

Regulatory Reporting Landscape Update An Interview with Stewart MacBeth

DerivSERV Today sat down with Stewart Macbeth, General Manager and Managing Director of DTCC Trade Information Warehouse, to get the scoop on how DTCC is working with regulatory bodies to bring increased transparency to the derivatives market.

DT: Stewart, can you describe for us how DTCC is working with the regulators?

SM: DTCC is working with regulators, market participants, and industry bodies

such as ISDA to provide greater transparency into the derivatives market. We are working with two levels of transparency – our service for the public (i.e. investors) and our service for regulators.

In regard to the public, DTCC publishes data on www.dtcc.com with key information on position sizes across different exposures, CDS indices, top names for single-name positions, and more. We believe this service helps boost market

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DTCC Establishes Warehouse Trust Company, Receives Approval from Fed

In February 2010, DTCC announced that the Federal Reserve Board and New York State Banking Department had approved the establishment of The Warehouse Trust Company, a DTCC subsidiary which is a member of the Federal Reserve System and a limited liability trust company under New York State banking law, to operate the Trade Information Warehouse for OTC credit derivatives.

The regulation of the Warehouse Trust is an important step in furthering regulatory and industry objectives to bring greater transparency and risk mitigation to the global OTC derivatives market. The Warehouse Trust will be directly regulated by the Federal Reserve and the New York State Banking Department as well as subject to a global cooperative oversight framework involving other U.S. and non-U.S. regulators. DTCC believes that regulatory harmonization across borders and a cooperative oversight framework will enable a more stable OTC derivatives market.

Peter Axilrod, DTCC managing director for New Business Development, said, "As the operator of the global processing infrastructure and trade repository for

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OTC Equity Derivatives Reporting Repository

DTCC will launch the new global OTC Equity Derivatives Reporting Repository at the end of July 2010, enabling major market participants to meet a commitment made to the New York Federal Reserve and other international regulators to report OTC equity derivatives to a repository by July 31, 2010. DTCC and MarkitSERV, a trade processing company jointly owned by DTCC and Markit, have partnered to deliver this new service.

In June 2009, major derivatives market participants made a commitment to regulators to provide registration of Equity Derivative transactions in an Equity Derivatives Reporting Repository, as part of a continuing effort to bring greater transparency to the OTC derivative markets. A dedicated steering committee comprised of dealers and buy-side firms and governed by ISDA published a RFP to which industry service providers submitted responses. A detailed selection process was then undertaken to determine which service provider could develop and launch this new repository.

DTCC and MarkitSERV partnered to propose a joint solution, leveraging the existing infrastructure and services which process all electronically confirmed equity OTC derivative trade confirmations in the market and the two firms' vast network and relationships with over 1,500 market participants and 16,000 legal entities.

"ISDA selected our joint solution because we have the know-how, experience, technology, and resources to deliver a robust and reliable service to the industry," said Andy Green, Vice President of Business Development at DTCC. "We are excited to be a part of this initiative because we truly believe that this is an essential step for the derivatives



market. We are building this for and with the industry, working closely with both regulators and market participants."

In order to deliver the service, DTCC is leveraging its technology and processing knowledge gained from processing OTC credit derivatives gold and copper trade records. The first phase of the equity repository service will provide reporting to regulators on positions held by market participants, with a view toward adding further capabilities and data in the future.

Specifically, the Reporting Repository will:

- Gather up-to-date trade data from firms
- Aggregate and cleanse data
- Report to participant firms, regulators and, ultimately, the public

Currently, DTCC and MarkitSERV are in the build phase, with testing beginning in June of 2010. The Reporting Repository is set to go-live July 2010 month-end.

Major broker/dealers and buy-side firms are involved in the development and testing phase to enable the service to launch seamlessly.

"We believe this new Reporting Repository will help market participants automate a regulatory responsibility they now have. We are implementing standards and best practices to make the process streamlined for the benefit of the market as a whole," said Green. "Regulators will have access to a global repository of OTC equity derivative data and market participants will benefit from an independent repository under industry control."

The Reporting Repository will be established as a separate entity, wholly owned by DTCC, with a dedicated board comprised of industry members to direct the development of the service. This new entity will be based in London.

