

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:

MarkitSERV<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

MarkitSERV is a provider of confirmation, connectivity, and reporting services to the global OTC derivatives markets, making it easier for participants in these markets to interact with each other. Specifically, we provide trade processing, confirmation, matching, and reconciliation services for OTC derivatives across regions and asset classes, as well as universal middleware connectivity for downstream processing such as clearing and reporting. Such services, which are offered also by various other providers, are widely used by participants in these markets today and are recognized as tools to increase efficiency, reduce cost, and secure legal certainty. With over 2,500 firms globally using the MarkitSERV platforms, including over 25,000 buy-side fund entities, our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in Europe, Asia, the United States, and elsewhere.

By integrating trade confirmation, allocation, routing and portfolio reconciliation MarkitSERV provides a single gateway for the processing of OTC derivatives transactions. Based on our experience as provider of connectivity and processing services, we have 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 over 20 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 the electronic confirmation of OTC derivatives transactions, efficient ways of reporting them to Trade Repositories ("**TRs**"), or the reconciliation of existing portfolios of such transactions. We have also made suggestions to 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 ESMA with our comments. Please find below our comments in relation to: a) implementation timing and phase-in; b) the confirmation requirement; c) the requirement to reconcile portfolios of derivatives; d)

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<sup>1</sup> MarkitSERV, jointly owned by The Depository Trust & Clearing Corporation (DTCC) and Markit, provides a single gateway for OTC derivatives trade processing. The company offers trade processing, confirmation, matching, and reconciliation services across regions and asset classes, including interest rate, credit, equity, and foreign exchange derivatives. MarkitSERV also connects dealers and buy-side institutions to trade execution venues, CCPs, and trade repositories. In 2011, over 20 million OTC derivative transaction processing events were processed using MarkitSERV. Please see [www.markitserv.com](http://www.markitserv.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).

dispute resolution; and e) the reporting of derivative transactions to Trade Repositories, including the data to be reported, responsibility for the reporting obligation, and delegation of reporting to third parties.

## Comments

### 1. Implementation timing and phase-in

The CP states that the earliest date by which a derivative contract must be reported to a Trade Repository would be July 1, 2013, when a TR has registered for the asset class by May 1, 2013.<sup>3</sup>

We appreciate that ESMA's CP herewith sets compliance dates for reporting to TRs that would provide market participants with some additional time to prepare for compliance. We also support ESMA's phased-in approach that would set the compliance date depending on the timing of TR registration in the various asset classes. However, based on our experience in helping market participants analyse and comply with reporting requirements in other jurisdictions, we believe that ESMA should consider making use of further phase-in for these requirements, specifically by differentiating by asset class and by participant type.

#### a) Phase-in by asset class

We believe that ESMA, when designing a compliance schedule for the requirement for counterparties to report their transactions to TRs, should take the characteristics of the different asset classes into account. This is because derivatives across the various asset classes vary widely in relation to their degree of product standardization and electronification, the number of product variations, and the nature and number of counterparties. Further, a phase in should take into account factors such as the size of the asset class and the amount of central clearing that occurs already today.

Based on these considerations, we recommend that ESMA consider requiring compliance with the requirement to report transactions to TRs first in asset classes such as interest rates and credit that are at a more advanced stage of development, while requiring compliance in the asset classes of foreign exchange, equities, and commodities only at a later stage. Such approach would be in line with what will be required in other major jurisdictions.<sup>4</sup> We believe that ESMA should further consider establishing timelines per sub-product category in an asset class as necessary since it is our experience that even within an asset class the levels of automation can vary significantly.<sup>5</sup>

#### b) Phase-in by participant type

We believe that any compliance dates should be set as such that they provide the relevant market participants with sufficient time to analyse, build, adjust and test their systems and procedures before they are required to be in compliance with the requirements. Such need to provide sufficient time to prepare for regulatory change has also been recognized by regulatory authorities in other major jurisdictions, for example by the SEC in the United States.<sup>6</sup>

Specifically, we believe that ESMA should take guidance from the CFTC's approach where compliance with some requirements would be expected first from the most active market makers,<sup>7</sup> some time before other

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<sup>3</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 6. 25 June 2012.

<sup>4</sup> Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

<sup>5</sup> For example, a customized product such as a basket transaction done for an end-user client may require further implementation phasing due to its complex structure.

