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February 28, 2011

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

Re: Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants [RIN 3038-AC96]

Dear Mr. Stawick:

MarkitSERV[1] is pleased to submit the following comments to the Commodity Futures Trading Commission (the "***CFTC***" or the "***Commission***") on the 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 Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants (the "***Proposed Rule***").[3]

## 1. Introduction.

MarkitSERV provides trade processing, confirmation, matching, and reconciliation services for swaps and security-based swaps ("***SBS***") across regions and asset classes. 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 swaps markets in the United States and globally. As a service and infrastructure provider to the international swaps markets, MarkitSERV supports the Commission's objectives of increasing transparency and efficiency in these markets and of reducing both systemic and counterparty risk.

In our comments below, with respect to the confirmation and portfolio reconciliation aspects of the Proposed Rule, MarkitSERV wishes to: (a) highlight certain significant market consequences and implementation impacts; (b) identify potential challenges with the Proposed Rule; and (c) propose solutions and recommendations on ways to more effectively implement the Proposed Rule.

## 2. Executive Summary.

As further explained below, MarkitSERV believes that, regarding the *confirmation* rules: (i) swap execution facilities ("***SEFs***") and designated contract markets ("***DCMs***") should be permitted to confirm transactions that are executed on their platforms, but that they should be required to produce a complete and legally binding confirmation, as defined by the Proposed Rule, in order to do so; (ii) the Commission should require that swaps be fully confirmed before being submitted to a derivatives clearing organization ("***DCO***") for novation; (iii) swap dealers ("***SDs***") and major swap participants ("***MSPs***") should only be required to produce draft

[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] Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519 (proposed Dec. 28, 2010).

acknowledgments if they reasonably expect that the parties will be unable to meet the confirmation deadlines set forth by the Commission, and draft acknowledgments should only be required to contain the key economic terms; (iv.1) the time deadlines to acknowledge or confirm a transaction should only begin to run when all information to acknowledge or confirm the transaction has been obtained; (iv.2) the Commission should institute deadlines for acknowledgment that begin when all necessary information has been obtained and for confirmation that begins when the acknowledgment has been received; (iv.3) parties should be required to confirm non-electronically processed transactions within 24 hours of execution, not within the same business day; (iv.4) the definition of "electronic processing" should be limited to transactions that are entered electronically and for which an acknowledgment is electronically communicated; (iv.5) the Commission should only initially require a shortened "economic tie-out" confirmation for certain complex, non-automated swaps; (v) parties should be required to acknowledge and communicate swap transaction information electronically when they are able to do so; (vi) parties should be permitted to delegate their recordkeeping responsibilities under the Proposed Rule to qualified third parties; and (vii) the implementation of the Proposed Rule should be phased in.

Also, regarding the *portfolio reconciliation* rules, MarkitSERV believes that: (i) parties should only be required to reconcile "key economic terms," not all material terms; (ii) in order to avoid requiring parties to disclose all of their potentially sensitive information to the other party, the Commission should permit parties to reconcile their portfolios by communicating their key economic terms to third parties who will compare the data; (iii) parties should adopt policies and procedures reasonably designed to reconcile their portfolios even for centrally cleared transactions.

## 3. Confirmation Rules.

### a. Current Market Practice.

Our comments below address market practice in the interest rate, credit, and equity derivative markets which represent the majority of transaction types that are processed by MarkitSERV today. Before we comment on the specific provisions of the Proposed Rule, we will describe how swap transactions are currently confirmed in these markets.

The process of documenting swaps in today's market involves three functions: (i) trade enrichment; (ii) trade affirmation or matching of material trade terms negotiated between the counterparties; and (iii) attachment to a legal framework. These three steps are present in the "confirmation" of the vast majority of all swap and SBS transactions, regardless of the execution method (*i.e.*, transactions executed via bilateral paperwork, telephone, voice-brokered, or electronic execution platforms), whether transactions are centrally cleared or not, and whether they are confirmed electronically or through other means.

#### i. Trade enrichment

Transactions in swaps are typically executed through the agreement on the main economic terms of the transaction (such as pricing and notional size), with other economic details only explicitly agreed to where they vary from accepted market practice (for example payment frequency, business day conventions, defaults, disruption fallbacks, termination events and termination calculation methodology, and holiday calendars), and additional terms which are specific to the terms of the counterparty relationship (for example master agreement reference or other credit terms).

