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February 3, 2014

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Submitted via www.cftc.gov

Re: **Public Meeting of the Technology Advisory Committee (TAC) on February 10**

Dear Sir/Madam:

Markit[1] is pleased to submit the following comments to the Commodity Futures Trading Commission (the "***CFTC***" or the "***Commission***") in relation to the public meeting of its Technology Advisory Committee ("***TAC***") on February 10, 2014. We would also welcome the opportunity to explain our below views further and comment on other relevant topics in person during this upcoming TAC meeting.

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.

[1]Markit is a financial information services company with over 3,000 employees in North America, Europe, and Asia Pacific. In addition to other services, 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 for additional information.

Most of Markit's processing services are provided by MarkitSERV,[2] a company that offers 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, MarkitSERV provides 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.[3]

Markit has been actively and constructively engaged in the discussion regarding regulatory reform of the financial markets.[4] Over the last several years, we have submitted over 90 comment letters to regulatory authorities around the world and participated in numerous stakeholder meetings. Please find below our views on some of the topics that the Commission is planning to discuss at the upcoming public meeting of its Technology Advisory Committee.

Markit's comments

1. <u>Swap execution facilities</u>

a) The Commission should clarify aspects of the "Embargo Rule" to ensure it does not harm the liquidity of the swaps market and create an unfair advantage of futures over swaps

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[2] MarkitSERV, a wholly owned subsidiary of Markit Group Limited, 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. Please see www.markitserv.com for additional information.

[3] Such services, which are also offered by various other providers, are widely used by swaps market participants and increase efficiency, reduce cost, and provide legal certainty. MarkitSERV handles over 80,000 OTC derivative transaction processing events daily. More than 1,500 dealers, clients and executions venues use our services meaning our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in North America, Europe and the Asia-Pacific region.

[4] We regularly provide regulatory authorities with our insights on current market practice, for example in relation to valuation methodologies, liquidity measurement, the use of reliable and secure means to provide daily marks, or pre-trade credit checks to achieve clearing certainty. We have also advised regulatory bodies on potential approaches to enable the 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 their regulatory obligations.

As the trading requirement for some interest rate and credit swaps becomes effective in the near future, we believe that the Commission urgently needs to address an issue created by the "embargo rule." If this issue is left unaddressed, we believe that it is likely to cause significant harm to swaps market liquidity and create a disadvantage for swaps *vis-a-vis* futures.

Execution platforms for swaps – such as swap execution facilities ("***SEFs***") – commonly "flash" execution data to their participants as soon as a transaction is executed. This allows market participants, including both the original parties and new participants, to create a "work-up", where they can trade at the original price until all of the parties to the trade exhaust their interest at that price. Such work-ups create immediate price transparency and increase liquidity and are hence beneficial for efficient market functioning.

However, CFTC Rule 43.3(b)(3) – the so-called "embargo rule" – creates uncertainty regarding the continued use of work-ups for swaps. Specifically, it prohibits SEFs and designated contract markets ("***DCMs***") from disclosing swap execution data to their participants until the "transmittal" of such data to a swap data repository ("***SDR***"). This creates two problems: first, many SEFs and DCMs that connect directly to an SDR will have to halt the flashing of the transaction until the transaction data has been enriched and converted as required by the SDR; second, SEFs that use a third party to route data to an SDR may interpret the rule to mean that they need to delay flashing execution data until the third party has notified the SEF that the data has been sent to the SDR. In both situations, the embargo rule could cause a delay for the flashing of the data to platform participants that, while small in absolute terms, would be long enough to prevent the practice of "work-ups" in most cases, thus reducing market liquidity.

In contrast, these workflow challenges are not applicable to futures trading where DCMs are permitted to flash execution data as soon as a futures contract is executed because there is no equivalent embargo rule. The embargo rule therefore provides yet another incentive to trade futures instead of swaps.