DTCC to Deliver Groundbreaking New OTC Equity Derivatives Cashflow Matching Services in 2010

As part of an industry-wide initiative led by ISDA and the Fed, DTCC plans to launch a groundbreaking OTC Equity Derivatives Cashflow Matching Service in November 2010. The industry seeks to establish an electronic cashflow matching platform for all cashflows relating to OTC Equity Derivative trade types, enabling cashflows to be submitted, matched and affirmed pre-value date and netted.

Last year ISDA and the Equity Implementation Group (EIG) conducted a competitive RFP across industry service providers to assure that the right firms would be working on this major initiative. After a detailed review process, ISDA and the EIG selected DTCC to establish the cashflow matching service for OTC Equity Derivatives.

“DTCC is the industry authority for OTC derivatives payments,” notes Bob Green, Vice President at DTCC. “Since our inception, our Payment Reconciliation Service has

processed over 34 million OTC payments. We can bring this expertise to the development of this new service. ISDA and the EIG recognized that this experience, coupled with our existing relationships with all major market participants and extensive connectivity to both dealers and buy-side firms, put us in a strong position to successfully deliver this robust, sophisticated, and much-needed cashflow matching solution to the industry.”

The DTCC OTC Equity Derivatives Cashflow Matching Service will:

- Provide both Equity Derivatives cashflow matching and affirmation
- Provide extensive cashflow break resolution tools including extensive MIS on cashflow breaks
- Allow firms to submit payment observations and calculations (cash flow substantiations) to facilitate break resolution
- Provide automation tools appropriate to firms of all sizes

- Provide daily bilateral nets of matched cashflows
- Provide flexibility to evolve with changing requirements

Green comments, “The key benefits of this innovative new service are that market participants will be able to reach payment certainty and avoid nostro breaks around cash. As the industry continues to move toward increased transparency, being able to have a standardized process and a centralized system will help bring efficiency to the markets.”

On March 15th, 2010, the business requirements for the project closed and DTCC and member firms have embarked upon the build phase of the project. DTCC will commence industry-wide testing in late August with production cashflow matching starting on November 15th, 2010.

Trade Information Warehouse Completes Record Year Processing OTC Credit Derivatives

The Warehouse Trust Company, a subsidiary of DTCC and a global repository that records the details of OTC credit default swap trades, completed a record year in processing OTC Credit Derivatives in 2009.

The Warehouse supported the processing and recordkeeping of more than 2.2 million contracts, worth more than US\$25.1 trillion. Also in 2009, the Warehouse managed 50 credit events with a gross value of US\$386 billion, 129 successor events caused by restructurings, and processed 11 million gross payments amounts in nine currencies through its central settlement service.

“This past year’s activity clearly demonstrated the value of the Warehouse as a single global repository both in providing needed transparency for the global OTC credit derivatives market to regulators and the general public, and in managing the necessary life cycle processing and settlement capabilities that bring greater safety and soundness to the market,” said Stewart Macbeth, DTCC managing director and head of the Warehouse. “We supported settlement throughout 2009 seamlessly and without interruption, despite handling an average of one credit event a week all year.”

The management of these 50 credit

events included the General Motors bankruptcy in April 2009 which was the largest credit event in U.S. History, with a total gross value of \$386 billion. This was a dramatic increase over 2008, when there were only 10 credit events processed totalling \$285 billion in gross value. Net settlement amount for credit events in 2009 was \$17.7 billion compared to about \$12 billion in 2008.

Macbeth noted, “2009 was a remarkable year and with the development of services such as the OTC Equity Derivatives Reporting Repository, 2010 will also be a year of tremendous change and growth for the industry and for DTCC.”

Strategic Restructuring Update

An Interview with Marisol Collazo and Andy Byatt

DTCC plans to launch its Strategic Restructuring Solution for Credit products in September of 2010. With restructuring events occurring on a more frequent basis, this innovative solution will provide the industry with a robust approach to the processing of restructuring credit events in the Trade Information Warehouse. Deriv/SERV Today sat down with Marisol Collazo, Vice President of Product Management, and Andrew Byatt, Director of Product Management, to get the details.

DT: Why is DTCC introducing the solution? How did it come about?

MC: For event processing, we have been working with the industry over the past year to identify how we can support the automation of restructuring events. There have been a number of efforts to standardize lifecycle processing and auction settlement, commencing with the ISDA Big Bang protocol in March of 2009, which introduced methodology for standardizing the auction settlement of credit events. This was followed by the ISDA Small Bang protocol in July 2009 addressing the methodology for the auction settlement of a restructuring event.

