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June 3, 2011

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

Re: Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act: FR Doc. 2011–10884

Real-Time Public Reporting of Swap Transaction Data: RIN 3038–AD08

Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties: RIN 3038–AD25

Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants: RIN 3038–AC96

Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants: RIN 3038–AC96

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants: RIN 3038–AC97

Dear Mr. Stawick:

Markit[1] appreciates the opportunity to revisit and comment on the totality of rules proposed by the Commodity Futures Trading Commission ("***CFTC***" or the "***Commission***") to implement applicable requirements included in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "***DFA***").[2] In particular, the following comments pertain to the Commission's proposed rules regarding real-time public reporting,[3] business conduct standards for swap dealers ("***SDs***") and major swap participants ("***MSPs***") with counterparties,[4] confirmation and portfolio reconciliation,[5] swap trading relationship documentation,[6] and margin requirements for uncleared swaps.[7]

Introduction

Markit is a service provider to the global derivatives markets, offering independent data, valuations and related services for swaps and security-based swaps across many regions and asset classes in order to reduce risk, increase transparency, and improve operational efficiency in these markets. Markit supports the objectives of

[1] Markit is a financial information services company with over 2,000 employees in North America, Europe 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 for additional information.

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

[3] Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76140 (published Dec. 7, 2010).

[4] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 Fed. Reg. 80638 (published Dec. 22, 2010).

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

[6] Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715 (published Feb. 8, 2011).

[7] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732, 23737 (published April 28, 2011).

the DFA, and the Commission's objectives of increasing transparency and efficiency in the OTC derivatives markets, of reducing both systemic and counterparty risk, and of detecting any market manipulation or abuse.

Executive Summary

Markit believes that many of the affirmative duties imposed on SDs and MSPs, as well as other market participants, by the Commission's regulations will improve market efficiency and transparency as long as they strike the correct balance between costs and benefits, and if they take into account the practices and infrastructures that are already established in the market.

However, as explained in our previous comment letters[8] and below, we also believe that several of the proposed requirements will impose significant costs on swap counterparties and that, as written, they may provide only little benefit:

- *Valuations*: We believe it will impose an impracticable challenge to require parties to agree, prior to execution, on a complete methodology, inputs, and fallbacks for the valuation of each swap to a level of detail that makes it independently verifiable. Swap valuation entails numerous complex considerations, and the assumptions associated with valuations and the inputs upon which a valuation is based frequently change over the life of a swap.
- *Price Normalization*: We believe it will impose an unrealistic challenge to agree upon standardized pricing conventions and methods to normalize publicly reported pricing for non-standard swaps in the near future as required by the Commission's real-time reporting rule. Therefore, requiring such a standardized convention will risk delay of implementation of the rules or could actually decrease the transparency that is created, contrary to the Commission's intentions.
- *Scenario Analysis*: Requiring SDs and MSPs to provide a scenario analysis for every high-risk complex bilateral swap would impose significant costs on SDs and MSPs, while we believe that transaction-level scenario analysis is only of benefit to a limited number of counterparties.
- *Portfolio Compression*: Portfolio compression can be costly because of the time and infrastructure required to perform it. Also, we do not believe that portfolio compression will always provide a material benefit because the characteristics of certain asset classes limit the number of economically equivalent swaps that can be successfully terminated.

Where the DFA imposes affirmative obligations on counterparties (*e.g.*, an obligation to keep records or to confirm trades), the counterparties should have the right to choose the most efficient means to discharge their duties without overly prescriptive mandates. This should include the ability to use independent third party providers ("***ITPPs***"). We believe that counterparties will often wish to satisfy their obligations through the use of ITPPs because many of the complications and costs associated with the Commission's proposed rules could be addressed and reduced by permitting swap counterparties and other market participants to delegate their responsibilities to such ITPPs. While we understand that many of the regulations may be read to provide this flexibility, we urge the Commission to generally permit counterparties to use ITPPs and, in particular, for the following obligations (which is not intended to be an exhaustive list):

- *Valuations*: Counterparties should be permitted to satisfy the requirement to agree on a complete valuation methodology, inputs, and fallbacks by referencing those that are employed and maintained by

[8] Markit has written comment letters to the Commission on the following topics: SDRs and Real-Time Public Reporting of Swap Transaction Data (Feb. 7, 2011); Business Conduct Standards for SDs and MSPs with Counterparties (Feb. 22, 2011); Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for SDs and MSPs (Feb. 28, 2011); Core Principles and Other Requirements for SEFs (March 8, 2011); and Swap Trading Relationship Documentation Requirements for SDs and MSPs (April 11, 2011).

an ITPP. Such approach would ensure that the valuations for swaps are fair and accurate while also permitting them to be flexible enough to adjust to market shifts and unexpected future events.

