

ISDA-AFME-BBA-NSA Response to CESR/09-837
On
Trade Repositories in the European Union
9 November 2009

This comment paper responds to the Committee of European Securities Regulators Consultation Paper (CESR/09-837) on Trade Repositories in the European Union, dated September 29, 2009 (the CP).

The co-signing Associations (**ISDA¹ (the International Swaps and Derivatives Association), AFMEⁱ (Association for Financial Markets in Europe), the BBA (British Bankers Association), and the NSA (Nordic Securities Association)**) believe, in principle, that trade data on OTC contracts should be made available to regulators, on a post-execution, non-real time basis, using open source data standards rather than proprietary data formats, and that Trade Repositories (TR) are a suitable vehicle for the provision of this data in, for example, the CDS, interest rate and equity derivative asset classes. We believe that competent authorities should be able to receive the information in question by querying TRs. From a global perspective, the DTCC Trade Warehouse has proved to be a valuable source of information for international regulators in the case of CDS contracts in particular (as well as providing many other operational benefits for industry and regulators, including facilitation of central clearing and trade compressions), making this information available to all international regulators.

We caution, however, that it will be a vital pre-condition of the deployment of TRs to address confidentiality issues. In some jurisdictions at least, this threatens to be a major obstacle to the inclusion of end-customer transactions.

Moreover, we note that it is not clear from this CP what CESR believes the purpose of a TR should be. CESR has heavily borrowed from the DTCC/CDS model in this CP, but is not sufficiently explicit in relation to the precise nature of the regulatory failure/risk it is seeking to address. We are concerned that this may be sub-optimal in terms of the effectiveness of the policy-making process, and that this may lead to a mis-specification of requirements in relation to TRs.

¹ It is important that regulators carefully consider the characteristics of, and consult participants in, other asset classes, including commodities, in evaluating tools for regulatory transparency (including the costs and benefits of using trade repositories) for those asset classes. The views of ISDA commodity firms, in this context, are set out in the Commodity Derivatives Working Group (CDWG) response to the European Commission consultation paper (dated 3 July 2009) on derivatives markets: http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/derivatives_derivatives/registered_organisations/cdwg_enpdf/ EN 1.0 &a=d

The signatories to this paper also caution against duplicative or overlapping requirements. For example, we remind CESR of its recent consultation paper on the transaction reporting exchange mechanism (TREM) system which exists already to share transaction information between supervisors. We urge CESR to avoid duplication of reporting requirements falling on firms in this context.² Reporting requirements should also be carefully considered in light of the specific nature of OTC derivatives, and additionally need to be tailored appropriately for each asset class.

Further to the theme of regulatory coherence and consistency, we welcome the view expressed in the CP that the establishment of TRs should be market-led. We note the support for adoption of legislative proposals for regulation of TRs in the 20 October European Commission Communication on Derivatives markets. We recognize that the EC and CESR represent different parts (with different competences) of the European regulatory landscape for derivatives markets, but would welcome greater consistency of regulatory views in this context.

Market participants and regulators would be best served by establishing a single, global TR for each asset class. Establishment of multiple TRs would run the risk of fragmenting the systemic-risk picture, thereby defeating the primary purpose of trade repositories. It would also give rise to duplication (given the global nature of markets), and so reduce efficiency and be more costly.

We caution that location of a data repository should not, in of itself, confer on the relevant financial regulator for that location any 'extra' or preferential access rights, nor any right of ownership of that data, nor, in of itself, jurisdiction over counterparties supplying this data (or to trades whose details are held at the repository). Any such 'extra-territorial' claim by a regulator in the jurisdiction in which a repository is located would further complicate the prospects for successful development and industry-wide usage of such a repository. We believe that international regulators should endorse this principle.

We strongly urge that any consideration of the establishment of TRs in additional asset classes (to those covered in this CP) should only take place after adequate consultation and careful consideration of the characteristics of each asset class (e.g. types of market participants, instrument most commonly used etc).