To mitigate the disparate impact of the embargo rule on swaps and futures, we recommend that the Commission interprets the word "transmittal" in Rule 43.3(b)(3)(i)(A) to mean the instance that a SEF or DCM execution engine *produces data to be delivered to an SDR using fully automated means*. This would permit SEFs and DCMs to flash data as soon as it is sent to a conversion tool (in case the SEF connects directly to SDR), or as soon as they have sent it to the third party (in case the SEF uses a third party for the reporting), provided

that the conversion tool and/or the third party use fully automated systems that do not introduce any unreasonable delay.[5]

b) Addressing anti-competitive behaviour in relation to the routing of swap transactions to DCOs

The CFTC's SDR rules explicitly prohibit SDRs from bundling ancillary services with mandated regulatory services. However, in its final SEF rules the Commission stated that the routing of a swap transaction to the derivatives clearing organization ("***DCO***") via an "affirmation platform" is permitted as long as it is an "acceptable" means for the DCO. Based on this statement, at least one DCO has insisted that certain types of transactions must be affirmed or matched between parties using a service provided by and owned by this DCO – with all other means, accordingly, being deemed unacceptable.[6]

We believe that this interpretation of the SEF rule – whereby DCOs could require their members to feed trades to them exclusively through their own affirmation/matching platforms – would be contrary to the intent of the Dodd Frank Act[7] because of the harm it would have on competition. The Commission should therefore address such anti-competitive behaviour by clarifying that DCOs may decide whether or not to allow the use of affirmation or matching platforms, and may place reasonable and objective conditions on the types affirmation or matching platforms used. However, they cannot require transactions to be affirmed or matched using a specific service or platform if these reasonable and objective conditions are met by another unaffiliated entity.

2. Cross-border aspects of SDR reporting

Many swaps market participants that qualify as the reporting party or reporting counterparty under Part 43 and Part 45 of the Commission's regulations have decided to delegate their

[5] The CFTC stated in its final real-time reporting rule that such rule "explicitly permits end-users, SEFs and DCMs to utilize third parties to comply with reporting obligations described in § 43.3." Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182, 1198-99 (Jan. 9, 2012). The real-time reporting rule also states that "SEFs and DCMs may enter into a contractual relationship with a third party service provider to transmit the swap transaction and pricing data to an SDR; however, the SEF or DCM will remain responsible for such reporting requirement pursuant to part 43." *Id*. at 1201.

[6] We understand that other DCOs are currently willing to accept transactions which have been affirmed or matched using a third party service.

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

reporting duties to third parties.[8] For example, many major derivative dealers use MarkitSERV to comply with their Dodd Frank Act reporting obligations, and all of them rely on MarkitSERV to meet their OTC Derivatives Regulators Forum ("***ODRF***") reporting requirements for interest rates, credit and equity derivatives. This has given us a broad insight into the challenges and successes of the Commission's reporting requirements as well as those imposed by other regulators around the world.[9]

We believe that the reporting requirements present unique challenges in the cross-border context. Specifically, while the Commission's reporting requirements alone impose significant burdens on market participants, such requirements are becoming effective in several major jurisdictions within a short period of time, further increasing this burden. Many market participants and providers of the relevant infrastructure are therefore faced with a situation where resources that would also be required to prepare for the Commission's cross-border reporting requirements will be tied up with implementation in other jurisdictions for the foreseeable future.

MarkitSERV, in dialogue with the industry, has implemented reporting logic based on the combination of the Commission's rules, its cross-border guidance, its exemptive order, and its no-action letters. If the Commission issues new or revised cross-border guidance that contained substantial changes (*e.g.*, a change in the categories of firms or changes to the types of cross-border swaps that must be reported), the industry will need time to unwind the current implementations and implement new functionality to support any new guidance or rules. We therefore encourage the Commission to provide market participants with a sufficient period of time between the publication of any guidance, exemptive orders, or no-action letters in relation to the reporting of cross-border transactions and the compliance deadline in order to minimize the potential for market disruptions.[10] We believe that any new or revised cross-border guidance should have a compliance date of

[8] The use of third party providers that report derivatives transactions to SDRs and Trade Repositories provides the benefit of centralizing and automating the logic that is required to determine relevant key characteristics for any given swap under reporting requirements, such as its reportability and the determination of the reporting party. Such interconnectedness therefore reduces costs and increases the efficiency of regulatory reporting. It is also likely to improve the quality of data that is received and stored by SDRs because it reduces the likelihood of duplicative reporting (when a transaction is inadvertently reported by both sides) or of under-reporting (when the transaction is inadvertently not reported by either side).

[9] For example, MarkitSERV platforms are live for the reporting of derivatives transactions to TRs in the United States, in Japan, in Hong Kong and in Australia. They will be going live in Europe and Singapore this month.

