

Testimony of

**Larry Thompson
Vice Chairman and General Counsel**

The Depository Trust & Clearing Corporation

***“Dodd Frank Turns Five: Assessing the Progress of Global Derivatives Reforms”*
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Introduction

Chairman Conaway, Ranking Member Peterson, and Members of the Committee, thank you for holding today’s hearing.

I am Larry Thompson, Vice Chairman and General Counsel of The Depository Trust & Clearing Corporation (“DTCC”). DTCC has more than 40 years of experience serving as the primary financial market infrastructure serving the global markets, enabling thousands of institutions worldwide to issue securities and raise capital to build businesses and support the global economy.

Through our subsidiaries and affiliates, DTCC provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities, mortgage-backed securities and money market instruments, and mutual funds and annuities. In 2014, our subsidiaries processed securities transactions valued at approximately US\$1.6 quadrillion. DTCC processes the equivalent of the U.S. annual gross domestic product every two days. Underscoring the critical role market infrastructures play in protecting the capital markets, DTCC’s U.S. clearing and depository subsidiaries were designated as Systemically Important Financial Market Utilities (“SIFMUs”) by the Financial Stability Oversight Council (“FSOC”) in 2012 pursuant to Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

As a critical infrastructure provider, DTCC is not only focused on reducing systemic risk in derivatives markets, but we are hard at work on a number of initiatives designed to make markets safer, more transparent, and more resilient. These include operating a CFTC provisionally registered swap data repository (“SDR”) and through DTCC’s Global Trade Repository, supporting regulatory regimes around the world. DTCC is also actively involved in efforts to: shorten the U.S. settlement cycle for equities, corporate and municipal bonds and unit investment trust trades;¹ facilitate compliance with new margin regulations for non-cleared derivatives;²

¹ See DTCC White Paper, “Shortening the Settlement Cycle: The Move to T+2” (June 18, 2015), available at <http://www.dtcc.com/news/2015/june/18/the-move-to-t2.aspx>.

create and assign globally-accepted legal entity identifiers (“LEIs”);³ standardize and automate cyber threat intelligence distribution;⁴ and work carefully towards addressing issues related to central counterparty resiliency.⁵

My testimony today, however, will focus on the progress of global financial reform, particularly with regard to new regulatory requirements for the over-the-counter (“OTC”) derivatives markets. DTCC provides services for a significant portion of the global OTC derivatives market and has extensive experience operating repositories to support derivatives trade reporting and enhance market transparency. Through regulated subsidiaries, DTCC supports regulatory reporting regimes in the U.S., Europe, Japan, Australia, Singapore, Hong Kong and Canada.

As described below, the 2009 Group of 20 (“G20”) initiatives for global financial markets pushed financial market regulation into the 21st century. The G20 Pittsburgh Summit introduced new trade reporting rules and spurred the advent of centralized clearing and new capital requirements. As a result, the OTC derivatives market has undergone a dramatic transformation over the past several years and continues to evolve rapidly as market participants meet new mandates, including new regulatory requirements stemming from Dodd-Frank.

Today, I would like to identify several key obstacles that frustrate global regulatory efforts to achieve the goals set forth by policymakers in the aftermath of the 2008 financial crisis. I will also highlight several solutions that policymakers should consider as implementation of the G20 commitments move forward, such as continued efforts to aggregate and standardize data, as well as ensure it can be freely and appropriately shared across jurisdictions.

Progress on global derivatives reform is at a critical juncture as the G20 goal of enhanced transparency remains only partly addressed. While regulators and the industry have made significant strides in addressing the data gap that existed in 2008, cross-border identification of risk remains difficult for macroprudential authorities. I applaud you for holding this hearing at such a critical time for global financial market reform.⁶

² See Press Release, Leading Global Banks, Service Providers and Market Infrastructures Create New Hub for End-to-End Margin Processing (July 7, 2015), *available at* <http://www.dtcc.com/news/2015/july/07/service-providers-and-market-infrastructures-create-new-hub.aspx>.

