of the Bank of England to represent the interests of the industry to regulators and in Parliament.

Wholesale brokers provide highly sophisticated trade execution services, combining teams of traditional "voice" brokers with sophisticated electronic trading and matching systems. As in virtually every sector of the financial services industry in existence over the past 50 years, wholesale brokers and their dealer clients began connecting with their customers by telephone. As technologies advanced and markets grew larger, more diverse and global, these systems have advanced to meet the changing needs of the market. Today, we refer to this integration of voice brokers with electronic brokerage systems as "hybrid brokerage". Wholesale brokers, while providing liquidity for markets and creating an open and transparent environment for trade execution for their market participants, do not operate as "exchanges." Instead, as competing execution venues, wholesale brokers vie with each other to win their customers' business through better price, provision of superior market information and analysis, deeper liquidity and better service. Our customers include large national and money center banks, major industrial firms, integrated energy and major oil companies, utilities and governmental and sovereign entities.

Increasingly, better service means better trading technology. To that end we develop and deploy sophisticated trade execution and support technology that is tailored to the unique qualities of each specific market. For example, GFI's customers in certain of our more complex, less commoditized markets may choose among utilizing our CreditMatch®, GFI ForexMatch® or EnergyMatch® electronic brokerage platforms to trade a range of fixed income derivatives, foreign exchange options, energy derivatives and emission allowances entirely on screen or they can execute the same transaction through instant messaging devices or over the telephone with qualified GFI brokers supported by sophisticated electronic technology. In addition, GFI's Trayport subsidiary is a provider of electronic trading software and services to other wholesale brokers and exchanges around the world (such as the CME and Intercontinental Exchange) and to energy trading desks across a broad swath of the European energy markets.[4]

The critical point is that competition in the marketplace for transaction services has led GFI and competing firms to develop highly sophisticated transaction services and technologies that are well tailored to the unique trading characteristics of the broad range of swaps and other financial instruments that trade in the over the counter markets today. Unlike futures exchanges, we enjoy no execution monopoly over the products traded by our customers. Therefore, our success depends on making each of our trading methods and systems right for each particular market we serve. From our decades of competing for the business of the worlds' largest financial institutions, we can confirm that there is no "one size fits all" method of executing swaps transactions.

Fostering Liquidity in Swaps Markets.

The essential role of a wholesale broker is to enhance trading liquidity. In essence, liquidity is the degree to which a financial instrument is easy to buy or sell quickly with minimal price disturbance. The liquidity of a market for a particular financial product or instrument depends on several factors, including the parameters of the particular instrument such as tenor and duration of a swap, the degree of standardization of instrument terms, the number of market participants and facilitators of liquidity, and the volume of trading activity. Liquid markets are characterized by substantial price competition, efficient execution and high trading volume.

While the relationship between exchange-traded and OTC markets generally has been complimentary, each market provides unique services to different trading constituencies for products with distinctive characteristics and liquidity needs. As a result, <u>the nature of trading liquidity in the exchange-traded and OTC markets is often materially different. It is critically important that regulators recognize the difference</u>.

Highly liquid markets exist for both commoditized, exchange-traded products, and the more standardized OTC instruments, such as U.S. treasury securities, equities and

[4] Trayport supplies critical exchange trading system technology to such commodities and stock exchanges as the Barbados Stock Exchange, Bayerische Borse, the Dutch Caribbean Stock Exchange, the InternationalMaritime Exchange, the Jakarta Stock Exchange and the New Zealand Stock Exchange. GFI's Trayport technology accommodates electronic trading, information sharing, STP capabilities and clearing links in commodity and financial instruments.

certain commodity derivatives. Exchange-traded markets provide a trading venue for the most commoditized instruments that are based on standard characteristics and single key measures or parameters. Exchange-traded markets with central counterparty clearing rely on relatively active order submission by buyers and sellers and generally high transaction flow. Exchange-traded markets, however, offer no guarantee of trading liquidity as evidenced by the high percentage of new exchange-listed products that regularly fail to enjoy active trading. Nevertheless, for those products that do become liquid, exchange marketplaces allow a broad range of trading customers (including retail customers) meeting relatively modest margin requirements to transact highly standardized contracts in relatively small amounts. As a result of the high number of market participants and the relatively small number of standardized instruments traded and the credit of a central counterparty clearer, liquidity in exchange-traded markets is relatively continuous in character.

In comparison, many swaps markets and other less commoditized cash markets feature a broader array of less-standardized products and larger-sized orders that are traded by fewer counterparties, almost all of which are institutional and not retail. Trading in these markets is characterized by variable or non-continuous liquidity. To offer one simple example, of the over 4,500 corporate reference entities in the credit default swaps market, 80% trade less than 5 contracts per day.[5] Such thin liquidity can often to be episodic, with liquidity peaks and troughs that can be seasonal (certain energy products) or more volatile and tied to external market and economic conditions (e.g. many credit, energy and interest rate products).

General Comparison of OTC Swaps Markets to Listed Futures Markets[6]

Characteristic	**OTC Swaps**	**Listed Futures**
Trading Counterparties	10s – 100s (no retail)	100,000s (incl. retail)
Daily Trading Volume	1,000s	100,000s
Tradable Instruments	100,000s[7]	1,000s
Trade Size	Very large	Small

Drawing a simple comparison, the futures and equities exchange markets generally handle on any given day hundreds of thousands of transactions by tens of thousands of participants (many retail), trading hundreds of instruments in small sizes. In complete contrast, the swaps markets provide the opportunity to trade tens of thousands of instruments that are almost infinitely variable. Yet, on any given day, just dozens of large institutional counterparties trade only a few thousand transactions in very large notional amounts. .

[5] ISDA & SIFMA, "Block Trade Reporting for Over-the-Counter Derivatives Markets," January 18, 2011, ("ISDA/SIFMA Block Trade Study"). *Available at* http://www.isda.org/speeches/pdf/Block-Trade-Reporting.pdf.
[6] *See* ISDA/SIFMA Block Trade Study.
[7] Inclusive of all tenors, strikes and duration.

The effect of these very different trading characteristics results in fairly continuous liquidity in futures and equities compared with limited or episodic liquidity in swaps. There is richness in those differences, because taken together, this market structure has created appropriate venues for trade execution for a wide variety of financial products and a wide variety of market participants. But the difference is fundamental and a thorough understanding of it must be at the heart of any effective rule making under Title VII of DFA. The distinct nature of swaps liquidity has been the subject of several studies and comment letters presented to the CFTC and the SEC.[8]

It is because of the limited liquidity in many of the swaps markets that they have evolved into "dealer" marketplaces for institutional market participants. That is, corporate end users of swaps and other "buy side" traders recognize the risk that, at any given time, a particular swaps marketplace will not have sufficient liquidity to satisfy their need to acquire or dispose of swaps positions. As a result, these counterparties may chose to turn to well capitalized sell-side dealers that are willing to take on the "liquidity risk" for a fee. These dealers have access to secondary trading of their swaps exposure through the marketplaces operated by wholesale and inter-dealer brokers such as GFI Group. These wholesale marketplaces allow dealers to hedge the market risk of their swaps inventory by trading with other primary dealers and large, sophisticated market participants. Without access to wholesale markets, the risk inherent in holding swaps inventory would cause dealers to have to charge much higher prices to their buy side customers for taking on their liquidity risk, assuming they remain willing to do so.

Dodd-Frank Impact on Swaps Market Structure: Clearing and Competing Execution.

Title VII of Dodd-Frank was an earnest and commendable effort by Congress to reform certain aspects of the OTC swaps market. The DFA's core provisions concerning swaps are: one, replacing bilateral trading where feasible with central counterparty clearing, and two, requiring that cleared swaps transactions between swaps dealers and major swaps participants be intermediated by qualified and regulated trading facilities, including those operating under the definition of "Swap Execution Facilities (SEFs)" through 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, through any means of interstate commerce..."[9] These two operative provisions seek to limit the current market structure where swaps and the underlying counterparty risk may be traded directly between counterparties without the use of trading intermediaries or clearing, and to replace it for most transactions with a market structure in which a central clearing facility acts as the single counterparty to each market participant (i.e. buyer to each seller and seller to each buyer) and where those cleared transactions must be traded through SEFs and other intermediaries and not directly between the counterparties.

In enacting these structural changes, DFA wisely rejected the anticompetitive, single silo, exchange model of the futures industry, in which clearing and execution are

[8] ISDA/SIFMA Block Trade Study; Comment Letter of JPMorgan(January 12, 2011) ("JP Morgan Letter"). .
[9] *See* Commodity Exchange Act ("CEA") Section 1a(50).

intertwined thereby giving the exchange an effective execution monopoly over the products that it clears.[10] Rather, by requiring central clearing counterparties to provide non-discriminatory access to unaffiliated execution facilities, DFA promotes a market structure in which competing SEFs and exchanges will vigorously compete with each other to provide better services at lower cost in order to win the execution business of sophisticated market participants. In this regard, DFA preserves the best competitive element in the existing swaps landscape: competing wholesale brokers.

GFI and its fellow WMBAA members heartily support Dodd-Frank's twin requirements of clearing and intermediation. Their advocacy of swaps clearing predates the legislation and, even, the recent financial crisis.[11] Their advocacy of swaps intermediation is fundamental to their business success in fostering liquidity, developing and deploying sophisticated trading technology tools and systems and operating efficient marketplaces in global markets for swaps and other financial products.

Wholesale Brokers Will Serve as Responsible SEFs.

As noted, GFI and its competitors actively deploy a range of execution services, technologies and other "means of interstate commerce" to display prices to "multiple participants" to connect them with other "multiple participants" in billions of dollars of daily swaps trades. As such, wholesale brokers are the true prototype for prospective independent and competitive SEFs under DFA.

More importantly, GFI and other members of the WMBAA look forward to performing our designated roles as SEFs under DFA. The wholesale brokerage industry is working hard and collaboratively with the two Commissions to inform and comment on proposed rules to implement DFA. The WMBAA has submitted several comment letters[12] (copies attached) and expects to provide further written comments to the CFTC and SEC. The WMBAA has also hosted the first conference, SEFCON 1[13], dedicated specifically to SEFs. Further, the WMBAA has conducted numerous meetings with

[10] As the Justice Department observed in a 2008 comment letter to the Treasury Department, where a central counterparty clearing facility is affiliated with an execution exchange (such as in the case of US futures), vertical integration has hindered competition in execution platforms that would otherwise have been expected to: result in greater innovation in exchange systems, lower trading fees, reduced ticket size and tighter spreads, leading to increased trading volume and benefits to investors. As noted by the Justice Department, "the control exercised by futures exchanges over clearing services...has made it difficult for exchanges to enter and compete." In contrast to futures exchanges, equity and options exchanges do not control open interest, fungibility, or margin offsets in the clearing process. The absence of vertical integration has facilitated head-to-head competition between exchanges for equities and options, resulting in low execution fees, narrow spreads and high trading volume. *See* Comments of the Department of Justice before the Department of the Treasury Review of the Regulatory Structure Associated With Financial Institutions, January 31, 2008. *Available at* http://www.justice.gov/atr/public/comments/229911.htm.

[11] In 2005, GFI Group and ICAP Plc, a wholesale broker and fellow member of the WMBAA, took minority stakes in the Clearing Corp and worked together to develop a clearing facility for credit default swaps. That initiative ultimately led to greater dealer participation and the sale of the Clearing Corp to the Intercontinental Exchange and the creation of ICE Trust, a leading clearer of credit derivative products.

[12] *See* Comment Letter from WMBAA (November 19, 2010) ("11/19/10 WMBAA Letter"); Comment Letter from WMBAA (November 30, 2010) ("11/30/2010 WMBAA Letter"); 1/18/11 WMBAA Letter; Comment Letter from WMBAA (February 7, 2011) ("2/7/11 WMBAA Letter").

[13] SEFCON 1 was held in Washington, D.C. on October 4, 2010. The keynote address was given by CFTC Commissioner Gary Gensler. The Closing address was given by Congressman Scott Garrett (NJ-5).

Commissioners and staffs. We and the wholesale brokerage industry are determined to play a constructive role in getting right the new regulations under Title VII of DFA.

Three Critical Elements To Get Right:

There are many things to get right under DFA. Given that DFA requires all clearable trades to be transacted through an intermediary (either an exchange or a Swap Execution Facility), three critical elements are:

1. Permitted Modes of Swaps Execution
2. Pre-Trade Price Discovery & Transparency for Market Participants
3. Post-Trade Price Transparency & Reporting

1. Permitted Modes of Execution:

As stated, DFA defines SEFs as utilizing "any means of interstate commerce" to match swaps counterparties. This is an appropriate allowance by Congress as the optimal means of interaction in particular swaps markets varies across the swaps landscape. Congress recognized that it was best left to the marketplace to determine the best modes of execution for various swaps and, thereby, foster technological innovation and development. Congress specifically did not choose to impose a Federally mandated "one-size-fits-all" transaction methodology on the regulated swaps market.

As the swaps market has developed, it has naturally taken on different trading, liquidity and counterparty characteristics for its many separate markets. For example, in more liquid swaps markets with more institutional participants, such as certain U.S. Treasury, foreign exchange and energy products, wholesale brokers operate fully interactive electronic trading platforms, where counterparties can view prices and act directly through a trading screen and also conduct a range of pre- and post-trade activities like on-line price analysis and trade confirmation. These electronic capabilities reduce the need for actual voice-to-voice participant interaction for certain functions, such as negotiation of specific terms, and allow human brokers to focus on providing market intelligence and assistance in the execution process. And yet, even with such technical capabilities, the blend of electronic and voice assisted trading methods still varies for different contracts within the same asset class.

In markets for less commoditized products where liquidity is not continuous, GFI and its competitors provide a range of liquidity fostering methodologies and technologies. These include hybrid modes of: (a) broker work up methods of broadcasting completed trades and attracting others to "join the trade" and (b) auction-based methods, such as matching and fixing sessions. In other swaps markets, brokers conduct operations that are similar to traditional "open outcry" trading pits where qualified brokers communicate bids and offers to counterparties in real time through a combination of electronic display screens and hundreds of installed, always-open phone lines, as well as through other email and texting technologies. In every case, the technology and methodology used is well calibrated to disseminate customer bids and offers to the widest extent and foster the greatest degree of liquidity for the particular market.

GFI and the WMBAA have been active in seeking to educate US regulators about the multiple modes of execution utilized in the swaps markets today. We have given technology demonstrations to regulators in their offices and hosted tours of our New York brokerage operations to CFTC Commissioners O'Malia and Chilton. We are in the process of trying to schedule these educational tours for other CFTC and SEC Commissioners and staff. We understand that budget constraints currently facing these agencies may be a hindrance for additional tours and demonstrations. Yet, we believe it is critical that the CFTC and SEC familiarize themselves with the many modes of execution currently deployed in the marketplace to accommodate the varying characteristics of different swaps markets *before* finalizing the rules governing trade execution.

CFTC Commissioner Bart Chilton had this to say about a recent visit he made to GFI's New York brokerage floor, "I was surprised by what I didn't know. GFI and others like them were always in OTC land. Why would I know about what they do? Well, these are big, dynamic operations, not just a couple of guys in a back room with a phone. I don't think we have a full appreciation of the OTC markets yet."[14]

It is vitally important that SEF rules promulgated by the CFTC and SEC encompass the many varied and beneficial trading methodologies that are used today to execute swaps in these very competitive swap markets. Under Dodd-Frank, Congress wisely permitted SEFs to utilize "any means of interstate commerce" to transact swaps. Congress recognized that restricting methods of execution of swaps instruments with non-continuous liquidity could do substantial harm to the orderly operation of US swaps markets overall, to the detriment of those market participants who need to manage risk. There is no basis in Dodd-Frank for regulations designed to restrict or promote any one component or other of the hybrid means of swaps execution utilized by wholesale brokers and SEFs. Moreover, we believe it would be detrimental to liquidity in the swaps markets for the CFTC or SEC to mandate unduly restrictive or prescriptive transaction methodologies. Similarly, we believe it would be harmful to liquidity for the CFTC or SEC to mandate swaps trading methodologies taken from the highly commoditized equities or futures markets that are inappropriate and ill suited for the multiple and varied US swaps markets. We are highly concerned about seemingly artificial and arbitrary divisions between electronic and human-assisted modes of swaps execution that would be imposed under the CFTC's SEF proposals.

The WMBAA is currently drafting comment letters on the CFTC and SEC SEF proposals. We will be happy to provide this Committee copies as soon as those letters are filed. At this stage we are concerned that the rules have not provided enough flexibility or sufficient guidance to ensure that all modes of trade execution utilizing "any means of interstate commerce" will be embraced, a very clear directive of the DFA. We believed this is rooted in a lack of sufficient exposure to how trades are currently executed in the wholesale markets in a way that employs a wide array of technology to

[14] Energy Metro DESK, February 7, 2011. p.6. ("Chilton Desk Interview"). The article further states, "Chilton says his trip North to GFI changed his opinion about SEFs and OTC transparency in general. He says the hybrid broker model (voice and screens) for example, which actually is the rule and not the exception around the market, was news to him."

provide a vibrant and transparent market for "multiple participants [to] have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system"

It is worth noting that European regulators do not appear to be considering rules with similarly proscriptive limits on trade execution methodology. We are not aware of any significant regulatory efforts in Europe to mandate electronic execution of cleared swaps by institutional market participants. In a world of competing regulatory regimes, business naturally flows to the market place that has the best regulations – not necessarily the most lenient, but certainly the ones that have the optimal balance of liquidity, execution flexibility and participant protections. In a market without retail participants, we question what useful protections are afforded to large institutions (required to transact swaps on SEFs) by proposed US regulations that would limit the methods by which market participants may execute their orders. Rather, US regulations need to be in harmony with regulations from foreign jurisdictions to avoid driving trading liquidity away from US markets towards markets offering greater flexibility in modes of trade execution.

2. Pre-Trade Price Transparency.

The SEF provisions in Dodd-Frank contain a rule of construction for their operation: "to promote pre-trade price transparency in the swaps market."[15] Not surprisingly, GFI and its competitors operate in furtherance of that goal. Our business model is driven by revenues from commissions paid on transactions. Our goal is to complete more transactions with more customers. Therefore, each of our firms naturally and consistently disseminates trade bids and offers to the widest practical range of customers with the express purpose of price discovery and the matching of buyers and sellers. We employ a number of means of pre-trade transparency from software pricing analytics to electronic and voice price dissemination to electronic price work up technology. There is no reason we should be required to or would wish to curtail these transparency techniques upon qualification as SEFs. We endorse and currently promote the goal of pre-trade price transparency by providing market information by voice and electronic means to multiple market participants to create greater trading liquidity, the natural activity of intermediaries.

