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Pre- to Post-Trade Implementation of Dodd-Frank and Regulatory Reform: Washington Update

Thank you, Roseanne. Good afternoon, everyone. I want to thank SunGard for inviting me to participate in today's forum on the implementation of Dodd-Frank – a topic that has been top-of-mind for everyone in the financial services industry for the past year.

This landmark legislation was signed into law on July 21st, 2010 – 339 days ago, and ever since we've been on a mad dash to prepare for the implementation of the bill. And it now looks like we're going to have to keep running....

After a lot of pressure from the industry, members of Congress and regulatory bodies overseas, the SEC and CFTC both announced plans to provide temporary relief from some of the self-effectuating rules that cover derivatives. They concluded that they simply don't have the time or manpower to get all the regulations written by July 16th – the date when a number of these measures were supposed to take effect.

As I look around this room, I'm sure that many of you are glad about this decision. The fact is...July 16th has a rather inauspicious place in world history. It was July 16, 1945, when the first atomic bomb was tested. It was July 16, 1973, when the Senate committee investigating Watergate learned that all of President Nixon's phone calls and office conversations had been recorded. And it was July 16th in 1979, when Saddam Hussein assumed the presidency in Iraq.

Now, maybe the SEC and CFTC sensed something about this date. The reality is that there was growing alarm about the impact the unfinished business would have on the industry. Now those concerns can be put aside, at least for a while.

The regulators recognize the systemic impact the new rules will have on the industry. And they understand the importance of getting it right rather than doing it fast. It also signals that regulators want to collect as much feedback as possible from market participants before finalizing the rules. This is a good thing and the agencies should be recognized for their hard work and dedication. As an industry, we should take advantage of this opportunity. First, we need to continue sharing our thoughts about the rules and identifying areas of concern. Second, we need to use this period to offer alternative ways to implement Dodd-Frank in a way that preserves the intent of the law and the vitality of the U.S. financial markets and industry.

Even with the temporary relief, there's still a lack of clarity over when the rules will be finalized and what they will say. All of this creates uncertainty in the marketplace. As today's conference reflects, this uncertainty is especially acute in the derivatives area, where Dodd-Frank requires regulators to make major changes in business practices that have developed over decades.

And as we all know, "uncertainty" is not conducive to fostering the type of long-term economic growth that's essential to creating jobs. Financial markets detest uncertainty. But that's what we face at the moment.

Some market participants have already responded to what they think the new regulations will require. In anticipation of the Volcker Rule, for example, the country's major banks have begun to shed their proprietary investment vehicles.

In fact, Citigroup announced earlier this month that it was shuttering a \$400 million hedge fund which traded the firm's own money. This tells us that change is already happening in response to Dodd-Frank, even though the rules are not yet final. As you can imagine, this creates many new challenges for financial firms in the months and years ahead.

Today...what I'd like to focus on are three matters. One is the timetable for phasing in the swaps portion of Dodd-Frank. Then I will talk about the work the industry needs to do cooperatively and collectively to offer a uniform approach to the regulatory agencies. And finally I will touch on some of the details in the proposed regulations that may prove to be more important than we imagine right now.

The DTCC Role

Over the past year or so, DTCC, which is the post-trade infrastructure utility, has taken a more "out-front" role on these issues. And we've taken on this greater leadership role because our central position as a utility gives us a good vantage point to observe most segments of the marketplace. We also believe that we have a lot to offer based on several factors, including our nearly 40 years of experience as a clearinghouse for the U.S. equity and fixed income markets and our unique insight into the swaps markets as the operator of the global repository for credit default swaps.

Our Trade Information Warehouse serves as the central repository for the CDS market and we operate it out of both New York and London. We keep track of a swap over its lifecycle – and we aggregate and publish some of the data we collect. As a result, we're able to provide an unprecedented degree of market transparency. We also give US-based and global regulators direct electronic access through a web-based portal to the data they require to meet their own regulatory responsibilities. In other words, the Warehouse is already helping regulators achieve many of the transparency goals for the CDS market outlined in Dodd-Frank.

The Phase-in Timetable

Let me now turn to the timetable for implementing the legislation. It's clear that regulators understand the need to provide market participants with a greater degree of clarity on this issue. When CFTC Chairman Gary Gensler visited DTCC recently, he said he expected both the CFTC and the SEC to digest all the comments on the rules through the summer. He also said at a recent CFTC open meeting that he expects to have virtually all the new rules completed before the end of the year and that from a planning perspective, market participants should have a good idea what the final implementation plan will look like by next spring – and could begin taking steps to come into full compliance sometime later next year. This suggests that it will be at least a full year, if not longer, from the time Congress mandated that the new rules be written until the rules are fully implemented.