To the extent that supervisors use TRs to monitor market risk exposures, it is important to note the limitations of TRs that only relate to OTC derivatives. Specifically, it is important to note that the risk/position view within the TR may be incomplete, from both the individual firm and industry perspective, as underlying positions being hedged (which will include, inter alia, securities, loans, listed derivatives and other asset class OTC derivative positions) will not be reflected in the TR and therefore will not provide a view of the overall risk position in most cases. More generally, every firm has its own risk management process and there is no substitute

² TREM is a pan-European mechanism which exists today to enable local regulators in the EU to share transaction information. At an EU level, transaction reporting requirements only cover MiFID instruments admitted to trading on a regulated markets e.g. cash equities and credit products. In the UK, FSA requires transaction reporting via its TRS for products linked to securities admitted to regulated markets.

In terms of OTC derivatives, FSA requires transaction reporting of Equities and CDS only. Other EU regulators currently don't require transaction reporting for OTC derivatives but this issue was the subject of a recent consultation from CESR. Transaction reporting information is used by FSA and other regulators for the detection of market abuse

for a supervisor's review of regulated firms on a firm-by-firm basis. Given these limitations, we would ask that CESR recognise that the primary use of repositories would be for the monitoring of counterparty risk.

The signatories would propose that international regulators agree (in conjunction with industry) a uniform approach to trade details to be collated and held by trade repositories. Adoption of a common counterparty reference data system will ensure that aggregate exposures can be identified in an efficient manner when data is examined on a consolidated basis, maximizing the value of this data.

As regards the monitoring of counterparty risk faced by a given firm, we note that it may be important for supervisors to look across that firm's entire derivatives portfolio (given that bilateral close-out netting and collateralization operate across derivatives with different types of underlying).

We believe that the priority for these proposals should be directed towards the major/systemically important market participants, rather than all market participants, as the latter includes a 'long tail' of many non-financial-services firms. These are not in themselves systemically important, and it is unreasonable to impose on them the costs associated with having a systemic role.

Answers to Questions:

'Functions and Characteristics of a Trade Repository'

Do you agree with the functional definition of what constitutes a trade repository?

We agree that the core functionality of a TR is to ensure storage of accurate trade data in order to enable users to have comfort over the accuracy of reports they obtain on the market. This efficient reporting function is the key benefit associated with trade repositories.

This being so, we stress that it is *not* the core function of a TR to provide the sole official legal record of a transaction. Further, in keeping with the purpose of a TR as a store of data for the purposes of facilitating reporting it should be noted that a TR would not keep a record of all trade attributes, only those that are necessary for reporting purposes and therefore not sufficient to be classed as an "official legal record".

We would highlight the different core functionality of a TR, and a trade warehouse, respectively, as follows:

Trade Repository – a storage of trade records to provide transparency at an industry level on trends and behaviours in a specific asset class at a defined point in time. The records contained in the repository are not considered the legal representation of the contract and the population of those records in the repository is not necessarily achieved through a bi-lateral matching

mechanism. Therefore a repository can never provide the following services: Transaction level reporting (either live or delayed), ancillary services such as central settlement and lifecycle event processing.

Warehouse – the defining factor of the CDS DTCC Warehouse is that in its legal construct it is defined as the legal and risk representation of the open contract. This means that the existing record has to be taken as the most recent instance of the trade, and the two counterparties have to ensure that the record is accurate, which can only be achieved through bi-lateral matching. By defining the trade representation in this way it is then possible to drive additional functionality through this information (e.g. multi-lateral central settlement, credit event processing, trade compression). From the above it is also critical to keep records as near live as possible so regulatory transaction reporting can also be obtained from this information.

The CP makes reference to the ability of a TR to interconnect with ancillary services which can intervene as necessary for trade maintenance through the life of the transaction – for example in providing settlement services or market observations when needed. We wholeheartedly believe that such interconnections are a desirable feature of a TR, but it should be stressed that this additional functionality should not be considered as being ‘at the core’ of the purpose of the TR³. The extent to which non-core downstream functions may also be provided by the TR infrastructure provider will differ by product. We would suggest that reference to the data in a TR being considered the sole “official legal record” is incorrect, as this would be dependent on complete life-cycle processing being in place - which is currently not the case and not necessarily appropriate for all asset classes. For example the processing of market events for equity derivatives is currently not standardized and, through necessity, there are elements of choice that need to be catered for. For interest rate derivatives, meanwhile, the scope and need for life-cycle event processing is limited. We would caution against use of the term “golden copy” for the same reasons as this has specific relevance to a Trade Information Warehouse type structure which is over and above the core function of a TR and not currently relevant for other asset classes.