³ See DTCC Global Markets Entity Identifier Utility Overview, <http://www.dtcc.com/data-and-repository-services/reference-data/gmei.aspx>.

⁴ See Press Release, Soltra Launches Soltra Edge, The First Industry-Driven Threat Intelligence Sharing Platform Designed to Enable Community-Driven Cyber Defenses (Nov. 4, 2014), *available at* [https://soltra.com/pdf/FINAL%20Soltra%20Edge%20press%20release_11.4.14FINALWEB%20\(1\).pdf](https://soltra.com/pdf/FINAL%20Soltra%20Edge%20press%20release_11.4.14FINALWEB%20(1).pdf).

⁵ See DTCC White Paper, “CCP Resiliency and Resources” (June 2015), *available at* <http://www.dtcc.com/news/2015/june/01/ccp-resiliency-and-resources.aspx>.

⁶ DTCC has also discussed the G20’s global derivatives transparency mandate. See DTCC White Paper, “G20’s Global Derivatives Transparency Mandate” (Feb. 2, 2015), *available at* <http://www.dtcc.com/news/2015/february/02/gtr-white-paper.aspx>.

Importance of G20 Commitments for Global Financial Markets

The global financial crisis of 2008 shook the foundations of the financial system to the core. This period was followed by a commitment, at a global level, led by the G20 to take a number of measures to enhance transparency in the derivatives market and improve the global response to systemic risk stemming from cross-border derivatives trading activities.

More specifically:

- The G20 agreed that “all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.”⁷
- The G20 leaders further called on the Financial Stability Board (“FSB”) and its relevant members to “assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.”⁸

This commitment was followed by the adoption, in November 2009, of the 20 recommendations put forward by the FSB in their report, “The Financial Crisis and Information Gaps.” The report identified four areas in which data gaps would need to be addressed, namely to better capture the build-up of risk in the financial sector, to improve data on international financial network connection, to monitor the vulnerability of domestic economies to shocks, and to enable communications of official statistics.

According to FSB’s *Eighth Progress Report on Implementation of OTC Derivatives Market Reforms*:

As of November 2014 the majority (16) of FSB member jurisdictions have trade reporting requirements in effect for one or more product and participant types, though specific reporting requirements currently vary across jurisdictions. By end- 2015, all but one jurisdiction are expected to have trade reporting requirements in effect for at least some product classes. As of end-October 2014, 13 FSB member jurisdictions have [trade repositories (“TRs”)] that are permitted to receive transaction reports for at least some asset classes. Globally, there are 23 TRs currently operational, spanning all asset classes.

Since then, significant steps within jurisdictions have been taken towards developing a framework to address the goals outlined in the FSB report. Trade reporting regimes are now in place in major derivatives jurisdictions around the world and regulators have access to more derivatives data than ever before.

⁷ See G20 Leaders’ Statement at the Pittsburgh Summit (Sept. 2009), available at http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

⁸ See *id.*

Despite these steps, the G20 goals remain only partly addressed. Data is being collected as prescribed by each jurisdiction's legislation and local regulators are able to review data. However, more work remains to fully achieve the FSB goals outlined in the 20 recommendations. Of most importance, the goal of global data transparency – one of the major factors that led to the 2008 financial crisis and a critical element in understanding systemic risks and interconnectedness – has not yet been achieved. In my testimony, I will address the following points as to what work remains to fully achieve this important goal:

1. Lack of global coordination resulting from the localized or jurisdictional approach to trade reporting regimes;
2. Lack of global data standards; and
3. Legal barriers to global data sharing among regulators.

DTCC's Trade Repository and Global Markets Entity Identifier Help Regulators Identify and Mitigate Global Financial Market Risk

DTCC has extensive experience collaborating with regulatory bodies and market participants to support new regulatory reporting mandates globally, including Dodd-Frank in the U.S., the European Market Infrastructure Regulation ("EMIR") and the Markets in Financial Instruments Directive ("MiFID") in Europe, as well as new reporting requirements for trade repositories throughout the Asia-Pacific region.

