ISDA®

International Swaps and Derivatives Association, Inc.
One Bishops Square
London E1 6AD
United Kingdom
Telephone: 44 (20) 3088 3550
Facsimile: 44 (20) 3088 3555
email: isdaeurope@isda.org
website: www.isda.org

by electronic mail Friday, 25th June, 2010

William C Dudley, Chair, Committee on Payment and Settlement Systems
Hans Hoogervoorst (*taking over from* Kathleen Casey), Chair Technical Committee, IOSCO

Dear Mr Dudley, Mr Hoogervoorst,

Considerations For Trade Repositories In O.T.C. Derivative Markets Consultative Report

Please find attached the response of the International Swaps and Derivatives Association (ISDA*) to the above-mentioned consultative report. We are pleased to have the opportunity to comment on the important issues addressed in this report, and would welcome further dialogue as appropriate.

Yours sincerely,

Richard Metcalfe, Head of Policy, ISDA

---

* ISDA, which represents participants in the privately negotiated derivatives industry, is among the world's largest global financial trade associations as measured by number of member firms. ISDA was chartered in 1985, and today has over 820 member institutions from 57 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Since its inception, ISDA has pioneered efforts to identify and reduce risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreement; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements; securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

Response

The industry understands and fully supports the importance of properly-managed trade repositories (TRs) in providing supervisors with trade data, including client names, to enable them to develop a more complete view of OTC derivatives market activity and thereby enhance their ability to oversee the market and its participants. This matters in assessing the distribution of counterparty and market exposure across participants, aiding the timely detection of concentrated positions by any one participant or 'crowded' positions in any one type of trade.

We warmly welcome the consultative report (CR). It is timely, given the emergence of TRs in the significant OTC derivative asset classes, driven by industry's efforts to establish better infrastructure around this business, given the sustained, strong growth in ever wider demand for risk management instruments.

We agree that the key risks to be managed by a TR are those of operational reliability and safeguarding of data. However, the referenced issues of "disclosure" – which are also classified in the consultative report as a "risk" to be managed by a TR – seem to us to be more a question of legal framework and appropriate regulation. We expand particularly on disclosure issues below, both from the perspective of client confidentiality and the perspective of the legitimate information needs and duties of various constituencies.

While we would agree that it is important for a TR to take adequate measures to safeguard data, it is also important that both market participants and TRs have the legal right to disclose data where required to do so, and that clear regulations govern when a TR should disclose data and to whom. Regarding legal considerations with respect to confidentiality, in some jurisdictions, and depending on their standard terms of business, dealers may currently not be able to disclose client data, even if clients consent to such disclosure.

Confidentiality duties attach to many parties: to the TR itself; to those who are to contribute data to it (whether on their own behalf or that of their customers, subject to any constraints); and to those who receive that data, whether regulators or other entities referred to in the paper.

We view TRs as supporting a global market and agree that their operations should be structured to support a global supervisory community that is as co-ordinated internationally as possible. We believe that the role of TRs in systemic oversight make it essential not only that they are operationally robust but equally that there is no fragmentation of this function, since that would defeat the whole object of ensuring efficient aggregation of information by asset class. Fragmentation would also impose unnecessary cost and operational complexity and risk.

We would similarly be concerned if fragmentation resulted in overlapping and duplicative data submissions or potential inconsistencies in data which is treated as the 'legal record'. Efforts should therefore be focused on the creation of a small number of sufficiently robust TRs. Care should therefore be taken to ensure adequate global regulatory co-operation in the establishment and governance of these TRs, as well as to mitigate any concerns about the availability of data to foreign regulators due to the unilateral actions of any domestic authority.

Numbering below follows that in 'Exhibit 1: Proposed factors for consideration by trade repositories and relevant authorities'. Where we do not specifically address a numbered item, please assume that our view is neutral to positive.