Trade confirmations that are established for swap transactions today must contain all of this information (*i.e.*, best evidence of the trade), and the process of adding additional information to the execution details to create a complete documentation of the swap transaction is known as "trade enrichment." The level of required trade enrichment depends on the complexity of the transaction type and the form of legal framework under which the

trade is confirmed. Enrichment can happen through a variety of means, including trade capture systems and automated confirmation services such as the ones provided by MarkitSERV.

ii. Trade affirmation vs. matching

Counterparties to a swap transaction typically use one of two methods to agree that the fully enriched set of transaction details accurately records the execution intent:

> *(a) Affirmation*: in the affirmation method, one party alleges the details of the swap transaction to their counterparty, equivalent to sending an "acknowledgment" as defined in the Proposed Rule.[4] The counterparty will then check or verify these details and, if appropriate, affirm that they are correct. For transactions that are facilitated through an intermediary, *e.g.* an inter-dealer broker or an electronic trading system, the intermediary may propose the transaction details to both parties, who then affirm them with each other.
>
> *(b) Matching*: as part of the matching method, both counterparties to the swap transaction allege the transaction details to each other, which are then compared. The comparison can be performed in a centralized fashion, *i.e.*, "central matching" through electronic matching services such as those provided by MarkitSERV. It can also be performed in a localized manner, where one or both counterparties make their own comparison and notify the other party of any discrepancies.[5]

Affirmation and local matching can also be used together, where the parties who receive alleged details of the swap transaction will perform a local match to their satisfaction, and then affirm to their counterpart.

When one of the automated electronic confirmation services, such as MarkitSERV, is used to affirm or match details of a swap transaction, the service provides notification to both parties when the process of affirmation or matching is complete, thereby completing the confirmation process. The service will also be used as a means to communicate and rectify any discrepancies prior to completing the confirmation.

Current market practice also includes confirmation of trade life-cycle events, varying amongst asset classes, but including for example negotiated full and partial terminations and full and partial novations.

MarkitSERV is one of the services that facilitates confirmation of swap transactions. It does so in various asset classes through affirmation, matching, and through affirmation with local matching. Each of these methods is widely used by a variety of market participant types. Quarterly metrics[6] show that the major market makers each executed on average around 40,000 credit derivative transactions per month in 2010. 99% of these transactions were electronically confirmed, with a very high percentage of those using a central matching method. The volume in interest rate derivatives was around 20,000 transactions per month, 80% of which were electronically confirmed, largely using affirmation or affirmation with local matching. The volume in equity derivatives was around 3,000 transactions per month, of which 40% were electronically confirmed using a mixture of central matching, affirmation and affirmation with local matching.

[4] *See* Proposed Rule, 75 Fed. Reg. at 81530 (to be codified at 17 C.F.R. § 23.500(a) ("*Acknowledgment* means a written or electronic record of all the terms of a swap signed and sent by one counterparty to the other.").
[5] "Local matching" can be performed by, *e.g.*, printing both forms of the counterparties' confirmations on paper and physically comparing them side-by-side and item-by-item, or by using a computer system to compare electronically captured trade data.
[6] Markit Metrics: available at http://www.markit.com/en/products/research-and-reports/metrics/metrics.page.

iii. Current market practice for attachment to a legal framework

Currently, almost every swap confirmation references master level documentation with the predominant framework provided by the International Swaps and Derivatives Association ("***ISDA***"). Parties to a transaction typically sign a Master Agreement prior to entering into a trading relationship, and all subsequent transactions to which the Master Agreement is applicable are governed by the terms of this agreement. For some products, such as some credit and equity derivatives, the parties also sign a Master Confirmation Agreement ("***MCA***") which contains those terms that do not vary across individual transactions within a product or regional sector. The use of MCAs allows individual trade confirmations to reference the relevant MCA and so contain fewer terms that would otherwise be repeated in a standardized form trade after trade. ISDA also publishes standard definitions for each asset class, which define terms that are frequently used in transaction documentation, in order to reduce the length and complexity of transaction level documentation. Additional ISDA documentation which may be relied upon includes master-level credit support documentation and other master netting agreements.

Automated confirmation services such as those provided by MarkitSERV allow participants to agree in advance to rely on master level documentation or commonly accepted industry-wide conventions. This reliance is created by both parties signing operating procedures with the platform providers which evidence that agreement, and which can be relied upon by both parties to a trade being confirmed using the service. Importantly, these platforms afford flexibility related to standardization. Working with all customers to the platform in an open and collaborative process, the confirmation development process includes working groups and notification related to legal construct, specifically data elements and field entries related to those elements. We believe that in this context the right balance between standardization, operational efficiency and legal certainty is paramount.

It is worth noting that, in contrast to the process described above where a master level documentation is referenced, some middleware services currently operating in the marketplace provide affirmation or matching functionality without any legal attachment. We do not believe that the record trail created by such a service is the best possible evidence of the terms or existence of a transaction because the parties do not consent to the binding nature of the affirmation or matching. In the interest of maximizing the certainty that parties have as to the terms and even existence of a transaction, we support the Proposed Rule's requirement that the parties consent to the binding nature of the confirmation process (*i.e.*, produce a legally binding confirmation),[7] and believe that this should be the case regardless of what framework the parties agree to use for attachment.

Also, as further discussed below, MarkitSERV generally believes that, in order to minimize legal risk in the swaps markets, the Proposed Rule should require transactions to be fully legally confirmed before being presented to a DCO for clearing. We note that such approach is not only consistent with the Commission's view[8] but also constitutes the market standard today for the large majority of clearable credit and interest rate derivative transactions.

iv. Current market practice for electronically executed trades

The documentation process for electronically executed swap transactions is currently the same as for those that are executed through other means. Execution platforms will typically not hold all of the data that would be required to bilaterally confirm trades. This is either because they support trading for standardized transactions,

[7] *See, e.g.,* Proposed Rule, 75 Fed. Reg. at 81530 ("*Confirmation* means the consummation (electronically or otherwise) of legally binding documentation (electronic or otherwise) that memorializes the agreement of the counterparties to all of the terms of a swap transaction. A confirmation must be in writing (whether electronic or otherwise) and must legally supersede any previous agreement (electronically or otherwise). A confirmation is created when an acknowledgment is manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty.").

