

CPSS-IOSCO

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**Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs**

London, June 25, 2010

Dear Sirs,

Markit welcomes the publication of CPSS-IOSCO's *Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs* and we appreciate the opportunity to provide you with our comments.

Markit is a financial information services company with over 1,500 employees in Europe, North America and Asia Pacific. More than 1,500 institutions use our independent services to value financial instruments, manage risk, improve operational efficiency and meet regulatory requirements. Markit is a provider of independent pricing for financial products across asset classes with a particular focus on those that trade in over-the-counter (OTC) markets. We also operate the Reference Entity Database (RED) for CDS, administer the tradable credit indices Markit iTraxx and Markit CDX, and perform portfolio compression services for OTC derivatives.

Given the range of our OTC derivatives related services we have been working closely with existing and potential providers of central clearing services to enable their access to reliable pricing data, licences, and other relevant services, and we have actively contributed to the creation of CCPs for CDS in Europe, North America and in Asia.

We feel therefore well positioned to comment on your recommendations for OTC derivatives CCPs and we hope that you will find our response helpful.

## Introduction

Based on our experience as a data provider for OTC derivatives we agree that the clearing of these products creates unique challenges compared to exchange traded instruments. As the OTC derivatives markets in general tend to be less centralized and many of these products trade less frequently it is essential for OTC derivatives CCPs to have access to reliable pricing sources. This will often require the use of separate services that aggregate quotes from market makers and other sources.

### Recommendation 3: Measurement of credit exposures

As OTC derivatives products often lack a continuous market, CCPs need to have access to pricing data that they consider reliable, especially in times of stress. Such data can include historical data, quotes, as well as transactional prices. We agree that the pricing sources of CCPs should generate results in a timely manner and that CCPs should review them on an ongoing basis. CCPs should also be in a position to use alternative pricing tools when market prices become temporarily unavailable. The data that is used for the calculation of margin requirements should be back tested and the liquidity of the respective products should be taken into account.

In this context, it is worth highlighting that the measurement of the liquidity of OTC derivative products can prove challenging. Given the low trade frequency of most of them, we believe that one needs to move away from the concept of “observed” ex-post liquidity, i.e. the use of trading volumes, to an approach that prioritizes “prospective” ex-ante liquidity, i.e. the likelihood of being able to sell a position in the product close to the current market price.

As liquidity in the OTC derivatives markets is provided by market makers acting on an “on demand” basis, we believe that several factors serve as indicators of prospective liquidity. They include:

- Bid/offer spreads
- The number of (active) market makers
- The agreement on price

We are of the view that CCPs when developing their risk management systems need to consider the above and other metrics to measure and manage their liquidity risks.

### Recommendation 8: Operational risk

CCPs for OTC derivatives often have to rely on information or services from other market infrastructures or service providers. Risk management and operation of CCPs can therefore sometimes be critically dependent on such providers of pricing data and, in the case of CCPs for CDS, those responsible for the management of credit events.

In this context it is worth pointing out that Markit has been working with CCPs for CDS and market participants alike for an extended period of time to devise the most appropriate algorithms to clean data and create reliable clearing prices, similar to the process that is described in Annex 3 of the Consultation Paper. The process is based on the clear identification of instruments and an obligation for market makers to provide prices for a defined size with a maximum bid-ask spread within a five minute submission window. Also, in order to ensure quality of price submissions, periodic trading activity for off-market submissions is envisaged. The methodology that underlies this pricing process is transparent and the names of the price data providers are made available. The price that is determined through this procedure is currently used by one of the CCPs for CDS margin calculations, however we are in discussions on how it could be made available to other CCPs for CDS. While we agree that the factors that are used to determine clearing eligibility should include the availability of pricing information, it is worth emphasizing that the use of such price determination procedures does create reliable pricing on a daily basis even for products for which the availability of pricing is rather limited today.

We do agree that CCPs need to understand and actively manage the operational risk that is created through their reliance on external providers and need to put strong arrangements in place for the selection and the ongoing monitoring of the quality of these services. In addition we feel all external providers to CCPs also need to recognise the systemic risk implications of a potential failure in their own service and they should therefore put appropriate resiliency and disaster recovery facilities and procedures in place. Markit in its function as a provider of pricing data and related services to CCPs has established service level agreements with respect to the provision of data which encompass stringent business continuity plans.

With respect to the procedures that are used to manage credit events, Markit has been integrally involved in the design, testing and implementation of the process for all credit event auctions that were performed since the adoption of the first ISDA protocol in 2005. To date more than 90 of such auctions have taken place in an efficient and effective manner under intense scrutiny from all stakeholders and the public. It is our view that the market is best served by the performance of a single auction that can provide the recovery price for all contracts compared to a situation where the process was run separately by individual CCPs.

#### **Recommendation 14: Transparency**

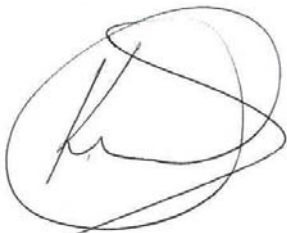
We support your recommendation that OTC derivatives CCPs should make price and volume data of cleared products available to the relevant authorities and to the public in line with their respective information needs as well as with the appropriate scope and granularity.

Markit, in conjunction with the clearing houses, will make the pricing data that is generated through the clearing price procedure described above available on commercially reasonable terms. We will also publish some of this data free of charge in order to increase public transparency in the OTC derivatives markets. Please refer to our CDS transparency webpage [www.markit.com/cds](http://www.markit.com/cds) for more details.

We agree that reporting by CCPs should use common standards for data representation to allow for aggregation. As we have experienced in European equity markets in the wake of MiFID, when public trade reporting in a market segment is performed by a number of different entities the consistency and quality of such data is of utmost importance to facilitate its consolidation. In this context one should not only consider the consistent formatting of the data, but also its quality, condition codes, publication channels, etc. One should not underestimate the amount of time and effort that will be required to achieve these goals in the context of OTC derivatives. We therefore strongly encourage the creation of an industry working group to discuss these issues and potentially agree on the appropriate standards.

We hope you will find our comments helpful. Please do not hesitate to contact us if you require any additional information.

Kind regards,



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