1. Legal framework: The existing legal framework may not be sufficient in all cases to support the rules, procedures and contractual arrangements of a TR. Although a TR will be able to make rules governing the disclosure of data to the TR and the TR's management of that data, it will not be able to make rules which enable market participants to disclose data if they are restricted from doing so under national law; nor will it be able to govern the ways in which authorities and supervisors use the data once they have access to it. Some of these issues may be addressed by agreement between the market participants and their customers, but in some cases it will be necessary to amend national legislation to allow TRs to function as intended and to ensure that data is disclosed and used appropriately.

The legal framework should cover the rights and obligations of supervisors as well those submitting data and managing its safekeeping. There should be a clear agreement as to which authorities may have access to the data and the purposes for which they may use the data. It will be necessary to determine which authorities are to have jurisdiction over a TR, and what powers they will have over that TR.

As discussed further below, it is likely that it will not be appropriate to disclose information to the public in the same form as the data disclosed to the relevant authorities. Any laws or regulations governing a TR, and the rules, procedures and contractual arrangements of the TR should set out the circumstances and the form in which the TR will be required to disclose data to the relevant authorities and to the public.

In particular, any relevant authorities 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.

It will also be necessary to ensure that market participants and TRs are able to disclose the data and are appropriately protected from any consequences of doing so. There should also be harmonised rules governing the information that must be disclosed to a TR and the form in which that information should be disclosed. This too is discussed in more detail below.

2. Market transparency and data availability: A number of issues potentially arise in connection with the use to which data stored in the repository is put. A threshold issue is the legal ability of dealer firms to submit data relating to customers, or for the repository to pass that data on to any third party. We elaborate on these crucial issues below, including a separate note on client confidentiality.

As regards disclosures, we believe that the purpose of TRs is to provide information to supervisors, who have a duty to form an accurate overview of the distribution of risks across market participants. We believe that a clear lesson from the 'financial crisis' of 2007-08 was that this duty was not being carried out as effectively as it might. TRs can dramatically improve the efficiency of the oversight process (although the direct relationship between any one supervisor and the firms it oversees will clearly remain important and should not be overlooked).

We further believe that TRs can also play a useful role in dissemination of transaction-related data to a wider audience, to the extent that the wider audience has a legitimate interest in what may be sensitive information. Bearing in mind that pre-trade transparency is generally recognised as being excellent across OTC derivatives and that data relating to specific risk-transfer transactions would normally be considered commercially confidential (viz, in the insurance sector), we firmly believe that, when considering any wider dissemination of data, it is essential to clearly identify what constitutes a 'genuine, proven benefit'. For instance, aggregate information about market volumes can help participants assess the depth of that market without revealing anything of a commercially sensitive nature. We do however caution against assumptions that forcing participants to show their hand will somehow 'create' liquidity, when inappropriately calibrated transparency would be more likely to have the opposite effect. We therefore support the CR's line that data availability should be "in line with... respective information needs". Due regard should be had for any impact on the ability of the market to function in the first place and the position of intermediaries whose capital is at risk every time they enter a transaction as principal.

4. Governance: We agree that all interested parties should be appropriately reflected in the governance structure, including end-users. Representation should be proportionate to the underwriting of costs and risks.

5. Access and participation: The CR states that denials of access should be based only on risk-related criteria. In order to give more certainty and protection to TRs / participants, we believe consideration should be given to guidelines as to when TRs may deny access.