[8] *See id.* at 81521 ("the DCO will require a definitive written record of all terms of the counterparties agreement prior to novation by the DCO; this too would serve as confirmation of a swap.").

where terms of the transaction such as, for example, payment frequency are assumed rather than explicitly stated at the time of execution, or because they do not hold bilaterally specific terms, such as MCA type and date. In either case these terms will be added during the enrichment process, and the full details are then agreed through an affirmation or matching process. Confirmation platforms such as MarkitSERV provide automated enrichment capabilities for a variety of electronic execution platforms which, combined with electronic affirmation/matching and legal attachment, allow a fully automated service for electronically executed transactions in swaps.

v. Confirmation submission and timeliness analysis

Part of the ongoing industry commitments to the Federal Reserve Bank of New York ("***FRBNY***") and other regulators[9] include submission timeliness and confirmation targets for electronically eligible confirmations that are processed on an electronic platform, with such targets agreed per asset class in order to take into account respective size, breadth, and levels of standardization. An analysis of transactions electronically confirmed through MarkitSERV shows the following submission and timeliness rates:

**Timeliness of Electronic Submission and Electronic Confirmation**

| | % Submitted | | % Confirmed | |
|---|---|---|---|---|
| | **T+0** | **T+1** | **T+0** | **T+1** |
| **Credit** | 96% | 99% | 88% | 95% |
| **Equity** | 79% | 94% | 69% | 80% |
| **Rates** | 89% | 97% | 84% | 94% |

**Electronically Eligible Volume as a % of Total Volume[10]**

| | |
|---|---|
| **Credit** | 99% |
| **Equity** | 41% |
| **Rates** | 92% |

**b. MarkitSERV's Comments Related to the Proposed Rules**

i. Any Confirmations Produced by SEFs and DCMs Should Be Legally Binding

The Proposed Rule states that the Commission expects that SDs and MSPs would be able to comply with the confirmation requirements by executing a swap on a SEF or DCM.[11] The Commission also indicates that it believes this type of execution will be sufficient confirmation because SEFs and DCMs "will provide the counterparties with a definitive written record of the terms of their agreement."[12]

[9] *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 on March 1, 2010 (the "***FRBNY Commitment Letter***"). Commitments spelled out in the FRBNY Commitment Letter include: (i) greater use of global derivatives repositories; (ii) promotion of clearable contracts and centralized clearing generally; (iii) promotion of processing and legal contract standardization; (iv) promotion of bilateral margining and collateral arrangements; (v) promotion and greater use of straight-through trade processing, electronification, trade date matching, affirmation and processing of trades. http://www.newyorkfed.org/newsevents/news/markets/2010/100301_letter.pdf.
[10] Markit Metrics Trend Report, Q4 2010, available at http://www.markit.com/en/products/research-and-reports/metrics/metrics.page.
[11] *See* Proposed Rule, 75 Fed. Reg. at 81520-21 ("For swaps executed on a SEF or DCM, the SEF or DCM will provide the counterparties with a definitive written record of the terms of their agreement, which will serve as a confirmation of the swap.").
[12] *Id.*

We support the Commission's objective of establishing efficient mechanisms to satisfy the confirmation requirement. However, we do not believe that execution on a SEF or a DCM in and by itself can automatically satisfy the confirmation requirements. Indeed, the execution and the documentation of a swap transaction are two separate and distinct activities, but the Proposed Rule considers them to be the same by assuming that SEFs and DCMs will adequately document a trade merely because they facilitate adequate execution. For example, it is conceivable that a SEF excels at facilitating algorithmic *execution* of a trade, but does not properly document all transaction details as required by the rule and create the best evidence trail (*i.e., confirming*) for this same transaction. Accordingly, by merely executing on such SEF, the counterparty may fulfill its execution duty, but would fail to fulfill its confirmation duty.

The Commission defines "confirmation" as "the consummation of legally binding documentation that memorializes the agreement,"[13] but execution of a trade on a SEF or DCM, in and of itself, does not meet this standard because it does not necessarily provide counterparties with a full, legally binding confirmation of the swap transaction. While SEFs and DCMs might possess or acquire the capabilities necessary to confirm transactions in a way that meets the Commission's definition, we do not believe that this should be presumed.

Therefore, while we believe that the Commission should permit SEFs and DCMs to confirm transactions that are executed on their platforms, we also believe that these entities should be required to produce a complete, legally binding record of the transaction that is based on a recognized legal framework in order to do so.