- *Daily Marks*: SDs and MSPs should be able to delegate the responsibility to provide daily marks to their counterparties to ITPPs because they would provide accurate and impartial marks without requiring SDs and MSPs to disclose any proprietary information.
- *Scenario Analysis*: SDs and MSPs should be able to delegate any responsibility to provide scenario analyses to ITPPs for the same reasons and because it would facilitate the use of portfolio-level scenario analysis.
- *Margin Calculation*: SDs and MSPs should be permitted to use ITPPs for margin calculation because this type of delegation might be cost efficient for SDs and MSPs and it would help ensure the comparability and reliability of these calculations.

Comments

1. **Business Conduct Requirements With Counterparties Should Take into Account Established Market Practices**

The Commission has proposed several rules which would impose requirements on the interactions between SDs, MSPs, and their counterparties. We believe that some of these rules, most likely unintentionally, create unnecessary hurdles that would delay the feasible pace of implementation and potentially disrupt the market. Below we describe how we believe these regulations should be revised to ensure that the requirements are attainable, strike the correct balance between costs and benefits, and take into account existing market practices.

a. <u>Parties Cannot Be Expected to Agree on a Complete Valuation Methodology That Will Be Accurate Through the Life of a Swap Prior to Execution</u>

The swap trading relationship rule (the "***STRD Rule***") would require parties to any swap to agree upon a "*complete* and independently verifiable methodology for valuing each swap"[9] which must be "stated with the specificity necessary to allow . . . the value of the swap [to be determined] independently in a substantially comparable manner."[10] Given the complexities involved in valuing swaps, we believe that the provisions as proposed could be read to require agreement on a nearly impossible degree of detail.

As a provider of valuations for various financial instruments including swaps and security-based swaps across asset classes and regions,[11] we know that valuing these products entails a number of complexities.[12]

We believe that requiring parties to agree on this level of detail would have undesirable consequences. First, it would make the process of transaction documentation very expensive and time consuming. Second, it would lead to extremely technical and verbose swap documentation. Third, because the pre-execution swap

[9] STRD Rule, 76 Fed. Reg. at 6719 (emphasis added).

[10] *Id.* at 6726 (to be codified at 17 C.F.R. § 23.504(b)(4)(i)).

[11] Markit Portfolio Valuations provides valuation services for swaps and other financial products to investment managers, fund administrators and custody banks that represent thousands of end-users. During an average month, Markit Portfolio Valuations produces approximately 1,800,000 valuations across many products and asset classes.

[12] For example, documentation designed to accurately assess the value of swaps on any given day until maturity of the swap would have to specify, among other things, the exact nature of the pricing model used, the method used to calibrate the model to market data, the parameters used for simulating future states of the relevant pricing variables, the exact methods of interpolation and extrapolation, and the approach for choosing comparable market data when market data required by the pricing model is not observable.

documentation would be so complex and lengthy, it might impede counterparties' ability to comply with the time deadlines imposed for confirming transactions.[13] We believe that these costs would outweigh the benefits.

Instead, the Commission can reduce the potential for valuation disputes by requiring parties to reach an agreement which is only detailed to the extent it is necessary. We believe that this, combined with the proposal to require portfolio reconciliation, will effectively ensure that counterparties agree on the value of swaps in their portfolios.[14] We therefore urge the Commission to impose more realistic requirements regarding valuation methodologies by merely requiring parties to agree on a more general set of inputs, models, and fallbacks for valuation purposes.

b. Pricing Normalization Can Be Best Achieved Through the Use of Market Mechanisms

Similarly, we believe that the Commission's rule on real-time reporting (the "***Real-Time Rule***") requires an impractical level of price normalization that will likely delay implementation, impose hefty burdens on counterparties, and might not even deliver the desired increase in pricing transparency. In that rule, the Commission proposes to require counterparties to include additional price notations where there are multiple premium yields, spreads, or rates that are characteristics of the swap in the data reported in real-time to swap data repositories ("***SDRs***").[15] Elements of swaps that would require normalization could include front-end payments, back-end payments, mid-cycle flat payments, collateral and margin.[16] The purpose of this requirement is to standardize pricing conventions across swap transactions.[17]