What became immediately apparent was that there needed to be a tactical solution to lead the industry through the Thomson SA restructuring event that was occurring in October 2009. We leveraged our existing infrastructure to develop an immediate, tactical solution to handle the Thomson restructuring event when the auction terms came out. Essentially, we looked at our event processing capabilities and fit those pro-

cesses into the Small Bang protocol – it was a tactical and effective solution. What we recognized then was that to support automation of these events and potentially multiple events, a more strategic solution was needed. Once Thomson was closed, we reconvened the industry participants

“Electronic triggering will bring much needed centralization, automation and transparency to this process.”

who were involved in developing our tactical solution and we have been working on introducing our new strategic solution to the market.

DT: Did that experience with the tactical solution help you develop this new strategic solution?

MC: Completely. We looked back at the restructuring events with Thomson and identified processing points that could be improved. This helped us plan and develop a strategic solution to avoid or overcome these sorts of challenges in the future

DT: What are some of the main features of the Strategic Restructuring solution?

AB: This new solution is complementary to our credit event processing service. Adding to the payment calculation and settlement functions of the existing credit event function, the restructuring solution will feature a dedicated triggering portal, giving front-office personnel access to transactions eligible to be triggered. This is important because a restructuring is an elective process. Under Big Bang, upon bankruptcy, all relevant transactions are automatically adhered to the event. Under Small Bang, triggering affected transactions is a front-office decision – a trading decision, not an operational one. The portal presents information to the front-office in a straightforward and near real-time process through the GUI.

Another feature is unilateral triggering, which will now also include partial trade triggering, which allows either party to take action without requiring a matched trigger by the counterparty. This is a different type of messaging and is much more time-critical because of the deadlines associated with restructuring events. An important part of our new solution is being able to track and validate messages in a near real-time manner and report back to all affected parties quickly. Another important piece is being able to ensure that the new functionality fits into a process involving multiple clearinghouses as unilateral triggering becomes more complex in a clearinghouse situation. Our solution enables clearinghouses to be able to indicate restructuring matched

pair transactions to “pass on” triggering on cleared transactions. We have worked closely with the industry and all the major clearinghouses to ensure that the designed functionality provides an integrated solution with the clearinghouses involved.

DT: Where are you in development process?

AB: The development is split into phases. The first phase comprises the majority of the new functionality that addresses the largest risks and operational stresses identified in the tactical approach. This phase will be released globally in mid-September of 2010. We will begin user acceptance testing on August 12th, which will include any and all clients who want to be involved in the process.

DT: What would you say are the primary benefits for the industry?

AB: The main benefit is the electronic triggering process. Manual triggering involves fax or e-mail, which contains inherent risks. The electronic solution makes the process more robust and transparent, in addition to moving the process to near real-time, yielding huge operational efficiencies. In addition, without electronic triggering, restructuring events would be virtually unworkable for clearinghouses because all three parties need to be aware of the triggering at the same time. Electronic triggering will bring much needed centralization, automation and transparency to this process. In addition, this solution will shed more light for regulators on the exchange of funds that are taking place.

DT: What future developments can we expect post-phase one?

AB: We’re going to continue to build upon the foundation we lay down in phase one. We’ll be developing a client clearing solution, which will be a priority after this first release. We will also be expanding the additional processing on restructuring events and look to include triggering via uniform settlement agreements.

In late 2009, we saw three restructuring events after the publication of the Small Bang, and we expect that restructuring events will be more frequent in the future. As a result, we will continue to invest in this solution and are excited to be delivering such an important service to our industry.

DTCC Establishes Warehouse Trust Company

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the OTC credit derivatives market, DTCC is committed to working with regulators and market participants worldwide to protect the safety and soundness of the OTC derivatives market.” He continued, “In establishing the Warehouse Trust as a regulated entity, our aim is to ensure that regulators, wherever they are located, have unfettered access to the information they need to assess risk exposure in this global market, and that industry partici-

pants have the assurance of that regulatory oversight over the critical infrastructure that supports their market activities.”

As part of its ongoing focus to deliver increased market transparency, DTCC continues to expand the public release of weekly aggregate information on OTC credit derivatives on its website at www.dtcc.com/products/derivserv/data/index.php. The release of this information has

been an important step toward increasing transparency in the market.

