DTCC

The Depository Trust & Clearing Corporation

THE ROLE OF A TRADE REPOSITORY IN THE EUROPEAN UNION

Response by The Depository Trust & Clearing Corporation to the Committee of European Securities Regulators' consultation paper

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Executive Summary

The Depository Trust & Clearing Corporation (DTCC) believes that a single central data repository for each over-the-counter (OTC) derivatives asset class would address three objectives cited by the Commission and others as critical to the stability and growth of the European economy:

- Enhancing market transparency for regulators and the investing public
- Reducing systemic risk by ensuring regulators can see a firm's underlying position and exposure from a central vantage point
- Promoting a pan-European capital market.

DTCC envisages a "global solution". A global solution recognises the international nature of trading in OTC derivatives but must also recognise the value of a "regional approach" which respects the critical importance of oversight by European regulators who must safeguard the integrity and soundness of Europe's financial markets. Each asset class can have its own repository to allow for contract and infrastructure differences.

A system which is global on a functional and logical basis but provides the necessary oversight to regulators on a regional basis will:

- Provide market participants and regulators with a global view of risk
- Satisfy regional supervisory policy and legislation
- Avoid unnecessary complexity, increased risk and the costs of duplicated investment.

The necessary level of oversight should be achieved by global co-operation between regulators from all continents and through appropriate reciprocity arrangements to guarantee access to data.

A single central data repository, for each asset class and serving Europe, can therefore help to meet the three public policy objectives because:

- Only a single central repository can provide a reliably comprehensive picture of market participants' exposure within a given asset class, and hence the systemic as well as firm risk.
- Multiple unsynchronised repositories within a given asset class, whether in Europe or globally, will result in operational inefficiencies and higher costs for market participants, creating "Giovannini barriers" in the OTC derivatives market and hindering regulators' access to readily usable and reliable data.

Finally, as a core component of the global OTC markets, a repository should be required to meet high standards of operational robustness, development standards and operational risk management. It is vital that the users of data provided by a repository can rely upon its accuracy.

Introduction
This paper is DTCC's response to the CESR consultation paper on trade repositories in the European Union, published on 29 September 2009

Our response begins by introducing DTCC before addressing each of the consultation paper topics in order:

- Functions and Characteristics of a trade repository
- Availability of Data by trade repositories
- Location of a trade repository
- Legal Framework for trade repositories

About DTCC
The Depository Trust & Clearing Corporation (DTCC) brings considerable experience and expertise in the operation of critical post-trade market infrastructures to this discussion. DTCC has a nearly 36-year history of acting as a market-neutral provider of clearing, settlement and depository services to the financial services industry. The organisation is owned and governed by our members and operated on an "at cost" or not-for-profit basis. DTCC is the product of 20 years of consolidation effort among multiple, competing central counterparties (CCPs) and central securities depositories (CSDs). Our central depository provides custody and asset servicing for 3.5 million securities issues from the US and 117 other countries and territories, valued at $27.6 trillion. In 2008, we settled more than $1.88 quadrillion in securities transactions.

Today, DTCC's customers are increasingly global financial institutions which are headquartered in Europe as well as in the U.S. and which handle globally-traded instruments. In response to these changes, DTCC is, more and more, developing services to accommodate global regulatory requirements, and which now serve a networked community of thousands of financial firms in dozens of countries.

Throughout its history, DTCC has brought safety, soundness, risk mitigation and transparency to the financial markets. As an example, following Lehman Brothers' bankruptcy last year, DTCC played a significant role in unwinding over $500 billion in open trading positions from trades in equities, mortgage-backed and U.S. government securities, without any loss to the industry, as well as saving taxpayers from shouldering an additional burden. We also have a history of working closely with regulators, especially during crises, to support their need for transparency and trade data to more effectively assess and mitigate risk – operational, market and systemic risk.

DTCC has been present in Europe since 1995 and today provides a number of services in Europe. Through our subsidiary, EuroCCP, we are one of the leading pan-European central counterparties in the equities market. In addition, DTCC's Fund/SERV mutual fund processing system has provided support to cross-border trading in investment funds (Luxembourg and Dublin funds) for nearly a decade. And its Global Corporate Action Validation Service supports firms in Europe and around the globe in providing a single source of validated corporate action data.