We are concerned, however, that this pre-trade price transparency rule of construction not be used as the basis for the imposition of artificial and, somewhat, experimental restrictions on market activity. For example, the CFTC's SEF proposals require "a minimum pause of 15 seconds between entry of two potentially matching customer-broker swap orders or two potentially matching customer-customer orders"[16] (Referred to below as the "15 Second Rule"). We are concerned that this provision could have a potentially devastating impact on liquidity in many swaps markets and we intend to address it in formal comments to the CFTC.

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[15] *See* CEA Section 5h(e).

[16] Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1,214 (January 7, 2011).

As noted earlier, buy-side customers often look to swaps dealers to undertake the liquidity risk of trading in swaps for which there is non-continuous liquidity. Under DFA, the dealer would take on that risk by placing both the customer's sale order and the dealer's buy order into a SEF for execution. One adverse impact of the proposed 15 Second Rule may be that the dealer will not know until the expiration of 15 seconds whether it will have completed both sides of the trade or whether another market participant will have taken one side. Therefore, at the time of receiving the customer order the dealer has no way of knowing whether it will ultimately serve as its customer's principal counterparty or merely as its executing agent. The result will be greater uncertainly for the dealer in the use of its capital and, possibly, the reduction of dealer activities leading, in turn, to diminished liquidity in and competitiveness of U.S. markets with detrimental results for buy-side customers and end users.

As a general matter, we note the conflict between, on the one hand, a rule of construction to promote pre-trade price transparency and, on the other hand, the express mandate under Dodd-Frank to allow delayed reporting of trade information for block trades because of the impact disclosure would have on liquidity in the market. In the first case, there are no operative provisions for pre-trade price transparency in Dodd-Frank that correspond to the non-binding rule of construction. In the second case, DFA specifically requires delayed reporting of block trades to preserve market liquidity and counterparty anonymity. We believe the specific DFA requirement for delayed block trade reporting takes precedence in implementation over the non-binding rule of construction to promote pre-trade transparency. We believe the Commissions should place great emphasis on complying with the operative requirements[17] of Dodd-Frank regarding block trading, ensuring liquidity of markets and preserving anonymity of parties to a trade as they relate to public reporting of trade information and ensuring that those requirements are not conflicted in the arbitrary pursuit of a "goal" of pre-trade transparency. We do not believe that the goal of pre-trade transparency justifies imposing on SEFS experimental trade execution mechanisms that are ill-suited for the unique characteristics of the swaps markets.

3. Post-Trade Price Reporting & Transparency:

It is certainly true that the right measure of pre and post trade transparency can benefit market liquidity. Yet, it is also true that absolute transparency can harm liquidity. The objective must be to strike the right balance. The impact on market liquidity of the CFTC and SEC's proposals on swaps trade reporting and transparency depend on finding the right balance in the final rules governing large block trading. If the rules do not properly define block trade size and thresholds in the context of the unique characteristics of various swaps markets, then the trade reporting of blocks could negatively impact market liquidity, disturbing businesses' ability to hedge commercial risk, to appropriately plan for the future and, ultimately, stifle economic growth and job creation.

Brokers have long recognized that in the less liquid swaps markets where a smaller number of primary dealers and market makers cross larger size transactions, the

[17] Section 727 of the Dodd-Frank Act; Section 763(i) of the Dodd-Frank Act.

disclosure of the intention of a major institution to buy or sell could disrupt the market and lead to poor pricing. If a provider of liquidity to the market perceives greater danger in supplying liquidity, it will step away from providing tight spreads and leave those reliant on that liquidity with poorer hedging opportunities. From a market structure standpoint, liquidity "takers" benefit from liquidity providers acting in a competitive environment. The liquidity providers compete with each other, often deriving reasonably small profits per trade from a large volume of transactions. By relying on their ability to warehouse trades and post capital to make markets and using their distribution and professional know-how to offer competitive prices to their customer base, dealers and market makers provide liquidity essential to the execution of hedging and other risk management strategies.

By imposing a regulatory regime where the market is quickly alerted whenever providers of liquidity take on risk, it becomes difficult for the risk takers to offset such risk without significant loss. The effect is greater risk, higher costs and, ultimately, less liquidity. Disseminating the precise notional amount of a particular large transaction could jeopardize the anonymity of the counterparties to such trades, making counterparties less willing to engage in transactions of size. Similarly, the effect of having no delay, or only a short dissemination delay, for a block trade report that includes the full notional size will discourage market makers from committing capital and providing liquidity to the broader market. For these reasons, having either no delay or a short dissemination delay will actually erode price discovery and the level of price efficiency in the market. We note and echo the concerns expressed by the Coalition for Derivatives End-Users that, "An across-the-board 15 minute time delay that does not account for the instrument type and market conditions is too simplistic to be effective for the derivatives market."[18]

There are historical examples of markets that have sought to achieve full post-trade transparency without adequate block trade exemptions. The results were not positive. In 1986, the London Stock Exchange ("LSE") enacted post trade reporting rules designed for total transparency with no exceptions for block sizes. What ensued was a sharp drop in trading liquidity as market makers withdrew from the market due to increased trading risk.[19] The LSE thereafter engaged in a series of amendments to make its block trade rules more flexible and detailed over time.

Achieving the right balance in block trade rules for swaps markets requires recognition that the thresholds and reporting delay must be different by asset class and instrument and need to be tailored with the greatest of precision. A "one-size-fits-all" approach will not work. The elements of trade size, delay period and disclosed information set should be individually established based upon the unique liquidity requirements of particular instruments and markets. It is vitally important that block trade thresholds and reporting periods be matched properly to the markets to which they apply; otherwise, the markets will adversely adapt to arbitrary rules leading to all manner of dislocation and misuse.

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[18] Comment Letter from Coalition for Derivatives End-Users (February 7, 2011) ("2/7/11 Coalition Letter").
[19] ISDA/SIFMA Block Trade Study, p. 8.

It is worth noting that the trade reporting regime that is often cited positively as a model for swaps trade reporting is the TRACE system for US corporate bonds. That system was phased in over three years. We believe that markets as complex as the swaps markets require at least as long a phase-in period to be cautious and make sure the formulas and mechanisms work properly. Furthermore, as with TRACE, during the phase-in period there should be appropriate study of the effects on market liquidity, as required by the statute.

We also note that because of the fundamental differences in liquidity in the swaps markets from those in the futures and equities markets, those markets provide inadequate and inappropriate models for the swaps markets for block trade calculations of size, content and time delay. As a result of the unique non-continuous nature of liquidity in certain swaps markets (with fewer participants), we believe that the CFTC and SEC need to carefully structure a public trade reporting regime that is not "one size fits all", but rather takes into account the unique challenges of fostering liquidity in the diverse range of swaps markets, provides for the transacting of larger transactions without unnecessary regulatory burdens, and does not materially reduce market liquidity.

The WMBAA has proposed[20] the formation of a block trade standards advisory board (the "Swaps Standards Advisory Board") made up of recognized experts and representatives of registered SDRs and SEFs to make recommendations to the Commissions for appropriate block trade thresholds for swaps and security based swaps. (Copy attached.) The WMBAA cites the role of existing advisory committees, such as the in Agricultural Advisory Committee, Global Markets Advisory Committee, Energy and Environmental Markets Advisory Committee, and the Technology Advisory Committee, which serve to receive market participant input and recommendations related to regulatory and market issues. Recent Commission rulemakings in agricultural commodities[21] and co-location[22] have benefitted greatly from the industry input of these advisory committees. While the Commission is authorized under Dodd-Frank to establish block trade standards on its own, we believe that a Swaps Standards Advisory Board, similar to the above-referenced advisory committees, could provide the Commission with meaningful statistics and metrics from a broad range of contract markets, SDRs and SEFs to be considered in any ongoing rulemakings in this area.

A Swaps Standards Advisory Board would work with the Commissions to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all swaps reported to the registered SDR in accordance with the criteria and formula for determining block size specified by the Commissions. The Swaps Standards Advisory Board would also undertake the market studies and research at industry expense that is necessary to help establish such standards. This arrangement would permit SEFs, as the entities most closely related to block trade execution, to provide essential input into the Commission's block trade determinations and work with

[20] 1/18/11 WMBAA Letter..

[21] *See* Agriculture Commodity Definition, 75 Fed. Reg. 65,586 (October 26, 2010).

[22] *See* Co-Location/Proximity Hosting Services, 75 Fed. Reg. 33,198 (June 11, 2010).

registered SDRs to distribute the resulting threshold levels to SEFs. Further, the proposed regulatory structure would reduce the burden on SDRs, remove the possibility of miscommunication between SDRs and SEFs, and ensure that SEFs do not rely upon dated or incorrect block trade thresholds in their trade execution activities.

Areas where Congress Can Help.

In this testimony, I have called on the CFTC and SEC to better understand the distinct nature of the swaps markets and not align their rulemaking with familiar but inappropriate models of the futures and equities markets. I have criticized a specific rule proposal (the 15 Second Rule) and arbitrary limits on SEFs' use of "any means of interstate commerce" to transact customer orders. I have also endorsed a proposal by the WMBAA for a Swaps Standards Advisory Board.

I commend the two Commissions (SEC and CFTC) and their staffs for their evident good faith and determination. They are working very hard to get this right. I and many colleagues in the wholesale brokerage industry are optimistic that, given enough time, we can work with the regulators to fine tune rules regarding modes of intermediation, transparency and non-discrimination towards SEFs. That said, there are two areas where Congress can help.

Time Frames: In proscribing specific rule promulgation dates, DFA did not give regulators enough time to complete an orderly transformation of the multi-trillion Dollar US swaps market to a cleared and intermediated structure. The mandated time frames are just too tight get the details right. CFTC Commissioner Scott O'Malia has called them "unrealistic."[23] They are indeed unrealistic and put an unreasonable burden on the staff of the regulatory commissions to sufficiently familiarize themselves with the workings of the OTC swaps markets. Yet, such familiarity and, indeed, expertise, is absolutely necessary since heretofore neither agency had direct regulatory authority or involvement with these markets. Without the time or the resources to understand these markets, each agency will have the natural tendency to fall back on the familiarity of the markets they already regulate. The CFTC's proposals are therefore generally based off of the futures market model and the SEC's rules more prone to a securities market model. Not only is the swap market and its diverse elements unique, but it is critically important that there be consistency between the two agencies. More time and resources would surely give both agencies a better chance to first, do no harm and second, reach the right outcome.

Several days after viewing our New York brokerage operations, CFTC Commissioner Bart Chilton put it thus in a speech: "... We are also working, in the crafting of SEF rules, to ensure that we do not mess up platforms that are currently working well. This is a delicate balancing act, and we need to hear from market participants that have the expertise and interest in this area to make sure we get it right."[24]

[23] Keynote Address by Commissioner Scott D. O'Malia at Tabb Forum Conference(January 25, 2011).
[24] Speech of Commissioner Bart Chilton to the American Public Gas Association Winter Conference, Fort Myers, Florida, (February 1, 2011).

Commissioner Chilton is exactly correct that in crafting SEF rules, regulators must better understand platforms that are currently working well so as not to mess them up.

Commissioner Chilton had this to say in another forum[25] "GFI and others like them...are big dynamic operations, not just a couple of guys in a back room with a phone. I don't think we have a full appreciation of the OTC markets yet. I am worried we're going to pull the trigger too soon."

What is needed is for Congress to give regulators the necessary time to understand more precisely those swaps platforms that are currently working well and discourage them from pulling "the trigger too soon". Commissioners like Bart Chilton and responsible regulators must have the opportunity to better consider how existing intermediaries function, how they deploy technology, how they promote price transparency and how they use many means of execution to connect multiple to multiple market participants. From an understanding of the effectiveness of these systems for the markets they serve, regulators may gain comfort to more fully endorse working execution models rather than having to impose artificial models or those from distinct markets. Market research and further studies may be required to provide the thorough knowledge necessary to craft workable, effective and appropriate rules and regulations, and will take time.

If regulators are given sufficient time and, frankly, resources to craft SEF rules that are well tailored to the existing trading methods in the swaps markets, a benefit may be a shorter and more effective implementation period by the swaps industry. Rushing the rules will make implementation slower, harder and more costly. Taking the time to make the rules reflect the way the swaps markets actually work will speed implementation and save money. As the adage goes, "Measure twice, cut once."

Industry Efforts: Secondly, DFA failed to dot a few '''s and cross a few 't's. For example, Dodd-Frank sets up a framework of competing SEFs and DCMs, yet in its core principles requires that each SEF monitor and enforce counterparty position limits and manipulative trading practices[26]. The requirement presumes that each SEF has sufficient market and customer knowledge to comply. However, as competing execution facilities, SEFs will rarely handle or be aware of a counterparty's entire trading activity, which will be directed most likely to numerous SEFs depending on best execution, price and liquidity. Because SEFs are not structured as Designated Clearing Organizations or Swap Data Repositories, they will have no way of knowing the aggregate position limits or composite trading strategies of their customers and will fail to comply with the respective Core Principles.

Another practical impossibility is presented by Core Principle 4 which requires SEFs to monitor trading and trade processing.[27] This requirement provides that when a

[25] Chilton Desk Interview. p. 6.
[26] CEA Section 5h(f)(6); *See* Section 733 of the Dodd-Frank Act.

[27] CEA Section 5h(f)(4); *See* Section 733 of the Dodd-Frank Act.

swap is settled by reference to the price of an instrument traded in another venue the SEF must also monitor trading in the market to which the swap is referenced. In other words, a SEF that executes a trade of a credit default swap on a Ford Motor Company bond must also monitor trading in Ford Motor Company bonds. Yet, while SEFs certainly have the ability to monitor trades that they execute, they are not in a position to independently and effectively monitor positions and trading that takes place in other markets.

As the CFTC states on their website[28] regarding their trade surveillance program, only it can "consolidate data from multiple exchanges and foreign regulators to create a seamless, fully-surveilled marketplace" due to the Commission's unique space in the regulatory arena. The surveillance "requires access to multiple streams of proprietary information from competing exchanges, and as such, can only be performed by the Commission or other national regulators". The CFTC correctly states that the surveillance "can not be filled by foreign and domestic exchanges offering related competing products", and there is no reason to believe a SEF would be better situated. And yet, unless each SEF fills this sort of surveillance function, it will be in violation of SEF core principles.

A further issue is that SEFs ideally should be able to delegate relevant functions to a self-regulatory organization ("SRO"). Unfortunately DFA does not expressly contemplate such delegation as, for example, the CEA permits for other types of registered entities.[29] Further, it is not clear that even if permitted, SEFs would voluntarily delegate responsibilities to the existing SROs.

What is clear is that the proposed SEF rules create a host of new obligations for SEFs, as well as for the CFTC and the SEC. It also appears that the SEC and CFTC lack the resources necessary to implement and enforce the new rules. And if projections of 50 – 100 SEFs are correct, a new regulatory structure to facilitate compliance by SEFs with the applicable laws and regulations will need to be developed.

To address some of these issues, the WMBAA proposes the establishment of a common regulatory organization (CRO)[30] that will facilitate compliance with the core principles by each of its members as well as for any other SEF that agrees to follow its rules. The CRO would not itself have any direct regulatory responsibilities, but it would, by way of contractual obligations, assist its members by addressing compliance issues that are common to all SEFs. This solution would be industry and not taxpayer financed. However, this solution is not expressly authorized by DFA and would benefit from a Congressional mandate to confirm its utility.

Conclusion.

[28]CFTC Market Surveillance Program. *Available at* http://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/tradepracticesurveillance.html.

[29] See 7 U.S.C. § 7a-2(b).

[30] Distinguished from an SRO to avoid confusion with the legal and regulatory implications of an SRO.

Dodd-Frank seeks to reengineer the US swaps market on two key pillars: central counterparty clearing and mandatory intermediation of clearable trades through registered intermediaries such as SEFs. Wholesale brokers like GFI are today's central marketplaces in the global swaps markets and, as such, are the prototype of swap execution facilities.

Liquidity in today's swaps markets is fundamentally different than liquidity in futures and equities markets and naturally determines the optimal mode of market transparency and trade execution. Wholesale brokers are experts in fostering liquidity in non-commoditized instruments by utilizing methodologies for price dissemination and trade execution that feature a hybrid blend of knowledgeable brokers and sophisticated electronic technology. Wholesale brokers' varied execution methodologies are specifically tailored to the unique liquidity characteristics of particular swaps markets.

It is critical that regulators gain a thorough understanding of the many modes of swaps trade execution currently deployed by wholesale brokers and accommodate those methods and practices in their SEF rulemaking. Too many of the SEC's and CFTC's Title VII proposals are based off of rules governing the equities and futures markets and are ill-suited for the fundamentally different liquidity characteristics of today's swaps markets.

Regulators are undoubtedly working hard to put in place appropriate rules under Title VII. They have their work cut out for them and there are at least three critical elements for success:

1. SEFs must not be restricted from deploying the many varied and beneficial trade price dissemination and trade execution methodologies and technologies successfully used today to execute swaps
2. The "goal" of pre-trade transparency must be realized through means that do not destroy market liquidity for market participants and end users.
3. Regulators need to carefully structure a public trade reporting regime that is not "one size fits all", but rather takes into account the unique challenges of fostering liquidity in the diverse range of swaps markets.

Congress can assist with technical corrections to Dodd-Frank and, crucially, by providing regulators with adequate time and resources to thoroughly understand the challenges and current solutions to garnering trading liquidity in the swaps markets. Rushing the rule making process and getting things wrong will negatively impact market liquidity in the US swaps markets, disturbing businesses' ability to hedge commercial risk, to appropriately plan for the future and, ultimately, stifle economic growth and job creation.

Taking adequate time to get the Title VII regulations right will expedite the implementation of the worthy goals of Dodd-Frank: central counterparty clearing and effective trade execution by regulated intermediaries in order to provide end users with more competitive pricing, increased transparency and deeper trading liquidity for their risk management needs. With Congress' help, and the input and support of the swaps industry, regulators can continue their dedicated efforts at well crafted rule making. If we are successful, our US financial system, including the US swaps markets, can once again be the well ordered marketplace where the world comes to trade.

