



COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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CONSULTATION PAPER

Trade Repositories in the European Union

Deadline for contributions: CESR invites responses to this consultation paper by **6 November 2009**. All contributions should be submitted online via CESR's website under the heading 'Consultations' at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests their submission to be confidential.



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1. INTRODUCTION

The financial crisis, especially the default of Lehman Brothers, underlined the importance of a robust and adequately functioning post-trading infrastructure, highlighted the need for more transparency on exposures generated by the over-the counter (OTC) market, in particular for derivatives, notably credit default swaps (CDS), and demonstrated the need to safeguard the OTC market from abusive behavior. The CESR/ESCB Recommendations for Securities Settlement Systems and Central Counterparties in the European Union, upon request of the ECOFIN, have been reviewed in order to encompass the OTC derivatives dimension.

On 31 July 2009 the European Commission¹ announced a major step towards financial stability for the European CDS market in (defined as the market in CDS that reference European entities and indices), related to European entities and indices will be cleared through central counterparties as of that date. The fact that various providers of clearing services have now expanded (or are in the process of doing so) their scope of services to central clearing of CDS is an important reason to consider what further improvements can be made in order to enhance risk mitigation and to improve the transparency and efficiency of the post-trading process as a whole.

On 3 July 2009 the European Commission published a Communication on ensuring efficient, safe and sound derivatives markets. In the Communication the Commission referred to the forthcoming report of CESR on trade repositories, on the basis of which the Commission will take appropriate actions. It also raised several other issues that it considers to be important in the context of derivatives markets.

2. PURPOSE OF THIS PAPER

The number of European entities active in these markets, the European origin of many underlying instruments, the number of contracts denominated in European currencies, the volumes involved and the need to satisfy the information needs of EU regulators justify CESR's interest in the establishment of trade repositories. Trade repositories should aim to foster transparency, thus supporting the efficiency, stability of and orderly functioning (i.e. avoidance of abusive behavior) of financial markets.

Against the background of the context outlined in the Introduction of this paper, the purpose of this consultation is to collect the stakeholders' views on trade repositories, including their functions, data and transparency requirements, their location and the legal framework.

CESR takes as a preliminary position that the establishment of one or more trade repositories should be market-led. It notes that it does not want to impose trading of all CDS, nor other OTC instruments in general, on regulated markets.

3. FUNCTIONS AND CHARACTERISTICS OF A TRADE REPOSITORY

What is a Trade Repository?

A trade repository (TR) for OTC derivatives is a centralised registry that maintains an authoritative electronic database of all open OTC derivative transactions (i.e. the contracts concerned). It collects data, derived from centrally or bilaterally clearable transactions, as inputted by both parties to a trade. Depending on the asset class, a TR may also engage in trade life cycle event management and downstream trade processing services. However, the core functionality of a TR is its record keeping and reconciliation function of definitive copies of trade data. Other market infrastructure or service

¹ Press release of 31 July 2009 (IP/09/1215)



providers that centrally maintain market-wide OTC derivative contract information (e.g., central counterparties (CCPs)) may also provide the function of a TR under the above-stated definition.

Contracts maintained in a TR can be considered the sole “official legal record” (the so-called ‘golden copy’) of a transaction, depending on the legal arrangements in operation with regards to the contracts in question. As such they constitute data usable for various downstream processings. Consequently, an important attribute of a TR is its ability to interconnect with multiple market participants in support of risk reduction, operational efficiency and cost saving benefits to individual participants and the market as a whole.

Other ancillary services provided by a TR and its affiliates may thus include, but are not limited to, central settlement, electronic novation and affirmation, and portfolio compression. Finally, flexibility (notably: and scalability) of the operations of a TR seem to be key with a view to keep in step with innovation of OTC markets and the need to evaluate the scope of the services provided by a TR.

Questions:

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

What other characteristics of a TR do you consider essential?

4. AVAILABILITY OF DATA BY TRADE REPOSITORIES

TRs serve as central record for OTC derivative trades. TRs are therefore primary sources of information. Information on OTC trades may be needed by different public and private entities such as regulators, market infrastructure and service providers, market participants and the public. Regulators may include direct regulators of TRs, direct regulators of market infrastructure and service providers, direct regulators of market participants and regulators with mandates to ensure market integrity and to promote financial stability. Market infrastructure and service providers may include CCPs and other specialised post-trading service providers (e.g. offering portfolio compression and reconciliation services).