<sup>6</sup> SEC Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act

<sup>7</sup> For example Real Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012) and Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

counterparties are expected to comply. Awareness, education and understanding are critical components for proper implementation of new regulatory requirements, and discussion with our clients provides insight that requisite time is needed in particular for end-users to come into compliance. We believe that such approach to phasing-in would be appropriate as it reflects the different levels of preparedness of these counterparty categories, but also the resources that are available to them to actively prepare for change.

## 2. Confirmation requirement

As we have stated previously,<sup>8</sup> we agree that “electronic execution may not always equal legal standardisation” and that electronic processing of a transaction “does not necessarily mean that the legal terms of the contracts can be agreed between counterparties quicker”.<sup>9</sup> We therefore welcome ESMA’s decision to remove the link between the form of execution or processing and the required timeliness of the confirmation of the transaction that it had proposed in its Discussion Paper.<sup>10</sup>

We also support the changes that ESMA has made to the actual timeliness requirements for confirmations and believe they are now more appropriate.<sup>11</sup> However, based on our experience in providing counterparties with electronic means to confirm their transactions in OTC derivatives in a timely and efficient manner, we believe that, particularly for more customized transactions, even these timing requirements might often be challenging to comply with. For example, an end-user with mid- to low transaction volume who does not have “matching” or more sophisticated technological capability may find it challenging to electronically “affirm” or “click-agree” transactions in very stringent timeframes. Such users may even need several levels of internal approval before being able to agree on a legal confirmation. We therefore support ESMA’s acknowledgement that confirmations for some transactions might remain outstanding for a number of days by introducing a requirement for those transactions to be reported.<sup>12</sup>

That said, we urge ESMA to address the following questions and comments in relation to Article 11 of EMIR, i.e., the requirement to confirm derivatives transactions in a timely manner:

- It is not clear from the CP what the requirement to “confirm” a derivative transaction actually means. While the definition of “confirmation” suggests that it is an agreement between the counterparties to the transaction<sup>13</sup> we are not sure whether ESMA intended to impose such a requirement. This is because compliance would depend on cooperation from both counterparties, including from those that are non-financials. We therefore urge ESMA to clarify whether the requirement to “confirm” a derivative transaction is satisfied as soon as one of the counterparties has *dispatched* a confirmation to the other counterparty, or whether ESMA requires the confirmation to be *signed / agreed* between both counterparties within the proposed timeframes.
- It is unclear which of the parties to the transaction has the obligation to confirm the transaction within the proposed timeframes, and who would be held accountable if the confirmation did not occur in a

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<sup>8</sup> See MarkitSERV comment letter to ESMA’s Discussion Paper on the Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories. 19 March 2012.

<sup>9</sup> As we stated in our previous comment letter (MarkitSERV comment letter 19 March 2012.) we believe that timing requirements for the confirmation of transactions in OTC derivatives across asset classes should not depend solely on the form of execution or processing. Instead, to ensure the timely confirmation of all OTC derivative transactions while providing market participants with sufficient flexibility to achieve compliance with these requirements, ESMA should require a derivative transaction to be confirmed “as soon as technically possible following its conclusion, and no later than 24 hours following its conclusion for a transaction where electronic means of confirmation are available.”

<sup>10</sup> ESMA Discussion Paper on the Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories.

<sup>11</sup> Where such transaction is “concluded after 16.00 local time” or with a “CP located in a different time zone which does not allow same day confirmation” the confirmation shall take place ASAP and at the latest by the end of the next BD.

<sup>12</sup> Financial CPs “shall have the necessary procedure” to report on a monthly basis to the CA the number of OTC derivatives contracts that remain unconfirmed for more than 5 business days.” There is no reporting required from non-financial CPs.

<sup>13</sup> “The confirmation of OTC derivative contracts may refer to one or more master agreements, master confirmation agreements, or other standard terms. It may take the form of an electronically executed contract or a document *signed by both counterparties.*” ESMA Consultation Paper, Annex II, Draft Regulatory technical standards on OTC derivatives.

timely fashion. The use of the phrase “a contract with”<sup>14</sup> might imply that the obligation to confirm is on the counterparty to the specified party, which would mean that for a transaction between a non-financial and a financial counterparty the requirement would be as demanding as for a transaction between two financial counterparties. However, we are not sure whether this was ESMA’s intention. We would hence urge ESMA to provide further clarification on the question whether the obligation to confirm the transaction in a timely manner is with one of the counterparties or with both of them and, if it the former, with which one.