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PROFESSIONAL

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Hearing on Assessing the Regulatory, Economic and Market Implications of the Dodd-Frank Derivatives Title before the House Committee on Financial Services
Statement of Craig Reiners
Director of Risk Management, MillerCoors LLC

February 15, 2011

Good morning, Mr. Chairman and members of the Committee, my name is Craig Reiners. I am the Director of Risk Management for MillerCoors. I am also testifying on behalf of the Coalition for Derivatives End-Users ("Coalition"). The Coalition represents thousands of companies across the United States that employ derivatives to manage risks they face in connection with their day-to-day businesses. We are pleased to have the opportunity to offer perspectives on rulemakings at the CFTC, SEC and the prudential regulators to implement the Dodd-Frank derivatives title.

MillerCoors is a U.S. brewing company headquartered in Chicago, Illinois. MillerCoors will brew and ship over 67 million barrels of beer annually within the United States. In 2010, total sales reached $7.6 billion. MillerCoors employs 9,000 people, all of whom reside in the United States. We have eight manufacturing facilities located in Irwindale, CA, Trenton, OH, Eden, NC, Fort Worth, TX, Albany, GA, Elkton, VA, Golden, CO, Milwaukee, WI, as well as the Leinenkugel's craft brewery in Chippewa Falls, WI, and two microbreweries, the 10th Street Brewery in Milwaukee and the Blue Moon Brewing Company at Coors Field in Denver. We sell our products in all fifty states and export in various international markets. MillerCoors is the recent combination of two of the oldest brewing companies in the United States, started by the Coors and Miller families over 150 years ago, both true American icons. MillerCoors vision is to create America's best beer company by driving profitable industry growth. MillerCoors insists on building its brands the right way through brewing quality and through responsible marketing, sales, environmental conduct and community impact.

We support this Committee's efforts to help ensure that derivatives markets operate efficiently and are well-regulated. We agree that proper regulation should reduce systemic risk and increase transparency in the over-the-counter ("OTC") derivatives markets. At the same time, the prudent use of derivatives by end-user companies, such as MillerCoors, does not generate risk or instability in the financial marketplace and played no role in the financial crisis. On the contrary, these risk management tools are critical to reducing commercial risk and volatility in our day-to-day business operations, allowing us to create sustainable and prosperous businesses.

MillerCoors uses derivatives for the sole purpose of reducing commercial risk associated with our business. At MillerCoors, we brew beer, and our commitment to our customers is to produce the best beer in the United States and to deliver it at a competitive price. In order to achieve these goals, we must find a way to mitigate and prudently manage our inherent commodity risks. I believe the prudent use of derivatives offers end-users of physical commodities the critical risk management tools to provide a necessary degree of predictability to our earnings. The derivatives our organization has approved for use provide the tools to manage volatility intrinsic to commodities, which allows us to manage cash flow expectations within reasonable parameters. Our single largest commodity exposure is to aluminum. Our agricultural risks include malting barley, corn and hops. Our energy risk portfolio includes coal, natural gas, deregulated electricity and diesel fuel. This annual commodity spend of over $2.8 billion must be prudently managed. In order to properly manage this significant risk, we created a strict Board-approved commodity risk policy that clearly forbids speculation. This policy allows us to use OTC swaps to precisely match the timing and prices of our complex manufacturing and distribution process. For example, we exactly match our OTC swaps for aluminum with our actual use of cans over the same time frame. This risk management technique allows us to prudently manage our costs and reduce price volatility. We have used this risk management process both prior to and since the inception of MillerCoors with no adverse consequences. In fact, we would create significantly more price volatility in our business by not hedging our business risks. We believe that end-users generally share the concern that if the cost of hedging our risks rises significantly, entering into swaps may no longer be economical. The result could be a reduction in risk mitigation through hedging, which, ironically, could increase risk and exposure to market volatility.

We believe that a broad end-user exemption is critically important as the CFTC promulgates final rules. During the regulatory process, we have sought to ensure that the exemption created by Congress would not be unduly narrowed. In particular, we have urged regulators to give thoughtful consideration to key definitions to ensure that end-users like us are not saddled with bank-like regulation.

I would like to address the prospect of margin being imposed on future— or even previously entered— contracts. This requirement would be particularly burdensome to end-users like MillerCoors. Retroactive application of a margin requirement would upset the reasonable expectations we had when we entered our existing risk management contracts. We engaged in extensive negotiations with our financial counterparties to develop our ISDA (International Swap Dealers Association) agreements, which established our expectations for the future. The negotiated arrangements already include a credit cost that we have paid, so retroactive application of margin requirements would make us pay twice for the same credit risk.

A requirement for end-users like MillerCoors to post margin to its counterparties would have a serious impact on our ability to invest in and grow our businesses. A 2010 Business Roundtable survey demonstrates that the imposition of a 3 percent initial margin requirement on S&P 500 companies alone would drain $269 million in liquidity per company and could reduce capital spending by $5 to $6 billion per year, causing a loss of 100,000 to 120,000 jobs. A new survey from the Coalition for Derivatives End-Users found similar results. For MillerCoors, the liquidity drain would be at least double the number stated in the survey. In these challenging times, as we emerge from the worst recession since the Great Depression, our ability to grow our business would be seriously hampered.

MillerCoors urges the financial regulators to avoid creating rigid and expensive trading requirements that unintentionally could cause companies either to retain more risk or seek risk management alternatives overseas. By utilizing OTC swaps, we are able to customize our hedges to perfectly match the underlying exposure. If MillerCoors were required to use only standardized or exchange-traded hedge products, we would not create the risk offset we currently achieve today, and this would result in both accounting and real economic volatility. Though end-users are not directly subject to the trading requirements, excessive capital requirements imposed on our counterparties aimed at forcing end-users onto regulated exchanges, execution platforms and clearinghouses could significantly increase our costs. Capital requirements should be appropriate for the risk of the product, and should not be increased to punitive levels so as to deter the prudent use of non-cleared OTC derivatives by end users. The unintended consequence of margin requirements applied to end-users or excessive capital requirements applied to our financial counterparties could be to reduce the risk management activity of end-users. Such a result could actually increase systemic risk or even push transactions offshore. Neither of these would be favorable to our economy. Such policies are not necessary for regulators to accomplish Congress' objectives of containing systemic risk and increasing transparency in the OTC derivatives market.

Additionally, because of this market's importance to main street businesses like MillerCoors, we believe it is critical to get the regulation right. The current rulemaking timeline is compressed, which may force regulators to prioritize speed over quality. Doing so could hurt companies' ability to manage their risks and would increase uncertainty. We urge Congress to provide regulators with more time for rulemaking, *and* for regulators to allow market participants sufficient time for implementation. This is critical to ensuring that market participants have ample opportunity to provide useful feedback, and to ensuring this important market continues to function with minimal disruption. Chairman Gensler has reached out to businesses for input on a realistic implementation timeline. That is a positive step and one that we appreciate greatly. However, developing a workable implementation timeline still would not fix the problem of too many rules being promulgated over too little time. The statutory effective date must be extended for end-users to be able to participate meaningfully in the regulatory development process.

As regulators go about the important work of finalizing these rules, it is imperative that they do so in a manner that does not break those processes and systems that functioned well before and during the financial crisis. I am confident that the way in which these products are utilized by our company and other end-users benefits the economy by reducing volatility and increasing stability. Though it may be tempting to view all derivatives as risky financial products that were central to the credit crisis, we must remember that these are important tools upon which thousands of companies depend to manage risks in the real economy. On behalf of MillerCoors and the Coalition, I thank the Committee for allowing me to appear today to discuss these important issues, and I am happy to answer any questions that you may have.

Testimony on Implementation of Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act by the U.S. Securities and Exchange Commission

by

Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission

Before the United States House Financial Services Committee
February 15, 2011

Chairman Bachus, Ranking Member Frank, and members of the Committee:

Thank you for inviting me to testify today on behalf of the Securities and Exchange Commission regarding its implementation of Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act"), which primarily relate to the regulation of over-the-counter ("OTC") derivatives markets and the supervision of systemically important payment, clearing, and settlement systems. Title VII of the Act requires the SEC, among other regulators, to conduct a substantial number of rulemakings and studies. Although this task is challenging, particularly when viewed in the context of the SEC's other Dodd-Frank Act rulemaking responsibilities, we are committed to fulfilling the objectives of the Act in a responsible and diligent manner, while seeking the broad public input and consultation needed to get these important rules right. My testimony today will briefly describe our progress and plans for implementing Titles VII and VIII of the Dodd-Frank Act, with a particular focus on the regulation of the OTC derivatives marketplace.

Background

OTC Derivative Marketplace

As has been frequently noted, the growth of the OTC derivatives marketplace has been dramatic over the past three decades. From its beginnings in the early 1980s, when the first swap agreements were negotiated, the notional value of these markets has grown to almost $600 trillion globally.[1] However, OTC derivatives were largely excluded from the financial regulatory framework by the Commodity Futures Modernization Act of 2000. As a securities and capital markets regulator, the SEC has been particularly concerned about OTC derivatives products that are related to, or based on, securities or securities issuers, and as such are connected with the markets the SEC is charged with overseeing.

Dodd-Frank Act

The Dodd-Frank Act mandates oversight of the OTC derivatives marketplace. Title VII of the Act requires that the SEC and CFTC write rules that address, among other things, mandatory clearing, the operation of security-based swap execution facilities and data repositories, capital and margin requirements and business conduct standards for security-based swap dealers and major security-based swap participants, and regulatory access to and public transparency for information regarding security-based swap transactions. This series of rulemakings should improve transparency and facilitate the centralized clearing of security-based swaps, helping, among other things, to reduce

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1 *See* Bank of International Settlements, Positions in Global Over-the-Counter (OTC) Derivatives Markets at End-June 2010, Monetary and Economic Department (Nov. 2010), http://www.bis.org/publ/otc_hy1011.pdf.

counterparty risk. It should also enhance investor protection by increasing disclosure regarding security-based swap transactions and helping to mitigate conflicts of interest involving security-based swaps. In addition, these rulemakings should establish a regulatory framework that allows OTC derivatives markets to continue to develop in a more transparent, efficient, accessible, and competitive manner.

Title VIII of the Act provides for increased oversight of financial market utilities and financial institutions that engage in payment, clearing, and settlement activities that are designated as systemically important. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability.

Implementation Generally

The implementation of these titles is a substantial undertaking and raises a number of challenges. Accordingly, we have been engaging in an open and transparent implementation process, seeking input on the various rulemakings from interested parties even before issuing formal rule proposals. We will continue to seek input on each proposal with the goal of producing effective and workable regulation of derivatives activities and oversight of financial market utilities and financial institutions that engage in payment, clearing, and settlement activities.

Public Consultation

We have enhanced our public consultative process by expanding the opportunity for public comment beyond what is required by law. For instance, we have made available to the public a series of e-mail boxes to which interested parties can send preliminary comments before rules are proposed and the official comment periods begin. These e-mail boxes are on the SEC website, organized by topic. We also specifically solicited comment, along with the CFTC, on the definitions contained in Title VII of the Act.

In addition, our staff has sought the views of affected stakeholders. This approach has resulted in meetings with a broad cross-section of interested parties. To further this public outreach effort, the SEC staff has held joint public roundtables and hearings with the CFTC staff on select key topics. Through these processes, we have received a wide variety of views and information that is useful to us in proposing and, ultimately, adopting rules that are appropriate for these markets.

Coordination with the CFTC and Other Regulators

In implementing Title VII, our staff is meeting regularly, both formally and informally, with the staffs of the CFTC, Federal Reserve Board, and other financial regulators. In particular, SEC staff has consulted and coordinated extensively with CFTC staff in the development of the proposed rules. Although the timing and sequencing of the CFTC's and SEC's proposed rules may vary, they are the subject of extensive interagency discussions. The SEC's rules will apply to security-based swaps and the CFTC's rules will apply to swaps, but our objective is to establish consistent and comparable requirements, to the extent possible, for swaps and security-based swaps. Due in part to differences in products, participants, and markets, some of our rule proposals contain different approaches to various issues. Nonetheless, as we move toward adoption, the objective of consistent and comparable requirements will continue to guide our efforts.

In addition, as required by the Act, we are working with the CFTC to adopt joint rules further defining key terms relating to the products covered by Title VII and certain categories of market intermediaries and participants. Joint rulemaking regarding key definitions will promote regulatory consistency and comparability, and thus help to prevent regulatory gaps that could foster regulatory arbitrage and overlaps that could confuse, or impose unnecessary added costs upon, market participants.

Finally, we recognize that other jurisdictions are also developing regulatory frameworks that will address many of the areas covered by Title VII. The manner and extent to which we and foreign regulators regulate derivatives will affect both U.S. and foreign entities and markets. Consequently, as we progress with the implementation of Title VII, we will continue to consult with regulatory counterparts abroad in an effort to promote robust and consistent standards and avoid conflicting requirements, where possible. The SEC and CFTC are, in fact, directed by the legislation to consult and coordinate with foreign regulators on the establishment of consistent international standards governing swaps, security-based swaps, swap entities and security-based swap entities. We believe that bilateral discussions with foreign regulators, as well as our engagement in the recently formed IOSCO Task Force on OTC Derivatives Regulation, which the SEC co-chairs, and our participation in other international forums will help us achieve this goal.

In short, we remain committed to working closely, cooperatively, and regularly with our fellow regulators to facilitate our implementation of the regulatory structure established by the Dodd-Frank Act.

Rulemaking

Actions Already Taken

The SEC has taken significant steps in implementing the rulemaking required by Titles VII and VIII of the Act. To date, the SEC has proposed nine rulemakings required by these titles.

In October 2010, we proposed rules to mitigate conflicts of interest involving security-based swaps. These proposed rules seek to address conflicts of interest at security-based swap clearing agencies, security-based swap execution facilities, and exchanges that trade security-based swaps.

In November 2010, we proposed anti-fraud and anti-manipulation rules for security-based swaps that would subject market conduct in connection with the offer, purchase, or sale of any security-based swap to the same general anti-fraud provisions that apply to all securities and reach misconduct in connection with ongoing payments and deliveries under a security-based swap. We also proposed rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps. Those rules lay out who must report security-based swap transactions, what information must be reported, and where and when it must be reported. In addition, we have proposed rules regarding the obligations of security-based swap data repositories, which would require security-based swap data repositories to register with the SEC and specify other requirements with which security-based swap data repositories must comply.

In December 2010, we proposed rules relating to mandatory clearing of security-based swaps. These rules would set out the way in which clearing agencies would provide information to the SEC about security-based swaps that the clearing agencies plan to accept for clearing. We also proposed rules relating to the exception to the mandatory clearing requirement for end users. These rules would specify the steps that end users must follow, as required under the Act, to notify the SEC of how they generally meet their financial obligations when engaging in security-based swap transactions exempt from the mandatory clearing requirement. In addition, we proposed joint rules with the CFTC regarding the definitions of swap and security-based swap dealers, and major swap and major security-based swap participants. These rules lay out objective criteria for these definitions and are a first step in helping the SEC appropriately address the market impacts and potential risks posed by these entities.

Thus far in 2011, we have proposed rules regarding the confirmation of security-based swap transactions, which would govern the way in which certain security-based swap transactions are acknowledged and verified by the parties who enter into them. And most recently, we proposed rules regarding registration and regulation of security-based swap execution facilities, which would define security-based swap execution facilities, specify their registration requirements, and establish their duties and core principles.

In addition, we adopted interim final rules in October 2010 regarding the reporting of outstanding security-based swaps entered into prior to the date of enactment of the Dodd-Frank Act. These interim final rules require certain security-based swap dealers and other parties to preserve and report to the SEC or a registered security-based swap data repository certain information pertaining to any security-based swap entered into prior to the July 21, 2010 passage of the Dodd-Frank Act and whose terms had not expired as of that date.

Our staff also is working closely with the Federal Reserve Board and the CFTC to develop, as required by Title VIII of the Act, a common framework to supervise financial market utilities, such as clearing agencies registered with the SEC, that are designated by the Financial Stability Oversight Council as systemically important. For example, we coordinated with the other agencies in December to propose rules under Title VIII regarding the filing of notices of material changes to rules, procedures, or operations by systemically important financial market utilities.

In addition, in December, the Financial Stability Oversight Council issued an advance notice of proposed rulemaking regarding the criteria and analytical framework that should be applied in designating financial market utilities under the Dodd-Frank Act.

Our staff also has been actively coordinating with the other agencies on the new authority granted to the SEC and CFTC to develop standards for these financial market utilities. Moreover, the SEC and CFTC staffs have begun working with staff from the Federal Reserve Board to develop a framework for consulting and working together on examinations of systemically important financial market utilities consistent with Title VIII.

Upcoming Actions

Early this year, we expect to propose rules regarding standards for the operation and governance of clearing agencies, including clearing agencies that are designated under Title VIII; rules to establish procedures for security-based swap dealers and major security-based swap participants to register with the SEC; and rules regarding business conduct, capital, margin, segregation, and recordkeeping for security-based swaps. We also expect to propose joint rules with the CFTC governing the definitions of "swap" and "security-based swap" as well as the regulation of "mixed swaps."

The SEC has been carefully reviewing all the comments received regarding the rules that already have been proposed and we are in the process of considering those comments. We also are continuing discussions with various market participants about their concerns and ideas regarding the proposed rules. This information is invaluable as we move toward consideration of final rules designed to further the purposes of the Dodd-Frank Act and the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation and provide effective regulation of the security-based swap markets without imposing unjustified costs or having unforeseen adverse consequences. We will, of course, be engaged in the same process for our upcoming proposed rulemakings, and I would like to take this opportunity to encourage market participants and the public to continue submitting comments on these upcoming proposed rulemakings.

Anticipated Completion of Rulemaking

We are working to complete the rulemaking proposal and adoption process under Titles VII and VIII within Congress' deadlines for implementation. Nonetheless, this is a very challenging task. The OTC derivatives markets are large and interconnected. The issues are complex and do not lend themselves to easy solutions.

We are progressing at a deliberate pace, taking the time necessary to thoughtfully consider the issues raised by the various rulemakings before proposing specific rules. We will take a similar approach as we move toward consideration of final rules.

Impact of Rulemaking on Existing Markets

There are unique challenges involved in imposing a comprehensive regulatory regime on existing markets, particularly ones that until now have been almost completely unregulated. For example, in proposing margin rules, we will be mindful both of the importance of security-based swaps as hedging tools for commercial end users and also of the need to set prudent risk rules for dealers in these instruments. We also need to carefully consider how our rules might impact pre-existing contracts. For example, in developing rules that concern the capital and margin requirements for security-based swap dealers, we will need to consider dealers' pre-existing security-based swaps. The application of new rules to existing security-based swaps could be very disruptive and impose on dealers or their counterparties burdens that they did not anticipate or bargain for. We discussed this issue, along with the end-user margin issue, with various stakeholders at a joint SEC-CFTC roundtable in December, and are taking the input we received at the roundtable and from other sources into account in writing proposed rules.

