55 Water Street
19th Floor
New York
NY 10041
United States

tel +1 212 205 7110
fax +1 212 205 7123
www.markitserv.com

August 29, 2011

Ms. Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: **S7-25-11: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants**

Dear Ms. Murphy:

MarkitSERV[1] is pleased to submit the following comments to the Securities and Exchange Commission (the "***SEC***" or the "***Commission***") on the Commission's request for comment regarding portfolio reconciliation in its proposed rulemaking to implement certain requirements included in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "***DFA***")[2] titled Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants (the "***Proposed Rule***").[3]

Introduction

MarkitSERV is an independent facilitator, servicing the global derivatives market and making it easier for derivatives market participants to interact with each other. MarkitSERV provides trade processing, confirmation, matching and reconciliation services for swaps and security-based swaps ("***SB swaps***") across regions and asset classes. MarkitSERV also provides universal middleware connectivity for downstream clearing and reporting. Such services, which are offered by various providers, are widely used by participants in the global derivatives markets today and are recognized as tools that increase efficiency, reduce cost, and secure legal certainty. With over 2,000 firms currently using the MarkitSERV platform, including over 21,000 buy-side fund entities, its legal, operational, and technological infrastructure plays an important role in supporting the SB swap markets in the United States and globally.

As a service and infrastructure provider to the domestic and international swaps markets, MarkitSERV supports the objectives of the DFA and the Commission's objectives of increasing transparency and efficiency, reducing both systemic and counterparty risk, and identifying any market manipulation or abuse.

Executive Summary

Unlike the Commodity Futures Trading Commission ("***CFTC***") in its counterpart rule, the Commission has not proposed to require counterparties to engage in portfolio reconciliation, but did request comment on whether

[1] MarkitSERV, jointly owned by The Depository Trust & Clearing Corporation (DTCC) and Markit, provides a single gateway for OTC derivatives trade processing. By integrating electronic allocation, trade confirmation and portfolio reconciliation, MarkitSERV provides an end-to-end solution for post-trade transaction management of OTC derivatives in multiple asset classes. MarkitSERV also connects dealers and buy-side institutions to trade execution venues, central clearing counterparties and trade repositories. In 2010, more than 19 million OTC derivatives transaction sides were processed using MarkitSERV. Please see www.markitserv.com for additional information.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[3] Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42396 (published July 18, 2011).

this should be required.[4] We believe that portfolio reconciliation that is applied in a consistent and economically efficient manner is an important tool to reduce counterparty and systemic risk. We therefore believe it should be required but also urge the Commission to ensure that any required reconciliation is not overly operationally burdensome in light of the benefits it provides. We believe the Commission could do so by: (a) requiring reconciliation to occur less frequently for smaller portfolios and to only require reconciliation for material disputes; (b) requiring counterparties to only reconcile "key economic terms" as opposed to all material terms; (c) permitting counterparties to use qualified third parties registered as clearing agencies for the reconciliation process; (d) requiring security-based swap dealers and major security-based swap participants (collectively, "***SBS Entities***") to institute policies and procedures reasonably designed to reconcile cleared SB swaps; (e) ensuring that SBS Entities are not responsible for aspects of the reconciliation process which only their counterparties have control over; and (f) establishing timeframes for the resolution of disputes that reflect, among other factors, the complexity of the trade and dispute.

Comments

1. Current Market Practice

Portfolio reconciliation today consists of four main components: (1) the exchange and normalization of position details; (2) the pairing (or reconciling) of the counterparties' records; (3) the identification of discrepancies; and (4) the communication and resolution of those discrepancies. It thus allows market participants to identify any issues related to their counterparty exposure at an early stage and minimizes the effort required to correct any such discrepancies in the future. MarkitSERV is one of several independent third party entities that currently provide portfolio reconciliation services ("***MarkitSERV PortRec***" or "***PortRec***"). PortRec and other similar reconciliation services are widely used by investment managers, hedge funds, and fund administrators to automate the pairing of counterparty records and to identify economic or valuation differences for the SB swap and swap portfolios.

Many major dealers have recently committed to reconciling terms and valuations for portfolios of SB swaps and swaps,[5] and a number of other counterparties engage in portfolio reconciliation on a voluntary basis. However, the benefits of reconciliation are currently limited for several reasons. First, the current practice of reconciliation is neither standardized nor very efficient. For example, reconciliation mechanisms are often either proprietary solutions, and thus based on unique specifications, or merely involve the exchange of spreadsheets, and thus are prone to errors. Second, although standards have been proposed, no regulatory or industry standards have been established to specify the data fields that should be exchanged between the counterparties.[6] As a result, even basic data like product names or reference entities will often vary between the parties' records, while useful data such as that pertaining to independent amount[7] is not consistently

[4] *See* Proposed Rule, 76 Fed. Reg. at 42439.