Markit agrees in principle that the pricing and separate display of additional price elements could make publicly reported swaps prices more meaningful. However, as the Commission recognized, "a number of different pricing conventions currently exist across swap transactions and even among market participants for similar swap transactions."[18] Standardizing these conventions would therefore take considerable time. As a result, we believe that requiring a standardized set of notations at the time that real-time reporting becomes mandatory will likely delay the implementation of this requirement.

We therefore urge the Commission to revise the Real-Time Rule as it relates to additional price notations to merely require parties to report any factors relevant to the pricing of swap transactions to the SDR or Real Time Disseminator rather than requiring parties to price additional swap elements themselves. We believe that a standardized pricing convention will naturally emerge through the use of market-wide mechanisms as swap pricing data becomes more transparent.

c. Scenario Analysis Should Be Available on an Optional Basis While The Commission Should Encourage The Use Of Scenario Analysis on a Portfolio Basis

The proposed rule on business conduct standards with counterparties (the "***BCS Rule***") requires SDs and MSPs to provide scenario analysis for any high-risk complex bilateral swap transaction or, on request, for

[13] *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519, 81531 (published Dec. 28, 2010) (to be codified at 17 C.F.R. § 23.501(a)).

[14] *See id.* at 81530 (to be codified at 17 C.F.R. § 23.500(i)) (Portfolio reconciliation means "any process by which the two parties to one or more swaps: (1) Exchange the terms of all swaps in the swap portfolio between the counterparties; (2) Exchange each counterparty's valuation of each swap in the swap portfolio between the counterparties as of the close of business on the immediately preceding business day; and (3) Resolve any discrepancy in material terms and valuations.").

[15] *See* Real-Time Rule, 75 Fed. Reg. at 76155.

[16] *See id.* at 76156.

[17] *See id.* at 76155.

[18] *Id.* at 76155.

swaps that have not been initiated on a designated contract market ("***DCM***") or swap execution facility ("***SEF***").[19]

We believe that transaction-by-transaction scenario analysis provides only limited benefit compared to scenario analysis on a portfolio level. Counterparties typically gain more useful insight into their potential exposure by understanding how entering into a transaction in a complex swap impacts their portfolio as a whole.[20] However, requiring the provision of scenario analysis for individual swap transactions would create a significant operational burden and cost for SDs and MSPs.

That said, occasionally counterparties may wish to receive a scenario analysis for individual, high-risk complex swaps. We therefore request that the Commission allow counterparties to request transaction-based scenario analysis for those swaps and situations where they find such analysis useful, but not require SDs and MSPs to provide transaction-level scenario analysis for any swaps. At the same time, though, we also believe that the Commission should encourage counterparties to make use of portfolio-level scenario analysis as it is generally more useful than scenario analysis on a transaction level.

d. Portfolio Compression Should Only Be Required Where it Produces a Sufficient Economic Benefit

Portfolio compression is another area where we do not believe that the Commission's requirements strike the correct balance between cost and benefit. The Commission has proposed to require SDs and MSPs to participate in portfolio compression cycles if they are required by the Commission or if offered by a self-regulatory organization ("***SRO***") of which the SD or MSP is a member.[21]

We believe that performing risk-neutral portfolio compression for centrally cleared swaps will almost always be worth the cost because compressing a portfolio of centrally cleared swaps in a risk-neutral manner is fairly straightforward.

However, performing portfolio compression cycles for non-cleared swaps will often provide only limited benefit. First, the potential to compress swaps in a given asset class may be limited by a number of factors including the number of counterparties, the number of outstanding swaps, and the amount of activity. Second, many swap positions cannot be characterized by the use of standard trades and therefore cannot be compressed. Third, participants will often use swaps as specific hedges against other positions, and must therefore withhold such transactions from compression cycles.

On the other hand, the costs associated with portfolio compression can be significant. Many market participants, for example, would have to upgrade their connectivity to electronic transaction processing platforms in order to enable the confirmation of the transactions that are executed as a result of the compression cycle.[22]

[19] *See* BCS Rule, 75 Fed. Reg. at 80644, 80658 (to be codified at 17 C.F.R. § 23.431(a)(1)).