“Certainly, the Warehouse is a key component of the global credit derivatives market’s infrastructure,” said Stewart Macbeth, DTCC managing director and head of the Warehouse. “As a regulated entity, our aim is to work with global groups, such as the OTC Derivatives Regulators’ Forum, in this critical area of global concern.”

Regulatory Reporting Landscape

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confidence and helps investors understand the depth of these markets.

When it comes to regulators, we provide key information that the regulators seek, which includes information on market dynamics or end users. These are oftentimes ad hoc queries but because of our position in the market, we have the ability to provide the reports containing the data needed.

DT: Which regulators are you working with?

SM: Broadly, we get requests at three different levels. First, we work with the banking supervisors. They may want to know about positions at firms they supervise. Although they can also ask the firms for this information, they come to us because we can provide market context and the data in a consistent format on a timely basis.

Secondly, we work with market regulators who may be looking at a specific instrument such as a fixed income bond that is traded in a regulated market within their jurisdiction. For example, they may want to understand the impact of a CDS product on that market. They may also be analyzing data to ensure that there is no market abuse relating to an instrument.

Thirdly, we work with Central Banks who are primarily concerned with general financial stability. As a part of their systemic oversight, they may want more aggregate data on markets or certain sectors, to identify large exposures and concentrations.

Two examples that have been used to describe the need for greater reporting relate to Lehman and AIG. Robust reporting can



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indicate the interconnectedness of financial firms and market participants. In hindsight, this may have assisted with better understanding the impact of Lehman’s bankruptcy on the market. Similarly, greater reporting could have facilitated the ability to spot a position concentration in the AIG situation.

DT: What have been some of the most recent developments in the regulatory reporting service?

SM: We are producing more reports and more formats that could potentially be accessed by regulators. For example, we recently introduced position reporting by currency and currency-based settlement reporting. This could act as a valuable tool for central banks as they are concerned with currency flows. The timing of such developments has fit in well with the establishment of the Warehouse as a regulated entity.

DT: What feedback have you received from the market, including your clients?

SB: The feedback has been resoundingly positive, as the majority believe this is the right thing to do for the good of the market. I think since the Lehman failure, people have generally recognized the value of our role in reporting. Once we made our public reporting live, people began to truly recognize the significance of the data we have in the repository.

DT: What benefits do clients experience through DerivSERV’s role with the regulators?

SB: The bottom line is confidence in the market. Regulators always had access to this information from individual regulated entities and markets. We are assisting regulators to more easily access accurate information in a useful format and on a timely basis. The public reporting aspect is also very important. We believe our services in this area help to increase confidence in the derivatives market and bring increased transparency to both our industry and our clients.

Wall Street Journal Recognizes DTCC's Pivotal Role in Derivatives Market and Reform

DTCC was featured in a recent Wall Street Journal op-ed, published on March 12, 2010, in which the editorial board reviewed the current outlook on financial reform and what is truly needed – a “sturdier system that is more likely to avoid, and survive without a taxpayer rescue, the next mania and systemic panic.”

A key part of the ongoing debate around financial reform focuses on the issue of derivatives and in particular, credit derivatives. The op-ed argues that hasty regulation could drive transactions off-shore without reducing risks to the financial system. Hundreds of letters have been sent to Senate offices from market participants asking to be exempt from the “heavy regulation”

passed by the House and being reviewed in the Senate. In addition, these customers included firms that the article describes as “more Main Street than Wall Street” as many firms such as Boeing, Disney and Procter & Gamble need derivatives to hedge their financial risks.

The op-ed argues that “those who favor derivatives regulation also still haven’t precisely defined the problem they wish to solve. Proponents talk of the need for transparency in the credit default swap market so that regulators can monitor risks. But today regulators can already see essentially the entire market in records held by the Trade Information Warehouse maintained by the Depository Trust & Clearing Corporation.”

As mentioned in the article, DTCC is focused on helping deliver market transparency, which is evident in its collaboration with regulatory bodies and the development of its equity derivative reporting and cash flow matching services and strategic restructuring solution. Despite some uncertainty around potential financial reforms, DTCC continues to work closely with industry bodies and participants to develop the processes and services needed to implement the “sturdier” system that reforms aim to achieve. We believe these efforts will continue to yield efficiency and transparency for the derivatives market as a whole.



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