[5] For example, the Federal Reserve Bank of New York has recently committed to improving reconciliation in several ways such as creating standardized methods for reconciliation and reducing thresholds for routine reconciliation. *See* the letter with certain commitments from the 14 buy-side and sell-side derivatives institutions addressed to the President of the Federal Reserve Bank of New York at 5, 17, 18, 28 (March 31, 2011), available at http://www.newyorkfed.org/newsevents/news/markets/2011/SCL0331.pdf.

[6] ISDA has recently drafted a loose set of guidelines for data to be reconciled, but these do not list specific data fields and, in any event, this is still in draft form. *See* ISDA, 2011 Convention on Portfolio Reconciliation and the Investigation of Disputed Margin Calls (Discussion Draft April 7, 2011), *available at* http://www2.isda.org/attachment/MjkzNw==/ICM-.

[7] Independent amounts can be applied on a transaction basis to provide for additional collateral outside exposure collateral. In a joint letter from ISDA and SIFMA, the organizations proposed the following definition: "Independent Amount" means money, securities or property posted by a party to secure its obligations pursuant to the terms of a swap agreement and that is either (i) specified as an "Independent Amount" in the relevant agreement of the parties or (ii) calculated based upon terms agreed between the parties (in either case, in addition to and separately from any Exposure Collateral requirement). *See* Letter from ISDA and SIFMA to the Commission at 2 (Feb. 1, 2011).

provided. Third, reconciliation is often only an irregular, reactive process because many swaps counterparties only reconcile their portfolios once a collateral dispute has arisen.

We believe that these shortcomings could be addressed if the Commission established an appropriately calibrated, standardized, and comprehensive regime for the use of portfolio reconciliation in the SB swaps market.

2. Portfolio Reconciliation Should Be Required But Should Not Be Unduly Burdensome

Reconciliation remains an important function even though the trading and confirmation processes for many SB swaps are becoming increasingly automated, standardized, and electronified because discrepancies in material terms and valuations continue to occur for a variety of reasons. For example:

- Confirmations may still be in the progress of negotiation, disputed, or may have been booked incorrectly, leading to inaccurate or contested data on one party's systems;
- Alleged trades may not be recognized by one party;
- A counterparty may have confirmed a transaction manually without matching its internal trade records to that of the confirmation system; or
- Differences may occur in the inputs that are used to calculate the valuation.

We therefore believe that portfolio reconciliation will continue to be an important tool to reduce systemic risk in the SB swaps markets, and recommend that the Commission establish an appropriately designed regime for the periodic reconciliation of SB swap portfolios. However, if the Commission determines to require portfolio reconciliation, we urge the Commission to ensure that these requirements are not unduly burdensome, which we believe can be achieved by following the guidelines outlined below.

a. Portfolio Reconciliation Requirements Should Be Based on Portfolio Size Thresholds and Resolution Should Only Be Required for Discrepancies That Are Material

We believe that SBS Entities should be required to engage in portfolio reconciliation with varying frequency based on the size of their portfolios with different counterparties. The CFTC has proposed to do this by requiring swap dealers ("***SDs***") and major swap participants ("***MSPs***") to engage in reconciliation once every quarter, week, or day based on the size of SD's or MSP's portfolio and the types of their counterparties.[8] We believe that the Commission should adopt a similar approach because this is an effective way to mitigate risk and because it would likely place a lighter burden on counterparties with less operational sophistication (*i.e.*, those with smaller portfolios).

The CFTC has also proposed to only require resolution of discrepancies for swaps between SDs or MSPs and other SDs or MSPs, and only when the difference between the lower valuation and the higher valuation is 10% or greater of the higher valuation.[9] We believe that the Commission should adopt similar limitations because this would ensure that resolution is not required for small discrepancies that do not pose significant and material market risk. Additionally, we believe that the Commission should structure these thresholds to ensure

[8] *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519, 81531 (published Dec. 28, 2010). SDs and MSPs are required to engage in portfolio reconciliation either once per quarter, week, or day with all counterparties, but the thresholds to determine the frequency of required reconciliation is higher for portfolios with non-SDs or MSPs. *See also* Letter from MarkitSERV to the CFTC at 11-14 (Feb. 28, 2011) (responding to the CFTC's proposed rule on Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants).