Alternatively, those SEFs and DCMs that do not wish to properly carry out the confirmation function should be permitted to allow this function to be performed by qualified third parties who can assist counterparties with meeting the documentation aspects of their confirmation duties.

ii. Counterparties Should Have a Legally Binding Confirmation Prior to Submitting A Trade to the DCO

The Proposed Rule states that DCOs "will require a definitive written record of all terms of the counterparties' agreement prior to novation by the DCO; this too would serve as confirmation of a swap."[14] We support this requirement as it promotes certainty of the terms of the swap that will be cleared, ensuring that both parties are in complete agreement on all the terms of the swap prior to it actually being cleared.

The DCO will also produce a confirmation of the swap transactions which results from the novation. However, there may be some delay between submission and completion of clearing, for example when trades are submitted for clearing outside the DCO's opening hours, or when the completion of clearing is subject to review of the transactions and approval by a futures commission merchant acting for a counterparty to the original execution.

iii. Draft Acknowledgments Should Not Be Required When the Trade Can Be Reasonably Expected to Meet Confirmation Deadlines, and Draft Acknowledgments Should Not Be Required to Contain All Terms of the Swap

The Proposed Rule would require SDs and MSPs to furnish or receive, prior to execution, a "draft acknowledgment specifying all terms of the swap transaction other than the applicable pricing and other relevant terms that are to be expressly agreed at execution" for any transaction it expects to enter into with a party which is not an SD or MSP.[15]

[13] *Id.* at 81530 (to be codified at 17 C.F.R. § 23.500(c)) (internal parentheses omitted).
[14] *Id.* at 81521.
[15] *See id.* at 81531 (to be codified at 17 C.F.R. § 23.501(a)(3)).

MarkitSERV believes that the Proposed Rule would result in unnecessary expenditure of resources because each SD/MSP competing for a trade will be required to create their own draft even though only one SD or MSP will enter into the trade.

When a confirmation is expected to be completed promptly after execution (most likely using an automated electronic system) there is little value in furnishing a draft acknowledgment prior to execution. In contrast, we believe that such a benefit would be realized when there is likely to be a significant amount of time between the execution and ultimate confirmation. We therefore believe that the provision (or receipt) of a draft acknowledgment prior to execution should only be required for transactions which cannot be processed electronically and where confirmation or "economic tie out" (as described below) is not reasonably expected to be completed within 24 hours.

We also believe that the Proposed Rule would require the unnecessary expenditure of resources because it would require draft acknowledgments of all of the terms of a transaction. Many of these terms do not typically affect the execution price, and are normally only finalized between the "winning" SD and its counterpart after execution has already taken place. Therefore, we believe that the content of a draft acknowledgment should only be required to contain terms of the swap which are required to determine the market price of the transaction or which could affect the decision of a party whether to enter into such a swap.

iv. <u>The Time Periods Applicable to Confirmation Should Be Consistent and Achievable</u>.

As currently written, we believe that the section in the Proposed Rule dealing with time periods for confirmation and acknowledgment has significant shortcomings and should be revised according to the following principles.

First, the time period "clock" for the various requirements should only start ticking from the point when the respective counterparties have all the relevant data and information to define the swap after the swap was executed (orally, electronically, or by any other means).

Second, time periods (*e.g.*, 15 minutes/30 minutes/24 hours) should apply separately to the acknowledgment and counter-verification components of the confirmation process.

Third, the Commission should permit non-electronically executed and non-electronically processed transactions to be confirmed "within 24 hours of the execution" instead of within the same calendar day as execution.

Fourth, the definition of "electronic processing" should also include "electronic communication".

Fifth, the time period applicable to swaps which are neither electronically executed nor electronically processed should be for "economic tie-out" rather than confirmation.

1. *The Time Period Applicable to Trade Acknowledgment Should Commence From the Point When All Information Required To Acknowledge a Transaction Is Available*

The Proposed Rule sets forth a series of requirements regarding the time period to *confirm* a transaction for swaps between SDs or MSPs and other SDs or MSPs,[16] and a series of requirements regarding the time periods for SDs or MSPs to send an *acknowledgment* of a swap transaction when the counterparty is not an SD or an MSP.[17] We believe that counterparties should be encouraged and required to acknowledge and verify

[16] *See id.* at 81531 (to be codified at 17 C.F.R. § 23.501(a)(1)).
[17] *See id.* at 81531 (to be codified at 17 C.F.R. § 23.501(a)(2)).

swap transactions in a reasonable period of time, but do not regard the proposed time periods as feasible in many cases.

Complications and operational challenges would arise from the proposed time periods. For example, transactions that must be allocated[18] are initially entered into at an "execution" level, for a certain notional size and price, and only allocated by the end-user to multiple underlying funds thereafter, usually by the end of the day. Until this allocation has taken place, the counterparties will not have all of the information required to acknowledge or to verify the transaction.[19]

We therefore recommend that the allowed time periods described in proposed Section 23.501 commence only when the SD or MSP is in possession of all of the information necessary to issue the acknowledgment.