- It is unclear from the CP to what extent the confirmation requirements apply to contracts that are designated to be cleared by a CCP but have not been accepted for clearing yet (and are hence at this moment, and potentially for some period of time, “not cleared by a CCP”). The requirement to confirm a transaction “as soon as possible post execution”<sup>15</sup> seems to imply that all contracts have to be confirmed, including those that are designated to be centrally cleared but have not been accepted for clearing yet. However, for the avoidance of doubt, we encourage ESMA to clarify this matter.
- The requirement to confirm “electronically where available” is only mentioned in relation to the 1<sup>st</sup>, but not in relation to the 2<sup>nd</sup> and 3<sup>rd</sup> timing requirements.<sup>16</sup> We urge ESMA to clarify whether this differentiation was intentional or whether it should apply in all three cases.
- The CP requires the reporting of transactions that remain unconfirmed. However, it is unclear whether this reporting requirement applies to derivatives contracts that remain unconfirmed for 5 Business Days from the time of *execution* or from the *expiry of the deadline to confirm*. We urge ESMA to clarify this issue.

### 3. Portfolio Reconciliation

We welcome the more measured approach that ESMA has taken in the CP in relation to the requirement for counterparties to derivatives transactions to perform Portfolio Reconciliation. That said we urge ESMA to clarify the following questions:

- The requirement to reconcile portfolios of derivatives on the least frequent basis would apply to all portfolios that consist of “less than 300 transactions”<sup>17</sup> and would hence effectively require *all* counterparties to derivatives transactions to engage in Portfolio Reconciliation. However, we believe that a requirement for all counterparties to engage in portfolio reconciliation is likely to create significant cost but rather limited benefit, particularly for counterparties with small portfolios of derivatives. We therefore encourage ESMA to consider granting a de-minimis exemption for counterparties with small portfolios of transactions, e.g. under a certain number of transactions and/or minimum notional.
- The CP states that “financial and non-financial counterparties shall agree in writing or other equivalent electronic means with each of their counterparties on the terms on which portfolios shall be reconciled.”<sup>18</sup> It therefore seems as if the CP requires *all* counterparties to establish the appropriate procedures for portfolio reconciliation before they enter into a transaction, which would apply even to those counterparties that are about to enter into their very first (and maybe only) derivative transaction.<sup>19</sup> We encourage ESMA to clarify whether such agreement can be reached on a standardized/master basis, as we believe such approach would be more efficient and less costly than

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<sup>14</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 6. 25 June 2012. Annex II, Draft Regulatory technical standards on OTC derivatives.

<sup>15</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 6. 25 June 2012. Annex II, Draft Regulatory technical standards on OTC derivatives.

<sup>16</sup> Paragraph 2 and Par. 3 and 3 (sic!) of Chapter VIII, Article 1 RM on page 73.

<sup>17</sup> Paragraph 4 of Chapter VIII, Article 2 RM on page 74

<sup>18</sup> Paragraph 2 of Chapter VIII, Article 2 RM on page 73

<sup>19</sup> Paragraph 4 of Chapter VIII, Article 2 RM on page 74

trying to achieve such agreement via bilateral negotiation. We further recommend that ESMA consider granting a de-minimis exemption for smaller and less active market participants as for them the costs of complying with this requirement are likely to outweigh the broader risk reduction benefits. We further encourage ESMA to clarify which of the parties would be held accountable for compliance with this requirement.

- The use of third parties to facilitate reconciliation for portfolios of derivatives transactions has been recognized by many counterparties as efficient tool, and we believe its use will also serve as means to enable a timely and cost-efficient implementation of new regulatory requirements. We therefore appreciate that ESMA has specified that portfolio reconciliation may be performed by a third party and encourage ESMA to continue to promote this flexibility for counterparties.
- The requirement for counterparties to reconcile the valuation of their derivatives contracts in addition to the key terms in principle seems sensible.<sup>20</sup> However, while the exchange of mark-to-market data might facilitate the identification and timely resolution of valuation disputes, as a general requirement it may impose an undue burden on buy-side counterparties<sup>21</sup> and might force them to disclose potentially sensitive information to their counterparties. We believe that this issue can be addressed by the use of automated solutions, including internal tools or appropriately qualified third-party providers for Portfolio Reconciliation. These solutions will identify and communicate discrepancies to both parties, and can also centrally facilitate the communication and audit the data that is required for dispute resolution. They can distribute mark-to-market data in case that valuation disputes exceed 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 ESMA permit counterparties to reconcile their portfolios by communicating key economic terms to third parties who will compare the data, while requiring counterparties to distribute valuation data to their counterparties only in case is applicable to a dispute.