Assuming this timetable is adopted, we still need to establish a sequence of steps to implement the new rules. Based on our experience at DTCC, we have a clear view what that sequence should be. We believe that new OTC derivatives rules should be implemented in three steps.

Step one should be establishing the appropriate infrastructure to ensure that the other rules can be implemented with minimal impact on the efficient operation of the market. Let me illustrate this with an everyday example. If the "check engine" light pops up on the dashboard of your car, it's unlikely your mechanic will be able to figure out what's wrong if your car's sensors aren't gathering data. Your car knows something's wrong, and you know something's wrong, but you don't know what.

That same experience can be applied to the markets. Therefore, we've suggested that regulators begin by mandating comprehensive trade reporting to SDRs.

Trade reporting is the critical first step because regulators will depend on current and accurate trade information to make decisions related to other parts of Dodd-Frank, including clearing and trade execution. This will allow regulators to think about whether they want to put some restrictions on markets or certain market functions. It will also assist them in appropriately defining large block trades.

Step two should be mandatory clearing of certain OTC derivatives trades. And step three should be implementation of the mandatory trade execution on exchanges or swap execution facilities.

Within each of these waves, we think it makes sense to sequence the implementation by asset class, focusing first on the products with the greatest automation because they will be the most capable of providing the highest quality data to SDRs. Under this scenario, credit and interest rate derivatives should be at the front of the line because the overwhelming majority of these markets are already confirmed electronically. Next would be FX derivatives....and finishing up with equity and commodity derivatives together.

While the order of implementation is vital to the success of the new rules, the proper implementation of Dodd-Frank requires more than appropriate phasing and sequencing of rules. It is just as important to focus on the degree of coordination among the three pillars of the Dodd-Frank infrastructure – the trading platforms, the clearing agencies and the swap data repositories. For starters, we believe that the twin principles of open access and user choice, which are deeply imbedded in both the letter and the spirit of Dodd-Frank and the proposed rules, should be made explicit. In other words, trading platforms and SDRs must maintain strict open access – and not impose artificial barriers to access or anti-competitive burdens on the trading, clearing or reporting of transactions. Also, it's critical that reporting counterparties dictate where their transaction data is reported. Given the ease with which any one provider can disrupt reporting implementation, additional clarity is needed to prevent disputes, delays and legal challenges.

In the case of SDRs, Dodd-Frank clearly defines their role as “collect[ing] and maintain[ing] information... with respect to... swaps entered into by third parties.” The SDR does this for “the purpose of providing a centralized recordkeeping facility.” The SDR should not be doing this to capture the commercial value of the data collected, because data ownership should continue to rest with the contributors of the data. Further, the SDR should not be performing its recordkeeping and reporting services to drive traffic to other services it provides, such as those in clearing and trade execution. In other words, the SDR should have no interest in a trade – or any other interest – than to provide record keeping services for the benefit of regulators and the general public. Therefore, we believe the agencies should provide additional clarification to protect the implementation and integrity of the trade reporting process, including:

- Explicitly disallowing vertical bundling and cross-subsidization of services, and
- Protecting open market access to all market participants.

As regulators begin the transition from writing rules to implementing them, we believe that appropriate sequencing will help promote more transparent markets for global regulatory oversight and systemic risk mitigation. We also believe that it will help protect the public and ensure liquid and efficient capital markets.

The Global Debate

Another topic I'd like to focus on today is the need for global harmonization of regulations. You've probably been hearing a lot about this in the news recently as United States and European officials publicly air their concerns and, in some cases, disagreements. Since the global financial collapse three years ago, European

leaders are not inclined to put too much faith in U.S. institutions or regulatory policy. They are intent on charting their own course on financial reform and not simply following the lead of the U.S.

A few weeks ago, Michel Barnier, the European Union's financial markets commissioner, said he wants to make sure Brussels and Washington are acting (quote) "in parallel." But then he made it clear he doesn't think that's happening yet. While raising concern over the potential for international regulatory arbitrage, he also said that if there isn't sufficient convergence, he will push for reciprocity.

Then, two weeks ago, U.S. Treasury Secretary Tim Geithner responded by predicting that without strong leadership, there could be a global "race to the bottom." The very next day, Martin Wheatley, who has been Hong Kong's chief financial regulator for the last six years, shot right back. He said, "To suggest that the US sets the gold standard that other markets should follow is nonsense."

Indemnification

And that gets me to the heart of an issue that is likely to be viewed very differently on each side of the Atlantic and the Pacific. The issue is indemnification, and we believe that if it's enacted the way it is now, there may be serious negative unintended consequences. The idea of indemnification is tucked deep inside Dodd-Frank, and it was intended to ensure the confidentiality and safety of data reported to and provided by swap data repositories. The requirement says that US-based SDRs need to obtain indemnification agreements from foreign regulators prior to sharing critical market data with them.

