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Chairman Frank, Ranking Member Bacchus and Members of the Committee, my name is Larry E. Thompson, General Counsel for The Depository Trust & Clearing Corporation (DTCC) and I'd like to thank you and the members of the Committee for the opportunity to share with you today our views as you consider legislation concerning the regulation of over-the-counter derivatives markets in light of the lessons learned during the past year's financial crisis.

We applaud the work of the Administration and this Committee under your leadership to advance the cause of providing sensible and effective regulation for the over-the -counter (OTC) derivatives markets. We share your desire to ensure more transparent markets for regulators, who must oversee market stability and mitigate systemic risk, and the public, who require more precise information, while ensuring that innovation and risk mitigation that are trademarks of the OTC business continue to exist. Our testimony will focus principally on one aspect that we strongly believe undermines the goals of re-regulation and represents a step backward by reducing the level of transparency that now exists. As you will note, we believe strongly that regulators and the public need a consolidated source of market information. However, the various proposals under consideration will result in fragmentation of that information. We present a specific proposal to remedy that situation.

What is DTCC?

DTCC has been the primary infrastructure organization serving the capital markets in the U.S. We have a 36 year history of bringing safety, soundness, risk mitigation and transparency to our financial markets. Indeed, as global financial markets went through crisis last year, DTCC's systems for record-keeping, transparency and risk mitigation helped federal regulators identify the true exposure of major market participants, and helped make possible informed decisions about to how to work through that exposure and how to protect the public.

As an example, following the Lehman bankruptcy last year, DTCC clearance and settlement systems played a significant role in unwinding over $500 billion in open trading positions in equities, mortgage-backed and U.S. government securities, without any loss to the industry—and avoiding any burden on taxpayers.

Bringing Automation and Efficiency to OTC Derivatives

By 2003, the market for OTC credit derivatives had taken off, but only 15% of the trades were being captured electronically. The trading process was manual and error-prone. Both the global dealers and regulators felt the market for these instruments faced growing risks, if a solution was not found. DTCC was asked to develop and we delivered an automated matching and confirmation system, called Deriv/SERV, within nine months. Today, over 95% of all OTC credit derivatives are captured in this automated environment and matched by MarkitSERV, an average of 41,000 transactions per day.

With major dealers making ambitious commitments about improving their operational practices to global regulators, DTCC's collaboration with the industry is continuing to bring a wider universe of the OTC derivatives market on to its electronic matching and confirmation platform, which is helping to significantly reduce the level of unconfirmed trades that remains in the market. These services, I might add, are provided at-cost to global dealers or sell-side firms and at no charge to buy-side customers.

However, after entering the OTC derivatives space, it was clear to DTCC and market participants that the downstream process for credit default swaps was another major area of concern. Once credit default swap trades were completed, these contracts could be resold or reassigned multiple times over their five-year lifecycle, but the process for recordkeeping and reconciling these transactions was largely manual.

DTCC launched the Trade Information Warehouse in November 2006, to provide an automated central repository to house and service all CDS contracts. During 2007, working with the industry, DTCC updated the Warehouse with information on over 2.2 million outstanding CDS contracts, and our Deriv/SERV matching engine is now supplying the Warehouse with more than 41,000 transactions daily. Today, our Trade Information Warehouse is the only comprehensive database or repository of OTC derivative activity in the world.

I'd submit to you, Mr. Chairman, and Members of the Subcommittee, that had DTCC and the industry not had the foresight to create this Trade Information Warehouse and load the Warehouse with all these records of CDS trades in 2007, we might still be sitting here today in 2009 trying to sort out the total exposure of trading obligations following the Lehman bankruptcy, i.e., who traded with whom, at what point in time and at what price? Instead, we have found ourselves at the center of financial storms – and are able to help rapidly to resolve them.

Need for Integrated Data on Derivatives Through Unified Repository

This experience leads me to emphasize one fundamental policy point. Fragmentation of data in the financial industry can impede the ability of regulators to protect investors and the integrity of the financial services system as a whole. These core policy goals are advanced when information on trades is held on a centralized basis.

We believe maintaining an integrated trade repository for OTC derivatives contracts is an essential element of safety and soundness for two primary reasons. First, it helps assist regulators in assessing systemic risks, thereby protecting consumer and financial markets. Second, as a practical matter, it provides the ability, from a central vantage point, to identify the obligations of trading parties, which can speed the resolution of these positions in the event of a firm failure, as we found last year in the case of Lehman Brothers.