#### 4. Dispute resolution

The CP requires financial and non-financial CPs to agree on a framework for resolving any dispute “when they enter” into an OTC derivative transaction. Specifically, it proposes that counterparties must agree on procedures relating to the identification, recording, monitoring of disputes relating to the recognition or valuation of the contract and to the exchange of collateral between counterparties, the resolution of disputes in a timely manner, and the resolution of disputes that are not resolved within 5 business days.

We believe that it would be beneficial if ESMA clarified the following questions in relation to the proposed dispute resolution requirements:

- Are all counterparties, including those that only enter into one transaction, required to agree on dispute resolution procedures? We believe that ESMA, from a cost-benefit perspective, should consider allowing for a de minimis exemption.
- Can the agreement on dispute resolution procedures be reached in a standardized/master fashion? We believe that such approach should be permitted as it will enable a more timely and cost effective implementation.
- Can data or services provided by third parties be used to resolve a dispute in an efficient and standardized manner? We believe that third party arbitration and/or market polling, in particular in

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<sup>20</sup> We note that ESMA requires portfolio reconciliation to cover a) valuation of each transaction and b) “key trade terms” that identify each particular OTC derivative contract such as effective date, scheduled maturity date, any payment or settlement dates, notional and currency of the transactions, underlying instrument, position of CPs, business day convention.

<sup>21</sup> Currently, for example, 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.

relation to valuation disputes, should be explicitly allowed by ESMA as experience has shown that it can make the process of resolving disputes about valuations more efficient and timely.

## 5. Reporting to TRs

### a) Data to be reported

We believe that harmonization of the reporting requirements between the various jurisdictions will create greater efficiencies, lower costs and improved data quality. Further, a two-pronged approach, as has been established in the United States,<sup>22</sup> seems to be an efficient way of achieving the regulatory goals of data reporting to TRs in a straightforward manner. On that basis, parties would report a limited set of economic data (as normalized data fields where available) as well as the confirmation data, to the TR. More specifically the following data would be reported:

- A basic data set that contains the key economic terms of the transaction in normalized data fields should be reported to a TR for every derivative transaction. Such data set could be standardized across asset classes and products, and the number of additional fields that are asset class specific would be very limited. We recommend that international regulators coordinate their efforts and also take the views of TRs into account when establishing an appropriate set of minimum key economic terms to be reported to TRs as the cost of compliance increases in accordance with regulatory agency differences.
- Further, as will be required in the United States, confirmation data for a transaction would be captured in a TR. Counterparties will therefore also report the transaction confirmation data (either as a copy/electronic image of the paper confirmation or in normalized data fields where available) to the TR for each OTC derivatives transaction.

### b) Who reports to the TR?

We agree with ESMA that counterparties should be provided with flexibility in terms of how they can satisfy their reporting obligations, which should include the option of delegating such task to a third party. However, as we have pointed out before,<sup>23</sup> we believe that counterparties and other relevant parties will need to have sufficient clarity about who will be responsible for the reporting of which data set to the TR. The lack of such clarity is likely to result in confusion, additional legal, operation and technical cost, and also under- or over-reporting. Unfortunately, we believe that the CP has provided little additional clarity on this important issue and we urge ESMA to clarify this matter.

We also request ESMA to provide clarification on the meaning of “details of a contract have to be reconciled or agreed between the two CPs when reporting to different counterparties.” We generally believe that ESMA should not simply accept that the two counterparties can report the transaction to different TRs. We believe that this would create significant issues in relation to data accuracy and there would be a need to reconcile the data that is stored in different TRs, without ESMA addressing this issue in the CP.

Finally, we believe that ESMA should create some further clarity in relation to the reporting of transactions that are cleared by CCPs:

- It is not clear from the CP what transactions or data a CCP would report, i.e., whether it would report the original transaction, the novated transactions, or all three, and which TR(s) it would report the novated transactions to in situations where the original counterparties had already reported the transaction to two different TRs.

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<sup>22</sup> Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

<sup>23</sup> MarkitSERV comment letter to ESMA's Discussion Paper on the Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories. 19 March 2012.

