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Public Consultation on Regulation (EU) No 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories

London, August 13th 2015

Dear Sirs,

We welcome the publication of the *Public Consultation on Regulation (EU) No 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories* (the "***Consultation Paper***") by the European Commission (the "***Commission***") and we appreciate the opportunity to provide you with our comments.

Introduction

Markit[1] is a leading global diversified provider of financial information services.[2] Founded in 2003, we employ over 3,500 people in 10 countries and our shares are listed on Nasdaq. Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 120 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

Markit's derivatives processing platforms provide STP Middleware services[3] to participants in the global OTC derivatives markets and play an important role in supporting firms' compliance with several EMIR requirements as well as with similar obligations in other jurisdictions. Specifically, the MarkitSERV platforms facilitate the electronic confirmation of a significant portion of OTC derivatives transactions, submit them for clearing to 16 CCPs globally, and, for many counterparties,[4] report their details to trade repositories ("***TRs***") in Europe, the United States, Canada, Japan, Hong Kong, Singapore and Australia. Such services, which are offered also by various other providers, are widely used by participants in these markets today and are recognised as tools to increase operational efficiency, reduce cost, and secure legal certainty. With globally over 1,500 firms using the various MarkitSERV platforms that process, on average, 80,000 OTC derivative transaction processing events

[1] Please see www.markit.com for further details.
[2] We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants' compliance with various regulatory requirements, many of Markit's services help level the playing field between small and large firms and herewith foster a competitive marketplace. For example, Markit's KYC Services provide a standardised end-to-end managed service that centralizes "Know Your Client" (KYC) data and process management.
[3] In the trade workflow model prevalent in the OTC derivatives markets the MarkitSERV platforms provide "middleware" services that generally occur post-execution and pre-clearing.
[4] Globally, we currently report transactions to TRs for over 100 firms and more than 1,000 entities, including most of the large, globally active dealers.

per day our legal, operational, and technological infrastructure plays an important role in supporting the global OTC derivatives markets.

Comments

Based on our experience as service provider in the global OTC derivatives markets we recommend the Commission use the EMIR Review to improve the effectiveness of several EMIR requirements, tackle some undesired consequences, and reduce unnecessary burden on market participants. Specifically, we believe the Commission should ***(a)*** only allow for a mandatory clearing requirement to be imposed for products that are cleared by more than one CCP; ***(b)*** provide an exemption from the reporting requirement for "smaller" market participants within the current double-sided regime; ***(c)*** reassess the justification for the reporting of certain data fields; ***(d)*** increase the regulatory focus on the use of global unique identifiers; and ***(e)*** reconsider some of reporting validation requirements for TRs while ensuring a broader industry consultation on such matters going forward. Importantly, we believe that most of these changes could be implemented through elaboration or revisions of existing EMIR Level 2 measures.

Question 2.2

- **i. With respect to access to clearing for counterparties that intend to clear directly or indirectly as clients; are there any unforeseen difficulties that have arisen with respect to establishing client clearing relationships in accordance with EMIR?**
- **ii If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?**
- **i. Are there any other significant ongoing impediments or unintended consequences with respect to preparing to meet clearing obligations generally in accordance with Article 4 of EMIR?**
- **ii If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?**

(a) Only allow for a mandatory clearing requirement to be imposed for products that are cleared by more than one CCP

Obligations to centrally clear certain derivatives instruments have been introduced with the objective to reduce systemic risk. However, this goal can only be achieved if a product is offered for clearing by several competing CCPs as mandating the use of a single CCP could increase risk concentration and establish the monopolistic position of this CCP. It would also increase risks by incentivizing CCPs to offer products for clearing even if they might not be fully prepared from a risk management perspective, which is particularly relevant given the elevated risks that can arise from clearing the less liquid and hard-to-value products. Moreover, if there is effectively only one CCP for a particular product, set of products, or asset class, the resolution of a failing CCP is likely to be complicated since no other CCP would be readily equipped to accept and manage the risks of the positions of the failing CCP. We therefore urge the Commission to establish specific safeguards in this respect.