DTCC's Trade Information Warehouse (TIW), launched in 2006, is the world's only comprehensive database and repository for OTC credit derivatives. The establishment of this global repository marked the first time that the financial services industry had addressed OTC derivative inventory control and transparency systematically. TIW provides a central, automated repository to house and service virtually all credit default swap (CDS) contracts.

At the height of the Lehman Brothers crisis, TIW held a large proportion of the information on CDS positions. Although market speculation put the CDS risk exposure from Lehman Brothers at $400 billion, DTCC was quickly able to tell the market publicly that the true exposure to Lehman Brothers was closer to a net notional value of about $6 billion. The actual value that changed hands eventually was $5.2 billion. Since then, TIW has been publishing aggregated OTC derivatives data for the public on a weekly basis on the DTCC Website (www.dtcc.com) and has been providing regulators in the Americas and Europe information which they require, with the agreement of the market participants where necessary.

Functions and Characteristics of a Trade Repository
A central repository occupies a technical space in the global OTC derivatives trading environment. For CDSs, DTCC, through the Trade Information Warehouse, supports the needs of the industry and regulators to hold, record and update information on OTC derivatives transactions from CCPs and more than 1,400 market participants worldwide. In addition, the TIW connects to other service providers and acts as a hub for the exchange of trade information and other relevant data.

The TIW provides a comprehensive operational infrastructure for CDS which is significantly over and above a reporting "repository" offering.

Among the TIW functions for CDSs are:

- Repository Services
  - Position keeping
  - Data validation
  - Data cleansing
  - Improving market transparency by public reporting
  - Improving market and firm position transparency to regulators by regulatory reporting.
  - Enhancing the transparency of deal-books for participant firms

- Asset Services
  - Complete, up-to-date legal record keeping
  - Standardising treatment of identical cleared and non-cleared contracts
  - Supporting novation of contracts to CCPs
  - Enabling participants to assign (change ownership of) contracts electronically
  - Managing life cycle credit events (for example, bankruptcies)
  - Managing other life cycle events (for example, re-organisations and renames)

- Settlement Services
  - Calculating and netting cash flows
  - Managing custodian workflow for asset managers
  - Calculating payments and conveying instructions to payment systems for settlement in multiple currencies

DTCC agrees with the comments in the European Commission Staff Working Paper accompanying the Commission Communication, "Ensuring efficient, safe and sound derivatives markets" (SEC 2009) 905 final, 3 July 2009) highlighting the different fundamental natures of the asset classes.

Therefore, for other asset classes (such as interest rates, equity derivatives, commodities, etc.) the nature of the products will dictate the overall operational infrastructure. For example, life cycle credit events are only relevant to CDSs.

DTCC therefore agrees that repository services, broadly speaking, should provide:

1) Position recording
2) Data cleansing
3) Reporting to regulators, the public and participant firms

This information should be provided on a global basis for each OTC asset class. The stated goals of a repository – “to foster transparency, thus supporting the efficiency, stability of and orderly functioning (i.e. avoidance of abusive behaviour) of financial markets” – are readily achieved through these services.

However, DTCC does not believe that for all OTC derivatives asset classes it is necessary to extend the definition of a repository to encompass the aspects of Asset Services (including legal record keeping) and Settlement Services that the TIW provides to the CDSs market. These additional services are customised to the needs of the CDS market and are not necessarily applicable to all other markets. We caution that a one-size-fits-all approach should not imposed, either globally or regionally

Availability of Data by Trade Repositories
DTCC believes that public disclosure and transparency will raise investor confidence in financial markets, which is especially important for OTC markets particularly during times of crisis. That said, regulators, working with the industry governance committees, should determine what data is released, when it is released and how timely it is. In general, any such publication should conform to the principle that publicly available information be aggregated and anonymous.

For regulatory reporting, the necessary levels of oversight, access to data, and confidentiality should be achieved through global co-operation by regulators from all continents and by appropriate reciprocity arrangements to guarantee access to data.