Global Trade Repository

DTCC's Global Trade Repository ("GTR") supports reporting across all five major derivatives asset classes – credit, interest rate, equity, foreign exchange and commodity – in nine jurisdictions across 33 countries. Despite differences in local reporting requirements across regions, DTCC has built a robust and flexible infrastructure with a global trio of fully replicated GTR data centers.

GTR has more than 5,000 clients in all regions of the world, including the top 30 global banks. In fact, GTR reports data for more than 100,000 entities globally and holds up to 40 million open derivatives trades. We also process more than one billion customer messages each month.

DTCC is a strong proponent of efforts to increase transparency in the OTC derivatives markets. In line with global reporting commitments, Dodd-Frank requires that all derivatives transactions, whether cleared or uncleared, must be reported to newly created SDRs. Based on our experience providing regulated trade repository services globally, DTCC is pleased significant progress has been made in implementing this mandate.

To support Dodd-Frank reporting requirements, the DTCC Data Repository (U.S.) LLC ("DDR") applied for and received provisional registration from the Commodity Futures Trading Commission ("CFTC") to operate a multi-asset class SDR for OTC credit, equity, interest rate, foreign exchange and commodity derivatives in the U.S. DDR is the only repository to offer reporting across all asset classes, a major milestone in meeting regulatory calls for robust trade reporting and risk mitigation in the global OTC derivatives market. Currently, DDR holds approximately 10 million CFTC-reported open derivatives trades.

DDR began accepting trade data from its clients on October 12, 2012 – the first day that financial institutions began trade reporting under Dodd-Frank. Furthermore, on December 31, 2012, DDR was the first and only registered SDR to publish real-time price information. DTCC – through its Trade Information Warehouse – has provided public aggregate information for the credit default swap market on a weekly basis, including both open positions and turnover data, since January 2009. This information is available, free of charge, on www.dtcc.com.

1. Global Coordination

While financial market infrastructures like DTCC have become fundamental in enabling G20 reforms, challenges remain regarding the introduction of new regulatory mandates, and the potential unintended consequences of various regulations. There remain significant concerns regarding the harmonization of new regulatory requirements and the cross-border impact of new rules throughout the marketplace.

While trade repositories are heralded as an essential pillar of systemic risk management, the global derivatives reporting regime that emerged following the 2008 crisis was developed along national or regional lines. Due to this fragmented regulatory landscape, trade repositories have not been able to reach their full potential as tools for systemic risk oversight.

Since the 2008 crisis, major derivatives jurisdictions around the world have developed frameworks to mandate reporting of derivative trades to trade repositories. Regulators have also devised local rules and designated authorized trade repositories to operate within their domains. Although transparency has been created through national reporting regimes, this localized approach has resulted in divergences among jurisdictions.

While local authorities were developing the mandated reporting frameworks, in 2010 DTCC implemented a voluntary reporting framework under OTC Derivatives Regulators Forum (“ODRF”) guidelines to data access. This framework leveraged DTCC’s Trade Information Warehouse post-trade processing service, which contains virtually all credit derivative trades transacted globally. A portal was established that made this data available to more than 40 regulators globally. The portal allows for regulators to access data within their jurisdiction and data provided is consistent with ODRF data-sharing guidelines. The portal assists regulators in their supervisory capacities in scenarios such as sovereign debt crises, corporate failures, credit downgrades and significant losses by financial institutions.

Despite these voluntary efforts, the mandated regulations that emerged throughout each jurisdiction have created a fragmented and inconsistent set of reporting requirements. This frustrates the ability to perform aggregation and data access provisions such as those previously established via this portal.

In 2013, DTCC stated that achieving the G20 goals of transparency required an optimal trade reporting framework which consisted of harmonized reporting requirements across jurisdictions

and advocated for one repository to collect data as a public good.⁹ However, the current trade reporting reality is quite different and reporting is now fragmented across jurisdictions as well as across multiple repositories. Given this current state, it is imperative that we focus on creating the necessary conditions for the reporting function to fulfill the G20 mandate.