6. Safeguarding of data: Safeguarding of data is vital to the confidence of participants in the market, given the crucial role TRs play. It should therefore be expected that a TR would indemnify market participants against any loss or legal liabilities that firms might suffer because of misconduct on the part of a TR or breaches of its confidentiality obligations. This further implies parameters relating to the ethics and conduct of TRs and their staff.

a) The CPSS-IOSCO Consultative Report emphasises the need for TRs to take steps to ensure the confidentiality of information and to have robust system controls and safeguards to protect data from loss and information leakage. There should be a commitment from the authorities that directly or indirectly seek access to the data to maintain corresponding standards.

b) The CR should specifically emphasise the need for TRs, when disclosing confidential information to authorities, to do so in a way that provides robust protection against the risks of loss and information leakage (eg, using encrypted formats when transmitting data to authorities). The authorities should use similar standards when sharing the data (when permitted to do so).

c) The CR paper does not refer to the desirability of TRs maintaining policies and procedures to ensure that confidential information is not used for the purposes of trading in securities or other financial instruments or otherwise misused by the TR or its staff. For example, it may be appropriate for TRs to put in place policies and procedures to control personal account dealing by staff and, where the TR or its affiliates engage in other businesses, information barriers to ensure that those other businesses do not have access to the information. The authorities seeking access should recognise equivalent restrictions.

d) Relevant authorities directly or indirectly seeking access to information in TRs should publicly commit to comply with the relevant standards and make publicly available information on the legal framework regarding their use of the information (including information on the circumstances in which the information can be disclosed to other authorities and the measures in place to ensure compliance with the standards regarding confidentiality and security). These disclosures should be in English and should be collated and published centrally by CPSS-IOSCO in a comparable form and subject to a peer review process. TRs should not be required to disclose information to authorities that have not publicly committed to observe the requisite standards and to participate in these arrangements.

   We note, for example, that the conference base text of the Bill for 'Restoring American Financial Stability Act of 2010' (HR4173) contemplates that a US-regulated trade repository will only be able to disclose information to non-US regulators in response to a request if:

   - the repository has previously notified the relevant US regulator (the SEC or CFTC) of the request;
   - the relevant US regulator has determined that it is appropriate for the repository to make disclosures to the recipient; and
   - the disclosure is on a confidential basis, pursuant to the confidentiality restrictions prescribed by US law, and the repository has received a written agreement from the recipient, stating that it will abide by the confidentiality restrictions prescribed by US law and will indemnify the repository and the relevant US regulator for any expenses arising from litigation relating to the information. (See sections 728 and 763 of the Bill.)

   These requirements are more demanding than those that apply under the provisions of US law with respect to disclosure of information to non-US regulators. (Compare, for example, rule 24c-1(b) under the Securities Exchange Act of 1934, which contemplates disclosure by the SEC of non-public information to non-US regulators, subject to SEC receiving "such assurances of confidentiality as the [SEC] deems

appropriate".) We can see that non-US authorities may have difficulty agreeing to those requirements, especially given domestic freedom of information and other constraints. On the other hand, the proposed regime does at least provide users of the repository with the assurance that there is a degree of regulatory oversight by the repository's US regulator of any proposed disclosures, and written undertakings that confidentiality will be respected (even if it may in practice be difficult for the repository or any third party to monitor compliance with or enforce these undertakings).

e) Consideration should be given to to the intellectual property rights in the trade data (notably for those who actually supply the data). There should be clear limitations on the use of the trade data by the TRs outside the context of providing trade data to the regulators.

The foregoing suggests that there perhaps ought to be a regulatory framework governing the operation of the TRs themselves. The TRs are commercial organisations, but they now have, or will have, significant access to and control of market information. The regulators should consider applying a consistent set of rules to the TRs to whom trade data is provided, governing their duties, ethics and conduct. TRs should also be required to indemnify firms against losses that firms suffer due to the TRs' misconduct or their breach of confidentiality obligations.

In addition, it should be emphasized that market participants should not be forced to take legal responsibility for data which is inaccurately transcribed or corrupted after it has been submitted to the TR. Indemnity from legal or regulatory actions as a result of post-submission corruption should likewise be mandated.

These issues apply consistently across asset classes and all centralised infrastructure initiatives (including in relation to central clearing and collateral) and need to be addressed in a consistent manner.