[9] *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. at 81531. *See also* Letter from MarkitSERV to the CFTC at 11-14 (Feb. 28, 2011).

that counterparties do not need to resolve disputes which are minor in the context of the counterparties' entire portfolio, and not on a transaction-by-transaction basis.[10]

b. Counterparties Should Only Be Required to Reconcile Key Economic Terms

In the Commission's reporting rule, the Commission proposed to require parties to report many non-economic terms such as the Master Agreement name, whether the parties are SBS Entities, and the trade execution time.[11] We urge the Commission not to require the reconciliation of such broad terms because it would create a significant operational burden but would not result in an equivalent benefit regarding the identification of valuation and collateral disputes.

Today, for example, many counterparties obtain data used for reconciliation purposes from internal systems such as trade capture and accounting systems. These systems, however, do not typically record several terms which will be required for reporting, including the Master Agreement date, whether the parties are SBS Entities, and the trade execution time. Thus, requiring the parties to a transaction to reconcile these terms could impose a significant additional operational burden on counterparties in order to handle the necessary amount of relevant static data. On the other hand, reconciling these non-economic terms would not result in a reduction of market risk because they are unrelated to the valuation or collateralization of a SB swap.

We therefore recommend that the Commission require reconciliation only of clearly defined material "key economic terms." Such terms should be the ones that could have a material impact on the valuation or collateralization of a SB swap, such as the notional amount, currency, and fixed rate. The Commission should note that industry recommendations have been published for the set of fields that market participants should reconcile,[12] which we believe could form the basis for the Commission's requirements. We further believe, however, that the Commission should require parties to also reconcile the transaction-level independent amount, when it is applicable, because it has a direct impact on collateralization.

c. Counterparties Should Be Permitted to Use Qualified and Registered Third Parties for Reconciliation Purposes

We believe that any portfolio reconciliation requirements should permit counterparties to use third-party reconciliation services such as PortRec and competing services because they can significantly increase the efficiency, accuracy and timeliness of the reconciliation process for both counterparties.[13] These third-party service providers should be properly qualified and registered with the Commission as clearing agencies.

Additionally, counterparties should be permitted to use these registered third-party services because doing so can address issues related to the exchange of data. Portfolio reconciliation either requires: (i) both parties to exchange data or (ii) one party to send data to the other party and that party to review and reconcile the data

[10] For example, a 10% difference in the valuation of a specific position can occur in relation to a mark-to-market of USD 500,000 or 100mm, or it can contribute only a small percentage to the total amount in the context of the counterparties overall relationship.

[11] *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information; Proposed Rule, 75 Fed. Reg. 75208, 75285 (to be codified at 17 C.F.R. §§ 242.901(c)-(d)) (published Dec. 2, 2010).

[12] ISDA published such recommended fields in December 2009. *See* http://www.isda.org/uploadfiles/_docs/Minimum_Market_Standards_for_Collateralised_Portfolio_Reconciliation_Edition_1_0_Jan_20_2010.xls.

[13] Reconciliations by PortRec can be performed bilaterally or can incorporate "three-way" reconciliation with fund administrator records or trade repositories such as DTCC's Trade Information Warehouse for credit derivatives. Disputes can be identified and resolved using PortRec's dispute module which conforms with the ISDA Dispute Resolution Procedures of 2009. *See* http://www.isda.org/c_and_a/pdf/ISDA-2009-Dispute-Resolution-Procedure.pdf. In addition, direct links to electronic and paper confirmation data, as well as to independent valuations, are available through the service to aid in the dispute resolution process.

with its own records. We believe that the mutual exchange of information would best facilitate the timely resolution of valuation disputes, but do not believe that the Commission should categorically require this mutual exchange because it would impose too great of a burden on many buy-side counterparties.[14] Additionally, buy-side firms may not wish to communicate their valuation data to counterparties for confidentiality reasons.

Instead, we believe that the Commission should require counterparties to either mutually exchange their data or use a qualified third party for reconciliation purposes because it would achieve the timely resolution associated with the mutual exchange of data and ensure that no undue burden is imposed on buy-side counterparties. Using a third party, for example, would impose less of a burden on counterparties and protect the confidentiality of both parties' data. If a third party is used, however, the Commission should require that such third party be appropriately qualified and registered as a clearing agency.