Given their risk profiles and liquidity, some derivative products are difficult to clear and, if cleared, could result in increasing overall risk to the financial system. Such concern is particularly relevant today for cross-currency swaps, swaptions, caps, and floors for which it is very likely that, once regulatory approval had been given to a CCP, these products would only be cleared by one single CCP for the time being.[5] We appreciate that ESMA

[5] For example, for market participants' perspective on the challenges of clearing swaptions, please see: http://www.ifre.com/swaptions-clearing-raises-ccp-risk-fears/21195457.fullarticle

in its clearing determinations[6] considers not just the liquidity and degree of standardization of the derivative product but also concentration risks and impact on competition in the clearing industry.[7] However, given the considerable negative impact that such decisions could have, we recommend the Commission make it explicit and compulsory that a derivative product could only be eligible for mandatory clearing once it is offered by *more than one* CCP.

Question 2.3

- **Are there any significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?**
- **If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?**

(b) Provide an exemption from the reporting requirement for "smaller" market participants within the current double-sided regime

We recommend the Commission use the EMIR Review to reduce the burden that the obligation to report transactions to Trade Repositories ("***TRs***") imposes on smaller market participants. This is because smaller and/or less active market participants tend to be less well equipped to report to TRs. The cost of compliance with this obligation will be significant for them and, in the extreme, could prevent them from continuing to use OTC derivatives herewith leaving some of their economic exposures unhedged and causing increased risk in the economy. We note that, in this context, some stakeholders encourage the Commission to consider a change from the current double-sided to a single-sided reporting regime.[8] However, we believe that the Commission could provide effective relief from the reporting requirements for smaller firms at much lower overall cost by providing them with an exemption within the existing double-sided reporting regime.

We generally believe that a properly designed single-sided reporting regime[9] will result in a lesser overall burden on market participants whilst allowing for a smooth and timely implementation.[10] However, in the context of the EMIR Review the Commission must consider that a double-sided reporting regime has now been up and running in Europe for 18 months. To comply with the EMIR reporting requirements, the financial industry, composed of thousands of individual firms, trading venues, CCPs, and service providers, has made substantial investments in establishing the necessary infrastructure, designing appropriate policies and procedures, and has spent further resources post implementation to optimize processes and improve the quality of the data that is reported to TRs. We are concerned that a move to single-sided reporting under EMIR at this point would not only represent a massive endeavour for the industry, but also risks devaluing many of the investments made over the last several years. Further, the need to rework workflows, internal systems and coding to support a single-sided regime would result in renewed disruption, cost and risk. Additionally, such change would call into question regulators' ability to monitor systemic risk in European derivative markets based on accurate data captured in TRs. Specifically, we believe that a move from the current double-sided to a single-sided reporting regime would create the following challenges:

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[6] Under Article 5 (2) of EMIR, ESMA is tasked to draft RTS that specify the classes of OTC derivatives that should be subject to the clearing obligation and the dates from which such clearing obligations should take effect. ESMA to this effect has published consultation papers for the clearing obligation for interest rate swaps, credit derivatives and FX NDFs. For further details please see: http://www.esma.europa.eu/page/OTC-derivatives-and-clearing-obligation

[7] Please see, for example, Section 4 – Conclusion of ESMA's *Consultation on the Clearing Obligation for Non-Deliverable Forwards*

[8] "There is a loud clamour for single-sided reporting across the industry …. ", said Simon Puleston Jones, chief executive of FIA Europe." See http://www.euromoney.com/Article/3461511/European-regulators-battle-with-derivatives-reporting.html

[9] I.e., an approach where only one of the counterparties, the "Reporting Counterparty" or "RCP", reports the transaction to the TR.

[10] Specifically, in a single-sided regime the reporting will typically be performed by the larger counterparties that are better positioned to perform this role. The quality of the reported data can be ensured by requiring the reporting party to report data that has been agreed by both counterparties.

- *All* of the counterparties, venues and service providers that already successfully report under the current, double-sided regime would be forced to adjust their processes and workflows, resulting in significant costs;

- New implementation challenges would keep all stakeholders occupied for at least 18 months,[11] preventing them from focusing on ironing out the few remaining challenges of the current regime or their regular business;

- Standards to govern a single-sided reporting regime would need to be agreed upon by the industry and established bilaterally, including an appropriate reporting hierarchy as well as reporting practices; and

- New data quality issues will inevitably arise, at a time when most such issues under the existing reporting regime have just been addressed.[12]

We therefore recommend the Commission reduce the burden for smaller counterparties by exempting certain firms from the obligation to report to TRs within the current double-sided reporting regime. Such approach would be consistent not only with other jurisdictions[13] but also with recently agreed European regulations.[14] Exemptions from reporting should be provided to clearly specified categories of firms, for example based on the number of transactions they execute per year[15] or their categorisation in relation to the clearing requirement.[16] Such approach would deliver largely the same benefits as a move to a single-sided reporting regime in terms of the reduction in the reporting burden. However, it should only have a very limited impact on cost and data quality given that all newly exempt parties would simply stop reporting once the exemption becomes effective whilst all other firms would just continue reporting as they do today.