- The CP states that “where novation occurs before reporting a report shall be made on the basis of the terms of the transaction before novation”. We encourage ESMA to clarify whether this would imply that, in this situation, the CCP would have to report the original trade and the novated trades. We also wonder who has the obligation to report novated trades to the TR, specifically, whether it is the counterparties or the CCP, and, if the CCP failed to report, whether the counterparties would be responsible or whether responsibility would only rest with the CCP.

### c) Reporting by third parties

EMIR permits a party that has an obligation to report data to a TR to delegate the reporting to a third party.<sup>24</sup> Such delegation is also permitted in other jurisdictions, and has been recognized by many counterparties, and also other entities such as execution venues, as an effective way to come into compliance with their reporting obligations in the most timely and cost efficient manner. However, we believe that ESMA’s approach to allowing the delegation of reporting to a third party requires some further clarification.

We agree that securing the accuracy and reliability of the reporting of transaction data to TRs is of paramount importance. However, the CP states that a third-party entity “is deemed appropriate if in the view of the delegating CP it guarantees protection of the data and compliance with the reporting obligation” in the same way the counterparty appointing them is required to do.<sup>25</sup> It is unclear what this really means in practice and we find the use of the expression “guarantees” particularly worrisome, as it could potentially result in few or no third parties being in a position to provide such services.

Importantly, however, it does not clarify who, in the case where reporting is indeed delegated to a third party, has the actual responsibility for accurate and timely reporting. One option to ensure accurate and timely reporting in cases where it is delegated by the counterparties or a CCP to third parties is by leaving the responsibility for the reporting with the reporting party/CCP. This party will then, typically in a bilateral contractual agreement, require adequate assurance from the third party of its operational resilience and appropriate backup facilities to properly perform its reporting functions. ESMA should note that this approach has been taken by the CFTC to reporting by third parties, and we believe it would be equally appropriate in Europe. However, if ESMA indeed regarded it as necessary to impose requirements similar to those that are contained in the CP on third party providers that reporting duties are delegated to, it should result in the reporting parties that delegate to such providers being discharged of their reporting obligations. We do not believe that there is any proper justification for ESMA imposing requirements *both* on the counterparties/CCPs *and* on the third parties.

### d) Backloading of existing derivative transactions into TRs

EMIR requires that derivative contracts entered into before the date of entry into force of EMIR<sup>26</sup> that are outstanding on that date are reported to a TR within 180 days of the reporting start date<sup>27</sup> for a particular asset class.<sup>28</sup> Further, derivative contracts entered into on or after the date of entry into force of EMIR but before the reporting start date<sup>29</sup> shall be reported to a TR within 90 days of the reporting start date for a particular asset class.

Based on the experience that market participants have made when preparing for compliance with the reporting requirements for “historical swaps” established by the CFTC<sup>30</sup> we believe that such requirements create a number of significant challenges. We therefore encourage ESMA to apply any requirement to

<sup>24</sup> European Market Infrastructure Regulation (“EMIR”) Article 3.

<sup>25</sup> ESMA Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, Article 6. 25 June 2012. Annex V, Draft Regulatory technical standards on trade repositories

<sup>26</sup> Expected August 2012.

<sup>27</sup> Expected July 2013 for many, if not all, asset classes.

<sup>28</sup> Equivalent to “Pre-enactment swaps” under Dodd Frank.

<sup>29</sup> Equivalent to “transitional swaps” under Dodd Frank.

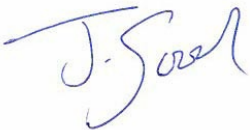
<sup>30</sup> Swap Data Recordkeeping and Reporting: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35200 (June 12, 2012)

report derivatives transactions that have been executed in the past only to transactions that are live as of the compliance date, not to those that existed at the time that the regulations became effective. This is because requiring firms to backload transactions into TRs that have already matured or have been terminated prior to the compliance date creates little value for regulatory authorities but a potentially significant burden on firms. We also urge ESMA to allow the backloading implementation to be phased-in per asset class, with the most standardised products (i.e., credit and interest rate products as referenced above) to be backloaded prior to other asset classes.

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MarkitSERV 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 points addressed above. In the event you may have any questions, please do not hesitate to contact the undersigned or Henry Hunter at [henry.hunter@markitserv.com](mailto:henry.hunter@markitserv.com).

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'J. Gooch'.

Jeff Gooch  
Chief Executive Officer  
MarkitSERV