

February 22, 2011

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties [RIN 3038-AD25]

Dear Mr. Stawick:

Markit<sup>1</sup> is pleased to submit the following comments to the Commodity Futures Trading Commission (“**CFTC**” or the “**Commission**”) on the proposed rulemaking entitled Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, proposed December 22, 2010 (the “**BCS Rule**”)<sup>2</sup> to implement certain requirements included in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**DFA**”).<sup>3</sup>

## 1. Introduction.

Markit provides valuation and analytical services for swaps and security based swaps across asset classes, product variations, and regions. Markit Portfolio Valuations provides an independent derivative valuations outsourcing service to investment managers, fund administrators, custody banks and auditors. The service is characterized by global analyst support, transparent pricing models, and consistent utilization of observable data and it has a SAS 70 Level II certification. Markit’s risk management service, QuIC, provides market and credit risk management and regulatory reporting software to banks and insurance companies. The software is able to calculate scenario analysis, stress tests, Value at Risk, potential future exposure, credit valuation adjustment and other analytical measures for swaps across asset classes.

As a service and infrastructure provider to the global swaps markets, Markit supports the Commission’s objectives of increasing transparency and efficiency in these markets and of reducing both systemic and counterparty risk. Markit believes that, while the BCS Rule aims at achieving important and valuable objectives, several modifications could capture significant opportunities to ensure a more efficient and timely implementation and to create market-based incentives for the creation of more easily monitored and transparent markets. In this letter, we wish to: (a) highlight some significant market consequences and impacts of implementing the BCS Rule as currently drafted; (b) identify potential challenges in the BCS Rule; and (c) propose solutions and recommendations on how to more effectively implement the intent of the BCS Rule.

## 2. Executive Summary.

Markit believes that: (i) the BCS Rule should permit swap dealers (“**SDs**”) and major swap participants (“**MSPs**”) to delegate any obligations to provide daily marks to appropriately qualified independent third party providers (“**ITPPs**”) as it will foster impartiality of valuations and allow for greater transparency of valuation

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<sup>1</sup> Markit is a financial information services company with over 2,000 employees in North America, Europe and Asia Pacific. The company provides independent data and valuations for financial products across all asset classes in order to reduce risk and improve operational efficiency. Please see [www.markit.com](http://www.markit.com) for additional information.

<sup>2</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 Fed. Reg. 80638 (proposed Dec. 22, 2010).

<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

methodologies; (ii) the Commission should further clarify the “reliable means” by which daily marks may be communicated and ensure that they are reliable and auditable; (iii) the rules regarding communication of daily marks should satisfy any requirements applicable to uncleared swaps; (iv) scenario analysis is most useful on the portfolio level and SDs and MSPs should be permitted to delegate any obligations to provide scenario analyses for their counterparties to appropriately qualified ITPPs; and (v) scenario analysis requirements should be modelled on industry best practices.

### 3. Daily Marks.

The BCS Rule requires SDs and MSPs to provide their counterparties with daily marks for all uncleared swaps and to inform their counterparties to cleared swaps of their right to request the daily mark from the appropriate derivatives clearing organization.<sup>4</sup> To make the daily mark more useful to counterparties and to make the process of providing daily marks more efficient, we suggest that the Commission amend the proposed rule as follows:

- a. SDs and MSPs Should Be Expressly Permitted to Delegate Responsibility for Creating Daily Marks to Appropriately Qualified Third Parties - ITPPs

We support the Commission’s proposal that SDs and MSPs should not be required to disclose proprietary information when providing the methodology and inputs that they used to prepare the daily mark<sup>5</sup> because this could compromise their ability to effectively compete in the swaps marketplace.

We believe, however, that the Commission should specifically allow SDs and MSPs to delegate the task of providing daily marks to independent third party providers - ITPPs. Valuations that are provided by ITPPs are based on objective and independent inputs, allowing them to provide the counterparties with impartial and unbiased daily marks. Furthermore, ITPPs typically apply a consistent valuation methodology across all clients and use multiple sources of price data. This not only tends to eliminate errors and any potential bias, but also allows them to value trades even in periods of illiquidity.

Most importantly, ITPPs are not trading entities and therefore have no direct financial interest in the prices that they distribute. They are therefore in a position to provide a higher level of transparency around the inputs and models that they used to produce a swaps valuation. ITPPs are generally able to provide their clients with details of the pricing models that they used, the nature of the data inputs such as curves, volatilities, correlations, or dividends, and other assumptions introduced into the valuation process. Daily marks as provided by ITPPs would therefore potentially create an increased level of transparency in the valuation process, while alleviating SDs or MSPs from any requirement to disclose their proprietary information.<sup>6</sup>

In order to maximize the utility of the services that ITPPs can provide, the Commission should explicitly permit parties to both cleared and uncleared swaps to agree to use an ITPP in the original documentation and should also permit SDs and MSPs to independently decide to delegate their daily mark responsibilities for uncleared swaps to an appropriately qualified ITPP.

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<sup>4</sup> See BCS Rule, 75 Fed. Reg. at 80645-46, 80659 (to be codified at 17 C.F.R. § 23.431(c)).

<sup>5</sup> See *id.* at 80659 (to be codified at 17 C.F.R. § 23.431 (c)(3)(i)).

