

Implementing the vision of financial reform

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There are three distinct phases of leadership when attempting to implement change: vision, structure and implementation. This same process can be applied to congressional leadership regarding U.S. financial reform.

Following the 2008 crisis, Congress crafted a vision for change within the financial industry to help ensure market transparency and risk mitigation. The Dodd-Frank Wall Street Reform and Consumer Protection Act is the legislative structure resulting from that vision. Dodd-Frank was signed into law almost three years ago, and as implementation continues, Congress needs to ensure the regulations promulgated support the original vision for financial reform.

Of Dodd-Frank's more than 2,300 pages, no section has received greater scrutiny than Title VII, which establishes a regulatory framework for the over-the-counter (OTC) derivatives market. As part of this reform, Congress mandated that all swaps transactions be reported to registered swap data repositories (SDR) to ensure that regulators and the public have transparency into the global OTC derivatives markets as a way to mitigate systemic risk. Unfortunately, Title VII includes provisions that threaten the high level of transparency and global data-sharing envisioned by Dodd-Frank.

Congress took an important step forward last week when the House Financial Services Committee, through a unanimous 52-0 recorded vote, joined the House Agriculture Committee in passing bipartisan legislation to solve this problem. H.R. 742 would remove Dodd-Frank's indemnification provision from the law, which would eliminate the need for U.S.-based SDRs to obtain indemnification agreements from foreign regulators prior to sharing critical market data with them. While this provision was intended to ensure the confidentiality and safety of data reported to and provided by SDRs, the reality is that U.S.-registered SDRs may be legally precluded from providing regulators market data on transactions that are subject to their jurisdiction without an indemnity agreement.

For example, if a U.S. bank and a London-based bank trade on an equity swap involving a Japanese underlying entity, and the trade is reported to a U.S. SDR, the Japan Financial Services Agency would need to provide a confidentiality and indemnity agreement in order to review transaction data maintained by the U.S. SDR — even though the trade falls within their jurisdictional oversight responsibilities.

The issue of indemnification is problematic for several reasons, but none more so than the fact that the concept itself doesn't exist in many foreign legal systems. In other words, these countries do not recognize indemnification as a legal concept. And even in countries where they do, many foreign governments cannot or will not agree to indemnify foreign, private third parties such as U.S. registered SDRs — in much the same way that a U.S. regulator would be unwilling to indemnify a trade repository in another country.

In order to avoid indemnification, global supervisors will be forced to establish local repositories, a move that would lead to data fragmentation. A proliferation of local trade repositories would undoubtedly undermine the ability of regulators to obtain a timely, consolidated and accurate view of the global marketplace.

The good news is that Congress's action last week demonstrates that U.S. lawmakers recognize the unintended consequences of indemnification and are intent on fixing it. During the 112th Congress, a bipartisan coalition of more than 40 lawmakers in the House signed on as co-sponsors of legislation identical to H.R. 742.

In addition to congressional backing, there is clear regulatory support for removing the indemnification provision. The Securities and Exchange Commission testified in support of legislation and three of the five Commodity Futures Trading Commission commissioners publicly endorsed the need for legislation to clarify this provision of Dodd-Frank.

H.R. 742 is a non-controversial yet crucial technical fix to Title VII of Dodd-Frank. We can't allow regulators to be "blinded" by indemnification requirements or risk global data fragmentation. By quickly passing H.R. 742, Congress would ensure that its vision of financial reform is consistent with the implementation of the law.

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