

05 August 2012

ESMA  
103 rue de Grenelle  
75007 Paris  
France

Submitted via [www.esma.europa.eu](http://www.esma.europa.eu)

Re: **Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories**

Dear Sir/Madam:

Markit<sup>1</sup> is pleased to submit the following comments to ESMA in response to its Consultation Paper on Regulatory Technical Standards for the *Regulation on OTC Derivatives, CCPs and Trade Repositories* (the “**Consultation Paper**”, or “**CP**”).

## Introduction

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, risk analytics, and related services across regions, asset classes and financial instruments. Our products and services are used by a large number of market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities.

Markit has been actively and constructively engaged in the debate about regulatory reform of the global OTC derivatives markets and the implementation of the Pittsburgh G20 commitments.<sup>2</sup> Over the last 18 months we have submitted close to 30 comment letters to regulatory authorities around the world, we have participated in numerous roundtables and we regularly provide the relevant authorities with our insights on current market practice, for example in relation to valuation methodologies, the provision of scenario analysis, or the use of reliable and secure means to provide daily marks. We have also advised regulatory authorities on appropriate approaches to enabling a timely and cost-effective implementation of newly established requirements, for example through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying regulatory requirements.

We welcome the publication of ESMA’s Consultation Paper and appreciate the opportunity to provide you with our comments. Please find below our comments in relation to a) marking-to-market and marking-to-model and b) requirements to perform compression for portfolios of derivatives.

## Comments

### 1. Marking-to-market and marking-to-model

EMIR requires that, where market conditions prevent marking-to-market, financial counterparties and non-financial counterparties above the clearing threshold must use reliable and prudent marking-to-model to value their positions in derivatives.<sup>3</sup>

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<sup>1</sup> Markit is a financial information services company with over 2,400 employees in Europe, North America, 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> “Leaders’ Statement: The Pittsburgh Summit” (Sept. 24-25, 2009), available at [http://www.g20.org/pub\\_communiques.aspx](http://www.g20.org/pub_communiques.aspx).

<sup>3</sup> Paragraph 95 of Chapter VIII RM, Article 11 of EMIR on page 20.

ESMA should note that some market participants seem to read this requirement as such that, even in situations where significant amounts of observable data are available, they might have to mark-to-model and effectively disregard observable data points. We therefore welcome ESMA's proposals that aim to clarify the use of the mark to model approach. We agree that, to ensure that valuations of uncleared OTC derivatives are indeed appropriate, it is paramount that "as much marking to market information as possible"<sup>4</sup> is used. We also support ESMA's approach to "ensuring marking-to-market is applied when market conditions allow".

That said, we recommend that ESMA further clarify the definition of "reliable and prudent" in the context of marking-to-model. In our experience, in situations where mark-to-model is used, the quality of the underlying model and of the data to which it is calibrated can substantially impact the quality of the resulting valuation. Further, given the scope for the use of judgment, potential conflicts of interest need to be effectively addressed in situations where models are used. ESMA should note that for less liquid financial products and OTC derivatives in particular it has therefore become best practice to utilize valuations provided by independent third parties either for financial reporting or to verify the valuation that is used in financial reporting. Such third party valuations generally use multiple price sources as inputs to eliminate errors and bias and create a consensus view of market data. They are also generally able to offer substantial transparency into the valuation process<sup>5</sup> which will help the reporting institution, its auditors and its regulators to more effectively assess the appropriateness of the model-based valuation. We therefore recommend for ESMA to explicitly recognize the industry practice of counterparties using pricing models and valuations that are provided by appropriately qualified third-parties as "reliable and prudent" in the context of the marking-to-model requirement of EMIR.

## 2. Compression

We welcome ESMA's more measured approach to introducing a requirement for counterparties to perform Portfolio Compression for their portfolios of derivatives. We believe that the requirements that ESMA proposed in the CP are consistent with our view that, in many cases, the costs of performing Portfolio Compression will outweigh its benefits and it should therefore not generally be required.<sup>6</sup>

That said, we noticed that the CP contains a requirement for financial and non-financial counterparties to "terminate each of the fully offset OTC derivative contracts no later than when the compression exercise is finalised".<sup>7</sup> However, it is worth highlighting that, given how compression runs are performed in practice, they rarely create such "fully offsetting transactions". Also, it is unclear how one could terminate an offsetting transaction *before* the compression run has been completed. We wonder whether this requirement could be a reference to a requirement proposed by the CFTC to unwind transactions that are fully offsetting.<sup>8</sup> This requirement, however, seems to refer to single transactions in OTC derivatives that happen to be offsetting and it does not seem to be related to compression runs for portfolios of derivatives. We therefore urge ESMA to further clarify this matter in order to avoid any confusion for market participants.

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Markit appreciates the opportunity to comment on ESMA's Draft Regulatory Technical Standards on *OTC Derivatives, CCPs and Trade Repositories*. We would be happy to elaborate or further discuss any of the

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<sup>4</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 6 RM. 25 June 2012. Annex II: Draft regulatory technical standards on OTC derivatives.

<sup>5</sup> Independent third-party valuation providers can offer details of the pricing models that were used to provide the valuation because they are not market participants that compete based on their view of price.

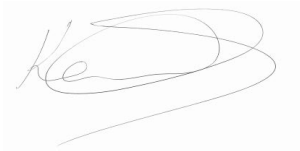
<sup>6</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 6RM. 25 June 2012. Annex VII: Impact Assessment. "Counterparties are required to regularly assess whether portfolio compression should be undertaken...as portfolio compression may not always be possible or appropriate."

<sup>7</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 3 RM. 25 June 2012. Annex VII: Impact Assessment.

<sup>8</sup> Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swaps Dealers and Major Swap Participants. 75 Fed. Reg. 81519 (Dec. 28, 2010).

points addressed above. 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).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Kevin Gould', enclosed in a light blue rectangular box.

Kevin Gould  
President  
Markit North America, Inc.