We would also add that, in the rates market, practical difficulties would probably arise in getting the large number of counterparties to input trades into such a mechanism, under a ‘golden copy’ approach, when many market participants are outside of the financial services sector.

We would welcome clarity from CESR in terms of whether it sees TRs and transaction reporting via local supervisors to TREM co-existing – or whether a TR providing information to regulators would negate the need for transaction reporting from firms. While surveillance is important to

³ Of course, it may be appropriate that, on occasion, some or all of such ancillary services are provided by the same vendor and therefore the distinction between the TR and the overarching integrated architecture may become blurred.

firms in terms of upholding standards of proper market behaviour, firms will want to avoid a situation where they are being asked to report transactions twice – i.e. to their local supervisor and to the relevant TR. We are aware that CESR has recently consulted on transaction reporting for OTC derivatives and would ask that these issues should be considered together.

What other characteristics of a TR do you consider essential?

Operational robustness is a *sine qua non*. We comment on this further below.

It is also vital to build on existing open standards that promote interoperability and reduce integration costs between organizations, notably FpML (or Financial products Mark-up Language), which is now clearly established as the lingua franca of electronic communications relating to OTC derivatives.

‘Availability of Data by Trade Repositories’

In your opinion, what kind of information should be available to: regulators, market participants and the general public, respectively? Please differentiate by asset class where appropriate.

Regulators should be provided with access to all the information that is necessary to enable them to perform their functions with respect to the firms that they regulate. It may well also be helpful for “canned” reports (i.e. fixed-format reports, the form and frequency of which have been pre-agreed) to be made available to assist regulators in obtaining the information they need in the most efficient manner.

The specific trade details to be held should be agreed in a timely and considered manner by the reporting institutions with the OTC Regulators Forum for each product set e.g. Credit, Rates and Equity. We believe that international regulators should work with industry to agree a common counterparty reference data system, to ensure that aggregate exposures can be efficiently identified. Failure to do so will compromise the value of data fed into different trade repositories, when viewed on a consolidated basis.

The way this data is reported is important. There are many Regulators and Supervisors with relevant requirements of the TR but they should not each have access to all the information in the TR – they should have access only to the information provided by the firms that they regulate (and anonymised market information). Similarly, market infrastructure providers and their regulators/ supervisors should only be given access to such information as they require to execute their functions – but this should be limited to information provided by direct participants in that infrastructure. Again, in this instance, regulators should only have access to information provided by firms that they regulate. We do not support blanket access or disclosure to all regulators or all market infrastructure providers. However, it should be noted that the TR should only be used to provide a point in time snapshot, on an agreed frequency, of all trades held in the TR.

We believe data should be reported using open standards, to avoid having to deal with multiple proprietary standards from different trade repositories and to be able to leverage the infrastructure for the different regulators. One data standard for reporting allows reporting across different asset classes: FpML⁴ is the industry standard for OTC derivatives and work is ongoing in a recently created FpML reporting working group to provide the technical schemas to allow transaction and position reporting, across different asset classes, including non derivatives where appropriate.

Any local jurisdictional confidentiality requirements which preclude the provision of trade information to the TR would undermine its overall purpose and should be addressed.

As we note later on, there are many confidentiality issues to be clarified jurisdiction by jurisdiction which may need to be addressed by local legislation/regulation. Any TR should provide a robust model to ensure any data subject to confidentiality requirements is only disclosed subject to a relevant permissions process.

At least one party to each transaction covered by the TR must submit data if the TR is to provide a full and complete picture of the market. It is anticipated that all senior market participants will submit data. All market participants should only be able to view their own data within the TR.