[10] For example, the CFTC Letter No. 13-71 extended no-action relief for certain transaction-level requirements for non-US Swap Dealers on November 26, 2013. Two months later this relief was extended in CFTC Letter No. 14-01.

at least 90 days from the final publication in the Federal Register if it is based on the categories of market participants in the Commission's current cross-border guidance. Guidance that introduces new or amended categories of market participants should have a compliance date of at least 180 days from the final publication in the Federal Register. Any changes impacting entity-level requirements – such as SDR reporting – should have an additional 90 days to complete backloading under CFTC Rule Part 46 when compared to the compliance date in CFTC Rule Part 45 in order to allow timely and efficient compliance with the revised rules.

C. **Concept Release Regarding Risk Controls for Automated Trading Systems**

We appreciate the attention that the Commission paid to risk controls and pre-trade credit checks through its September 2013 concept release (the "***Concept Release***").[11] Markit has established one of the leading technology systems used for pre-trade credit checks, and has been at the forefront of the discussions regarding risk controls. For example, we created the Markit Credit Centre, which is a low latency, centralized pre-trade credit checking platform that connects trading counterparties, execution venues, futures commission merchants ("***FCMs***") and clearing houses.[12]

Such tools (that are also offered by other providers unaffiliated with Markit) can ensure that the necessary pre-trade credit checks and other risk controls become as efficient and effective as possible. In this regard, we note that the Concept Release suggests that pre-trade risk controls should be applied at one or more of three points in the execution chain: (i) individual firms, (ii) intermediaries (*e.g.*, FCMs and SDs), and (iii) SEFs.[13] We believe that the Commission should also consider, and indeed encourage, the use of a central "hub" to apply pre-trade risk controls, for a number of reasons:

[11] Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, 78 Fed. Reg. 56542 (Sept. 12, 2013).

[12] Credit Centre gives buy-side users control over their credit lines and allows SEFs to check credit in milliseconds before orders are posted.

[13] *See* Concept Release, 78 Fed. Reg. at 56552. We believe that the Commission should focus on the credit limits set by derivatives clearing organizations ("***DCOs***") in addition to FCMs, because swaps would fail to clear if an FCM exceeds its credit limit with the DCO.

- Fostering competition by reducing cost

    - The Commission has indicated that pre-trade credit checks must be performed on an order-by-order basis.[14] Therefore, a counterparty's credit will need to be checked against an FCM's risk limits, or risk limits provided by an FCM, for each individual order. To achieve this objective, it will be much less expensive for individual SEFs to build connectivity to a central hub that manages the credit lines provided by each FCM than to establish connectivity with each of the many FCMs individually.

    - Using a central hub would also allow for the use of a standardized messaging protocol for pre-trade credit checks because all parties involved would use the same API, and error messages would also be standardized. This would lead to increased efficiencies and a more simplistic regime for pre-trade credit checks.

- Effective use of available credit capacity in real-time

    - One way of performing pre-trade credit checks would be for FCMs to "push" their risk limits to individual SEFs and have SEFs check each order against those limits. However, this would be less efficient than using a central hub because more than 20 SEFs could be managing the same FCM's risk limits. While an FCM could allocate a certain amount of credit for each customer to various different SEFs, this would hinder a customer from placing large orders on one SEF because its available credit would be fractured across several SEFs.

      FCMs using a central hub will be in a position to adjust credit lines in real time across the entire market, while SEFs can check for executability of submitted bids and offers in real time. Such effective checking of credit availability will be particularly important in the context of cleared transactions.[15]

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[14] *See Staff Guidance on Straight-Through Processing* (Sept. 26, 2013).

[15] A swap that is submitted for clearing will entail three different transactions: the initial transaction between the original counterparties (the "alpha trade"), and the two subsequent transactions between the DCO and each counterparty upon novation (the "beta trade" and "gamma trade"). A SEF will create unique swap identifiers ("USIs") for alpha trades, and a DCO will create different USIs for the beta and gamma trades. Currently, however, there is no market-wide system for connecting the three transactions together for recordkeeping and credit purposes because they will all have different USIs.

- Central functions
    - Sometimes, a market participant will exceed its limits or experience another problem requiring it to cease trading activities. In such cases a central hub could provide a standard kill switch that would send a message to all relevant parties, including all relevant SEFs and FCMs. Experience has shown that the availability of an automated low latency kill switch will be particularly important in the context of automated trading.

    - A central hub would also be able to send other types of reports, such as drop copies[16] to all relevant parties in real-time because it would have direct connections to market participants, SEFs and FCMs.

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Markit appreciates the opportunity to comment on the Commission's TAC meeting. 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 us.

Yours sincerely,

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[16] A drop copy is a report that details a participant's order and execution activity on a trading venue and is generated at the point of either entering an order or upon trade execution, in as close to real-time as possible.