Fragmentation of Information the Result of Initial Committee Draft

While we greatly appreciate the intent of all parties involved in this debate to increase regulatory and market transparency, some of the proposals represent a step backwards from existing practice – a move that we believe could jeopardize the one comprehensive repository that currently exists for the credit default swap market. Unfortunately, by **<u>not</u>** requiring all swap documentation and trade information to be reported to a single, comprehensive repository, the proposals would have the effect of denying regulators the opportunity to see systemic risk from a central vantage point, because it would fragment the existing information on CDS contracts stored in the Trade Information Warehouse. In other words, it would be significantly more difficult to create a comprehensive source of information for regulators and the public for all other classes of OTC derivatives.

First, the various proposals would authorize two different mechanisms for the collection of information on OTC derivative contracts – either a derivatives clearing organization, or a trade repository. The latter would only be required for derivative contracts that were not accepted for clearing by a derivatives clearing organization. While it may be contemplated here that the proposal would encourage multiple trade repositories, the real effect is to create multiple sources of different information for OTC derivatives, making it more difficult for regulators and the public to see a comprehensive view of market activity.

The result of this approach to repositories would mean that information on derivatives contracts could be split up among a number of different clearing organizations, as well as one or more trade repositories. For public policy reasons, this is very undesirable. The fragmentation of information would create grave inefficiencies and delays at times of crisis, impairing the kind of view that DTCC was able to give regulators in the minutes and hours after the Lehman Brothers collapse.

Another major concern with having multiple repositories is the confusion that would likely arise over where a trade should be housed. Take, for example, a situation where a U.S. firm executes a CDS contract with a European firm on an underlying asset in Asia. Where should that contract be stored?

If you go by parties to the trade, the contract would need to be placed in both the U.S. and European repositories. However, under that scenario, the contract would be duplicated, and therefore double counted in reporting to the public and regulators. Because there's no common identification system for derivatives, regulators, the public and the industry would not necessarily know that the U.S. repository listing and European listing of the trade are, in fact, the same. And if the US firm at some point decided to assign the trade to a European firm, it would simply drop out of the US repository – and there would be no audit trail on the contract.

Likewise, if the storage of trades in a repository is based on the underlying asset, then the above trade would be held only in the Asian repository. As a result, neither U.S. nor European regulators would have regulatory authority over the data even though the risk of the contract is assumed by parties under their jurisdiction. The systemic risk regulators in each region would have only a partial and incomplete view of the market.

A Better Alternative – Unified Reporting in a Trade Repository

DTCC urges this Committee to consider revising the bill to require all derivatives traded by U.S. financial institutions be reported to a single trade repository for each asset class, which would serve regulators as a comprehensive source of information. The derivatives central counterparties (CCPs), which are organized as derivatives clearing organizations, would continue to retain the data from the trades that they clear – and this would allow them to capture whatever commercial value they desire from that market data. However, from a public policy perspective and in the interests of ensuring the stability and transparency of financial markets, there must be a consolidated, comprehensive single entity that collects and maintains the underlying position data and makes it available to regulators in the most efficient, timely and usable manner.

Indeed, based on our long experience managing the risk flowing from the failure of a single market participant, we have found that knowing the underlying position data of multiple transactions across asset classes in a timely manner is significant in providing transparency to regulators—and in protecting confidence in the market itself. Given this, we ask the Committee to reinforce the role of a central repository as a matter of public policy, instead of moving forward with an approach which would fragment that responsibility and create the risk of inadequate oversight of derivatives markets at times of crisis.

DTCC also suggests that revisions to the draft include a few basic principles guiding how a trade repository should function so that it meets public policy needs, as follows.

1. Any trade repository should function as a utility that would serve the market in a non-discriminatory manner.
2. Any trade repository should be neutral and independent and therefore be prohibited from being owned by any single market participant or small group of market participants to protect its independence.
3. The data collected by the repository would be fully available to regulators, with aggregate data released publicly.
4. Sufficient experience in these activities should be required to ensure that a swap repository is able to carry forth its role successfully and protect the integrity of over the counter markets.

Background on DTCC and its History

The general public may not have heard of DTCC before. That's probably not an accident. We have traditionally kept a low profile, given the critical nature of the essential infrastructure role we play in U.S. financial markets. Last year DTCC settled $1.88 quadrillion in securities transactions across multiple asset classes. We essentially turnover the equivalent of the U.S. GDP every three days—and we provide the post-trade processing efficiency and low cost that attracts investment capital that helps fuel the U.S. economy.