9. Communication procedures and standards: We strongly encourage greater and more specific support of "relevant international communication procedures and standards". In particular, there exists a well established electronic standard for describing the economic content of OTC derivatives and related processes such as collateralisation, in the form of FpML (Financial products Mark-up Language). This is an open, international standard, which supports automation of post-trade processes such as confirmation matching as well as the storage of information. In the interests of cost-effectiveness as well as international supervisory co-ordination, we believe that supervisors should recognise the role that FpML already plays and should a) specifically and explicitly promote its use and b) include summary information about it in future publications. Please note that FpML provides a suitable basis for any further supervisory reporting, whether related to existing needs such as enforcement of market abuse rules or other yet-to-be-identified applications.

Issues of data quality and data standards need to be addressed in any consideration of a data repository. In particular, we note that TRs often support several categories of transaction records

which are each intended to serve different purposes. These separate categories are not (and are not intended to be) equal with respect to data accuracy and granularity. For example, DerivServ's US-based Trade Information Warehouse (TIW) holds, amongst other types, Gold, Silver, Bronze and Copper records, with each subset providing a differing level of data certainty and fulfilling a different role. Not all of the recommendations of the report will be appropriate for all types of records handled by a TR.

12. Regulation and oversight: The CR defines "relevant authorities" as financial sector public authorities including central banks, securities and market regulators, and prudential supervisors of market participants. The term "relevant authorities" includes the authorities who have jurisdiction over a TR (for example, the authorities of a country in which the TR is located) and other authorities who have interests over a TR. We believe that internationally agreed standards will be important in clarifying who might constitute an "other authority who has an interest over a TR".

Annex: Client-data confidentiality

The industry is committed to providing as much of the required data to TRs as it is legally able to do. We highlighted to supervisors the fact that there are legal obstacles to providing client data as soon as we became aware of it. As a first step towards addressing those obstacles the industry undertook a survey of the G20 jurisdictions with a view to establishing the current position in those jurisdictions so as to provide to supervisors a picture of the current position and an indication of where action is required. Having reviewed the results of that survey and considered the complex interaction of the different applicable legal systems, we have discussed these issues with supervisors, and have been exploring ways to overcome the hurdles identified.

As part of this effort, dealers have been reviewing their own terms of business with customers in order to identify the extent to which those terms of business would either permit or prevent the contemplated disclosures. It has been suggested that dealers seek consent of their customers, where necessary, to the disclosure of the relevant data. However, for the reasons set out below, it is unlikely that most customers would be willing to give such consent or to sign up to a Protocol. Therefore, this can only ever be part of the overall solution. .

ISDA has highlighted the issues listed below to the OTC Derivatives Regulators' Forum. In short, whilst there is more work for the dealers to do, the industry also needs help from the regulators.

1. The survey indicated that laws relating to confidentiality and professional secrecy in the G20 jurisdictions may restrict the circumstances in which a dealer would be permitted to disclose customer data. Although there are some exceptions, in general a dealer would only be permitted to disclose data which identifies a particular client if an obligation to disclose arises under the same law which imposes the confidentiality obligation, or if the client has given its express consent to disclosure. In addition, it may be difficult for a dealer as a practical matter to identify from the transaction record the jurisdiction applicable to individual trades with multi-jurisdictional counterparties.

2. It is clear that there is no single action that can be taken to address the various legal obstacles to provision of client data. There is likely to be a "patchwork" of different steps that can be taken, such as obtaining customers' consent, seeking changes in the law in relevant jurisdictions and identifying those circumstances in which existing legislation and/or the dealers' own terms of business would currently permit disclosure.

3. Since any contractual consent will have to be couched in broad terms in order to capture all the contemplated disclosures and to address the need for "informed" consent in many jurisdictions, industry faces the risk that its customers will refuse to provide that consent. This risk is exacerbated by the current uncertainty over how the data will be used (please see item 8(a) below).