The fact is, this makes little sense in the global derivatives market – especially because many regulators are already following policies and procedures to safeguard and share data based on guidelines established by the OTC Derivatives Regulators Forum (ODRF).

If the indemnification provision is not revised or eliminated, it has the potential to undermine the ability of regulators and market participants to obtain a comprehensive and unfragmented view of the global marketplace. If you can only see data from one or two jurisdictions, then you can't get a full picture of where the market is as a whole. And as a regulator, if you can't see the whole market, you can't see the potential for systemic risk.

Some Members of Congress have already begun outreach to their European counterparts to seek a resolution. We're working with them because we know, based on our experience operating the Trade Information Warehouse, how high the stakes are if the indemnification provision is enforced. But, the clock is ticking. The European Parliament is poised to adopt counter indemnity language in the final version of its own reform regulation, which would mean that U.S. regulators, like the CFTC and SEC, could face diminished access to information held in overseas repositories – just like their overseas counterparts in the U.S..

I was encouraged last week when Chairman Gensler testified before the House Financial Services Committee that the CFTC and SEC agree that indemnification is unnecessary and suggested two potential solutions:

- The first case is when a foreign regulator requests data from a repository that has dual-registration in the United States and overseas.
- The second case is when a foreign regulator seeks to obtain information that is held by the CFTC or SEC.

While this issue is far from resolved, I'm encouraged because indemnification is clearly on the radar of Chairman Gensler and SEC Chairman Mary Schapiro. Hopefully, progress is being made. However, based on an early review of the two exceptions, it appears that the concepts are not sufficient to allay concerns and, therefore, have not resolved the indemnity issue. Clearly, more needs to be done.

The Data Warehouse Business

I mentioned earlier that DTCC created and operates the repository for the global OTC credit default swaps market. In addition, we're also building the global equity derivatives repository, which will be headquartered in London. And just last week, following a global competition, the International Swaps and Derivatives Association selected us to work with European trading services provider EFETnet to develop and operate the first global repository for commodities swaps trades. There are several reasons why I believe market participants have placed such a high level of confidence in DTCC.

First, market participants seem to be coalescing around the concept of trade reporting as a non-commercial function that's best carried out by a utility. From both an industry and regulatory viewpoint, they see significant value in having a cooperative, at-cost industry utility like DTCC create, develop and run the repositories. As a non-commercial entity, we view trade reporting as a pure regulatory and public policy function...and we see our role as supporting the industry and regulators in meeting the requirements of the new law. As I mentioned earlier, we have no commercial interest in the data we collect.

In addition, our governance model makes our users also our owners...and our users span virtually the entire financial industry, including the buy side, the sell side, banks, insurance carriers and mutual funds, among others. As a result, this organizational structure has contributed to our ability to connect with all market participants and to ensure robust and secure systems.

Second, market participants recognize the significant cost-savings benefits of leveraging a common infrastructure that's already built and operating efficiently.

Third, the industry understands the value of DTCC's deep global experience and very successful track record operating a trade repository. Because of the time we've invested, the resources we've spent and the efforts of hundreds of our personnel to build and operate the Trade Information Warehouse, we continue to get better at solving the complexities of global data repositories. For example, it is less likely that we will run into problems setting up the commodities SDR that we haven't already solved in setting up one of our other SDRs. This experience is critical when working on tight deadlines in a fast-moving and complex market – and we leverage this knowledge to ensure the integrity, the breadth and the timeliness of the data we collect. In addition, we work hard to ensure our repositories are open to global industry requirements and global regulatory needs – not to mention, open to any and all market participants.

Fourth, a centralized repository ensures that data across asset classes is unified to provide the highest degree of transparency into the market for both regulators and the public. And fifth, DTCC has been battle-tested during times of crises...and our robust, secure and redundant infrastructure allows us to continue operating through periods of extreme volatility or market shocks.

The Big Picture

As the implementation of Dodd-Frank enters its second year, the industry and regulators will need to continue to work together to find the right balance of market innovation and regulatory oversight. The new rules can't be so severe that, while they make our markets safer, they also restrict innovation, ingenuity and creativity. We know that capital will flow to the most competitive markets – the ones that are efficient, liquid and robust. But we also know that the hallmark of such markets is a strong regulatory regime that promotes safety, soundness and stability. This is not an easy task by any means. I know that regulators understand that critical issues like long-term economic growth, job creation and economic security will be impacted by the decisions they make in the weeks and months ahead.

The panelists participating in today's forum are certain to delve into these and other issues in greater detail. I'd like to hear your thoughts on these topics. I'm more than happy to answer any questions you may have, or expand on any of the points I've raised. Thank you for listening to me and for allowing me to share my thoughts on financial reform.