We therefore urge the Commission to require counterparties to mutually exchange information or use a qualified and registered third party for reconciliation purposes if this would be too burdensome.

d. SBS Entities Should Be Required to Create Policies and Procedures Regarding the Reconciliation of Cleared SB Swaps

We do not believe that counterparties should generally be required to reconcile portfolios of SB swaps that are subject to the clearing requirement because collateral disputes are less likely for cleared SB swaps. However, the Commission should take into account that, for a number of reasons, reconciliation is useful even for cleared SB swaps. For example:

- The clearing agency's "matching" process is unlikely to require a physical comparison of a firm's internal system records with the clearing agency's records;
- SB swap transactions that were intended to be centrally cleared might fail to actually to do so; and
- Lifecycle events, such as post-trade netting activities, may not be automatically carried back into the systems of the buy-side counterparty.

We do not believe that the Commission should directly require SBS Entities to engage in reconciliation for these SB swaps. However, because of the possibilities for disagreement and error, we believe that the Commission should require counterparties to adopt policies and procedures reasonably designed to ensure that they periodically reconcile their positions in cleared SB swaps against clearing agencies or clearing brokers.

e. SBS Entities Should Not Be Responsible for Their Counterparties' Reconciliation Obligations

Any portfolio reconciliation requirements that the Commission imposes must clearly define which party or parties is/are responsible for complying with which obligations, such as resolving disputes that are identified through the reconciliation process. However, portfolio reconciliation in general and dispute resolution in particular require the involvement of both counterparties.

We therefore caution the Commission against imposing all responsibilities for portfolio reconciliation on SBS Entities alone because these entities should not be and cannot be responsible for their counterparties' actions (or inactions). Thus, we believe that the Commission should granularly assign responsibility for each component of the reconciliation process (including the time frames applicable to dispute resolution, as

[14] Buy-side firms do not traditionally communicate all of their valuations to their sell-side counterparties (unless an active dispute is involved), so requiring this disclosure on a frequent basis could impose a significant operational burden on them.

discussed below) so that SBS Entities are only responsible for the aspects of the reconciliation process that they have control over.

f. Time Frames For Dispute Resolution Should Be Granular And Reflect Several Factors

The Commission requested comment on the appropriate time frames for dispute resolution.[15] Industry participants have been working to establish realistic time frames for dispute resolution that nonetheless achieve dispute resolution as soon as possible. In 2009, for example, ISDA published its "Collateral Dispute Resolution Procedure," which proposed standard time frames and optional extended time frames for resolving disputes.[16] Under these proposals, counterparties would be expected to resolve standard disputes within 3 days (which was referred to as "deliberately tight"[17]) but, upon mutual consent, could extend that time period to 9 days. Additionally, this 9 day period could be further extended upon mutual consent to 30 days.[18] In this way, ISDA recognized that several factors may cause counterparties to require additional time to resolve disputes.[19]

However, even these time frames with their optional extensions have proven impossible to meet in certain circumstances. We therefore believe that, if the Commission determines to require portfolio reconciliation and to impose time frame restrictions on dispute resolution, the Commission must create realistic and tiered time frames which provide for differing amounts of time based on several factors (as ISDA proposed in 2009). Specifically, we believe that resolution time frames should differ based on the complexity of a given trade, the complexity of the dispute, and the magnitude of the dispute in relation to the counterparties' portfolio as a whole. Nonetheless, we note that best practice would dictate that parties should resolve even complex disputes as soon as reasonably possible.

* * * * *

MarkitSERV appreciates the opportunity to comment on the Proposed Rule. We would be happy to elaborate or further discuss any of the points raised.

In the event you may have any questions, please do not hesitate to contact the undersigned or Gina Ghent at gina.ghent@markitserv.com.

Sincerely,

Jeff Gooch
Chief Executive Officer
MarkitSERV

[15] *See* Proposed Rule, 76 Fed. Reg. at 42439.

[16] *See* ISDA, Collateral Dispute Resolution Procedure at 9 (2009), available at http://www.isda.org/c_and_a/pdf/ISDA-2009-Dispute-Resolution-Procedure.pdf.

[17] *See id.* at 22 n.36.

[18] *See id.* at 9.

[19] *See id.* at 22 n.36 (including within the reasons parties may have for extending the time frame for resolution the complexity of a given transaction and resource management when there is little credit concern and the parties desire to extend the resolution time frame in order to manage their resources in a commercially reasonable manner).