Conclusion

The Dodd-Frank Act provides the SEC with important tools to better meet the challenges of today's financial marketplace and fulfill our mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As we proceed with implementation, we look forward to continuing to work closely with Congress, our fellow regulators, and members of the financial and investing public.

Thank you for inviting me to share with you our progress on and plans for implementation. I look forward to answering your questions.

For release on delivery
10:00 a.m. EST
February 15, 2011

Statement by

Daniel K. Tarullo

Governor

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

February 15, 2011

Chairman Bachus, Ranking Member Frank, and other members of the Committee, I appreciate this opportunity to provide the Federal Reserve Board's views on the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Board's responsibilities with respect to over-the-counter (OTC) derivatives fall into three broad areas: consultation and coordination with other authorities, both domestic and international; efforts to strengthen the infrastructure of derivatives markets; and supervision of many derivatives dealers and market participants.

Consultation and Coordination

The Dodd-Frank Act requires that the Commodity Futures Trading Commission and the Securities and Exchange Commission consult with the Board on the rules they are crafting to implement Title VII. Immediately after passage of the act, the staff from the commissions and the Board met to fashion a process for this consultation; at the Board, we identified members of the staff with relevant expertise, both here and across the Federal Reserve System. Our staff have commented on proposed rules of the commissions at each stage of the development process to date. In providing feedback, we have tried to bring to bear our experience from supervising dealers and market infrastructure and our familiarity with markets and data sources to assist the commissions.

Important coordination activities related to derivatives regulation also are occurring within international groups. Most prominently, the Group of Twenty (G-20) leaders have set out commitments related to reform of the OTC derivatives markets that, when implemented by national authorities, will form a broadly consistent international regulatory approach. Work on the G-20 commitments is being carried forward in numerous groups of technical and policy experts, and staff members from the Federal Reserve are actively participating in these groups.

More generally, the Board participates in many international groups that serve as vehicles for coordinating policies related to the participants and the infrastructure of derivatives markets. These groups include the Basel Committee on Banking Supervision (Basel Committee), which has recently enhanced international capital, leverage, and liquidity standards for derivatives, and the Committee on Payment and Settlement Systems, which is working with the International Organization of Securities Commissions to update international standards for systemically important clearing systems, including central counterparties that clear derivatives instruments, and trade repositories.

The goal of all of these efforts is to develop a consistent international approach to the regulation and supervision of derivatives products and market infrastructures, as well as to the sound implementation of the agreed-upon approaches. Our aim is to ensure a level playing field that will promote both financial stability and fair competitive conditions by preventing activity from flowing to less regulated jurisdictions.

Infrastructure Issues

The Dodd-Frank Act addressed both the infrastructure of the derivatives markets and the regulation and supervision of its dealers and major participants. Central counterparties are given an expanded role in the clearing and settling of swap and security-based swap (hereafter referred to as "swap") transactions, and the Board believes benefits can flow from this reform. Since 2005, Federal Reserve staff members have worked with market participants to strengthen the infrastructure for OTC derivatives, including developing and broadening the use of central clearing mechanisms and trade repositories. Market participants have already established central counterparties that provide clearing services for some OTC interest rate, energy, and credit derivatives contracts. If properly designed, managed, and overseen, central counterparties offer an important tool for managing counterparty credit risk, and thus they can reduce risk to market participants and to the financial system. Both central counterparties and trade repositories also support regulatory oversight and policymaking through provision of more comprehensive data on the derivatives markets. The Board is committed to continuing to work with other authorities, both in the United States and abroad, to ensure that a largely consistent international approach is taken to central counterparties and trade repositories and that their risk-reducing benefits are realized.

Title VIII of the act complements the role of central clearing in Title VII through heightened supervisory oversight of systemically important financial market utilities, including systemically important facilities that clear swaps. This heightened oversight is important because financial market utilities such as central counterparties concentrate risk and thus have the potential to transmit shocks throughout the financial markets. As part of Title VIII, the Board also was given new authority to provide emergency collateralized liquidity in unusual and exigent circumstances to systemically important financial market utilities. We are carefully considering ways to implement this provision in a manner that protects taxpayers and limits any rise in moral hazard.

Supervisory Issues

Although central counterparties will provide an additional tool for managing counterparty credit risk, enhancements to the risk-management policies and procedures for individual market participants will continue to be a high priority for supervisors. As the reforms outlined in the act are implemented, the most active firms in bilateral OTC markets likely will become active clearing members of central counterparties. As such, the quality of risk management at these firms importantly affects the ability of the central counterparty to manage its risks effectively and to deliver risk-reducing benefits to the markets.

Capital and margin requirements are central to the prudential regulation of financial institutions active in derivatives markets, as well as to the internal risk-management processes of such firms. The major rulemaking responsibility of the Board and other prudential regulators under Title VII is to adopt capital and margin regulations for the noncleared swaps of banks and other prudentially regulated entities that are swap dealers and major swap participants. The commissions are responsible for adopting capital and margin requirements for swap dealers and major swap participants that are not supervised by a prudential regulator. The prudential regulators and the commissions are consulting in developing the rules, and all agencies must, to the maximum extent practicable, adopt comparable standards. The commissions also have the responsibility for defining those dealers and major participants, and they have consulted with the Board prior to issuing their proposed rules. The commissions have tried to identify objective criteria that would enable firms to monitor whether they fall within the scope of the definitions. The comment process should provide information as to the effectiveness and appropriateness of the proposed approaches.

The capital and margin rules for banks and other prudentially regulated dealers and major participants are to be developed jointly with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Farm Credit Administration. The Board and the other U.S. banking agencies played an active role in developing the enhanced capital, leverage, and liquidity regime agreed to in the Basel Committee. These requirements will, among other things, strengthen the prudential framework for OTC derivatives by increasing OTC derivatives' risk-based capital and leverage requirements and by requiring banking firms to hold an additional buffer of high-quality, liquid assets to address potential liquidity needs resulting from their derivatives portfolios.

The statute requires the prudential regulators to adopt rules imposing initial and variation margins on noncleared swaps to which a swap dealer or major swap participant that they oversee is a party. The statute also directs that these margin requirements be risk based. Within these statutory constraints, the Board and the other prudential regulators are working to implement the margin provisions in a way that takes appropriate account of the relatively low systemic risk posed by most end users. For example, we are considering if it would be appropriate to allow a banking organization that is a dealer or major participant to establish a threshold with respect to an end-user counterparty, based on a credit exposure limit that is approved and monitored as part of the credit approval process, below which the end user would not have to post margin. The Board appreciates that posting margin would impose costs on end users, possibly inhibiting their ability to manage their risks. The Board also believes that the margin regime should be applied only to contracts entered into after the new requirement becomes effective.

A much-discussed part of the act is the requirement that banks push portions of their swap activity into affiliates or face restrictions on their access to the discount window or deposit insurance. Under the push-out provisions, banking organizations with deposit insurance or access to the Federal Reserve's discount window will have to reorganize some of their derivatives activity, pushing certain types of swaps out of subsidiary banks and into separate legal entities that will require separate capitalization and separate documentation of trades with existing customers. The act permits domestic banks to continue to engage in derivatives activities that have been a traditional focus of banks, including hedging activities and dealing in interest rate swaps, cleared credit default swaps, and other swaps that reference assets that banks are eligible to hold. However, because of the specific language contained in the act, this exemption for traditional bank derivatives activities does not apply to foreign banking firms that have access to the Federal Reserve's discount window through their U.S. branches. A possibly unintended effect of the act's push-out provision may be to require some foreign firms to reorganize their existing U.S. derivatives activities to a greater extent than U.S. firms.

Conclusion

As the implementation process for the act continues, the challenge facing the Board is to enhance supervision, oversight, and prudential standards of major derivatives market participants in a manner that promotes more-effective risk management and reduces systemic risk, while retaining the significant benefits of derivatives to the businesses and investors who use them to manage financial market risks. The Board is working diligently to achieve these goals.

Testimony of Don Thompson

JPMorgan Chase & Co.

Committee on Financial Services

U.S. House of Representatives

February 15, 2011

Chairman Bachus, Ranking Member Frank, and Members of the Committee, my name is Don Thompson and I am a Managing Director and Associate General Counsel at JPMorgan Chase & Co (JPMC). I head the derivatives legal group and have been actively involved in JPMorgan Chase's implementation of Title VII of the Dodd-Frank Act. Thank you for inviting me to testify at today's hearing.

Benefits of OTC Derivatives To Our Economy

For the past 30 years, American companies have used, and continue to use, over-the-counter (OTC) derivatives to manage a wide variety of risks that they encounter in their day-to-day business, such as interest rate, currency and commodity risk. The role of entities like JPMC in the OTC derivatives market is to act as financial intermediaries. In much the same way that financial institutions act as a go-between with investors seeking a return on their capital and borrowers seeking to raise capital in the capital markets, we work with companies, other end users and investors looking to manage their risks and with entities looking to take on those risks to hedge the opposite exposure or earn a return. Many of the companies we work with want to hedge their risks in the OTC markets because it enables them to hedge risk in a flexible and customized manner, often in large size, in a way that is not possible in the exchange-traded markets. These same companies often prefer the flexible and customized credit arrangements of OTC derivatives rather than the rigid daily cash margin regimes necessarily imposed by clearinghouses, which can drain scarce working capital from their balance sheets. And as this Committee has heard in testimony from American companies, the use of OTC derivatives has a significant impact on their ability to compete internationally.

OTC derivatives have many benefits, but it is also the case that there were problems with their use. Through the legislative process, JPMC supported many of the provisions in Title VII that will bring needed reform to the OTC markets to ensure that the role that OTC derivatives played in the financial crisis is never repeated: mandatory registration and regulation of Swap Dealers and Major Swap Participants, mandatory clearing of standardized contracts between financial firms, greater pre- and post-trade transparency and other needed reforms enacted in Title VII. These and other reforms, taken together, will fundamentally alter the market structure of OTC derivatives—how and where these instruments are traded, the economics of transactions, the nature of products available to American companies and the liquidity and efficiency of these markets. Given these wholesale changes, it is critical that the regulations implementing them be done carefully and thoughtfully, to limit unintended consequences and ensure that American companies continue to have access to these products.

We are increasingly concerned, however, given the number of new rules to be crafted, that the deadlines set by Congress in the statute may be too aggressive, limiting regulators' flexibility to craft appropriate rules. As discussed in detail below, we are specifically concerned that some of the proposed rules, if finalized, would harm the ability of American companies to manage risks in liquid and efficient markets. For example, we believe that for some rules, such as real time reporting and block trade levels, gathering data from market participants is a necessary prerequisite to setting effective standards and that such data should inform rulemaking. And in the rush to meet statutory deadlines, there has also been insufficient focus on the statutory mandate to examine the effects of proposals on market liquidity. Another area of concern in the rulemakings is the extent to which the Swap Execution Facility (SEF) definition fundamentally changes the protocols currently in place for market participants. Currently less than 10 percent of trades in the OTC markets are executed electronically. Requiring changes to the existing platforms that serve this market, as required by the CFTC proposal, adds an additional level of complication to the already complex and difficult transition to electronified markets. Without care, there is a real risk that the current proposals will drive liquidity out of US markets and increase the cost of managing risk, if not eliminate altogether the ability to do so by making it prohibitively expensive, inflexible or burdensome. For example, the CFTC's minimum 5 quote requirement in the request-for-quote aspect of the SEF rule will inhibit the willingness of liquidity providers to quote aggressively in response to requests because their quotes will be displayed to the entire market. There are tradeoffs between the policy goals of transparency and liquidity. We believe the agencies need to carefully implement the statute to preserve liquidity and enable American companies to continue to manage their risks in an increasingly volatile, and competitive, global marketplace.

We are also concerned about the competitive harm to American companies resulting from differences in final regulations, the gap in implementation dates in Europe and other jurisdictions as well as confusion over the extraterritorial application of these provisions. While there has been significant transatlantic dialogue on areas of agreement in regulating OTC derivatives, the final shape of regulations in Europe is still unknown. The European Union is in the process of developing its proposals in its EMIR (European Market Infrastructure Regulation) and MiFID (Markets in Financial Instruments Directive) proposals. MiFID is now at the consultation stage and not expected to be implemented across the EU until late 2013 or early 2014. EMIR, which covers clearing and reporting requirements, will come into effect early in 2012. This gap has provided a significant competitive opportunity for European institutions that are basing marketing campaigns on US institutions' compliance with Dodd-Frank. The pitch is simple: "Do business with a US bank and take your chances." This problem can be addressed by a simple clarification of the intended extraterritorial reach of the Act and by harmonizing the implementation timetables between the US and the EU.

I would like to turn now to a more detailed explanation of the aspects of regulatory implementation of Dodd-Frank that are of most concern to us and, where appropriate, we have noted recommendations made by JPMC to the regulatory agencies through the comment process.

Post Trade Transparency Issues

Block Trade Definition

In order to enhance transparency in the swaps markets, Title VII of Dodd Frank requires the agencies to publish regulations providing for real time reporting of price data relating to swaps. In the statute, the agencies are required to take into account whether public disclosure will materially impact liquidity and to specify the criteria for block trades – those that are very large in size for the specific instrument being traded – and for the appropriate time delays for block trades. In the draft regulations that have been issued to date, proposed block trade size and time delay provisions risk impairing market liquidity.

The block trade definition is critical because it serves two purposes: (i) it determines what trades get the benefit of delayed reporting for purposes of post trade transparency, and (ii) it also determines what trades are exempt from the SEF execution requirement. Block trades are important for our clients because they allow them to manage their risk exposures efficiently and in size. To determine block trade sizes, the CFTC applies two tests: a "distribution" test (only largest 5 percent of trades are blocks) and a "multiple" test (takes greatest of mean, median and mode, then multiplies by 5 to arrive at minimum block size), and then defines the block size as the greater of the two tests. The SEC did not offer a proposed definition of block trade but asked for comment on the issue.

The CFTC's tests, by taking the greater of two formulations, each of which is biased toward producing a high block size, will restrict liquidity because the block size will be so high as to capture a *de minimis* number of trades. Using the highest of mean, median and mode skews the results with outliers (and in fact by the block trades themselves). One possible approach would be to use the mode because by definition it is the "social size." The purpose of a multiplier is to ensure that most trades are subject to real time reporting and any multiplier above the social size accomplishes this, though we believe that five is excessive. The distribution threshold should function as a backstop to ensure that under no circumstances can a majority of trades be block trades, so we suggest setting it at 50 percent. It is worth noting that that the concept of block trades is well established on futures exchanges and stock exchanges and that block trade sizes set in those contexts distinguish between the needs of the retail and institutional customer.

Time Delays for Block Trades

Title VII also requires the agencies to specify the appropriate time delay for reporting block trades to the public so as to avoid materially reducing market liquidity. The draft regulations promulgated by the CFTC provide for a uniform 15 minute delay for Block Trades executed through a SEF. The SEC version provides for immediate reporting of all trade details of block trades except the notional amount – the notional amount is subject to an 8-26 hour delay based upon the time of day the trade is executed. We believe that instead of a "one size fits all" solution to the time delay issue, reporting delays should be flexible and be a function of the daily trading volume of the market in question. Reporting delays are needed to avoid adverse impacts on liquidity – the problem they address is that if the market knows a dealer has taken on a large risk position, it makes it more difficult and expensive for that dealer to trade out of the risk. Therefore, without appropriate reporting delays, dealers will be discouraged from taking large positions, resulting in less liquidity in the market. From this it follows that reporting delays should be a function of the trading volume of the asset being traded, since it is easier and quicker to trade out of a risk that has a higher trading volume than one with a lower trading volume. If a dealer is able to trade out of risk more easily and quickly, then it is able to offer better pricing on risk management transactions to its customers.

Reporting of notional amounts and the "masking rule"

The SEC and CFTC post trade transparency regimes are based largely on the TRACE reporting regime, which has been successful in enhancing transparency in the corporate and agency securities markets. The principal reason for TRACE's success is its "masking rules," which report trade sizes above $5 Million as "5+" for investment grade names and trade sizes above $1 million as "1+" for high yield names. The CFTC-proposed masking rule applies only to notional amounts of $250 million or more. On a comparable risk basis to TRACE, the threshold of a $250 million interest rate swap entails far more risk than a $5 million corporate or agency bond trade. We propose setting the masking rule at the "social size" determined for block trade purposes, *i.e.*, the mode of transactions of that type, so that if the social size for a particular trade is $25 million, we propose that trades above $25 million be reported as "25+." As is the case with block trade sizes, the effect of this would be to make it easier for dealers to hedge the risk arising from risk management transactions with their customers and thus to improve the pricing and execution of those transactions.

Position Limit Issues

Title VII of Dodd-Frank authorizes the agencies to adopt position limit rules relating to OTC derivatives. The CFTC-proposed position limit rulemaking has several aspects that, if adopted, would materially harm liquidity in US markets and thus impose additional risks and costs on all market participants, including end users. Given that non-US jurisdictions are, at best, years away from imposing similar regimes, if they do so at all, it is likely that liquidity will migrate outside the US and this will adversely affect the competitive position of US entities.

In particular, the proposed rule does not allow netting of physical delivery and cash settled contracts for purposes of determining compliance with aggregate and single month limits. Netting is critical to preserving liquidity in each market and presenting an accurate picture of market positions. Because of the absence of netting, the proposed limits are set at levels so low they will dramatically reduce dealers' ability to provide liquidity to each other and to clients. The spot month limits, including those for cash-settled contracts, are based on the "estimated deliverable supply" of each commodity, as determined by the relevant exchange. Estimated deliverable supply is not relevant to cash-settled contracts and should not form the basis for setting a limit on those positions. Moreover, no systematic, rigorous process for determining estimated deliverable supply exists, and the exchanges have not made their current determinations of estimated deliverable supply publicly available. Consequently, there is significant uncertainty in the market as to how this critical concept, on which the entire spot month limit infrastructure is based, will be defined and thus how spot month limits will be set.

We believe this concept must be studied further before being implemented; otherwise there is a significant risk of market disruption. The draft rule allows financial intermediaries to avail themselves of hedge exemptions only if their counterparty is eligible for a hedge exemption. "Pass-through" of position limits should be available for *all types* of counterparties in order for financial intermediaries to be able to continue to provide liquidity to the markets. The CFTC has the authority under Dodd-Frank to permit this, but has thus far proposed not to do so.