Instituting this more practical confirmation process would not be detrimental to the Commission's reporting regime because data relating to all swaps will be reported in real-time regardless of the timing of trade acknowledgment and confirmation.[20] We believe that there should be the right balance between accuracy of data and timeliness, with more importance being placed on accuracy. The Commission should favor accuracy by granting the parties the requisite time to obtain all information necessary to accurately acknowledge and verify the transaction data.

*2. The Proposed Rule Should Create Separate Time Periods For Acknowledgment and Response to Acknowledgment*

We do not believe that the Proposed Rules prescribing time periods for confirmation of a swap between two SD or MSP counterparties and for acknowledging a swap when one counterparty is a non-SD/MSP are workable.[21]

Regarding the schedule for confirming a swap between two SDs or MSPs, we do not believe it is equitable to place obligations on one counterparty that are dependent on the action of another counterparty. The Proposed Rule does this, however, by imposing a duty to *confirm* a transaction within a given amount of time on the party that is merely sending the acknowledgment. On the other hand, we believe that implementing deadlines on acknowledgment but not verification, as in the SEC's rule,[22] would undesirably grant the parties an open-ended period of time to actually confirm.

Therefore, we suggest that the Commission adopt a compromise solution by imposing deadlines on both the acknowledgment and verification (or dispute) of a transaction. We believe that the time period for the provision of the acknowledgment should start *when all necessary information is obtained and that the time period for the verification should begin once the acknowledgment is received*.

On the basis of these proposed deadlines, for example, if a swap transaction was electronically executed and processed, the acknowledgment should be communicated by the SD/MSP within 15 minutes after execution, and the acknowledgment should be verified (or disputed) by the counterparty SD/MSP within 15 minutes from the time the acknowledgment was received– *i.e.*, a total of 30 minutes post execution would be permitted to

[18] Fund managers will often combine the transactions that they want to enter into for the various funds that they manage in one swap transaction which they execute with a counterparty. Following execution, the fund managers will notify their counterparty which of the individual funds will enter into what portion of the notional of the overall transaction.
[19] Middleware providers such as MarkitSERV currently provide electronic allocation delivery (EAD) mechanisms which can reduce the interval between execution and confirmation. However, adoption of EAD by end users is variable.
[20] *See* 7 U.S.C. 2(a)(13)(A) (defining real-time public reporting as reporting data relating to a transaction as soon as technologically practicable after the time at which the transaction has been executed).
[21] *See* Proposed Rule, 75 Fed. Reg. at 81531.
[22] *See* Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 Fed. Reg. at 3874 (to be codified at 17 C.F.R.§ 240.15Fi-1(c)) ("Any *trade acknowledgment* . . . must be provided promptly, but in any event. . . .") (proposed Jan. 21, 2011) (emphasis added) ("*SEC Rule*").

complete the confirmation. Likewise, a trade that was not executed electronically but processed electronically, should be acknowledged within 30 minutes and verified (or disputed) within 30 subsequent minutes – *i.e.*, the confirmation should be executed within one hour post execution. For the non-electronically processed trades, the acknowledgment should be sent (*e.g.*, via a fax or a pdf email or any other method) within the permitted time, and verification or dispute should be communicated within the permitted time after receipt of the acknowledgment.

*3. Time Periods Applicable to Non-Electronically Processed Transactions Should Be "Within 24 Hours," Not "Within the Same Business Day"*

We do not believe that the Commission's proposed requirement to confirm non-electronically processed transactions by the end of the day of execution[23] is appropriate. For example, this would require confirmation of a complex trade within minutes if a transaction took place late in the day.

We therefore support the SEC's approach in its counterpart rule of using an elapsed time period for non-electronically processed transactions,[24] as long as this time period applied to business days only. However, we do not believe that even 24 hours is a sufficient time period to allow all non-electronically processed trades to be confirmed due the bespoke nature of many transactions in these markets.

*4. The Definition of "Electronic Processing" Should Consider Whether the Trade is Communicated Electronically*

We believe that the determination of how much time a party is given to acknowledge or verify a transaction should not only be based on whether a transaction is entered into an SD's/MSPs system electronically, but also whether the acknowledgment and verification are communicated electronically. Communication is a critical component in this chain of events (*i.e.*, communication of trade terms, execution, communication of acknowledgment, communication of confirmation), and therefore should be factored into the calculation of the time periods. For example, even if acknowledgment or verification data is entered electronically, it may take a considerable amount of time to ultimately confirm the transaction if this data is communicated non-electronically. Accordingly, we propose that the definition of "processed electronically" should include not only the concept of being entered into the computerized trade system, but also the concept of being capable of being promptly communicated to the counterparty as follows:

> "(j) *Processed electronically* means entered into a [SD] or [MSP]'s computerized processing systems to facilitate clearance and settlement**, as well as to become capable of being communicated electronically to the counterparty either as an acknowledgment or verification**."

*5. Allow the Selective Use of "Economic Tie-Out"*

Some trades that are not executed or capable of being processed electronically may not be suitable to be reduced to a confirmation including all of the terms of the swap by the end of the business day or even within 24 hours. Current industry practice for many of these non-electronic transactions is for the parties to agree to the key economic terms through an "economic tie-out" which is typically performed shortly after execution. The parties perform a complete confirmation for the transaction, but this can sometimes take a considerable amount of time.