2. Global Standards as Means to Improve Data Quality

While progress has been made to improve standards globally, additional work remains before the G20 transparency mandate can be achieved. Standards are necessary as they provide a means to transforming data into information that can be used to help identify and mitigate systemic risk. Through the global adoption and use of identifiers and consistent standards, the quality of data will improve and data can be effectively aggregated.

Legal Entity Identifier

DTCC is actively engaged in the global effort regarding LEIs, which allow for the unique identification of legally distinct entities that are counterparties on financial transactions. Global use of LEIs would serve as a valuable building block to increasing transparency and risk mitigation in the financial markets.

Following the 2008 financial crisis, the importance and benefit of a universal LEI became clear. The inability of regulators to quickly and consistently identify parties to transactions across markets, products, and regions hindered their ability to evaluate systemic risk, identify trends and emerging risks, and take appropriate corrective steps. Recognizing the critical data gap in regulatory oversight as a result of the lack of an international standard for an LEI, authorities around the world have taken incremental steps to develop a global LEI system.

Through a competitive process, DTCC was chosen to build and operate an LEI utility for the industry and was designated by the CFTC to provide LEIs to swap market participants as required by CFTC recordkeeping and reporting rules. This utility, which was developed and operates in conjunction with SWIFT, is the Global Markets Entity Identifier (“GMEI”). To date, the GMEI utility has assigned LEIs to and maintains reference data corresponding to more than 185,000 legal entities across more than 140 jurisdictions, representing approximately 50 percent of all global LEIs that have been assigned. I am pleased to announce that last week the CFTC extended the GMEI utility’s designation as the provider of LEIs in support of the CFTC’s swap data recordkeeping and reporting rules.

To ensure adoption of LEI both domestically and globally, it is essential that new registration, recordkeeping and reporting rules include an LEI mandate. DTCC is pleased there is widespread regulatory support for the LEI to serve as the international standard. Among U.S. regulators, the CFTC¹⁰ was the first to mandate use of the LEI and the Securities and Exchange Commission

⁹ Michael C. Bodson, CEO, DTCC, “New Infrastructures for a Sounder Financial System,” Financial Stability Review, Banque de France (April 2013).

¹⁰ See Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2,136 (Jan. 13, 2012).

(“SEC”)¹¹ is advancing rules with LEI mandates. Additionally, several authorities—including the European Securities and Markets Authority, the Monetary Authority of Singapore, the Hong Kong Monetary Authority, the Australian Securities and Investment Committee, and the Ontario Securities Commission—have promulgated recordkeeping and reporting rules for OTC derivatives transactions that require counterparties to be identified by LEIs. Given the progress by the public and private sectors working together to implement the Global LEI System, DTCC anticipates LEI mandates in rulemaking in the U.S. to greatly accelerate, thus enabling a significant improvement in systemic risk management.

Global LEI adoption would serve as a significant step in the process to increase transparency and mitigate risk. However, additional standards need to be addressed at a global level to support the trade reporting regime. For example, currently there is a lack of global agreement regarding the appropriate standard for a trade identifier or product identifier. In addition, more client information must be standardized such as the branch locations for each Global LEI and the hierarchy structure for company (referred to as parent LEIs to enable aggregation by grouping all legal entities to one parent). These standards are necessary requirements in creating an effective regulatory reporting framework.

Making Data Useful: Aggregation and Standardization

Notwithstanding divergent reporting requirements, jurisdictions have made significant progress in implementing derivatives reporting rules and a massive amount of data is being reported to trade repositories. However, data collection alone is not sufficient to address the G20 transparency goal. The ability to aggregate this data, convert it into information, and use it to monitor the build-up of risk in the system is absolutely essential.

