



## Transparency, Dodd-Frank and Unintended Consequences

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As a starting point, it's important to understand how sweeping Dodd-Frank is. The legislation covers 2,300 pages, calls for at least 243 separate rulemakings and establishes new rules for virtually every sector of the financial industry. However, despite the far-reaching scope of the law, Dodd-Frank is built on two fairly simple concepts:

- that the rules governing the futures market can be applied to the over-the-counter (OTC) derivatives market, and
- that the use of trading platforms and clearinghouses will reduce systemic risk and make these markets more transparent.

The question we in the industry are forced to answer is whether a model based primarily on short-term instruments like futures can be applied to the swaps markets? As you know, the swaps markets are roughly 10 times the size, in terms of outstanding open interest, of the futures market and include a significant proportion of longer-term instruments relating to thousands of different underlying assets and securities. Until Dodd-Frank is fully implemented, the answer is that we simply don't know.

### **Trade Repositories Enhance Transparency**

Trade repositories are an essential part of Dodd-Frank. Along with swap execution facilities and clearinghouses, they form the three pillars of the Dodd-Frank infrastructure. Repositories are the key to bringing transparency to the swaps derivatives markets because they will hold the underlying transaction data on all swaps derivatives trades. When this data is consolidated in a centralized repository, such as DTCC's Trade Information Warehouse for credit default swaps (CDS), market positions and concentration of risk are fully transparent to regulators worldwide.

A key feature of the Warehouse's transparency is the online regulators portal we created. The portal gives global supervisors unfettered, direct electronic access to detailed transaction data on virtually all CDS trades executed worldwide in which they have a material interest. Today, nearly 40 global regulators are actively using this portal to monitor systemic risk within their jurisdictions.

If, for instance, a British regulator wants to know the exposure of a particular British bank to the sovereign debt of Greece in the CDS market, he can obtain that information in a matter of seconds through the TIW. In fact, the regulator can access this data faster than he can obtain details about the actual debt holdings of that bank.

### **Indemnification Provision Undermines Transparency**

That's the good news. The bad news, however, is that certain provisions in Dodd-Frank may create unintended consequences that will undo the progress that's been made in bringing transparency to this market.

The first provision is the indemnification clause in the data security section of Dodd-Frank, which was intended to ensure the confidentiality and safety of data. We'll file this under the heading "Good Intentions, Bad Results."

The requirement states that U.S.-based repositories must obtain indemnification from foreign regulators before sharing critical market data with them. The fact is that the regulators we've met with have told us that they are unlikely to enter into these agreements for two reasons.

First, the extraterritorial mandate is inconsistent with traditions and legal structures in Europe. Second, global regulators are already following policies and procedures to safeguard and share data based on guidelines established by the OTC Derivatives Regulators Forum (ODRF).

Without an indemnity agreement, U.S.-based repositories may be legally precluded from providing critical market data to global regulators. The clear risk is that it may prompt these regulators to create their own local repositories to avoid indemnification — a move that could inevitably lead to data fragmentation.

A proliferation of local repositories would make it extremely difficult to quickly and accurately obtain a full picture of any particular asset class. This is problematic because it would impair market and regulatory oversight, create inconsistencies in market data and impede data analysis.

Fortunately, some members of the U.S. Congress have reached out to their European counterparts to seek a resolution. But the clock is ticking. It's uncertain how the EU will respond. We believe Europe should provide international leadership on this issue and push for a uniform global data set.

### **Bundling of Services – Picking Winners**

Dodd-Frank is clear in its support for free market competition between trading platforms, clearinghouses and trade repositories. However, the final rule for repositories approved by the

Commodity Futures Trading Commission in August...prohibits horizontal bundling but seems to leave the door open for vertical bundling.

In other words, under the rules, a repository would not be permitted to tie its trade reporting services with non-mandatory ancillary services such as asset servicing and confirmation. But a derivatives clearinghouse or execution platform may be able to require counterparties to report to a particular repository.

By permitting the bundling of mandated services, the CFTC would not only be picking winners — it would be permanently enshrining data fragmentation into the new regulatory landscape.

And as I mentioned earlier when discussing indemnification, data fragmentation would undermine market safety and soundness and lead to the inaccurate public reporting of overall market data. We are working closely with the regulators to address this issue, but like indemnification, it's impossible right now to predict the outcome or impact on the market.

### **Global Harmonization**

The challenge going forward will be two-fold. First, we need to ensure that new U.S. regulations, which in some cases differ materially, are harmonized between the U.S. agencies. Second, we need to ensure the harmonization of global regulations between the U.S., Europe and Asia.

As lawmakers look to resolve these issues, they'll also need to address differences of opinion over extra-territoriality, a hot-button issue that has the potential to derail harmonization efforts.

Gaining consensus among dozens of supervisors across several continents will not be easy. Fortunately, events like this are an important part of the dialogue, and I applaud the Financial Markets Law Committee for sponsoring this program.

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