[23] *See* Proposed Rule, 75 Fed. Reg. at 81531 (to be codified at 17 C.F.R. § 23.501(a)(1)(iii)).
[24] *See* SEC Rule, 76 Fed. Reg. at 3874 (to be codified at 17 C.F.R. § 240.15Fi-1(c)(iii)).

We believe that the Commission should only initially require this truncated "economic tie-out" from parties to these un-automated swaps because these swaps cannot practically be confirmed – according to the definition in the Proposed Rule – in the proposed time limits.

We therefore propose that the definition of "confirmation" and "acknowledgment" be modified to specify "the key economic terms of a swap" rather than "all the terms of a swap" for transactions which cannot be electronically processed. The key economic terms of the swap are any of the terms which are required to determine the market price of the transaction or which could affect the decision of a party whether to enter into such a swap.

Additionally, we believe that the parties should be required to complete this "economic tie-out" within 24 hours of the time when all information is available to the parties. Then, the parties should be required to have in place policies and procedures reasonably designed to ensure the timely completion of the entire confirmation.

v. Electronic Processing Encouraged.

In encouraging electronic handling of swap transactions, the Proposed Rule correctly requires "as many transactions as possible and practicable [to] be executed on electronic platforms."[25] However, we believe that acknowledgments should also be required to be provided through electronic means,[26] and the Commission should also require SDs/MSPs to communicate swaps transaction information electronically where they have the ability to do so.

Furthermore, we generally believe that the Commission should encourage the use of electronic matching and confirmation platforms. Such a requirement is already effectively in place, based on the G14 dealer commitments to the FRBNY[27] and other regulatory authorities. These commitments apply to confirmable events that can be processed electronically using an electronic confirmation platform, and include commitments for each asset class for market participants to support eligible products on an electronic matching platform within targeted dates. For example, it contains a standing commitment for major dealers to support all electronically eligible trades within 90 days of availability on an electronic confirmation platform where they are trading more than an asset-class agreed number of eligible trades per month based on a three month average.[28]

However, although great strides have been made with respect to asset-class standardization and electronic confirmation, there will be situations where electronic confirmation might not be feasible or practicable. Due to product innovation or the bespoke nature of some swaps, situations might arise where electronic confirmation technically has not been provided, or the low number of transactions in a specific instrument type might sometimes not be sufficient to justify the cost of building electronic confirmation capabilities. We therefore believe that it would not be realistic or achievable for the Commissions to mandate electronic confirmation of *all* swap transactions.

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[25] *See* Proposed Rule, 75 Fed. Reg. at 81521.
[26] *See id.* at 81523 ("Is it feasible to require that all acknowledgments be provided electronically?").
[27] *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 on March 1, 2010 (the "***FRBNY Commitment Letter***"). Commitments spelled out in the FRBNY Commitment Letter include: (i) greater use of global derivatives repositories; (ii) promotion of clearable contracts and centralized clearing generally; (iii) promotion of processing and legal contract standardization; (iv) promotion of bilateral margining and collateral arrangements; (v) promotion and greater use of straight-through trade processing, electronification, trade date matching, affirmation and processing of trades. http://www.newyorkfed.org/newsevents/news/markets/2010/100301_letter.pdf.
[28] http://www.newyorkfed.org/newsevents/news/markets/2010/100301_table.pdf.

vi. Recordkeeping Delegation.

We believe that it will often be most efficient for counterparties to delegate the task of recordkeeping for confirmations to dedicated confirmation platforms. Any forthcoming rules should therefore clarify that the task of recordkeeping for confirmations can be delegated to third parties and under what conditions.

vii. The Proposed Rule Should be Phased-In.

We believe that the proposed requirements regarding the confirmation process and time periods for such confirmations would be demanding in many cases. In order to avoid market disruption, then, we suggest that the Commission implement the rules in phases, and work with market participants to achieve the goals set forth in the Act. These phases could be based, for example, upon the complexity of products or the average time to confirm similar transactions. Such a phased-in approach would permit market participants to adapt to the Proposed Rule without causing adverse market consequences due to premature implementation.

We also request that efforts be made to coordinate and consult with the SEC, the Board of Governors of the Federal Reserve System, and international regulatory bodies relative to this phased-in implementation. Our ability as a service provider to swaps markets both in the United States and elsewhere will rest with the needs and demands of the regulators and participants alike, where prioritization will be essential.

**4. Portfolio Reconciliation Rules.**

The Proposed Rule would require the two parties to one or more swaps to exchange the terms of all swaps, exchange each party's valuation of each swap, and resolve any discrepancy in the material terms or valuations of each swap in a portfolio between the two parties.[29] MarkitSERV believes that the active reconciliation of material terms and valuations for swaps portfolios ("***Portfolio Reconciliation***") allows market participants to identify any issues related to their counterparty exposure early and to minimize the reconciliation efforts required to locate any contributing trades. We therefore believe that Portfolio Reconciliation is beneficial to reduce systemic risk in the swaps markets, and we provide the following comments to assist the Commission in effectively implementing the reconciliation rules.