<sup>6</sup> For example, Markit provides clients of its Portfolio Valuations service with documentation that describes its pricing models, methodology and sources of market data inputs in detail. The market data that was used in the valuation is returned along with the valuation result in the standard results file.

b. The Meaning of “Reliable Means” for the Communication of Daily Marks Should be Further Defined

The BCS Rule states that SDs and MSPs may communicate daily marks by “any reliable means” agreed to in writing by the counterparty.<sup>7</sup> We agree that SDs and MSPs should be allowed to choose between various available means for the provision of daily marks for swaps because their counterparties’ preferences may differ, and that such means should include “password protected access to a webpage.”<sup>8</sup>

However, given the sensitive nature and systemic importance of swaps valuations, we encourage the Commission to establish minimum requirements for what would qualify as “reliable means.” Based on our experience,<sup>9</sup> we believe that any permitted means of communication need to be sufficiently secure, timely and auditable. Such requirements would be helpful to effectively reduce systemic risk in the swaps markets, while the increased level of efficiency and transparency provided by such means would benefit the counterparties and the Commission.

We believe that permitted interfaces for the provision of daily marks for swaps should provide the counterparties with tools to initiate, track, and close valuation disputes with SDs or MSPs. They should also be designed to prevent any unintentional or fraudulent addition, modification, or deletion of a valuation record.

c. Rules Regarding the Communication of Daily Marks Should Satisfy Requirements for Cleared and Uncleared Swaps

In our experience, market participants have a strong preference for receiving a comprehensive solution to their valuation needs across asset classes and products. For example, counterparties typically wish to view both their cleared and uncleared swap valuations through a single interface as it will help them to consider valuations on a portfolio level and to more effectively manage their overall risk. We therefore suggest that any requirements related to the means of communication of daily marks shall also satisfy any requirement relating to uncleared swaps.

**4. Scenario Analysis.**

The proposed BCS Rule requires SDs and MSPs to provide scenario analysis for any high-risk complex bilateral swap transaction or, on request, for swaps that have not been initiated on a designated contract market (“**DCM**”) or swap execution facility (“**SEF**”).<sup>10</sup> We believe that the use of scenario analysis on a transaction-by-transaction level, as opposed to a portfolio level, presents significant challenges.

a. Scenario Analysis is Most Useful on a Portfolio Level

We agree that the provision of scenario analysis for a particular high-risk complex bilateral swap at the time of execution may help the counterparty to better understand the swap’s dynamics and assess potential exposure in connection with the swap. However, we believe that counterparties typically gain more useful insight into their potential exposure by understanding how entering into a transaction in a complex swap impacts their portfolio as a whole. In order to do so, it is necessary to consider scenarios that stress-test the entire portfolio, and not just the single trade.

We believe that the Commission should amend the BCS Rule in two ways to address the above issues:

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<sup>7</sup> See BCS Rule, 75 Fed. Reg. at 80646, 80658 (to be codified at 17 C.F.R. § 23.402(f)).

<sup>8</sup> See *id.* at 80646.

<sup>9</sup> Markit Portfolio Valuations provides derivative valuation services to many of the top fund administrators and custody banks, who represent thousands of end-users. During an average month, Markit Portfolio Valuations produces approximately 1,800,000 valuations.

<sup>10</sup> See BCS Rule, 75 Fed. Reg. at 80644, 80658 (to be codified at 17 C.F.R. § 23.431(a)(1)).

First, the required provision of transaction-level scenario analysis by SDs and MSPs to their counterparties of all complex swaps should be revised to simply allow counterparties to request transaction-based scenario analysis for those swaps and situations where they find such analysis useful.

Second, the Commission should expressly permit SDs and MSPs to delegate their responsibilities to provide transaction-level scenario analysis to appropriately qualified ITPPs. Using ITPPs for scenario analysis would result in more transparent, verifiable, consistent and useful information being provided to counterparties, and would alleviate the need for SDs or MSPs to disclose any of their proprietary information.

b. Scenario Analysis Requirements Should be Modelled After Industry Best Practices

The Commission indicates<sup>11</sup> that the proposed rule requiring scenario analysis for high-risk complex swaps is modelled on the industry best practices as detailed in a report by the Counterparty Risk Management Policy Group (“**CRMPG III**”).<sup>12</sup> We believe that, in the interest of timely implementation, it would be beneficial for the Commission’s proposed rules related to scenario analysis to be more specific and closely aligned with this established industry practice, including with respect to stress testing on a portfolio basis.<sup>13</sup>

We thank the Commission for considering our comments. In the event you may have any questions, please do not hesitate to contact the undersigned or Marcus Schüler at [marcus.schueler@markit.com](mailto:marcus.schueler@markit.com).

Sincerely,



Kevin Gould  
President  
Markit North America, Inc.

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<sup>11</sup> See *id.* at 80644 (“Proposed § 23.431(a)(1) is modeled on the CRMPG III industry best practices recommendation for high-risk complex financial instruments.”).

<sup>12</sup> The Counterparty Risk Management Policy Group, “Containing Systemic Risk: The Road to Reform, The Report of the CRMPG III” (Aug. 6, 2008) (“CRMPG III Report”), available at [www.crmgroup.org](http://www.crmgroup.org).

<sup>13</sup> See *id.* at 82-84 (stating that, among other things, “The Policy Group recommends that credit risks be viewed in aggregate across exposures, giving full consideration to the effects of correlations between exposures.”).