Swap Execution Facilities

Title VII of Dodd-Frank requires swaps that are cleared to be traded on an exchange or a SEF. Block trades and swaps that are not made available for trading on a SEF are exempt from this requirement. The statute states that "multiple participants" must have the ability to interact on SEFs. By requiring all SEF trades to involve a minimum of five participants, we believe the CFTC's proposed definition restricts customer choice unnecessarily and will result in significantly reduced liquidity. We believe the rule should lower this requirement to two participants and give clients the ability, but not the requirement, to request additional quotes. Any user of the platform could choose to request five, ten or 15 quotes if they believed it was in their interest to do so, but our clients have told us they want the flexibility to make that determination themselves, based on market conditions. That is the approach the SEC takes in its SEF proposal.

In addition, we believe that the CFTC impartial access requirement should not be interpreted to restrict the idea of dedicated liquidity pools for clients only, dealers only, or any other kind of rational self-organization that the private sector deems efficient. We believe that the CFTC should allow dedicated liquidity pools to rationally self-organize as long as the admissions criteria are not anti-competitive.

Lastly, the CFTC proposed rule requires that in order to be a SEF, the platform must support an expanded set of execution protocols that many of the existing SEF candidates do not currently support, which will result in significant transitional issues for market participants. Currently approximately less than ten percent of the market is executed electronically, and in some asset classes, that percentage is closer to one percent. Requiring market participants not only to execute electronically but to do so using protocols that don't currently exist and are foreign to the methods they currently use decreases the likelihood of a smooth transition to electronification.

Extraterritorial Application of Title VII

Another significant concern for market participants is the extent to which regulators apply provisions of Title VII to transactions outside of the United States. Extraterritorial application not only goes beyond Congressional intent, but harms the competitiveness of US financial institutions with global businesses. Title VII explicitly provides that it "shall not apply to activities outside of the United States" unless such activities have a direct and significant connection with activities in or effect on commerce of the United States or are necessary to prevent evasion of Title VII.

One area of concern is the potential application of the Section 716 "pushout rules" to foreign branches of US banks, which we believe was neither the Congressional intent of Title VII nor consistent with US banking law. Section 716 restricts certain swaps activities such as trading credit derivatives or equity derivatives in entities that qualify for federal assistance (such as Federal Deposit Insurance). Section 716 should not be applied to foreign branches of US banks or foreign subsidiaries of US banks because those entities do not qualify for Federal Deposit Insurance and thus do not pose any risk to the US taxpayer.

Similarly, application of other provisions of Title VII, such as the mandatory clearing and SEF execution provisions, to foreign branches of US banks or foreign subsidiaries of US banks is not warranted because those activities do not have a direct and significant effect on US commerce. It is worth noting that foreign branches of US banks and foreign subsidiaries are generally subject to comprehensive regulation and examination in the countries in which they operate – for example, foreign branches of US banks which operate in London are subject to comprehensive regulation by the UK Financial Services Authority.

In addition, the European Union is in the process of enacting comprehensive reform of the OTC derivatives markets, and so applying US rules to activities conducted in European jurisdictions runs the risk of inconsistent regulations ultimately applying to the same activity and harming the competitive position of US financial entities operating overseas.

Regulatory coordination

Title VII of the Dodd-Frank Act requires agency consultation and cooperation in their rulemaking activities. Despite this stated requirement, certain proposed regulations are treating very similar products differently in a way that is difficult to justify from a public policy perspective.

An example of this is in the post-trade transparency rules, which require the capture at point of trade of many trade details for eventual reporting. The trade details to be captured under the CFTC proposed rule and the SEC proposed rule, however, are not the same. This will make implementation of the rules very difficult for market participants who are subject to them. These differences will require different systems and workflows and largely duplicative but separate training and compliance regimes, all of which will result in widespread confusion among trading, operations and compliance personnel employed by market participants.

For example, at JPMC we employ traders who enter into both credit default swap index transactions, which are "Swaps" and thus subject to the CFTC proposed rule, and single-name credit default swap transactions, which are "Security Based Swaps" and thus subject to the SEC proposed rule. Just as it makes no sense to regulate salmon differently depending upon whether they are in fresh water or salt water, it makes no sense to treat very similar OTC derivatives activities differently depending upon whether they are subject to CFTC or SEC jurisdiction. The existence of two separate post-trade transparency regimes that will need to be implemented differently at the trader level will make such implementation difficult and will make the information that is ultimately reported less useful to the public. The result is likely to frustrate the post trade transparency objectives of the rules.

Another example is the definition of SEF. There are significant differences between the regulatory agencies' proposed regulations that will require two distinct trade execution infrastructures. We urge the Commissions, to the maximum extent possible, to conform their regulations and eliminate any differences which are not absolutely necessary in order to eliminate these negative consequences.

We are also concerned about the increased costs and burdens that our clients, many of which are mainstream US companies, will incur as a result of Title VII implementation. The mandatory clearing requirements, even if the client is an exempt end user, will result in increased costs because JPMorgan Chase's hedge transactions will be cleared, and we will have to pass on those costs. To the extent that the post trade transparency and SEF rules materially reduce liquidity, dealers' impaired ability to hedge will mean less competitive pricing for clients. The business conduct rules will result in much more extensive documentation at point of trade, and clients will have to bear the costs of reviewing and negotiating that documentation. Finally, the costs of complying with the extensive rules under Title VII, which will impose significant costs on dealers that will be passed along to clients, will be exacerbated by Section 716 which will require JPMC to maintain three swap dealers instead of a single legal entity, significantly raising compliance costs.

JPMorgan Chase is committed to working with Congress, regulators and industry participants to ensure that Title VII is implemented appropriately and effectively. I appreciate the opportunity to testify before this Committee and look forward to answering any questions you may have.

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Gary Gensler
Chairman

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June 13, 2011

The Honorable Scott Garrett
Chairman, Subcommittee on Capital Markets
and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, D.C.

Dear Mr. Chairman:

Thank you for your letters of March 3, 2011 and June 3, 2011, asking for responses to a number of questions related to the topic of the meeting of the Committee on Financial Services that was held on February 15, 2011.

I am pleased to enclose responses to your questions. Thank you for the opportunity to address these matters.

Sincerely,

Gary Gensler
Chairman

1. I am concerned that the CFTC, through its rulemaking, may be setting up a system that encourages regulatory arbitrage, one where American financial companies will be severely disadvantaged vis-a-vis their foreign competitors. At a time when every job is critical to this recovering economy, it is imperative that we preserve America's status as the preeminent financial center. Unnecessarily onerous rules will, without doubt, drive money to non-US markets. You have previously testified that you are in contact with regulators in Europe and beyond, and that you expect them to follow the American approach. But what assurances - real, concrete assurances - do you have that these jurisdictions will follow our approach? How can you convince us that we won't see American firms lose business to foreign competitors and lose jobs overseas?

The Commission is actively consulting and coordinating with international regulators to promote robust and consistent standards and avoid conflicting requirements in swaps oversight. The Commission participates in numerous international working groups regarding swaps, including the International Organization of Securities Commissions Task Force on OTC Derivatives, which the CFTC co-chairs. Our discussions have focused on clearing and trading requirements, clearinghouses more generally and swaps data reporting issues, among other topics.

As we do with domestic regulators, the CFTC shares many of our memos, term sheets and draft work product with international regulators. We have been consulting directly and sharing documentation with the European Commission, the European Central Bank, the UK Financial Services Authority, the new European Securities and Markets Authority, the Japanese Financial Services Authority and regulators in Canada, France, Germany and Switzerland. Two weeks ago, I met with Michel Barnier, the European Commissioner for Internal Market and Services, to discuss ensuring consistency in swaps market regulation.

Both the CFTC and European Union are moving forward on addressing the four key objectives set forth by the G20 in September 2009, namely clearing through central counterparties, trading on exchanges or electronic trading platforms, where appropriate, recordkeeping, reporting and higher capital requirements for non-cleared swaps.

Through consultation, regulators are working to bring consistency to oversight of the swaps markets. In September of last year, the European Commission released its swaps proposal. The European Council and the European Parliament are now considering the proposal. Similar to the Dodd-Frank Act, the European Commission proposal covers the entire product suite, including interest rate swaps, currency swaps, commodity swaps, equity swaps and credit default swaps. It is important that all standardized swaps – including exchange-traded swaps – are subject to mandatory central clearing. The proposal includes requirements for

central clearing of swaps, robust oversight of central counterparties and reporting of all swaps to a trade repository.

The E.C. also is considering revisions to its existing Markets in Financial Instruments Directive (MiFID), which includes a trade execution requirement, the creation of a report with aggregate data on the markets similar to the CFTC's Commitments of Traders reports and accountability levels or position limits on various commodity markets.

2. As a follow-up to the previous question, the Dodd-Frank Act recognizes the limits of U.S. jurisdictional authority by clarifying that the provisions of Title VII do not apply to activities outside the United States unless they have a direct and significant connection with activities in, or effect on, commerce of the United States. What steps has the CFTC taken, or does it intend to take, to ensure that U.S. firms can compete internationally on a level playing field with their foreign competitors in foreign jurisdictions?

   The Dodd-Frank Act provides that its swaps-related provisions "shall not apply to activities outside the United States unless those activities—(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the [CFTC] may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the [Commodity Exchange] Act that was enacted by" the Dodd-Frank Act.

   The CFTC's proposed rule on swap dealer and major swap participant registration addresses this matter and includes guidance. Under the proposal, a person would not have to register as a swap dealer if their only connection to the U.S. was that the person uses a U.S.-registered swap execution facility, derivatives clearing organization or designated contract market in connection with their swap dealing activities or reports swaps to a U.S.-registered swap data repository. In proposing the rule, the Commission specifically requested comment on a series of questions regarding the appropriate application of Title VII to swap dealers and major swap participants overseas.

3. Title VII-related rules are being proposed by both the CFTC and the SEC at a rapid pace and in many instances without apparent coordination. Their seems to be no order in which the rules are being proposed, which can have a profound impact on the ability of the public to meaningfully comment on the rules and their impact on the financial markets. For example, the business conduct rules for swap dealers and major swap participants were proposed well before the rules defining swap dealer and major swap participants were proposed. You have justified this "cart before the horse" problem in order to meet statutory deadlines. Are you concerned that this pattern of rulemaking

coupled with its unsustainable pace is depriving the public of the opportunity to provide meaningful comment on the CFTC's proposals? How will the CFTC ensure that the public has had a meaningful 0ppoliunity to comment on all of its proposals, consistent with the requirements of the Administrative Procedures Act? Will you re-propose rules where the overwhelming majority of the public comments disagree with the CFTC's proposals (i.e. real-time public reporting, designated contract markets core principles, swap dealer external business conduct standards, etc.)?

With the substantial completion of the proposal phase of rule-writing, the public in recent weeks has had the opportunity to review the whole mosaic of proposed rules. To facilitate this review, the CFTC reopened or extended comment periods for most of our proposed rules for an additional 30 days -- allowing the public to submit any comments they may have after seeing the entire mosaic at once, including comments about potential compliance costs as well as phasing of implementation dates to help the agency as we go forward with finalizing rules. In addition, on May 2-3, 2011, CFTC and SEC staff held a two-day roundtable to hear from the public on implementation dates for final rules. The Commission also is receiving written comments in connection with the roundtable. We will begin considering final rules only after staff can analyze, summarize and consider comments, after the Commissioners are able to discuss the comments and provide feedback to staff, and after we consult with fellow regulators on the rules.

4. Most observers of Title VII would probably agree that the requirements under the statute are demanding and will have far-reaching consequences. It is concerning to me, however, that the CFTC in many cases is going even beyond what the statute requires. For instance, many would like to preserve the ability of state pension funds to hedge risk. Congress decided to maintain that flexibility in Dodd-Frank. Through your business conduct standards rule, however, you have clearly gone beyond what the statute requires and applied obligations on firms that will essentially make it impossible for pensions to affordably hedge their exposure. What authority do you cite in going beyond the scope of Dodd-Frank in this area and others?

The Commission's proposed business conduct standards rules track the statutory directive under the provisions of the Dodd-Frank Act that create a higher standard of care for swap dealers dealing with Special Entities, including municipalities and pension funds. The Commission's proposed rules were drafted following consultations with Special Entities and potential swap dealers and were designed to enable swap dealers to comply with their new duties in an efficient and effective manner. The Commission is reviewing the comments it has received in response to the proposed rules to ensure that the final rules achieve the statutory purpose without imposing undue costs on market participants. CFTC staff is working closely with Department of Labor officials responsible for pension fund regulation to ensure harmonization of the rules under the two regimes.

5. Given that Congress specifically modeled the "market maker" concept of the "swap dealer" and "security based swap dealer" definitions on the '34 Act, it would seem that a reasonable interpretation of those terms would be based on precedent from the securities laws. In the joint rulemaking defining "swap dealer" and "security based swap dealer," however, the CFTC and SEC appear to have taken different approaches to that precedent. Specifically, the CFTC seems to have rejected the "dealer/trader" distinction which exists under the relevant statutory precedent, and which the SEC acknowledges in interpreting nearly identical language in the definition of "security based swap dealer". Can you please explain how it would be consistent with congressional intent to have only one agency recognize the "dealer/trader" distinction embodied in the "swap dealer" and "security based swap dealer" definitions?

   In December 2010, the CFTC and the SEC jointly issued a proposed rule to further define the terms "swap dealer" and "security-based swap dealer". In the joint proposal, the CFTC and the SEC "recognize that the principles relevant to identifying dealing activity involving swaps can differ from comparable principles associated with security-based swaps. These differences are due, in part, to differences in how those instruments are used. For example, because security-based swaps may be used to hedge or gain economic exposure to underlying securities ..., there is a basis to build upon the same principles that are presently used to identify dealers for other types of securities." Because security-based swaps are related to securities, the CFTC and SEC agreed that the dealer-trader distinction (which refers to the SEC's interpretation of aspects of the Securities Exchange Act of 1934) is "an important analytical tool to assist in determining whether a person is a 'security-based swap dealer.'"

   Swaps, unlike security-based swaps, are related to financial and non-financial commodities such as interest rates, currencies, agricultural commodities, energy commodities and metals. The CFTC and the SEC agreed that it would not necessarily be appropriate to use principles developed to determine if a person is a securities dealer to determine if a person is a dealer in commodity swaps. The proposal requested comment on this interpretive approach. To date, there are more than 180 comments responding to the proposal. The use of the dealer-trader distinction will be addressed in the final rules relating to the swap dealer and security-based swap dealer definitions, after taking the comments into account.

6. Proponents of position limits often claim that the so-called "massive passives" have adversely affected the functioning of the futures markets and contributed to price fluctuations. I am aware of only two reports which attempt to provide a factual analysis of the issue and neither is compelling. The Senate Permanent Subcommittee on Investigations' 2009 report lacked direct causal evidence. The 2008 CFTC Interagency Task Force on Commodity Markets Report found no direct causal relationship between

speculative activity and the run-up in gasoline prices during 2007-2008. Are you aware of any credible reports providing a clear, factual record that diversified commodity index funds distort prices? Given the increased .costs associated with the proposed rule, including the risk that price discovery shifts to foreign boards of trade, doesn't a cost-benefit analysis dictate the CFTC should wait to impose position limits until it has demonstrated a need to do so?

The Dodd-Frank Act mandates that the CFTC set aggregate position limits for certain physical commodity derivatives across the derivatives markets. The Dodd-Frank Act broadened the CFTC's position limits authority to include aggregate position limits on certain swaps and certain linked contracts traded on foreign boards of trade in addition to U.S. futures and options on futures. Congress also narrowed the exemptions traditionally available from position limits by modifying the definition of bona fide hedge transaction.

Position limits have served since the Commodity Exchange Act passed in 1936 as a tool to curb or prevent excessive speculation that may burden interstate commerce. When the CFTC set position limits in the past, the agency sought to ensure that the markets were made up of a broad group of market participants with a diversity of views. Integrity is enhanced when participation is broad and the market is not overly concentrated.

The CFTC considers all of the comments it receives to inform its final rulemaking. The CFTC and its staff will review all estimates of costs and benefits that are received from commenters and any data or studies supporting them.

7. In many sections of the statute (real time reporting, position limits, SEFs), the CFTC is required to assess how its proposals might impact liquidity. Yet in none of the relevant notices of proposed rulemakings is there any discussion of the impact on liquidity. Has the CFTC reviewed how its real time reporting, SEF (including block trade definition) and position limit proposals will affect market liquidity? If so, what are the results of that review? If not, why not? Is there a reason why the CFTC's proposals do not contain a section that discusses whether the cost of its rules will increase the probability that market participants in the derivatives markets may seek liquidity offshore? Will you commit to placing such a discussion in your rules going forward?

In its proposed rulemakings, the CFTC considered how the rule proposals might affect liquidity in the swap markets through discussions with market participants, domestic and international regulators and other interested parties. The CFTC addressed those issues in the rulemakings. In addition, the Commission has sought public comment specifically with regard to expected effects on liquidity. The Commission will thoroughly and carefully review submitted public comments before proceeding to consider final rules.

8. The CFTC is charged with coming up with capital requirements for swap dealers and major swap participants. Relative to the banking regulators, however, the CFTC does not have the long-time institutional and technical expertise associated with developing policy on this issue. Yet capital requirements will have a significant impact on the swaps market. Please comment on how the CFTC will approach this issue. How will the CFTC develop capital requirements to ensure a competitive marketplace and broad participation? Will the CFTC impose Basel capital requirements, which are bank requirements, on non-bank swap dealers in the energy and agricultural industries? Has the CFTC released an advanced notice of proposed rulemaking to get input from the public to determine how imposing Basel capital standards on non-bank swaps dealers in the agricultural and energy sectors would affect hiring, capital expenditures, and the pricing of goods and services for companies in those sectors? If not, will you commit to doing so? Does the CFTC intend to release an advanced notice of proposed rulemaking analyzing how the imposition of capital charges on swap dealers will impact the pricing of non-cleared swaps between swap dealers and end-users? If not, will you commit to doing so?

   The Dodd-Frank Act requires capital requirements to help ensure the safety and soundness of swap dealers and major swap participants. Capital rules help protect commercial end-users and other market participants by requiring that dealers have sufficient capital to stand behind their obligations with such end-users and market participants. The CFTC's proposed rule to establish capital requirements for nonbank swap dealers and major swap participants was published in the Federal Register on May 12, 2011. The proposal fulfills the Dodd-Frank Act's mandate in Section 731 to establish capital rules for all registered swap dealers and major swap participants that are not banks, including nonbank subsidiaries of bank holding companies.