**a. The Current Reconciliation System**

The process of reconciliation today has four main components: (1) the exchange and normalization of position details; (2) the pairing of both parties' records; (3) discrepancy identification; and (4) the communication and resolution of discrepancies. For many OTC participants, portfolio reconciliation is a critical, but reactive process that is usually triggered after a margin dispute is already identified. This process therefore typically involves more operational support as multiple days or weeks of trading activity may be involved versus daily fluctuations.

Electronic execution and confirmation platforms have enabled counterparties to review and confirm swaps more quickly; however, this has not eliminated material term or mark discrepancies entirely. These discrepancies arise for a variety of reasons:

- Confirmations may still be in progress, disputed for recent trading activity, 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 trade manually without matching its internal trade records to that of the confirmation system; or
- Differences may occur in inputs to the valuation calculation.

[29] *See* Proposed Rule, 75 Fed. Reg. at 81524-25, 81531-32 (to be codified at 17 C.F.R. § 23.502).

Parties currently engage in Portfolio Reconciliation, but the practice today is neither standardized nor completely efficient. For example, several different types of tools are used for the reconciliation process, including vendor-provided services and proprietary solutions, but also the simple exchange of spreadsheets. To complicate matters, no specific standards apply to the categories of data that are exchanged during the reconciliation process. The parties often exchange between 10 and 30 sets of economic or valuation details, but the type of data supplied by one party may differ from the type of data supplied by the other party. As a result, reconciliation may be challenging for certain data sets, and useful data such as independent amount[30] is not consistently provided. Even term or reference data, such as product names or reference entities, will often vary between the parties' records.

Additionally, Portfolio Reconciliation is not performed consistently by all parties and is often a reactive process. For example, while many large buy-side institutions perform Portfolio Reconciliation on a consistent basis, many other swaps counterparties only reconcile their portfolios when a collateral dispute arises or as part of their month-end net-asset-value ("***NAV***") process.

MarkitSERV is one of the providers of Portfolio Reconciliation services. The service ("***MarkitSERV PortRec***" or "***PortRec***") is used by investment managers, hedge funds, and fund administrators to automate the pairing of counterparty records and to identify economic or valuation differences for swap portfolios. Reconciliations by PortRec can be performed bilaterally or can also incorporate "three-way" reconciliation with Fund Administrator records or trade repositories, such as DTCC's Trade Information Warehouse for credit derivatives.[31] Direct links to electronic and paper confirmation data are also available to aid in the dispute resolution process.

**b. Comments related to the Proposed Rules**

i. Parties Should Not Be Required to Reconcile All Material Terms

We believe that the Commission should create more specific and less burdensome requirements regarding the data required to be reconciled. Under the Proposed Rule, Portfolio Reconciliation consists of the parties: (i) exchanging the "terms" of all swaps in their mutual swap portfolio, (ii) exchanging each party's valuation of each swap as of the close of business on the immediately preceding business day, and (iii) resolving any discrepancies in the "material terms" and valuations.[32] Presumably, the reference to "terms" in the first step is meant to require an exchange of all "material terms," because the third step requires the parties to resolve discrepancies over all material terms and because material terms is a defined term, while "terms" is not. Material terms consist of all terms required to be reported under Part 45, or the proposed rule "Swap Data Recordkeeping and Reporting Requirements."[33] Based on the currently proposed Part 45, this would require parties to reconcile between 21 sets of data (for currency swaps) and 27 sets of data (for interest rate swaps), plus the applicable Generic Data Fields.[34]

The Proposed Rule states that the Commission is requiring Portfolio Reconciliation because "parties need to know the terms of their executed agreements."[35] We do not believe, however, that reconciliation of *all* "material

[30] Independent amounts can be applied on a transaction basis to provide for additional collateral outside exposure collateral. In the joint ISDA and SIFMA comment letter to the CFTC on Feb 1, 2011, the organizations proposed the following definition for "Independent Amount:"

> "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).

[31] The Trade Information Warehouse is a repository service offered by DTCC's subsidiary, The Warehouse Trust Company LLC.
[32] *See* Proposed Rule, 75 Fed. Reg. at 81530 (to be codified at 17 C.F.R. § 23.500(i)).
[33] *See* Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76574 (proposed Dec. 8, 2010).
[34] *See id.* at 76605 app. 1&2.
[35] *See* Proposed Rule, 75 Fed. Reg. at 81524.

terms" is necessary to ensure that parties understand the terms of their agreements, and therefore believe that this requirement is unnecessarily burdensome. Today, for example, many counterparties obtain the data used for reconciliation purposes from different internal systems, *e.g.*, trade capture and accounting systems. These systems frequently do not hold – and therefore do not supply – fields such as Master Agreement date, whether the parties are SDs or MSPs, or the trade execution time. Thus, requiring parties to reconcile these terms would impose potentially significant additional operational burdens on counterparties in order to handle the amounts of relevant static data. This cost must be weighed against the seemingly small benefit obtained by requiring parties to spend time and effort reconciling terms that do not seem relevant to the purpose of Portfolio Reconciliation: the resolution of disputes that materially impact collateralization. Examples of terms with relatively little benefit are: Master Agreement date, execution venue, the exchange rate at the moment of agreement (for currency swaps), and platform/deal source.