We understand that ensuring the quality of the data that is reported to TRs is a significant concern for the Commission and regulatory authorities. We believe that, regardless of whether the transaction is reported by only one or by both counterparties, one important step to achieve this goal is to require that reported data has been agreed between the counterparties to the transaction. Such requirement can be more easily complied with in asset classes where centralised infrastructure for the confirmation/matching of transactions exists, for example in interest rates, credit and equities. This is because middleware providers have established the necessary process and data standardization to allow for consistent reporting between multiple market participants, including strong parent-child trade linkages that are maintained throughout the entire trade lifecycle. This contrasts with asset classes such as foreign exchange and commodities where middleware providers do not operate or have significant market share yet. We therefore recommend that, when identifying necessary changes to and clarification of some of the TR reporting requirements to ensure quality and consistency of the reported data, the Commission should focus on these asset classes.

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[11] This is based on an estimate of at least 9 months for the Commission to adopt a single-sided reporting regime followed by up 12 months necessary for the industry to prepare for, test, and implement the change.
[12] Our experience has shown that many data quality issues that were initially encountered in the EMIR dual-sided reporting regime were due, in addition to low matching rates at TRs, mostly to client onboarding issues. The majority of those have been resolved over time.
[13] For example, smaller firms are not required to report to TRs in Japan and in Singapore. Further, ASIC, the Australian regulator, recently decided to exempt certain smaller entities from the obligation to report their derivatives transactions to TRs. Please see *Subdivision 2.1B—Phase 3 reporting entities: exemption from OTC derivative reporting requirements* of the *Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015:* http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2015/OTC%20derivatives/Key%20Documents/PDF/OTC_derivatives_Exposure_draft.ashx
[14] Article 4 of the Securities Finance Transaction Regulation (SFTR) defines the conditions under which certain NFCs will be exempted from the reporting obligation. Specifically, NFCs will be exempted from the reporting obligation if they meet 2 of the following 3 criteria: 1) balance sheet total less than EUR 20mm; 2) net turnover under EUR 40mm; and 3) less than 250 employees.
[15] Importantly, such exemption should be designed to secure some stability of the firms that are in or out of scope. For example, a firm would only move into scope if it exceeded the relevant threshold for 2 consecutive years. Also, if no longer exempted from reporting, firms would need to be provided with sufficient time to prepare before the reporting requirement became effective.
[16] For example, the Commission could exempt firms from the reporting requirement that are classified neither as Category 1 nor as Category 2 counterparties for the purposes of the clearing requirements.

We strongly believe that the Commission, by providing exemptions from reporting to certain categories of firms within the existing double-sided regime whilst reinforcing data quality standards, can create effective relief for smaller market participants whilst avoiding disruption, cost and risk that would be triggered by a switch to a single-sided regime. However, if the Commission decided to establish a single-sided reporting regime, it can secure data quality by requiring the reporting counterparty to confirm/match the details of the transaction before it reports them to a TR.[17]

We understand that some stakeholders might argue in favour of the introduction of a single-sided reporting regime in Europe based on the desire to harmonise reporting rules across jurisdictions. While a commendable goal in principle, we believe that an effort to harmonize global TR reporting to make the globally reported data useable for regulators would be most effective if it focused not on harmonizing counterparty reporting (the "inputs" into TRs), but rather on standardising the outputs from TRs. In other words, any harmonisation effort should focus on what data fields and formats are necessary to allow regulators to conduct effective surveillance and to require TRs to transform the data they collect to match this format. Such approach to international harmonisation would minimize the disruption to the large number of market participants that are already reporting data to various TRs today and would be a more cost-effective solution. At the same time it would allow for the flexibility of input formats to foster competition between TRs and enable the creation of efficient solutions, and it would also be more likely to allow authorities to aggregate data across TRs.