Understanding the challenges associated with data aggregation requires distinguishing between the requirements of microprudential regulators, who are responsible for local market surveillance, and macroprudential regulators, who are focused on monitoring risk in the financial system. While national reporting regimes have been mostly effective at providing transparency into local markets, the same is not true at the macroprudential level due to the fragmented nature of jurisdictional reporting rules, which has led to the absence of harmonized global data standards across jurisdictions and trade repository providers. By lacking a common vocabulary with which to communicate, trade repositories are unable to share and aggregate data on a global scale.

To address this situation, regulators must come to agreement on the specific data set required for systemic risk identification and adopt consistent reporting standards across jurisdictions in order to fully capitalize on the benefits of the data being collected.

Data standardization requires a collaborative effort by the industry, trade repositories and regulators globally. As operator of the largest global trade repository, DTCC strongly supports efforts to create a common data vocabulary, such as those spearheaded by the Committee on

¹¹ Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 80 Fed. Reg. 14,564 (Mar. 19, 2015).

Payments and Market Infrastructures (“CPMI”) and International Organization of Securities Commissions (“IOSCO”) Harmonization Working Group. Active dialogue between the industry and its supervisors is vital to resolving this fundamental issue.

In June 2015, DTCC provided recommendations to CPMI IOSCO, detailing a proposed path towards global data harmonization with credit derivatives identified as the first step.¹² The approach involves harmonizing approximately 30 data fields across global trade repository providers, essentially creating a global data dictionary. These fields are viewed as critical to financial stability and systemic risk analysis.

3. Remove Barriers to Global Data Sharing

While data standardization is essential, it will have limited impact if barriers that hinder cross-border data sharing are not also concurrently addressed. Significant legal barriers need to be removed before data can be aggregated at a cross-border level and used by relevant supervisory authorities.

For example, the Dodd-Frank Act requires swap data repositories to obtain indemnification agreements before sharing information with regulatory authorities.¹³ The indemnification requirements in Section 21(d) of the Commodity Exchange Act and Section 13(n)(5)(H) of the Securities Exchange Act of 1934, as amended by Dodd-Frank, require—prior to sharing information with various regulatory authorities—that (i) registered SDRs receive a written agreement from each entity stating that the entity shall abide by certain confidentiality requirements relating to the information on swap transactions that is provided, and (ii) each entity must agree to indemnify the SDR and the CFTC or SEC, respectively, for any expenses arising from litigation relating to the information provided.

In practice, these provisions have proven to be unworkable and run counter to policies and procedures adopted by regulatory bodies globally to safeguard and share information. In addition, these provisions pose a significant barrier to the ability of regulators globally and within the U.S. to effectively utilize the transparency offered by SDRs, and may have the effect of precluding U.S. regulators from seeing data housed at non-U.S. repositories. These provisions also limit access to and sharing of data among U.S. authorities such as the CFTC, SEC, the Federal Reserve Board, and the Office of Financial Research.

Concerns regarding global information sharing have been echoed by regulatory officials and policymakers globally. In an August 2013 report, the Committee on Payment and Settlement Systems and the Board of IOSCO highlighted that legal obstacles may preclude trade repositories from providing critical market data and encouraged the removal of legal obstacles or restrictions to enable effective and practical access to data.¹⁴

¹² See Press Release, DTCC Proposal to CPMI IOSCO on Global Data Harmonization (June 18, 2015), *available at* <http://www.dtcc.com/news/2015/june/18/dtcc-proposal-to-harmonization-working-group.aspx>.

¹³ Such regulatory authorities include U.S. prudential regulators, the Financial Stability Oversight Council, the Department of Justice, foreign financial supervisors (including foreign futures authorities), foreign central banks, and foreign ministries.

¹⁴ See CPSS-IOSCO Report, “Authorities’ Access to Trade Repository Data” (Aug. 2013).