[20] One reason is that individual complex swaps are often used as hedges against risks that are already present in the counterparty's portfolio, so the behavior of these swaps in isolation is not very relevant in terms of understanding actual risk.

[21] *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. at 81532 (to be codified at 17 C.F.R. § 23.503(c)(2)).

[22] For example, some compression cycles for single name CDS create the need for participants to book and process up to 5,000 transactions on a single day. This represents a significant operational challenge, particularly seen in the context of the 40,000 CDS transactions that are executed on average per month. *See* the Quarterly Metrics for further details related to average monthly volumes of the G14 dealers, available on http://www.markit.com/en/products/research-and-reports/metrics/metrics.page.

We therefore believe that the Commission should establish thresholds for determining whether a category of non-cleared swaps should be subject to any mandatory compression.[23]

2. Counterparties Should Be Permitted to Use Third Parties for Swap Valuation, Daily Marks, and Scenario Analysis Requirements Because Using Third Parties ensures Efficiency, Transparency and Impartiality

As described above, we believe that many of the Commission's proposed requirements would impose heavy burdens on the counterparties to a swap. In order to allow parties to individually decide how to most effectively and efficiently meet these responsibilities, we believe that the Commission should explicitly allow parties to outsource certain of their responsibilities to qualified ITPPs. This would make the market more efficient and allow a more timely implementation of the rules because, for example, counterparties would not each have to independently develop internal systems to meet these requirements. ITPPs could introduce economies of scale into the market by developing systems that would accommodate the needs of multiple parties.

a. <u>Counterparties Should Be Permitted to Rely on Third Party Valuation Methodologies, Inputs, and Fallbacks for Swap Trading Relationship Documentation</u>

As described above, valuing swaps as required by the STRD Rule[24] would require the agreement on and documentation of an almost impossible level of detail. Moreover, even with extremely sophisticated models, we do not believe that any valuation methodology agreed upon at time of execution will truly be able to accurately predict the most appropriate way of valuing swaps in the future due to the occurrence of unpredictable market events.[25] Even if all agreed-upon inputs continued to exist through the life of a swap, though, new pricing models may be developed post-execution which value a swap more accurately than the method agreed upon in the STRD documentation. Pre-trade agreement on a complete valuation methodology would theoretically preclude the counterparties from using these more accurate methods. Finally, we believe that some parties may find it difficult to bilaterally agree upon a complete valuation methodology because they might base their valuation models on proprietary information. Thus, negotiating valuation methodologies may result in some disclosure of proprietary information, which we do not think should ever be required.[26]

One solution would be for counterparties to agree to value their swaps during a swap's entire lifetime by reference to the inputs, valuation methods, procedures, and rules of an ITPP. Such ITPPs are in a position to adjust their valuation methodologies to account for market changes and new, more accurate pricing models. Thus, the parties would be able to agree, prior to execution, on a procedure to value swaps at any point in time which would maintain the flexibility necessary to accurately value such swaps. Moreover, parties would not be required to disclose or exchange any proprietary information if they agree to use valuations established by a third party.

[23] *See* Markit Letter to the Commission pp. 3-5 (regarding Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for SDs and MSPs).

[24] *See* STRD Rule, 76 Fed. Reg. at 6719, 6726 (requiring parties to agree upon a "complete and independently verifiable methodology for valuing each swap" which must be "stated with the specificity necessary to allow . . . the value of the swap [to be determined] independently in a substantially comparable manner.").

[25] For example, few if any market participants would have expected that turmoil in the interbank lending market could ever be so severe that it would lead to widespread disagreement on how to compute a standard yield curve for an extended period of time.

[26] The Commission revealed a similar belief in the BCS Rule. *See* BCS Rule, 75 Fed. Reg. at 80659 (to be codified at 17 C.F.R. § 23.431(c)(3)(i)) ("the swap dealer or major swap participant is not required to disclose to the counterparty confidential, proprietary information about any model it may use to prepare the daily mark.").