(c) Reassess the justification for the reporting of certain data fields

As further measure to avoid creating unnecessary burden on the marketplace created by the obligation to report transactions to TRs, we recommend the Commission reconsider the need for the reporting of some datafields from a cost benefit perspective. Specifically, we encourage the Commission to analyse whether there is sufficient justification to require the reporting of the Master agreement version and date.[18] This is because our experience has shown that, while the Master agreement type is more readily available and generally useful information, a significant effort is required from firms to generate information in relation to the Master agreement version and date from their internal systems. However, we believe that the reporting of these two data fields adds little value from a regulatory perspective. We therefore recommend that the reporting of Master agreement version and date should not be required.

In contrast, we believe that the reporting of valuations to TRs is valuable as it enables regulators to understand exposures between institutions, and that such valuations contain information that is relevant for regulatory analysis. Since many derivative transactions take place off-exchange, there is often no single observable price or valuation for these products. This is true even for transactions that are centrally cleared, highlighted by the fact that, where various CCPs clear a specific derivative, they will generate different valuations because of variations in inputs, assumptions and methodologies used. Active market participants in the derivative markets will therefore perform their own valuations, both for cleared and for uncleared trades[19] for their own risk management purposes, and regulators can benefit from those valuations being reported to TRs by the counterparties. However, given the subjectivity of valuations, we recommend that regulators consider sourcing also an independent valuation for the positions held in TRs. Such independent valuations are typically based

[17] This would avoid the need for the non-reporting counterparty to query the TR for confirming the trade details and would also address the problem of current poor trade matching rates at TRs.
[18] Specified as "Reference to the name of the relevant master agreement, if used for the reported contract (e.g. ISDA Master Agreement; Master Power Purchase and Sale Agreement; International ForEx Master Agreement; European Master Agreement or any local Master Agreements)." and "Reference to the year of the master agreement version used for the reported trade, if applicable (e.g. 1992, 2002, ...)." respectively.
[19] Other, less sophisticated counterparties should, in principle, also be in a position to value their derivative positions from time to time and report the resulting valuation data to TRs. However, we believe that this should only be required at less regular intervals. Such entities will often be able to rely on the valuations that they receive from their counterparties or on independent valuations that they have received from qualified third party providers.

on a multitude of inputs that are sourced from the marketplace and they can therefore provide perspective to an individual valuation provided by a party to the transaction. In terms of the entity reporting the valuation to the TR, we note that some market participants use third parties to provide independent valuations. For that reason, the use of third parties for the reporting of valuations to TRs should be made expressly available to counterparties independently of and separately from the ability to delegate the reporting of other swaps data.

Question 2.7

- **Have any significant ongoing impediments arisen to ensuring that national competent authorities, international regulators and the public have the envisaged access to data reported to trade repositories?**
- **If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?**

(d) Increase the regulatory focus on the use of global unique identifiers

Given the fragmentation of the European trade reporting infrastructure between several trade repositories ("***TRs***"),[20] the ease of regulatory access to the data that is captured in TRs is impaired. Specifically, where the counterparties to a transaction decide to report the same transaction to different TRs, regulatory access to and use of the data will be challenging. We believe that the use of unique identifiers is essential to addressing these challenges. However, given the only limited progress in their adoption to date, we recommend the Commission take specific actions in this area.

The European Commission in its delegated regulation (EU) No 148/2013, adopting draft RTS prepared by ESMA on reporting obligations, recognised the issue of data fragmentation and proposed the use of Unique Trade Identifiers ("***UTIs***") to allow for the reconciliation of data that has been reported to different TRs. However, the efforts to establish UTIs as well as legal entity and unique product identifiers ("***UPIs***") have not been very effective so far. We believe this to be one of the key reasons why the quality of some information in TRs is poor which will hinder the efforts of regulators to fulfil their mandates. We therefore encourage the Commission to address this issue in the context of the EMIR Review.