We therefore encourage the Commission to require reconciliation only of "key economic terms." Key economic terms should be defined to only include data which could have a material impact on the valuation or collateralization of a swap, for example notional amount, currency, and fixed rate, and that the Commission should clearly define which data fields are encompassed under this definition. In this regard, we particularly believe that the Commission should require parties to reconcile their Independent Amount data, only where applicable, on a transaction level. Given its direct impact on collateralization, transaction-level Independent Amount is important in the process of discrepancy resolution, and therefore should be included in the set of data fields that need to be reconciled.

Additionally, the Proposed Rule states that the Commission "anticipates that swap dealers and major swap participants will be able to efficiently reconcile their internal records with their counterparties electronically by reference to data in the repositories."[36] We agree that swap data repositories ("***SDRs***") can offer a standardized version of the reporting party's trade representation to counterparties that are not SDs or MSPs. However, the other party's data is not currently captured in SDRs, and the reconciliation requirements in the Proposed Rule should take this into consideration. We do believe that it is beneficial for firms to leverage the SDR as a source of counterparty records, thereby minimizing the need to normalize counterparty data submissions, but the availability of fields in the SDR should not drive the selection of material terms required.

We therefore recommend that the Commission: (1) define and require a smaller subset of data fields or "key economic terms" for purposes of reconciliation and associated dispute resolution requirements, including for example, submitting party and counterparty, notional amount, reference entities, currency, trade and maturity date; and (2) clarify the use of the SDR in the reconciliation process. We believe this would be useful to the parties and would increase market integrity while avoiding unnecessary burdens on parties to a swap.

ii. <u>The Commission Should Clarify the Duty to Exchange Swap Data</u>

The Proposed Rule is unclear whether and in what circumstances both parties would be required to exchange swap data or whether only one party would be required to send its data to the counterparty. For example, the rule defines "portfolio reconciliation" to be the process by which "the *two* parties ... *exchange* the terms of all swaps ... [and] exchange *each party's* valuation of *each* swap,"[37] but later gives an example of a reconciliation between an SD or MSP and non-SD/MSP entity where "the exchange of terms and valuations between the counterparties may consist of one party reviewing the details and valuations delivered by the other party and either affirming or objecting to such details and valuations."[38]

We believe that the mutual exchange of mark-to-market data would facilitate the timely resolution of valuation disputes, but believe that this may impose undue burdens on buy-side counterparties. Currently, for example,

[36] *Id.*
[37] *See id.*
[38] *Id.*

many buy-side firms receive position and valuation details from counterparties, but it is less common for these buy-side firms to also communicate their own valuation data, which can be viewed as private information, unless a significant difference has become apparent.

We believe that this issue can be resolved while at the same time ensuring transparency and active resolution of discrepancies through the use of automated solutions, including third-party providers or internal tools, to perform Portfolio Reconciliation. These solutions are capable of identifying and communicating discrepancies to both parties, and can also centrally facilitate the communication and audit data required for dispute resolution. Third party platforms or in-house tools can distribute mark-to-market data when valuation disputes exceed the Commission's designated thresholds, or bilaterally agreed procedures, to ensure that valuation disputes can be effectively addressed without imposing the additional operational burden firms may face in preparing more regular and comprehensive dissemination of valuation data externally.

We therefore recommend that the Commission clarify its position on the requirements of both parties with respect to the exchange of swap data. We also request that the Commission permit non-SD/MSP entities to perform reconciliation internally or via third parties, and that they should only be required to distribute valuation data where applicable to a dispute.

iii. Parties Should Adopt Policies to Ensure that Some Portfolio Reconciliation is Performed Even for Swaps that are Centrally Cleared

The Proposed Rule creates "a safe harbor for cleared swaps because . . . [w]hen swaps are cleared, the clearinghouse requires that each swap be matched prior to novation."[39] We generally believe that this safe harbor provision is appropriate and that parties should not be mandated to frequently reconcile their portfolios with DCOs.

However, we believe that some Portfolio Reconciliation may be beneficial even for cleared swaps, *e.g.* by helping to correct some potential discrepancies. For example, even though cleared swaps are "matched" before novation, a physical comparison of a firm's internal system records to the DCO record may not occur. Additionally, in certain situations, swap transactions that were intended to clear fail to actually to do so. Finally, lifecycle events, such as post-trade netting activities, may not be automatically carried back into the systems of the buy-side counterparty.

We therefore recommend that the Commission maintain its position with respect to a safe harbor provision, but believe that it may be advisable for counterparties to adopt policies and procedures to reconcile their positions in cleared swaps against SDRs, DCOs, or clearing brokers on a regular basis. We do not believe that the timeliness or manner of these internal reconciliations should be prescribed by the Commission, but should be left to the client's discretion to use in-house processes or third party providers at intervals they regard as appropriate.

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

[39] *Id.* at 81525.

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