   The proposed rule addresses capital requirements for swap dealers and major swap participants in three different categories: 1) if they are futures commission merchants (FCMs); 2) if they are subsidiaries of bank holding companies or systemically important financial institutions; or 3) if they are not in either category.

   With regard to dealers that also are FCMs, generally speaking, the Commission's existing capital rules for FCMs would apply. This is to ensure that FCMs have sufficient capital to continue to carry and clear customer swaps and futures transactions cleared by a DCO.

   The proposed rule would require dealers that are subsidiaries of bank holding companies or that have been designated as systemically important financial institutions by the Financial Stability Oversight Council (FSOC) to follow the rules set by the prudential regulators. For instance, a subsidiary of a U.S. bank holding company would have to comply with the capital requirements set by the Federal

Reserve Board as if the subsidiary itself were a U.S. bank holding company. This is intended to prevent regulatory arbitrage and ensure consistency among capital regimes for those entities that are regulated by prudential regulators.

For those swap dealers and major swap participants that are not regulated for capital by a prudential regulator and not FCMs, part of a bank holding company or a systemically important financial institution, the proposed rule departs from bank capital rules. It takes into consideration that these dealers are likely to have different balance sheets from those financial institutions that traditionally have been subject to prudential supervision. Such entities would be required to maintain a minimum level of tangible net equity greater than $20 million plus a measurement for market risk and a measurement for credit risk. This market risk and credit risk would be scaled to the dealers' activities and be measured based upon swaps activity and related hedges. The proposal would allow such firms to recognize as part of their capital fixed assets and other assets that traditionally have not been recognized by prudential regulators.

CFTC staff worked very closely with prudential regulators to establish these capital requirements that are comparable to the maximum extent practicable. Staff also consulted with the SEC and with international authorities. The proposed rule benefited from the CFTC and SEC staff roundtable on capital and margin requirements where we received significant input from the public.

9. The majority of end-user hedging is done with bank swap dealers, and the Federal Reserve Board's rules for margin will apply to bank swap dealers and bank major swap participants. Do you anticipate that the CFTC's proposed rule on margin for non-bank swap dealers will differ substantially from the rule proposed by the Federal Reserve Board?

The CFTC worked closely with the Federal Reserve and other prudential regulators on rules regarding margin requirements. The CFTC's proposed rule was published in the Federal Register on April 28, 2011. The proposed rules of the CFTC, the Federal Reserve, and other prudential regulators are substantially similar.

10. The CFTC's governance rulemaking proposed to limit the voting and ownership of enumerated entities (swap dealers, major swap participants, and others) in derivatives clearing organizations to a 20% individual limit and a 40% aggregate limit. In proposing the aforementioned limits, the CFTC's rulemaking ignored the fact that Congress had already spoken on the issue of voting and ownership limitations when it explicitly did not include the "Lynch Amendment" in the Dodd-Frank Act. Please explain why the CFTC proposed a rule which contains almost identical language as that found in an amendment that was openly debated and rejected by Congress. In addition, please explain how the CFTC could propose a rule that limits the voting and ownership of derivatives clearing organizations, designated contract markets, and swap execution facilities when it has not

yet conducted a review of these entities, as is required by Section 726(b) of the Dodd-Frank Act. If you have conducted a review which recommends that numerical limits on ownership and voting are "necessary", then please provide it and make it publicly available for comment. I am especially interested to know how the CFTC could determine that a 20% individual limitation on voting and ownership is necessary for swap execution facilities, given that they do not yet exist. If you have not conducted a review, then please provide the legal and empirical justification for the voting and ownership limits for SEFs, DCOs, and DCMs in your proposed rule.

The Commission's proposed rule on governance for DCOs, DCMs and SEFs implements Section 726 of the Dodd-Frank Act, which requires the Commission to mitigate conflicts of interest in the operation of certain DCOs, DCMs and SEFs. It is designed to advance the goals of the Dodd-Frank Act that clearinghouses and trading platforms have open decision-making and that their governance be protected from potential conflicts of interest. Such conflicts may arise with respect to determinations regarding the clearing and trading of swaps; access to such clearing and trading; and in the responsibilities of registrants for overseeing their members for compliance. Open governance is important to promoting competition amongst trading platforms as well as to lowering risk to the American public by ensuring that as many standardized swaps are cleared as possible.

Section 726(a) of the Dodd-Frank Act authorizes "numerical limits…on control" or "voting rights" that enumerated entities may hold with respect to such DCOs, DCMs, and SEFs. Enumerated entities include: (i) bank holding companies with more than $50,000,000,000 in total consolidated assets; (ii) nonbank financial companies supervised by the Board of Governors of the Federal Reserve System; (iii) affiliates of (i) or (ii); (iv) swap dealers; (v) major swap participants; or (vi) associated persons of (iv) or (v).

Section 726(b) of the Dodd-Frank Act directs the Commission to adopt rules determined to be necessary or appropriate to improve the governance of certain DCOs, DCMs or SEFs or to mitigate systemic risk, promote competition or mitigate conflicts of interest in connection with the interaction between swap dealers and major swap participants, on the one hand, and such DCOs, DCMs and SEFs.

Section 726(c) of the Dodd-Frank Act directs the Commission to consider the manner in which its rules address conflicts of interest in the abovementioned interaction arising from equity ownership, voting structure or other governance arrangements of the relevant DCOs, DCMs and SEFs.

The CFTC proposal has two important components. One is with regard to the functioning of the boards of directors and the inclusion of a sufficient number of public directors.

The second component is related to possible limits to the voting control of trading platforms and clearinghouses. The proposal recommends no aggregate limits on such voting control of trading platforms but does propose a limit of 20 percent on any individual member. With regard to clearinghouses, the proposal would set an aggregate limit of 40 percent of voting control for certain entities, but it also has another option: placing no aggregate limit if the voting ownership is more diverse, with no one member or named entity holding more than 5 percent. Importantly, the proposal also recommends that the Commission retain the authority in certain circumstances to grant exemptions to ownership limits.

The Commission has received extensive public comment with regard to the proposed rule and will summarize and consider those comments before proceeding to consider a final rule.

11. Why has the CFTC chosen to require market participants who use a SEF to send a request for quote to five entities? What is the legal and policy justification for interpreting the word "multiple" in the swap execution facility definition to mean five? Why is the CFTC's proposal substantially different from the SEC's on this interpretation? Are the agencies working together on the SEF definition? What legal and policy justification is there to require a dealer entering an order on a SEF on behalf of its customer to post that order for fifteen seconds? Has the CFTC thought through the market implications of this requirement? What are they?

The CFTC's proposed SEF rule will provide all market participants with the ability to execute or trade with other market participants. It will afford market participants with the ability to make firm bids or offers to all other market participants. It also will allow them to make indications of interest – or what is often referred to as "indicative quotes" – to other participants. Furthermore, it will allow participants to request quotes from other market participants. These methods will provide hedgers, investors and Main Street businesses both the flexibility to execute and trade by a number of methods, but also the benefits of transparency and more market competition. The proposed rule's approach is designed to implement Congress' mandates for transparency and competition where multiple market participants can communicate with one another and gain the benefit of a competitive and transparent price discovery process.

The proposal also allows participants to issue requests for quotes, whereby they would reach out to a minimum number of other market participants for quotes. It also allows that, for block transactions, swap transactions involving non-financial end-users, swaps that are not "made available for trading" and bilateral transactions, market participants can get the benefits of the swap execution facilities' greater transparency or, if they wish, would still be allowed to execute by voice or other means of trading.

In the futures world, the law and historical precedent is that all transactions are conducted on exchanges, yet in the swaps world many contracts are transacted bilaterally. While the CFTC will continue to coordinate with the SEC to harmonize approaches, the CFTC also will consider matters associated with regulatory arbitrage between futures and swaps. The Commission has received public comments on its SEF rule and will move forward to consider a final rule only after staff has had the opportunity to summarize them for consideration and after Commissioners are able to discuss them and provide feedback to staff.

12. Do you agree with Ranking Member Frank's letter, dated February 18, 2011, in which he states that "swaps are very different products than those currently traded in the highly evolved equity and futures markets"?

The Commission recognizes that there are differences between the futures markets and swaps markets. I believe that the mosaic of proposed rules issued by the Commission reflect that understanding and provide a thoughtful approach to implementation of the Dodd-Frank Act's mandate guided by the expertise of the CFTC staff and the thoughtful and creative engagement of my fellow Commissioners. The Commission also benefits greatly from ample guidance provided the public through comment letters, meetings and roundtable participation and from cooperation with fellow regulators.

THE WALL STREET JOURNAL.
WSJ.com

REVIEW & OUTLOOK | FEBRUARY 11, 2011

The Futures of America

Lessons of the NYSE-Deutsche Borse merger.

The likely sale of New York Stock Exchange parent NYSE Euronext to Deutsche Börse of Frankfurt, Germany, is playing as a blow to America's capitalist pride, and understandably so. It's painful at first blush to imagine ownership of the famous symbol of American financial markets transferred out of New York City. Yet the merger is itself a story of inevitable capitalist change and how no country or institution can take its dominance for granted.

The merger would continue the long-term consolidation of global financial trading, as new technology has upset old business models and leapt over geographic boundaries. The Big Board long ago lost its monopoly on trading listed stocks to Nasdaq and electronic exchanges. The result has been lower prices for customers wanting to buy and sell stocks, though perhaps at the cost of some stability in the markets, as orders are routed across dozens of trading platforms with varying rules.

Then last decade, the NYSE became a stock company to raise capital to expand, reaching abroad to buy Euronext in Paris and grab a share of the exploding derivatives market. NYSE Euronext has evolved to the point where it now collects only 3% of its earnings from U.S. stock trading.

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Getty Images

Traders on the floor of the New York Stock Exchange.

A Deutsche/NYSE combination would create a more formidable competitor for other leading exchanges, such as Chicago's CME Group. The German exchange operator is a leader in European interest-rate futures, and combined with NYSE's European assets it would match the CME Group's futures dominance in the U.S. Deutsche Börse is also a major player in options trading and with the acquisition will lead in U.S. market share. NYSE Euronext has developed valuable technology and has a well-regarded management team.

The combination could offer efficiencies of scale and technology that neither firm can achieve on its own. NYSE Euronext's competitive weakness has been evident in its share price, which is down 60% in the last four years. If the merger succeeds competitively, we doubt its shareholders will care if the headquarters is in Frankfurt or New York.

The merger is nonetheless one more lesson in how easily capital, both financial and human, can relocate. It's no coincidence that the heavily regulated equity business has languished or moved out of the U.S., while lightly regulated derivatives markets have boomed in the United States and elsewhere.

In the early 1990s, American exchanges played host to half of the world's new public companies. Last year, according to Dealogic, U.S. exchanges hosted 171 initial public offerings worth a total of $45 billion. But this U.S.

deal-making was dwarfed by the action overseas, where 1,295 companies went public with a total value of $237 billion. The iconic NYSE now lags behind two Asian exchanges in IPO volume. This is partly the result of more rapid growth in developing economies, but it used to be that foreign companies wanted to float their shares in the U.S. Now they're as happy in Hong Kong.

U.S. over-regulation is certainly to blame here, especially the 2002 Sarbanes-Oxley law and its multimillion-dollar compliance burden on public companies. The Securities and Exchange Commission's own exhaustive 2009 survey of U.S. and foreign firms showed that the burden of complying with Sarbox remains a major deterrent to going public in the United States. Yet the agency still hasn't made a serious effort to pare these burdens.

If the merger proceeds, the temptation in Washington will be to fret about foreign ownership of U.S. financial assets. But far more constructive would be some reflection about Washington's contribution to sending these assets and trading offshore. The Dodd-Frank law requires mountains of new rules that will further burden U.S. financial players, not least in the new derivatives regime emerging from the Commodity Futures Trading Commission. We would not be surprised if the NYSE Euronext managers view the Deutsche Börse merger as a potential refuge for its derivatives business if CFTC Chairman Gary Gensler realizes all of his regulatory ambitions.

For most of the last century, America could count on the size of its economy and quality of its technology to give it a competitive edge. No more. If we want the U.S. to be home to the next great financial institution, or even to keep the ones we have, our politicians need to make America a more inviting place to trade and do business.

Donald F. Donahue
Chairman and
Chief Executive Officer

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DTCC

The Depository Trust & Clearing Corporation
55 Water Street
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April 4, 2011

The Honorable Rubén Hinojosa
2262 Rayburn House Office Building
Washington, DC 20515

Re: Oversight Hearing: Assessing the Regulatory, Economic and Market Implications of the Dodd-Frank Derivatives Title

Dear Congressman Hinojosa:

Thank you for inviting me to participate in the hearing on February 15, 2011 to discuss OTC derivatives regulation. I appreciated the opportunity to share DTCC's thoughts on the implementation of Title VII of the Dodd-Frank Act, with a focus on issues raised by the Dodd-Frank Act's creation of a swap data repository system.

Enclosed are responses to the questions for the Record you posed. I would be pleased to discuss these issues with you and your staff in greater detail. Please do not hesitate to contact me, or Dan Cohen in our Washington office (202.329.1825), if you have additional questions about our concerns.

Sincerely,

Enclosure

Subsidiaries:
The Depository Trust Company
National Securities Clearing Corporation
Fixed Income Clearing Corporation
DTCC Deriv/SERV LLC
DTCC Solutions LLC
EuroCCP

QUESTIONS OF THE HONORABLE RUBEN HINOJOSA

COMMITTEE ON FINANCIAL SERVICES

"ASSESSING THE REGULATORY, ECONOMIC AND MARKET IMPLICATIONS OF THE DODD-FRANK DERIVATIVES TITLE"

FEBRUARY 15, 2011

#1 For each witness:

The derivatives markets are important for end-users, including important agricultural processers and producers.

What benefit does using a "swap execution facility" provide end-users in conducting their risk management and hedging operations?

#2 For each witness:

One of the key goals of the Dodd-Frank Act was to reduce systemic risk within the financial system.

(a)What role can "swap execution facilities" play in terms of reducing systemic risk to the overall system?

(b)How will these rules impact employment in the United States as it relates to trade execution?

* * *

As indicated in Committee testimony delivered during the February 15, 2011 hearing, The Depository Trust & Clearing Corporation ("DTCC") brings a unique perspective to discussions regarding the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

DTCC has an expertise in enhancing market transparency for regulators and market participants, and acts (and has acted) to ensure that transparency promotes equal data access to regulators world-wide. DTCC would defer to other market participants' expertise with regard to: 1) the benefits provided to end-users in connection with the utilization of a swap execution facility ("SEF") in conducting risk management and hedging operations; 2) the role SEFs play in terms of reducing systemic risk to the overall system; and 3) how Title VII's implementation rules will impact employment in the United States as it relates to trade execution, as DTCC does not operate an execution platform.

DTCC is sensitive to the different end-user perspectives presented in the market and believes that the benefits to end-users of SEFs will depend on the depth of each market and how these markets actually function.

The sense of DTCC on these issues is that there is significant concern that there could be unintended consequences relating to the implementation of SEFs. DTCC would advocate that a detailed analysis is conducted prior to implementation on a mandatory basis as opposed to discretionary offerings, and implementation is phased to allow appropriate impact assessment. DTCC holds the view that the swap data repository implementation should precede SEF implementation, as this is a necessary tool to provide data to inform mandatory SEF implementation.

DTCC's Trade Information Warehouse ("TIW"), a centralized, comprehensive global electronic data repository containing detailed trade information for the global credit default swap ("CDS") markets, has demystified the size and level of trading in global CDS derivatives markets. It has provided added protection, allowing regulators to see the risk posed by a single trading entity from a central vantage point across this market. This trade repository model and systemic architecture design can—and should—be replicated across other asset classes of derivatives to capture and ensure market transparency. Further, this goal can be accomplished without the need for the government to develop completely new data systems at a significant cost to taxpayers.

The comprehensive global CDS market information that DTCC is now able to publish includes net market-wide exposures to each CDS index and index tranche, and market-wide exposures to each of the top 1,000 individual corporate and governmental entities (ranked by size of exposure) on which CDS are written. This allows market participants, regulators, and the public to assess risks, in real-time, on the basis of comprehensive data to enable them to develop much more informed views. The published data also indicates which broad categories of market participants hold what positions in relation to important areas of the market, such as overall exposure to sovereign debt, corporate debt, and other broad categories, although not in such detail as would threaten to disclose the identity of position holders. Had this global market and sectoral market information been available and published in the run-up to the 2008 crisis, much of the exposure uncertainty that contributed to market instability at the time, at least in the CDS market, would have been mitigated.

Swap data repositories, like DTCC's TIW, will work closely with SEFs in the collection of trade information and assist in determining the appropriate size of large block trades. This is important to many end-users, as the framework for determining block trades will impact market liquidity for end-users and other market participants. Such issues have the potential to greatly impact end-users' ability to manage their own risk on competitive terms.

THE FINANCIAL SERVICES ROUNDTABLE

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February 7, 2011

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: The Commodities Futures Trading Commission Swap Data Recordkeeping and Reporting Requirements (RIN 3038-AD19).

Dear Mr. Stawick:

The Financial Services Roundtable1 (Roundtable) submits this letter in response to the Commodity Futures Trading Commission's (the Commission) notice of proposed rulemaking (the Proposal) on Swap Data Recordkeeping and Reporting Requirements. The proposal seeks to implement provisions in Title VII of the Dodd- Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010). Title VII establishes swap data repositories (SDR) and authorizes the Commission to prescribe recordkeeping and reporting standards for swap data. The proposal also includes new swap data reporting and record-retention requirements for swap dealers ("SDs"), major swap participants (MSP), and non-SD/MSP counterparties.

The Roundtable supports the CFTC's intent to enhance transparency, promote standardization and reduce systemic risk. We understand that the Commission modeled the proposed swap data recordkeeping requirements after the Commission's Core Principles 17 and 18, which require certain market participants to keep "full and complete records, together with all pertinent data and memoranda, of all activities relating to the business entity or person that is subject to the Commission's authority." See Part IIA of the Proposal. However, the Roundtable is concerned with the data retrieval requirements and we request additional clarification regarding the term "systematic records."

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[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $ $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

Proposed § 45.2. General Swap Recordkeeping

The proposal would require non-SD/MSP counterparties to "keep full, complete, and systematic records, together with all pertinent data and memoranda, with respect to each swap in which they are a counterparty[.]" *See* 75 Fed. Reg. 76599, proposed § 45.2(b). The swap data must be retained by non-SD/MSP counterparties during the life of the swap and for at least five years following the termination of the swap. *See* § 45.2(c). During the retention period, swap data must be retrievable by a non-SD/MSP counterparty within three business days. *See* § 45.2(d)(3).