Therefore, we believe the Commission should permit market participants to mutually agree to value their swaps by reference to the standards, methodologies, and inputs that are established by ITPPs, or to agree on using the actual swap valuation as provided by those ITPPs.[27]

b. SDs and MSPs Should Be Permitted to Rely on Third Parties for The Provision of Daily Marks

The BCS Rule requires SDs and MSPs to provide their counterparties with daily marks for all uncleared swaps and to inform their counterparties to cleared swaps of their right to request the daily mark from the appropriate derivatives clearing organization.[28] For similar reasons to those discussed above, we also believe that SDs and MPS should to be permitted to delegate the task of providing daily marks to ITPPs.

Valuations that are provided by ITPPs are based on objective and independent inputs, allowing them to provide the counterparties with impartial and unbiased daily marks. Furthermore, ITPPs typically apply a consistent valuation methodology across all clients and use multiple sources of price data. This not only tends to eliminate errors and any potential bias, but also allows them to value trades even in periods of illiquidity.

Importantly, ITPPs are not trading entities and therefore have no direct financial interest in the prices that they distribute. They are therefore in a position to provide a higher level of transparency around the inputs and models that they used to produce a swaps valuation. ITPPs are generally able to provide their clients with details of the pricing models that they used, the nature of the data inputs, and other assumptions introduced into the valuation process. Daily marks as provided by ITPPs would therefore potentially increase the level of transparency in the valuation process, while alleviating SDs or MSPs from any requirement to disclose their proprietary information.[29]

c. SDs and MSPs Should Be Permitted to Delegate Scenario Analysis Requirements to ITPPs

Also as described above, we believe that the proposed requirement in the BCS Rule for SDs and MSPs to provide scenario analyses for any high-risk complex bilateral swap transactions and counterparties' ability to request a scenario analysis for swaps executed outside of a SEF or DCM[30] would impose significant cost on SDs and MSPs. The Commission should therefore permit SDs and MSPs to delegate their responsibilities to provide transaction-level scenario analyses to ITPPs, given the advantages of using them for the provision of scenario analysis.

d. SDs and MSPs Should Be Permitted to Use ITPPs for Margin Calculation

Finally, we believe that margin calculation for uncleared swaps could prove to be burdensome for some SDs or MSPs and that, as a result, they may find it beneficial to use third parties for such calculation. The requirements for a margin calculation model are very detailed and complex.[31] As a result, we believe that

[27] Swap trading documentation could state that "the counterparties to the swap mutually agree to utilize swap valuations as provided by ITPP "X", and, having performed sufficient due diligence on X's methods, procedures, rules, inputs and alternative methods, the parties mutually agree that these are acceptable for the purpose of valuing this swap." If a higher degree of detail was required, the ITPP could provide the counterparties with documented methods, procedures, rules and/or inputs. Such document could be referenced as an addendum to the swap trading document.

[28] *See* BCS Rule, 75 Fed. Reg. at 80645-46, 80659 (to be codified at 17 C.F.R. § 23.431(c)).

[29] For example, Markit provides clients of its Portfolio Valuations service with documentation that describes its pricing models, methodology and sources of market data inputs in detail. The market data that was used in the valuation is returned along with the valuation result in the standard results file.

[30] *See* BCS Rule, 75 Fed. Reg. at 80644, 80658 (to be codified at 17 C.F.R. § 23.431(a)(1)).

[31] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732, 23737 (published April 28, 2011).

some SDs or MSPs may not want to invest the substantial resources needed to create their own margin model, while others may not wish to invest the necessary time to calculate the actual margin requirements.

We believe that ITPPs are well-suited to perform these services and should therefore be permitted to provide margin calculations to the counterparties. ITPPs could save counterparties the need to invest in creating or using a model, and can calculate margin requirements without any concern regarding conflict of interest or partiality.[32] Further, we believe that ITPPs could play a role in testing and verifying correlation assumptions that are used for portfolio offsets, or the validity of DCO models and required modifications when applied to margin calculation for uncleared swaps. Therefore, we request that the Commission explicitly permit SDs and MSPs to use ITPPs for margin calculation purposes.

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We appreciate the opportunity to provide these comments on these proposed regulations.

We thank the Commission for considering our comments. In the event you may have any questions, please do not hesitate to contact the undersigned or Marcus Schüler at marcus.schueler@markit.com.

Sincerely,

Kevin Gould
President
Markit North America, Inc.

Cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia

[32] For example, an SD may have an incentive to attempt to offer lower margin requirements than its competitors because doing so would reduce the cost of doing business with that SD.