We believe that it would be most appropriate, at this stage, to require 'G15' dealers to report data to TRs. Other market participants could be encouraged to report, but we would observe that these market participants could face considerable logistical and technical challenges in so-doing, at this stage.

Only aggregated, anonymised delayed information should be made available to the broader market/public.

Do you agree that trade repositories should provide adequate processes to ensure the reliability of the data provided? How could reliability be ensured?

TRs should be configured and embedded in the post-trade processing framework in such a way that best use is made of existing transaction recording and validation processes since, within firms, existing systems already hold reliable and accurate data (which is utilized by firms to manage their own risks).

⁴ Financial products markup Language (FpML) is the open source industry standard for the OTC derivatives industry, developed under the auspices of ISDA. FpML/ISDA is an active member of the ISO 20022 Registration Management Group, working actively with other standard bodies to harmonize financial industry standards under ISO. For more information on FpML, see www.fpml.org.

Do you see any other entity with legitimate information needs with regard to OTC derivative trades recorded in a trade repository? If yes, please explain.

No. Nota bene: the information in a TR is both sensitive and potentially commercially valuable. A clear distinction should be made between, on the one hand, supervisors using it for the benefit of the financial system and, on the others, those (such as exchanges) who may potentially wish to use it for their own commercial advantage.

'Location of a Trade Repository'

Do you see a need for establishing TR facilities in Europe if a global repository already exists elsewhere? Do you believe that a European repository is needed for each OTC asset class as described above (i.e. CDS, interest rate and equity derivative markets)? Please give reasons.

The location of a TR should not be the over-riding consideration. It is important that all trades for any one asset class should be retained in a single TR, given the global nature of the OTC derivative markets.

Multiple trade repositories for a single asset class would fragment information, making access to aggregate information inefficient and more costly. Multiple TRs also run the risk of confusion/duplication for trades which cross international boundaries.

Access to TRs should be given to regulators globally via terminal screens as appropriate. Location of a data repository should not, in of itself, confer on the relevant financial regulator for that location any 'extra' or preferential access rights, nor any right of ownership of that data, nor, in of itself, jurisdiction over counterparties supplying this data (or to trades whose details are held at the repository). Such 'extra-territorial' claims could create important obstacles to industry-wide usage of such a repository. We believe that international regulators should endorse this principle.

All TRs should be subject to the same global standards, including robust business resiliency management standards.

We again underline that regulators' decisions as to whether or not TRs should be established for different asset classes and/or on a regional basis should only be taken after careful consideration of the characteristics of these asset classes and their participants.

Regulators may be aware of existing initiatives towards establishment of TRs in the interest rate and equity derivative asset classes.

Requests for Proposal (RFP) for the Interest Rate Trade Reporting Repository and the Equity Trade Reporting Repository were published on the ISDA website on 17th July 2009 and 11th

August 2009 respectively. ISDA received 8 proposals for the Interest Rates Trade Reporting Repository and 6 for Equity. The choice of vendor was made following two rounds of presentations.

ISDA hosted vendor presentation afternoons to allow all vendors that responded to the RFP to present their solution to a sub-set of the Rates Implementation Group and the Equity Implementation Group. Following these presentations three vendors were shortlisted for the second round.

The shortlisted vendors were invited to present in more detail to the relevant (ISDA) Steering Committees (which have the purpose of agreeing industry standard practice in different asset classes, guided significantly by, and linked with their consideration of the views of the industry's most important regulatory bodies [or groups of regulatory bodies]). Members of those Steering Committees then voted on their preferred supplier.

The Rates Steering Committee voted for Trioptima, and the Equity Steering Committee voted for MarkitServ. These decisions were endorsed by the IIGC (a broad-based and inclusive committee in terms of market sector representation, which acts as the main interface, along with ISDA, for senior regulatory contact and oversees all market practice and post-trade issues in the OTC derivatives market, as well as providing strategic direction. It comprises senior business professionals, of which a proportion will be ISDA Board Directors).