4. The dealers will not – and indeed cannot – agree among themselves simply to refuse to deal with customers that withhold consent. Any such agreement would breach anti-trust laws. (It has not been suggested that dealers should do this; however, we would like to point out that this constraint does exist.)

5. It is important to note that the industry-led survey covered only the G20 jurisdictions and Switzerland. There may be additional concerns which arise under the law or regulation of other jurisdictions. For example, in some jurisdictions, legislation may not permit disclosure of customer data, even where the customer has given express consent to such disclosure.

6. Until, and except to the extent that, a legal framework – involving both contractual consent and broad-based, consistent legislative change – permitting the contemplated disclosures is put in place, dealers may not be able to provide client names or other information which would identify a particular client as the source of the data. It should be noted in this regard that the provision of data, even on a no-names basis, involves relationship and reputational risks to firms and possibly in some jurisdictions legal risks. Some firms currently providing trade data to TRs on a no-name basis are concerned that they may in some cases face the risk that doing so may breach contractual confidentiality obligations to their clients. Supervisors should be aware that until there is a legal framework supporting the required disclosure, in order to mitigate legal risks dealers may have to screen data that they have for each customer (or class of customer) and manually block its disclosure until a legal basis for disclosure exists with respect to that customer (or class of customer). This may result in the data submitted to TRs being incomplete.

7. The industry encourages the regulators to commit to supporting and implementing a suitable legal framework to protect dealers providing the required data. Contractual consent may provide a limited short-term fix, but the legislative solution will be the most effective in the long term. A legislative initiative that would permit dealers to disclose client data to TRs, for which ISDA has provided suggested wording, is being proposed in the EU in the context of the market infrastructure legislation. The industry appreciates the proactive role that some regulators have taken in this process. However, other applicable jurisdictions also need to be addressed. ISDA and the dealers are working to identify and prioritise those jurisdictions. In the interim, industry is faced with the difficult prospect of having to manage conflicting regulatory requests and requirements and contractual obligations.

8. In addition to working together to promote legislative change, there are some important areas in which the industry needs the help of supervisors if it is to comply with their requirements to provide client data. These include the following:

    a) To assist the industry in soliciting the consent of its customers, the industry requests a clear statement from the supervisors outlining the intended use of data, access rights and the measures that will be put in place to protect its confidentiality. The proposals in the recently-published CPSS-IOSCO Consultative Report "Considerations for trade repositories in OTC derivatives markets" (discussed further below) do not go far enough in this regard. We understand that the OTC Derivatives Regulators Forum is working on guidance on these issues, which will be published soon.

b) Terms of business with clients differ from dealer to dealer, but they may permit disclosure of information to regulators "upon request". Whether or not "upon request" covers an ongoing request for broad disclosure as well as occasional one-off requests will be a matter of interpretation for each dealer, but generally speaking a clear request from relevant supervisors to each dealer to report client trade data to the TRs for subsequent disclosure to the regulators could enable some dealers to provide the required data on the basis of their existing terms of business. Since the TRs are simply the means to achieve such disclosure, any such request should make clear that the data should be disclosed through TRs, for onward transmission to regulators.

c) The industry requests the regulators' practical and meaningful support with regard to the dialogue with local regulators. Regulators should be aware that, in order to avoid infringing local laws, dealers may have to identify affected group entities and block out data originating from those entities in the relevant jurisdictions. This may again result in incomplete data being submitted to TRs. Dealers have tried to address this issue by approaching local regulators on an ad-hoc basis. This approach provides inconsistent results (even from the same regulator) and is hugely inefficient, both for firms and for regulators. A broad-based legislative approach would solve this, or at least reduce the problem to a manageable level. In the meantime, regulators could provide support in the form of a letter from the OTC Derivatives Regulators' Forum to other regulators outlining the basis of the TRs project. This should give firms the basis on which to approach local regulators. ISDA would be happy to provide assistance in drafting such a letter.

   The ISDA legal working group will approach the TRs with a view to agreeing standard wording for disclosure to regulators