Information needs may vary depending on the nature and mandate of the requesting entity. The TRs may therefore provide different data to different entities. Regulators should receive all the information required to fulfil their respective public mandates. Market infrastructure and service providers as well as market participants should have access to relevant information on a non-discriminatory basis, subject to relevant confidentiality provisions. The public may have a need for aggregate information on size, structure and major participants of OTC derivative markets. Depending on their mandate regulators may have a need for more detailed information. Data reported by trade repositories should at least include matched and confirmed trades. TRs should provide adequate processes to ensure that the data on these trades is reliable and not duplicated (e.g. portfolio reconciliation). Work is ongoing in the international OTC Regulators Forum which is in the process of defining both data input and output of trade repositories.

As an example, for CDS the following more detailed information may serve the needs of regulators (for other OTC instruments a similar level of details might be constructed):

- Type of product (i.e. single names, tranching and untranching indices)
- Type of underlying (i.e. for single names and indices)
- Type/Category of buyers/sellers
- Maturity
- Currency
- Top single names by gross and net notional
- Top indices and tranches by gross and net notional
- Product data by sector
- Position data by counterparty upon request by the appropriate regulatory authority
- Position data for the main counterparties by gross and notional upon request by the appropriate regulatory authority



Questions:

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.

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

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.

5. LOCATION OF A TRADE REPOSITORY

Currently, there is only one existing TR for CDS, the Trade Information Warehouse (TIW), operated by the DTCC in the US. The newly established clearing services for credit default swaps by ICE Clear and Eurex Credit Clear rely on the recording of trades by the TIW. The TIW will be subject to joint supervision by the Federal Reserve Bank of New York and the New York State Banking Department. In addition, a co-operative oversight framework is currently under construction at global level in the OTC Derivatives Regulators' Forum. On 2 June 2009 major derivatives dealers have committed to the Federal Reserve and other banking supervisors for all trades not cleared through a CCP to universal recording in a central TR of CDS trades by 17 July 2009, of interest rate derivative trades by 31 December 2009 and of OTC equity derivative trades by 31 July 2010.

Although no TR exists currently in the EU, Trioptima, a Swedish based and regulated company, is in the process of setting up a trade repository for interest rate swaps. It was chosen by the major industry representatives as the preferred choice for reporting of interest rate derivatives. Whilst it is not yet clear where they will establish their trade repository, it is likely it will be based in the EU.

There are also other entities active in the broader OTC derivatives market (e.g. interest rate swaps) which offer part of the services CESR considers essential for a repository. These entities may adapt their business models in the future to operate repositories.

In Europe, there is currently no TR facility for CDS. In recent months a discussion has started on whether or not the establishment of such a facility, at least for contracts concluded between European market participants and/or trades referring to underlying entities established in Europe, could be useful. In favour of the establishment of such a facility it has been argued that only a facility located in Europe can provide legal certainty and adequate legal protection to relevant parties, in tune with European legal practices. In addition, it has been argued that relying on one single site in the US for a global market may be problematic in terms of business continuity.

Against the establishment of a second TR facility in Europe it has been argued that the creation of multiple TRs facilities will lead to a fragmentation of data, making efficient and effective supervision of OTC markets even more difficult. Opponents against a European solution have also argued that the costs for the industry to set up an additional site in Europe would outweigh the benefits to be gained from the establishment of such a site. The supervisory needs of European regulators could be satisfied by establishing a supervisory framework with regard to the TIW and by giving European regulators access to the data provided by the TIW (in this respect a process is already underway in the OTC Regulators Forum to define the data access by European and other regulators). Business continuity would be no less endangered by setting up an additional European facility unless such a facility would be limited to mirroring the trades registered in the TIW and to providing a back-up for the data on these trades.

Questions:

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.

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.

6. LEGAL FRAMEWORK FOR TRADE REPOSITORIES

The legal framework for regulating and supervising post-trading activities in the European Union is mainly based on national laws. The dimension of EU law for these activities so far is limited and dispersed among various EU directives (e.g. MiFID, SFD, FCD). CESR recognizes that progress in this area is primarily a case for public authorities. In this context, CESR continues the dialogue among its members and with EU Institutions to improve and converge to a framework that caters for a European level playing field.

In May of this year, CESR and the ESCB adopted Recommendations for Securities Settlement Systems and Central Counterparties, addressed to public authorities. At this stage, no specific Recommendations have been formulated with regard to trade repositories.

CESR is fully aware that the creation of formal - national or EU - rules and regulations is not in the hands of the industry. In case a European trade repository facility for OTC derivative trades would be established, there is currently no harmonised European rule book. In the absence of such rules, requirements would be decided on and executed by the national regulator in the country of establishment. In a scenario where a trade repository would be established in Europe, a review of the existing regulatory and/or supervisory structures may have to be considered.

Questions:

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

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

7. TIMETABLE

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