Markit has long-standing experience in the creation of identifiers in the financial markets. Specifically, the Markit Reference Entity Database ("***RED***") has established itself as the industry standard, legally verified reference data source for the credit default swap ("***CDS***") market.[21] Given our expertise in this area we have recently developed a Credit UPI solution that covers the majority of CDS products. If adopted as industry standard, we would make such Credit UPIs and related tools widely available to allow for use by all relevant parties,[22] and would ensure that an appropriate industry governance framework is established to decide on their availability and use. We believe that our broad relationships with participants in the CDS markets could secure a speedy UPI adoption. Also, the UPI generation by matching platforms will limit the risk of a UPI mismatch during the confirmation process. Overall, our Credit UPI solution has been designed to allow the industry to operate "as is" while supporting the industry-wide generation and use of a Unique Product Identifier for CDS products in the near future.

[20] According to the ESMA website, there are currently 6 trade repositories registered with ESMA. Please see http://www.esma.europa.eu/page/Registered-Trade-Repositories

[21] The RED database confirms the legal relationship between a reference entity and a reference obligation. RED Codes are issued for all entities and indices that are referenced in CDS. Specifically, 6-character RED codes represent single name entities while 9-character RED codes represent single name pairs (reference entity plus underlying obligation) as well as each series and version of the CDX and iTraxx indices.

[22] For example, we plan to host a UPI calculator on a public website along with UPI methodology and field codes, including ISDA Taxonomy, sector, currency, and maturity dates. UPIs utilising the RED code would be available on a non-fee basis for trade reporting purposes, eliminating any need for licensed access to the broader RED database. Markit would also provide access to the UPI calculator to any trade repository.

Question 2.9

- **i. Are there any significant ongoing impediments or unintended consequences with respect to requirements for trade repositories that have arisen during implementation of Titles VI and VII of EMIR, including Annex II?**
- **ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?**

(e) Reconsider some of reporting validation requirements for TRs while ensuring a broader industry consultation on such matters going forward

We agree with the Commission that, where needed, specific mechanisms should be employed to ensure the quality of the data that is reported to TRs. We believe that an effective path to achieving this goal it to require for such data to be agreed upon between the counterparties *before* it is reported to the TR, consistent with requirements that have been established in other jurisdictions.[23] In this context, we generally welcome ESMA's recently published Level 2 validation requirements and we believe that they are an important step to improving data quality.[24] However, we are concerned that some elements of these validation requirements might have unintended consequences and prove to be counterproductive.

Specifically, we are concerned that, for certain types of transactions, ESMA's validation requirements could trigger the need for the creation of specific "ESMA UTIs" in addition to global UTIs, much in conflict with the objective of assigning and using only a single UTI globally for each transaction. Such situation could arise where a transaction has been reported to a European TR by both counterparties, before one of them realizes it reported in error[25] and would hence send an "error" notice to the TR. Once such "error" message was attached to the transaction in the TR the other counterparty would need to re-report the transaction with a new UTI despite the fact that it had already reported the transaction correctly and in compliance with EMIR requirements. However, in the meantime the existing UTI might have already been used for reporting in other jurisdictions and could not be changed.[26] Forcing the creation of a new UTI for reporting under EMIR would hence create a second, "European" UTI in addition to the already existing "global" UTI. We believe that this problem could be resolved by allowing for a specific "error – not report" flag to allow the counterparty that reported in error to cancel its report whilst the other counterparty's report, and the UTI assigned to the transaction, would remain valid.

On a more general note, we believe that such problems could be avoided in the future if such validation requirements were exposed to consultation with *all* relevant stakeholders, including reporting parties and relevant third party service providers, prior to their finalisation and implementation. Also, an appropriate implementation schedule should be established to provide firms with sufficient time to analyse, code and test changes. We are confident that such approach would result in improving reporting standards overall.

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[23] See CFTC Rule 49.11, "Confirmation of data accuracy" ("A registered swap data repository has confirmed the accuracy of swap creation data that was submitted directly by a counterparty if the swap data repository has notified both counterparties of the data that was submitted and received from both counterparties acknowledgement of the accuracy of the swap data and corrections for any errors." Id. at (b)(i) (emphasis added)).

[24] Please see Q.20b "Reporting to TRs: Validations of EMIR reports" from the latest EMIR Q&A: http://www.esma.europa.eu/system/files/2015_775_qa_xii_on_emir_implementation_april_2015.pdf

[25] For example, the firm might realize that the correct counterparty to the trade was its US branch rather than its European entity.

[26] E.g., under the CFTC's Part 43 and 45 reporting requirements.

We hope that our above comments are helpful to the Commission. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,

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