Proposed § 45.2(b). The Commission should define what constitutes "systematic records".

Proposed Section 45.2(b) augments the Commission's general recordkeeping principles with the addition of the phrase "systematic records." Non-SD/MSP counterparties must retain "full, complete, and ***systematic*** records." (emphasis added). However, the Proposal is not clear about what comprises "systematic records." We encourage the Commission to limit the definition for systematic records, to have requirements that clearly define pertinent data fields, and to limit those requirements to no more data than is available in existing systems.

The lack of clarity regarding whether a data-retention program is "systematic" creates concern about the potential impact of the new recordkeeping and retrieval requirements. For example, institutions periodically archive records and remove the archived data from servers. Additionally, archived records may be difficult to restore to a particular system. We encourage the Commission to clearly define systematic records and provide examples of what constitutes "systematic records" as well as providing an extended retrieval time, beyond three business days, to allow for the retrieval of archived records.

Proposed § 45.2(c). The retention period following final termination of a swap by a non-SD/MSP should be less than five years.

Proposed section 45.2(c) would require non-SD/MSPs to retain swap data for a period of five years following the final termination of the swap. This is the same retention period required of designated clearing organizations, designated contract markets, swap execution facilities, SD, and MSP. We are concerned that five years is an unduly burdensome period of time for a non-SD/MSP to retain this data. Some institutions may have constraints with respect to keeping data beyond the termination date of trades. The cost of compliance for non-SD/MSPs would be significant because of issues regarding data storage. In light of the Commission's recognition that Congress intended to place a lesser burden on non-SD/MSP counterparties to swaps, we believe it would be appropriate to implement an incremental approach for recordkeeping requirements. We also ask the Commission to consider adopting a two year retention period for non-SD/MSPs to minimize compliance costs on end-users.

Proposed § 45.2(d)(3). Non-SD/MSPs should have at least seven business days to retrieve swap data.

The data retrieval requirement outlined in § 45.2 (d)(3) requiring the swap data of non-SD/MSPs to be retrievable within three business days will cause complications for many non-SD/MSP entities. In situations where institutions file physical records off-site, the compliance cost would be problematic, as a three day time period would require an expedited return. Beyond general geographic distance of the records, there are additional constraints due to the speed of transfer, indexing, and service levels. Institutions may have records relating to hedging transactions in different offices, so if all records need to be in one location for production, the three-day retrieval period would be difficult, if not impossible. As well, indexing methodologies and service levels from off-site companies can vary by office within one institution. Therefore, the requirement to create and keep a detailed index for all records would be time consuming and costly, especially if not needed for any other purpose.

We believe that the Commission should take into consideration the many variables and subsequent cost surrounding the storage of records and their retrieval. We support the Commission's desire to establish a reasonable time-frame for retrieval, but we ask the Commission to balance the retrieval burden on end-users, and allow non-SD/MSPs seven business days to retrieve records. We also encourage the Commission to provide a safe harbor for the retrieval of records by non-SD/MSPs to cover good faith and best effort situations when an absolute deadline to retrieve the data cannot be met.

Proposed § 45.2(d)(3). Determination of which counterparty must report.

Proposed section 45.5(d) contemplates that, where only one party to a swap is a U.S. person, the U.S. person would be designated the reporting party, regardless of the status of its counterparty. This requirement does not seem to take into account a scenario where the non-U.S. person is more adequately suited to fulfill the reporting requirement. For example, consider the scenario where a buy-side company, designated as an MSP, is entering into swap transactions with offshore dealer counterparties that are not designated as SDs. It would be impractical to require such an MSP to implement a costly reporting infrastructure to report only this portion of its trades. Accordingly, we encourage the Commission to consider allowing the parties to such a swap to independently determine which party will be designated as the reporting party.

Inter-affiliate transactions

We believe that there are special considerations with respect to inter-affiliate swaps in the context of the reporting requirements that should be considered. Corporate groups often use one or more designated entities to enter into third-party swaps to hedge their risks. These designated entities often then enter into back-to-back swaps with the affiliate that has the risk being hedged. In the case of swaps between affiliates, reporting does not appear to add any value in terms of increasing transparency and would have the effect of increasing costs and administrative burdens on corporate groups. Additionally, the reporting of these swaps could be distortive to the data in the SDRs that would be used to calculate block trade sizes and for other purposes. Companies would generally be willing to provide information about these swaps to the Commission and maintain records for inspection.

Conclusion

In closing, the Roundtable supports the Commission's intent to enhance transparency and reduce systemic risk. However, the Roundtable seeks clarity regarding the term "systematic records" and asks that the Commission reconsider whether the proposed data retrieval requirements may be unduly burdensome. Thank you again for the opportunity to share our views with you on this subject. If you have any questions, please contact the Senior Vice President of Regulation at BITS[2], William Henley at William@fsround.org or me at Rich@fsround.org.

Sincerely,

Richard M. Whiting

Richard Whiting
Executive Director and General Counsel

[2] BITS is the technology division of the Roundtable. BITS fosters the growth and development of electronic financial services and e-commerce for the benefit of financial institutions and their customers.

SDMA SWAPS & DERIVATIVES MARKET ASSOCIATION

April 20, 2011

Honorable Ruben Hinojosa
Committee on Financial Services
U. S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Hinojosa:

The Swaps & Derivatives Market Association ("SDMA") appreciates the opportunity to respond to the United States House of Representatives Committee on Financial Services.

The SDMA is a non-profit financial markets trade group of US and internationally based broker-dealers, investment banks, futures commission merchants and asset managers participating in all segments of the exchange-traded and over-the-counter derivatives and securities markets.

Question 1: What benefit does using a "swap execution facility" provide end-users in conducting their risk management and hedging operations?

The SDMA believes that using a swap execution facility ("SEF") will provide end-users with the following benefits in conducting their risk management and hedging operations: (1) best execution price, (2) increased liquidity, and (3) trade anonymity.

Best Execution Price: In the current OTC market it is difficult for end-users to obtain the best possible execution price due to: a lack of price transparency, a few overly dominant players, and too little automation. Trading on a SEF will provide end-users with efficient "all-to-all" trading platform that will display real time markets and enable buyers and sellers to execute at the best possible price. Greater price transparency, technology innovation and trading efficiency will result in lower execution costs for the end user – translating into more cost effective hedging operations.

Increased Liquidity: The documentation requirements currently employed in the OTC market restrict trading and inhibit liquidity. OTC trades cannot be transacted without an ISDA Master Agreement ("ISDA Agreement"), which is individually negotiated with each counterparty. As a result, end-users are limited to trading with a known group of counterparties with whom they have an ISDA Agreement in place. These agreements are costly and time consuming to create and manage. ISDA Agreements will no longer be required in a post Dodd Frank marketplace, because counterparty risk will be addressed through central clearing. Therefore, any end-user who is registered with a Clearinghouse and a Clearing Member will be able to trade through a SEF with a far broader counterparty population. This model opens the market in a controlled way and greatly increases liquidity. This increased liquidity results in a broader marketplace and a greater array of alternatives for the end users risk management and hedging practices.

Trade Anonymity: Trading on a SEF can preserve trade anonymity. Currently in the OTC market each time an end-user executes a trade they must call a dealer and reveal sensitive information regarding their market position and, at times, their trading strategy. All traders in every market seek a competitive advantage through the collection of market and counterparty information. There is a continuous pursuit to predict the behavior of the marketplace by predicting, anticipating, or knowing (!), the intended behavior of those who are active in the market – ie. the counterparty. As has been made clear to us by the buy-side, the end user often does not want to expose their trading intent. The valid concern here is that they, the end user, is then put at a pricing disadvantage by exposing this information. Buyers and sellers trading on a SEF can provide a marketplace where every counterparty is anonymous and therefore – equal. This empowers the end users with more predicable risk management practices as their prices will be based on the real market and not other pricing forces adversely influenced by "name give up". In addition, any information regarding the proprietary hedging strategies of the end user stays where it belongs – in the "hands" of the end user's firm and the regulators.

Question 2(a): What role can "swap execution facilities" play in terms of reducing systemic risk to overall system?

SEFs will play a key role in reducing the systemic risk to the overall system by (1) promoting market and trade integrity, and (2) enabling greater price and market transparency.

Let's first look at SEFs promoting market and trade integrity. The design of the new post Dodd Frank marketplace contains three primary capability points: the SEF, the Clearinghouse, and the Clearing Member, each of these "points" plays a specific role: the SEF for execution, the Clearinghouse for clearing, and the Clearing Member for counterparty accounting – including margin and risk management. As the execution arm of this new marketplace, the SEF will be the engagement point for the end user. Here is where the user will find the real time market prices, the means to safe, transparent execution, and a gateway to efficient clearing services. It is critical for each of these links – between the end user and the SEF, between the SEF and the Clearinghouse, and between the Clearinghouse and the Clearing Member – to all interact in a high speed, low latency fashion to ensure an efficient marketplace that the end user can feel confident in. Confidence comes from knowing that the "points" in the marketplace are providing not only prices that are clean, firm and executable, but also counterparties that are clean, registered and credit worthy. Trade integrity on a pre-trade and a post-trade basis are guaranteed through the efficiency of these links, and the SEF can enforce these qualities in the market with the invaluable support of the clearing houses and the Clearing Members.

SEFs will also promote market integrity as they will all be regulated by a consistent, transparent set of rules. In addition, SEFs will be a central point for the regulators to implement rules of execution and market standards for all buyers and sellers in the swaps market.

Greater price and market transparency provided by SEFs will also reduce system risk. SEFs are the new view into the swaps market – where and how are swaps trading. As central clearing helps open the market and it becomes less restrictive, volume and liquidity will increase as a natural course. These changes translate into increased transparency and finally an ability to see into a market that for years has been damagingly opaque. The SEFs will provide a view into, and an ability to execute across a broader, more regulated and safer swaps market – where everyone can see what is really going on.

Question 2(b): How do these Rules affect employment in the US?

The Rules will have a positive effect on employment in the US by: (a) reducing end user execution costs, (b) fostering technology and operational innovation, and (c) by solving the current shortcomings of the swaps market that contributed to the financial crisis.

As discussed above, SEFs will reduce execution costs by increasing market efficiency with greater price and market transparency. The SDMA estimates that the savings on execution costs will be approximately $35 billion. This frees up a lot of capital that can be utilized by the end users to grow their business and create jobs for Americans.

The Rules will also foster innovation in technology and operational practices employed for the new post Dodd Frank marketplace. We expect the application of technical and operational capabilities used in other mature markets to now turn their attention to the swaps market. With this attention comes start-up ventures, diversification and expansion of existing companies, and new product offerings. For example, as SEFs are electronic trading platforms, competition among SEFs will clearly drive new advances in technology. Which will in turn, drive new innovative business models to enhance the efficiency and effectiveness of the marketplace.

Finally, we must continually remember that the current uncleared bilateral trading of swaps acted as an accelerant to the financial crisis that resulted in an estimated 8.5 million jobs lost across the United States. The underlying causes of the financial crisis will continue until Congress and regulators intervene to mandate the implementation of the Dodd Frank Act. The Rules are critical to rebuilding the American economy – as they will bring price transparency, enhanced market integrity, and reduced systemic risk to the OTC swaps market – and what follows is stability and jobs in the US.

Respectfully Submitted,

James Cawley
The Swaps & Derivatives Market Association
(646) 588-2003

QUESTIONS OF THE HONORABLE RUBEN HINOJOSA
COMMITTEE ON FINANCIAL SERVICES
"ASSESSING THE REGULATORY, ECONOMIC AND MARKET IMPLICATIONS OF THE DODD-FRANK DERIVATIVES TITLE"
FEBRUARY 15, 2011

#1 For each witness: The derivatives markets are important for end-users, including important agricultural processors and producers.

What benefit does using a "swap execution facility" provide end-users in conducting their risk management and hedging operations?

Proponents of SEFs assumed that end-users in the OTC market were at the mercy of swap dealers who could set prices without regard to legitimate competition. This assumption was based in large part on the fact that the market was opaque to regulators and the public. All of the Congressional testimony from end-users has been to the contrary. Indeed, end-users have testified that they (i) have no trouble getting competing bids from a number of dealers, (ii) are satisfied with the current market structure and (iii) are not required to expose their requests for bids and offers to the market generally.

Of particular concern to end-users is the extent to which the CFTC, in its proposed rules, has limited the definition of SEF to exclude many popular methods of swap execution. The CFTC's proposal requires that an SEF provide "all market participants" with: "(i) the ability to make any bid or offer transparent to *all* other market participants of the SEF"; *and* (ii) "the ability to post both firm and indicative quotes on a centralized screen such that they can be executed or traded against by other multiple market participants." With respect to a Request for Quote ("RFQ") model for trading, the proposed rules require that a request be disseminated to at least five market participants. Nothing in the Dodd-Frank Act requires the CFTC to place such prescriptive parameters on the market. Rather, Congress intended the definition of SEF to have broad application and include a host of existing trading platforms and facilities, including traditional RFQ and voice-brokered systems.

In the swaps market, carefully controlling dissemination of information about a trade is often the key to successful transfer of risk. Indeed, end-users often lose their ability to hedge risk effectively if they expose their trading strategy, and information about their trades and trading strategies will often be exposed in the regulatory framework discussed above. As such, they are subject to additional market risk. Given these limitations, as well as end-users' general satisfaction with the trading facilities available in the market today, if the proposed rules are adopted, the creation of SEFs is likely to do end-users more harm than good.

#2 For each witness: One of the key goals of the Dodd-Frank Act was to reduce systemic risk within the financial system.

(a)What role can "swap execution facilities" play in terms of reducing systemic risk to the overall system?

We do not believe that Congress embedded the concept of SEFs in the legislation as a means of reducing systemic risk in the markets. Rather, Congress contemplated that SEFs would increase competition in the swaps market primarily by introducing a level of pre-trade price transparency that does not exist today. Congress intended to achieve the goal of reducing systemic risk through the central clearing mandate, as futures clearing houses have been models of risk management for over a century.

As has been publicly discussed several times over the past several years, CFTC-regulated clearing houses (and futures exchanges) operated flawlessly and performed all their essential functions without interruption during the recent financial crisis. Indeed, while large financial firms regulated by other agencies failed, CFTC-regulated clearing houses experienced no defaults and no futures customers lost their collateral or were unable to immediately transfer positions and continue managing risk. Thus, it is appropriate to conclude that by bringing a significant portion of the trades in the OTC swaps market into CFTC-regulated clearing houses and onto CFTC-regulated SEFs, and modeling the new regulatory regime for the swaps market on that which existed for the futures market, Congress believed that if we experienced substantial market turmoil again, the regulated swaps market would perform like the futures market did in 2008.

Rather than focusing on bringing the previously unregulated OTC swaps market into a regulatory scheme similar to that which allowed the futures markets to function flawlessly in 2008, the CFTC proposes to drastically alter the futures regulatory regime and create a parallel regulatory regime for swaps. Specifically, the CFTC has proposed prescriptive rules that would, in effect, repeal the principles-based regulatory regime that has existed for more than a decade, under which the regulated U.S. futures markets have experienced unparalleled growth and innovation. We believe that principles-based regulation of futures exchanges and clearing houses permitted U.S. exchanges to regain and maintain their competitive position in the global market. Undoubtedly, it allowed U.S. futures exchanges to keep pace with rapidly changing technology and market needs by introducing new products, new processes and new methods by certifying compliance with the Commodity Exchange Act and thereby avoiding needlessly lengthy regulatory review. U.S. futures exchanges have operated more efficiently, more economically and with fewer complaints under this system than at any time in their history. The CFTC's efforts in this regard are contrary to Congress' intent—indeed, Congress reinforced the principles-based regulatory regime for regulated futures exchanges and clearing houses by adding new core principle obligations and extended this principles-based regime to SEFs and swap data repositories as well.

In further contravention of Congress' intent, the CFTC has proposed rules that would remove markets and market participants from the regulated futures regime and force them into the newly-established swaps regime. For example, the CFTC has proposed a rule under Core Principle 9 (§ 38.502(a)) that would require 85% or greater of the total volume of any contract listed on a futures exchange be traded open and competitively in the centralized market. Under the proposed rule, if a contract fails this test, the futures exchange is required to delist the contract and transfer the open positions in the contract to a SEF (or liquidate the contract within 90 days). Nothing in Core Principle 9 or any other part of the statute requires this. In fact, many successful contracts that trade on futures exchanges today would fail this proposed rule. Notably, new futures products often initially build open interest and gain trading momentum in off-exchange transactions, and in many instances, it takes years before trading on the centralized market becomes the predominant mode of trading. This proposed rule will, among other things, significantly deter the development of new products by existing exchanges like CME Group, and likewise deter any new futures exchanges from being established. Such a result defies the logic behind Dodd-Frank, especially considering that there are no regulatory or public benefits gained by forcing these futures markets and market participants into the swaps regime.

(b)How will these rules impact employment in the United States as it relates to trade execution?

The CFTC's proposed prescriptive rules on both DCMs and SEFs may have a detrimental effect on employment in the United States. As noted above, the principles-based regulation of futures markets had a transformative effect on U.S. futures markets over the past decade. The adverse effects of stifling growth and innovation in the futures industry, which certainly impact the relevant job markets, cannot be overstated.

Moreover, the CFTC's proposed rules in many areas are not in harmony with international regulators. That is, international regulators, such as those in the EU, are far from adopting an approach as prescriptive of the CFTC's proposals on position limits and and other areas. The disparate regulatory regimes create an incentive for market participants to move their business to international exchanges where they may be subject to less prescriptive regimes, threatening negative consequences for U.S. exchanges.

Another reason that the CFTC should be careful in adopting regulations that may tilt the competitive playing field in favor of overseas markets is that such regulations threaten to export the price discovery process to overseas exchanges. This could lead to both a loss of jobs in the U.S. and less cost-efficient hedging for persons in business in the U.S. As an example, consider the two major price discovery indexes in crude oil: West Texas Intermediate, which trades on NYMEX, and Brent Oil, which trades overseas. If the CFTC places heavy restrictions in areas such as position limits or margins on traders in the U.S., traders in crude oil, and with them the price discovery process, is likely to move to overseas markets.

Further, as noted above, the CFTC's proposed rules defining SEF are not inclusive of many facilities on which swaps are currently traded. By eliminating these facilities from the definition of SEF, despite many end-users' preference for these facilities, the CFTC not only drives traders to other markets but essentially puts facilities out of business. This would directly results in job losses for individuals whose jobs rely on the existence of such facilities, not because their facility was unsuccessful, but because it failed to meet unnecessarily restrictive rules and regulations imposed on SEFs by the CFTC.