In the rates area, a Deal Team has been formed to move ahead with planning, commercial arrangements and governance of the Trade Reporting Repository. This team is liaising with TriOptima and also, with regards to requirements, with the relevant competent authorities.⁵

If yes, what form should the trade repository facilities to be established in Europe take (e.g. single point of information, back-up facility) and which trades should be registered in such facilities (e.g. trades of European market participants, trades referring to European underlying entities)? Please specify.

We don't believe that trade repositories should be established on a 'regional' basis, or that trades should be divided into 'European' and 'non-European' trades that should be registered in a European or non-European TR.

There should only be one TR per product set globally. Each relevant regulator should then have the ability to request the relevant data from each TR to enable them to perform their responsibilities. Provided each regulator has access to the information, we do not think it is necessary to insist that a TR for each product or more than one product is located in Europe⁶.

⁵ In this instance, this is the UK FSA. The UK FSA is leading the sub group of the OTC Regulators Forum on Trade Reporting Repositories

⁶ In practice, the TR for Rates will be based in Europe.

Each TR should have a business continuity plan of its own, and each TR should be set up in such a way as to address the legitimate legal concerns of all parties using it.

The same entity may run the TR for more than one product (for example the DTCC is involved in both the credit and equity TRs) but they should be treated as separate TRs in that data will not be co-mingled.

'Legal Framework for Trade Repositories'

Do you think there should be harmonised EU requirements for the regulation and supervision of trade repositories?

Requirements should be harmonized for all TRs, applying a global standard.

At this stage, while we do not believe there is a need for regulation (except perhaps to address confidentiality concerns), further consideration may be needed on various issues depending on the nature of the repository (public body vs private company, insolvency procedures (if relevant), and so on).

To what extent do you expect that protocols, common market practices and the like, surrounding proposed solutions for trade repositories, could promote harmonization and foster safety and efficiency in the post-trading process? Please provide reasons for your position.

In their own right, TRs should provide global transparency on position information (and, through market participants' interactions with them, may additionally reinforce the efficiency of the post-trading process).

Dealers in OTC derivatives will often owe duties to their clients and counterparties to keep information relating to their affairs confidential. These duties may be reinforced by privacy or data protection laws, particularly in cases where the client or counterparty is an individual (natural person). Some clients or counterparties may have concerns about the extent to which TRs may be able to disclose information about individual transactions, including their details, to a broad range of governmental entities around the world, who themselves may be able or required to disclose that information to other agencies. In some cases, it may not be enough for the dealer simply to include standard form consent wording in documentation or to notify existing clients of the intention to disclose information to TRs (for example, because of requirements for the client specifically to agree or to give informed consent), and, in any event, there may be concerns about whether it is necessary to carry out a repapering exercise with respect to all OTC derivatives clients and counterparties. Dealers will wish to ensure that there is a clear legal framework which does not expose them to risks of liability to their clients or counterparties as a result of disclosure of client and counterparty details to a TR.

Similarly, all market participants will wish to understand the circumstances in which a TR may be able to disclose their individual details to third parties, on an identifiable basis. It will be necessary to establish clear criteria as to how to determine which regulators around the world are able to obtain data from TRs (and whether there are any limits on the data they are allowed to request from the TR), as well as to establish the extent to which those regulators may be entitled or required to disclose that information to third parties and the extent of their ability to refuse third party requests for disclosed data. Similarly, it will be necessary to establish the extent to which, as private bodies, TRs may be liable to disclose information as a result of litigation between third parties or to law enforcement agencies (or in response to judicial assistance arrangements). Market participants will wish to see that there is a legal framework regulating the TRs that provides adequate protection for their information.

For more information on this paper please contact Julian Day (jday@isda.org), Head of Trading Infrastructure or Roger Cogan (rcogan@isda.org), European Policy Director, at the International Swaps and Derivatives Association (ISDA®).

ⁱ **AFME** (Association for Financial Markets in Europe) was formed on November 1st 2009 following the merger of LIBA (the London Investment Banking Association) and the European operation of SIFMA (the Securities Industry and Financial Markets Association). AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with SIFMA in the US, and the Asian Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association), and provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. For more information please visit the AFME website, www.AFME.eu.