During a February hearing this year before this Committee, CFTC Chairman Timothy Massad stated that removal of the indemnification provisions would facilitate the sharing of information and collaboration among regulators to monitor risk.¹⁵ CFTC Commissioner J. Christopher Giancarlo and Commissioner Mark Wetjen also identified indemnification as a priority issue and expressed support for a legislative fix during an April hearing before the Subcommittee on Commodity Exchanges, Energy and Credit.¹⁶ In addition, SEC Commissioner Michael Piowar has voiced concern and called for removal of the indemnification provisions.¹⁷

DTCC strongly supports legislation that would resolve issues surrounding the indemnification provisions. DTCC is pleased that removing the indemnification provisions from Dodd-Frank remains a bipartisan, bicameral priority for the current Congress. Indemnification correction amendments have recently been considered by the House Financial Services, House Agriculture, House Appropriations, Senate Banking and Senate Agriculture Committees.

On July 14, the House passed the *Swap Data Repository and Clearinghouse Indemnification Correction Act of 2015* (H.R. 1847). DTCC applauds House passage of H.R. 1847, which would help ensure regulators obtain a consolidated and accurate view of the global OTC derivatives marketplace. We urge the Senate to move swiftly to support this non-controversial, technical fix.

There is precedent for global information sharing. As mentioned previously, DTCC's Trade Information Warehouse, established in 2006, provided authorities access to data pursuant to guidance issued by the ODRF, a group of regulators from across the globe that were able to define the parameters of what information could be disclosed based on parties to the transaction and the underlying reference entity to whom credit protection was being bought or sold. The credit derivatives data provided was standardized, aggregated and shared across jurisdictions. The ODRF serves as an example of a well-functioning governance model, demonstrating the potential of what can be achieved with consistent data standards, data aggregation and clear access rules.

Looking Forward: Global Regulatory Coordination and Market Guidance

Following the removal of legal barriers, market infrastructures such as DTCC will be able to play an important role in supporting data quality efforts to ensure that data can be turned into useful

¹⁵ For example, Chairman Massad stated that if legislation “did remove [the indemnification] provision, then it would facilitate . . . the sharing of information.” See 2015 Agenda for CFTC: Hearing Before the H. Comm. On Agric., 114th Cong. (2015) (colloquy between Chairman Massad and Congressman Eric Crawford).

¹⁶ See Testimony of CFTC Commissioner J. Christopher Giancarlo Before the H. Comm. on Agric., Subcomm. on Commodity Exchanges, Energy, and Credit (April 14, 2015), *available at* <http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/images/Giancarlo%20Testimony.pdf>; see also Testimony of Mark Wetjen, Commissioner, CFTC, Before the H. Comm. on Agric., Subcomm. on Commodity Exchanges, Energy, and Credit (April 14, 2015), *available at* <http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/images/Wetjen%20Testimony.pdf>.

¹⁷ Commissioner Michael Piowar, Secs. and Exch. Comm'n, Remarks at the Int'l Swaps and Derivatives Ass'n 30th Annual General Meeting (Apr. 22, 2015).

information. A key step is the establishment of a governance framework to set the conditions upon which regulators could access each other's data once legislative hurdles such as Dodd-Frank's indemnification provisions are removed.

A global college of regulators – for example, CPMI IOSCO – is best positioned to provide the industry with specific guidelines outlining clear data access rules based on the individual regulator's authority. Such an undertaking requires defined cross-border guidance that each jurisdiction adopts and adheres to. While removing legal barriers and establishing a governance model for data sharing will take time, these are necessary elements to achieve the G20 goal of increased transparency and systemic risk mitigation.

To continue progress on global derivatives reform, a critical next step is the analysis of data and use of tools to transform data into information which can be used to identify systemic risk. That is the value provided by reporting data – to provide regulators with transparency into the marketplace to assist with potential risk identification and mitigation.

DTCC encourages CPMI, U.S. policymakers and regulatory bodies globally to take a leadership role in the governance process and address global standards. Collaboration among the industry and regulators is paramount and an increased sense of urgency is needed to address current challenges.

Conclusion

Mr. Chairman, Ranking Member, thank you for inviting me to speak today on this important topic. As you can see, a great deal of progress has been made in modernizing the global derivatives market, but there is much work yet to be done. I will be happy to answer any questions you may have and look forward to a continued dialogue on these issues with you and your staffs.