Deleted: :

#1 For each witness: The derivatives markets are important for end-users, including important agricultural processers and producers.

What benefit does using a "swap execution facility" provide end-users in conducting their risk management and hedging operations?

<u>Response:</u> **The Dodd-Frank Act requires standardized swaps – those that are cleared and made available for trading – to be traded on exchanges or swap execution facilities ("SEFs"). The Act includes an exception from this exchange trading requirement for transactions involving commercial end-users. Although commercial end-users are not obligated to use a SEF, they may do so to achieve the benefits SEFs provide such as pre-trade transparency. SEFs will allow investors, hedgers and speculators to meet in a transparent, open and competitive central market, where prices are made publicly available. The more transparent a marketplace, the more liquid it is, the more competitive it is and the lower the costs for companies using derivatives to hedge risk. Transparency to the public brings better pricing and lowers risk for all parties to a derivatives transaction. Commercial end-users may use a SEF to achieve these benefits.**

#2 For each witness: One of the key goals of the Dodd-Frank Act was to reduce systemic risk within the financial system.

(a)What role can "swap execution facilities" play in terms of reducing systemic risk to the overall system?

<u>Response</u>: **Swap Execution Facilities ("SEFs") are intended to increase transparency in the swaps market which in turn brings better pricing. As noted above the Dodd-Frank Act requires standardized swaps – those that are cleared and made available for trading – to be traded on exchanges or SEFs. Centralized clearing is intended to reduce the counter party risk.**

(b)How will these rules impact employment in the United States as it relates to trade execution?

<u>Response</u>: **The Dodd-Frank Act sought to bring transparency to the swaps market. This includes transparency both to the regulators and to the public. Swap execution facilities will aid in transparency by allowing investors, hedgers and speculators to meet in a transparent, open and competitive central market, where prices are made publicly available. The more transparent a marketplace, the more liquid it is, the more competitive it is and the lower the costs for companies using derivatives to hedge risk. Transparency to the public brings better pricing and lowers risk for all parties to a derivatives transaction.**

#3 Chairman Gensler, in your testimony, you stressed the importance of transparency and the necessity for reporting requirements in these markets.

(a) Why do you believe the proposals from the SEC and CFTC are insufficient in addressing your concerns about the liquidity for block trades?

See below

(b) Could you please explain how they will delay the dissemination of this information to all market participants?

Response: **The Commission proposed that each swap transaction be time-stamped upon execution of the swap. For standardized large notional swaps and block trades, the Commission proposed a 15-minute delay in reporting to the public the swap transaction and pricing data. The proposal requires the reporting party to transmit the data to the SDR or third party service provider as soon as technologically practicable and such real-time disseminator would hold those data until 15 minutes had elapsed from the execution time. Upon expiration of that 15-minute period, the swap transaction and pricing data would be publicly disseminated in the same manner as other swap transaction and pricing data. In its proposal, the Commission requested comment from the public as to the appropriate time delay for customized large notional swaps and block trades.**

(c) What are your thoughts on the 15 minute delay?

Response: **For large notional swaps and block trades, the Dodd-Frank Act directed the Commission to specify an appropriate delay in reporting swap transaction and pricing data to the public. The Commission proposed a 15-minute delay in reporting for standardized swaps based on experiences in other markets, including futures markets in the US and overseas and FINRA's TRACE system for corporate bonds. Fifteen minutes is an appropriate delay, as it should provide market makers sufficient time to lay off the risk they accept from their end-user clients and diminish the impact on the price that could be caused by a large swap transaction. For customized large notional swaps and block trades, the Commission requested comment from the public as to an appropriate time delay for publicly disseminating such swap transaction and pricing data.**

RESPONSE TO QUESTIONS OF THE HONORABLE RUBEN HINOJOSA COMMITTEE ON FINANCIAL SERVICES

"ASSESSING THE REGULATORY, ECONOMIC AND MARKET IMPLICATIONS OF THE DODD-FRANK DERIVATIVES TITLE"

FEBRUARY 15, 2011

J. Christopher Giancarlo,
Executive Vice President,
GFI Group Inc.
Board Member, WMBAA

#1 The derivatives markets are important for end-users, including important agricultural processers and producers. What benefit does using a "swap execution facility" provide end-users in conducting their risk management and hedging operations?

Title VII of Dodd-Frank was an earnest and commendable effort by Congress to reform certain aspects of the OTC swaps market. The DFA's core provisions concerning swaps are: one, replacing bilateral trading where feasible with central counterparty clearing, and two, requiring that cleared swaps transactions between swaps dealers and major swap participants be intermediated by qualified and regulated trading facilities, including those operating under the definition of "Swap Execution Facilities" ("SEFs") through 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, through any means of interstate commerce..." These two operative provisions seek to limit the current market structure where swaps and the underlying counterparty risk may be traded directly between counterparties without the use of trading intermediaries or clearing, and to replace it for most transactions with a market structure in which a central clearing facility acts as the single counterparty to each market participant (i.e. buyer to each seller and seller to each buyer) and where those cleared transactions must be traded through SEFs and other intermediaries and not directly between the counterparties.

As is widely known, DFA exempts commercial end-users from the obligation to execute swaps transactions on a SEF. Nevertheless, the benefit to users of SEFs will be twofold: greater price transparency and transaction security from trading on a well regulated facility. To the first point, the SEF provisions in Dodd-Frank contain a rule of construction for their operation: "to promote pre-trade price transparency in the swaps market."[1] Not surprisingly, GFI and the other member firms of the Wholesale Markets Brokers Association Americas ("WMBAA") that intend to register and operate as SEFs

[1] *See* CEA Section 5h(e).

act in furtherance of this transparency goal. Our business model is driven by revenues from commissions paid on transactions. Our goal is to complete more transactions with more customers. Therefore, each of our firms naturally and consistently disseminate trade bids and offers to the widest practical range of customers with the express purpose of price discovery and the matching of buyers and sellers. We employ a number of means of pre-trade transparency from software pricing analytics to electronic and voice-based price dissemination to electronic price work up technology. We endorse and currently promote the goal of pre-trade price transparency by providing market information by voice and electronic means to multiple market participants within our trading platforms to create greater trading liquidity, the natural activity of intermediaries.

The second benefit for market participants in using a SEF is the greater confidence and certainty that will come from transacting on a regulated market entity. As stated in the WMBAA's "Principles for Enhancing the Safety and Soundness of the Wholesale, Over-The-Counter Markets" which we provided regulators after passage of the DFA, we support more effective regulation of the OTC cash and derivatives markets to enhance market safety and soundness and to provide regulators with effective tools and means to monitor and police markets and market participants. DFA contains a comprehensive set of core principles with which SEFs will be required to comply. Those core principles are focused on assuring capital adequacy, market surveillance, appropriate trading practices and market supervision, among other things. General adherence to these core principles by SEFs, including WMBAA members, will allow market participants to transact with greater confidence and certainty.

#2 One of the key goals of the Dodd-Frank Act was to reduce systemic risk within the financial system:

(a)What role can "swap execution facilities" play in terms of reducing systemic risk to the overall system?

(b)How will these rules impact employment in the United States as it relates to trade execution?

(a) As noted in the answer to Question #1 above, the DFA's primary initiative to reduce systemic risk is the adoption of a market structure for swaps transactions in which central counterparty clearing facilities act as single counterparties to each market participant. Within this structure, SEFs can play an important role in reducing systemic risk by providing trading counterparties with direct, impartial and efficient connectivity to central counterparty clearers. Such connectivity, however, relies on such clearers (*i.e.,* derivatives clearing organizations) providing SEFs with non-discriminatory access to their clearing services in accordance with the requirements of DFA. Without such non-discriminatory access, clearers that are aligned with affiliated execution facilities may leverage their dominance over clearing in particular swaps instruments to create monopolies in execution in contravention of the impetus of DFA to provide a diverse and competitive swaps marketplace. Finally, the WMBAA has recognized the importance of SEFs reporting trade information as soon as technologically practicable and supports the reporting of trades to swap data repositories for regulatory oversight and appropriate public dissemination.

(b) Under the DFA, Congress wisely permitted SEFs to utilize "any means of interstate commerce" to transact swaps. Congress recognized that restricting methods of execution of swaps instruments with non-continuous liquidity could do substantial harm to the orderly operation of US swaps markets. Such harm would be felt by those market participants who need to manage risk as well as by the job market for thousands of American brokers who serve their needs.

Wholesale brokers that intend to register and operate as SEFs employ thousands of Americans in jobs all over the United States from Southern California to Houston, Texas to the New York metropolitan area, where the industry probably employs close to 10,000 people. These employees support the "hybrid model" of swaps execution, where transactions are executed through a combination of human interaction and sophisticated electronic trading technology.

We are concerned that regulations that seek to force swaps to be executed by exclusively electronic trading systems would have a detrimental impact on the employment of thousands of industry professionals in the United States. European regulators do not appear to be considering rules with similarly proscriptive limits on trade execution methodology. There do not appear to be any significant regulatory efforts in Europe to mandate electronic execution of cleared swaps by institutional market participants. US regulations need to be in harmony with regulations from foreign jurisdictions to avoid driving trading liquidity – and well paying jobs - away from US markets towards markets offering greater flexibility in modes of trade execution.

Questions for The Honorable Daniel Tarullo, Governor, Board of Governors of the Federal Reserve System, from Representative Hinojosa:

1. The derivatives markets are important for end-users, including important agricultural processors and producers. What benefit does using a "swap execution facility" provide end-users in conducting their risk management and hedging operations?

The Dodd-Frank Act exempts swaps transactions involving non-financial firms that are using the transactions to hedge or mitigate commercial risk from mandatory exchange trading requirements. Nonetheless, we expect that by improving price transparency and competition for non-exempt swaps transactions, Swap Execution Facilities (SEFs) will provide indirect benefits to end users. SEFs are trading systems or platforms 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 (CEA Section 1a(50)). Registered SEFs will be required to comply with a rigorous set of core principles designed to prevent market manipulation and abuse and to ensure fair and open access to trading facilities. By providing market participants with greater pre-trade price transparency for swaps contracts, SEFs will allow market participants to better assess the costs and benefits of swaps transactions. Furthermore, because SEFs will allow market participants to view bids/offers from multiple potential counterparties, we expect these facilities to foster more robust price competition in the swaps market, which will ultimately benefit end-users.

2. One of the key goals of the Dodd-Frank Act was to reduce systemic risk within the financial system.

a. What role can "swap execution facilities" play in terms of reducing systemic risk to the overall system?

SEFs will help to mitigate systemic risk in at least three ways. First, by providing broad access to pre-trade price information, SEFs will make swaps markets more transparent to both regulators and market participants, which will help to improve market liquidity and will make swaps markets more resilient in times of stress. Second, SEFs will be required to take measures to prevent market manipulation and abuse which might otherwise undermine confidence in swaps markets. Finally, by fostering more robust price competition, we believe that SEFs will ultimately make it easier and cheaper for end-users to hedge risk, which will help to protect them from unanticipated changes in commodity prices, interest rates, or exchange rates.

b. How will these rules impact employment in the United States as it relates to trade execution?

Broadly, we expect that SEFs will improve competition and efficiency in the swaps market, which will have a positive though unquantifiable effect on the economic performance of sectors that make use of swaps for hedging and risk-management purposes. With respect to employment specifically related to trade execution, the net impact of SEFs is uncertain. Overall employment related to trade execution is a function of both the aggregate volume of new swaps activity as well as the extent to which such activity can be executed though automated electronic trading facilities. If swaps activity migrates into SEFs, some jobs may shift into SEFs.

Dear Congressman Perlmutter,

Thank you for your work on the important issue of effective regulation of the over-the-counter ("OTC") derivatives market, both during the legislative phase of Dodd-Frank, and as your committee oversees the implementation of Title VII. I was pleased to hear - from you, your fellow Members, Chairman Gensler and other panelists - a general recognition that end users should be protected from certain potential unintended consequences related to Title VII and, specifically, that end users should not be subject to margin requirements. It is important for Congress and the regulatory agencies to get the rules right - to fix the parts of the market that are broken without breaking the parts of the market that work quite well. We believe that it is vital that the regulators heed congressional intent and promulgate rules that reduce systemic risk and increase transparency in the OTC derivatives market, but that also provide a clear end-user exemption from the clearing, trading *and* margin requirements in Title VII.

I wanted to expand upon an answer that I provided during the hearing on Tuesday in response to a question you had asked about the margin requirements. You asked whether I was less concerned about margin being imposed on end users after having heard Commodity Futures Trading Commission Chairman (the "CFTC") Gary Gensler provide his testimony on the first panel. I responded that I was pleased with what Chairman Gensler said, but thought that "other participants" had said something that was inconsistent with Chairman Gensler's statements. To clarify, Chairman Gensler said that margin requirements should not focus on non-financial end users; however, Governor Daniel Tarullo said that the Federal Reserve Board ("Board") reads the statute as *requiring* the prudential regulators to impose margin requirements on all trades entered into with bank swap dealers, including end-user hedges.

Indeed, Governor Tarullo's written testimony indicated that the Board is considering a risk-based approach whereby swap dealers are required to set credit exposure thresholds on any end-user hedge, and *collect margin* from the end user if the exposure exceeds the threshold. In short, it appears that the Board and the other prudential bank regulators are at least considering imposing margin requirements on all end users. Such an approach appears contrary to the clear statement of congressional intent as memorialized in the Dodd-Lincoln letter and subsequent Frank-Peterson colloquy. Moreover, the majority of end user trades are entered into with bank swap dealers, therefore it is the prudential bank regulators and not the CFTC that would set margin rules for most end-user hedges.

Thank you for the opportunity to clarify and provide more detail related to my response at the hearing. I appreciate your interest in ensuring that the regulators promulgate rules that are consistent with the legislation that you and your colleagues passed last July. I would be happy to discuss this matter in more detail, if you have any questions.

Regards

Craig Reiners
MillerCoors

The New York Times
DealB%k
Edited by Andrew Ross Sorkin
FEBRUARY 14, 2011, 9:36 PM

Vanishing Act: 'Advisers' Distance Themselves From a Report

By ANDREW ROSS SORKIN

Correction Appended

Joseph E. Stiglitz, a Nobel-winning economist, criticized a study opposing rules intended to add clarity to the derivatives market.

A new study backed by pro-business groups takes a harsh stance on rules intended to bring transparency to the $600 trillion derivatives market. The report, published on Monday, claims that proposed regulation could cost 130,000 jobs and could cut corporate spending by $6.7 billion.

The findings are clearly meant to scare politicians and drum up public support — just as financial regulators are set to testify on the issue before a Congressional committee on Tuesday. And at first blush, the study would seem to be good ammunition for the Chamber of Commerce and its other supporters.

The study was conducted by Keybridge Research, a seemingly independent economics and public policy consulting firm. The firm's bona fides include an all-star roster of academics, including Joseph E. Stiglitz, a Nobel laureate in economic science; David Laibson, a professor of economics at Harvard, and Stephen P. Zeldes, a professor of economics and finance at Columbia's Graduate School of Business.

But a closer look at the report raises some serious questions. For one, the findings seem oddly out of step with the views of some of the group's luminaries, including Mr. Stiglitz, who is advertised on Keybridge's site as an adviser.

How could that be?

Well, it appears that Mr. Stiglitz and many of the firm's advisers are not advisers at all.

"This is the first I have heard about it," said Mr. Stiglitz, who just returned home on Sunday after a five-week trip abroad. He said he was surprised to be listed on the group's Web site. After reading the study, he said, "It's not a very good report."

Some of the firm's other so-called advisers must have agreed with him.

As I made calls about the relationship between Keybridge and the academics, names mysteriously disappeared from the group's site on Monday. By the end of the day, Keybridge's list of affiliated advisers had shrunk to four, from seven.

When I called Keybridge's president, Robert F. Wescott, who during the Clinton administration was a special assistant to the president for economic policy at the National Economic Council, he seemed slightly startled.

"It is true that David and Steve asked to be removed from the Web site," he said. "These professors did not work on this project and were not aware of it, but they helped us with other projects." He asserted that none of their names were attached to the study, just to the firm.

He also contends that Mr. Laibson and Mr. Zeldes were distancing themselves as a result of "what happened with the movie 'The Inside Job,' " not the study. "That's how it was presented to me," Mr. Wescott said.

The movie, which focuses on the financial crisis, raises questions about economists and their consulting arrangements with big business. Shortly after the film's release, the American Economic Association voted to establish a special committee to create a professional code of conduct.

Mr. Laibson and Mr. Zeldes both said in e-mails that they just learned about the report on Monday and were not advisers to the firm. The Chamber of Commerce did not return a call for comment.

Mr. Stiglitz said he had done "some work" for Keybridge, but not for a while. "The last thing I did for them was in May 2009."

Clearly the substance of the study — and the regulations it takes aim at — matter in shaping the future of the derivatives market. The study was strategically released for high impact. Gary Gensler, the chairman of the United States Commodity Futures Trading Commission, and other financial regulators are scheduled to testify on Tuesday about proposed derivatives rules before of the House Financial Services Committee.

At issue is how the rules apply to so-called end users like airlines or food companies that often buy derivatives to hedge their commodity costs. The fear is that companies will be required to post extra capital against those complex securities, amounting to 3 percent of their value. The potential results: a hit to their bottom lines and, more broadly, the economy.

The study, whose proponents also include the Business Roundtable, was clearly in the camp that such legislation would be bad for the economy since companies would have to set cash aside for derivatives instead of spending the money on jobs or new factories.

But many economists derided the report within hours of its publication.

"This is not any kind of research. This is people who want to overleverage and risk the system — because, once again, they will get the upside and taxpayers/all citizens get the downside," Simon Johnson, a professor at the Sloan School of Management of the Massachusetts Institute of Technology and a senior fellow at the Peterson Institute for International Economics, wrote on his blog. (Mr. Johnson also contributes to the Economix blog of The New York Times.)

Mr. Stiglitz was even more adamant, saying the study's conclusions encouraged the equivalent of "free fire insurance," in that companies could protect themselves from commodity price swings without paying up. "The argument they make is particularly foolish," he said. Mr. Stiglitz also said the argument seemed ludicrous in light of corporate America's already stingy ways: "Companies are sitting on $2 trillion of cash. It's just an embarrassment that they'd use that argument in the current context."

When I told Mr. Wescott of Keybridge about Mr. Stiglitz's comments, he replied that "the client had asked us" to put the report together. "It was a hypothetical study."

Correction: February 15, 2011

An earlier version of this article referred incorrectly to the size of the $600 trillion derivatives market.

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