To facilitate an overall view, this information should be derived from cleared and non-cleared data sets:

- A single central repository containing all positions will be more effective than multiple repositories in increasing market transparency for regulators and the investing public and in reducing systemic risk by ensuring regulators can see a firm’s underlying position data and exposure from a central vantage point.
- It is more efficient for all parties to have one central process for collation and dissemination of information to the public and to the global regulatory community.
- Capturing CCP positions in the repository will ensure that public reporting for centrally-cleared and bilaterally-cleared positions is kept consistent, that all key market infrastructures adopt the same standards

for data representation and processing, and that client to clearing member trades are transparent.

Given the central role envisaged for a trade repository, there are a number of additional features that are appropriate:

- A repository should run on a robust high-availability (ie >99.9%) operating infrastructure with documented capacity planning procedures and business continuity plans *("BCP")* in place and tested frequently. Such BCP plans should include the ability to operate the service (including staff) in the event the primary site become unavailable.
- IT analysis, development and testing should be undertaken to a standard befitting such a key infrastructural component – for example CMMI Level 3 or equivalent. It is vital that the information produced by a repository is of assured quality.
- Repositories should be required to allow open access and connectivity to other service providers. Such access should be offered either free or at-cost, with specifications that are freely available and up to date at all times.

Location of a Trade Repository
The OTC derivatives markets operate on a global basis, with few restrictions on cross-border contracts. Furthermore, in some asset classes, there is a liquid secondary market where contracts are assigned between parties, again with few, if any, cross-border restrictions.

It has been argued that multiple repositories on a regional basis allow competition and provide legal certainty and protection to relevant parties. But the global nature of the markets coupled with the technical nature of the products can lead to significant risks and complexities if provision is fragmented:

- In a multi-repository environment, determining which contracts are registered in which repository or repositories, is difficult. To date, no reliable method for classifying contracts as relevant to any particular jurisdiction has been found. For example, a scenario in which a French dealer enters into a transaction with a U.S. or U.K. counterparty on a CDS with an Asian underlying security leaves questions on which repository the contract should reside.
- Furthermore, moving contracts between repositories as a result of assignment processing adds an additional layer of complexity.
- To achieve the same level of control in the OTC derivatives markets as is present in cash securities markets, carefully designed and enforced rules would need to be created concerning where to register trades to address the difficulties that arise. All regulators (and other appropriate authorities) would need to agree to these rules, otherwise duplication or gaps would arise.
- Fragmentation is further complicated by the lack of standardization in identifying underlyings and other classification matters.

- Given the complexity of determining which position is recorded in which repository, and the global nature of trading activity, legal certainty and protection are not provided as all regulators may need to access data in all regional repositories to form an overall view.

Given these issues, the formation of a cohesive global view of the markets in a multi-repository environment will prove impractical to all but a handful of the most sophisticated participants.

Conversely, practical experience bears out the benefit of a single repository. For example, the 9 March 2009 report by the Senior Supervisors Group – which consists of the senior financial regulatory supervisors from seven major countries: Canada, France, Germany, Japan, Switzerland, the UK and the US – highlighted that it was easier for market participants to identify affected trades and to facilitate handling of various life cycle events, such as settlement and credit event processing, when all CDS trade information was in one central infrastructure.

Therefore DTCC does not believe that establishing separate repository facilities in Europe is necessary. The fragmentation of data and processes that this causes will only serve to undermine the very transparency a repository is designed to provide.

Instead, DTCC believes that a better solution is offered through operation of a single central data repository for each over-the-counter (OTC) derivatives asset class. The necessary level of oversight should be achieved by global co-operation between regulators from all continents, and through appropriate reciprocity arrangements to guarantee access to data.

Legal Framework for Trade Repositories

Given the cross-border nature of the OTC derivatives markets, harmonisation of requirements for the regulation and supervision of repositories is a desirable goal.

Repositories should be designed to meet the needs of all regulators, both prudential and markets, with a legitimate interest in the data contained therein. A globally co-ordinated approach to oversight of repositories will facilitate this.

For regulatory reporting, the necessary level of oversight and access to data should be achieved by global co-operation between regulators from all continents and through appropriate reciprocity arrangements to guarantee access to data.

Furthermore, through this co-operation, arrangements should be made to coordinate requests for information. Whilst different regulators have legitimate reasons to request transparency on different subsets of global data, there should be a framework of general report formats through which such data should be provided. Without coordination, there is a risk that a multiplicity of reports in different formats and on different data subsets will develop on an ad-hoc basis leading to potential for confusion and misunderstanding.