DTCC, through its subsidiaries, provides clearing, settlement and information services for virtually all equities, corporate and municipal bonds, U.S. government securities, mortgage-backed securities, commercial paper and other money market instruments, and over-the-counter derivatives. In addition, DTCC has supported the enormous growth and consumer choice in the purchase of mutual funds and annuity transactions, by linking funds and carriers with the firms who market these products. Lastly, DTCC's depository is the largest securities depository in the world, providing custody and asset servicing for 3.5 million securities issues from the United States and 110 other countries and territories valued at $30 trillion.

Equally important, we are a market-neutral, member-owned and governed organization. We are regulated by the SEC, the Federal Reserve Board of Governors and the New York State Banking Department for many of our activities.

DTCC, throughout its history, has played a central role in helping our financial markets during a period of crisis. Our subsidiaries, The Depository Trust Company (DTC) and National Securities Clearing Corporation (NSCC), were created in the 1970s to help address the famous paperwork crisis on Wall Street, when thousands of messengers carried bags of stock certificates and checks to settle trades and recordkeeping strains forced the New York Stock Exchange to shut down on Wednesdays to process the backlog of trade records. During this period the NYSE traded an average of 15 million shares daily. Today, DTCC supports more than 50+ equity markets, including the NYSE, Nasdaq, ECNs and ATSs, and we can process 19.3 billion shares traded in a single day. In the mid-1980s, we implemented similar protections for the U.S. Treasury markets, providing automation and processing safeguards to protect the certainty and attractiveness of trading in U.S. Government securities. In the late 1980s, we removed the barriers preventing the growth in sales of mutual funds—and providing U.S. investors with unprecedented choice and low cost.

At its core, DTCC is a huge data processing and risk management business, involving the safe transfer of securities ownership and settlement of trillions of dollars in trade obligations, under tight deadlines every day. At the same time, DTCC's primary mission is to protect and mitigate risk for its members and to safeguard the integrity of the U.S. financial system. Mitigating risk means we not only have the capacity to handle unpredictable spikes in trading volume, but that we have the business continuity and resiliency to withstand both the "unthinkable" –and even the "unknowable."

Operating During Crises

For example, one major challenge to our resiliency was after the September 11 attacks. Our headquarters was just 10 blocks from the World Trade Center. While the stock exchanges did not open, DTCC still had a job to do and never missed a beat. Despite the chaos that Tuesday morning, nearly 400 employees remained at DTCC 's headquarters, even though lower Manhattan was sealed off by the government, to complete that day's settlement of more than $280 billion in outstanding trades from the prior Friday and Monday. And throughout that week, working from backup facilities, DTCC completed settlement of nearly $1.8 trillion in trades that were in the "pipeline", which was a critical step to allowing our capital markets to open the following Monday.

The crisis following the Lehman bankruptcy was equally challenging. Because of our ability to manage risk and see exposure from a central vantage point across asset classes, DTCC was able to help market participants and regulators ensure that market risk – and systemic risk – was controlled. DTCC successfully closed out over a half trillion dollars in exposure from Lehman's trading in equities, mortgage-backed and U.S. government securities. Most would agree this was the largest and most complex wind-down in history, but with nearly 36 years of experience in managing risk events, we were able to complete this wind down in a matter of a weeks with no impact to our own company's balance sheets, loss to our market participants' clearing fund deposits—or additional exposure to taxpayers. These are just two examples of the comprehensive and critical roles DTCC plays in maintaining stability for our capital markets.

Managing Multiple Credit Events from a Central Vantage Point

Our Warehouse for OTC credit derivatives likewise does more than simply maintain comprehensive records on CDS transactions. The Warehouse also handles the calculation, netting, and central settlement of payment obligations between counterparties, and it has automated the processing of "credit events" – situations where the protection against default provided by a credit default swap is activated.

Over the past year, DTCC has seamlessly processed or is processing, through the Warehouse, more than 40 credit events, including the Lehman Brothers and Washington Mutual bankruptcies as well as the conservatorships for Freddie Mac and Fannie Mae. No one could have foreseen the storm of credit events that shook the market last year and this year, but thanks to the central infrastructure we built for the CDS market and our ability to see and manage these credit events from a central vantage point, we were able to ensure a more seamless and safe final disposition of hundreds of billions of dollars in CDS payouts triggered by these bankruptcies and government takeovers.

If I may cite the March 9, 2009 report, prepared by the Senior Supervisors Group, which comprises the senior financial regulatory supervisors from seven major countries, including Germany, France, UK, Swiss, Japan and the U.S.:

"DTCC's credit event processing service enabled firms to manage the large number of affected CDS trades during the recent events. All surveyed participants indicated that without the DTCC service and the [Trade Information Warehouse], the process would have been manual and burdensome and they could not have completed timely processing."

Having all CDS trade information in one centralized infrastructure was highlighted in the report as making it easier for market participants to identify affected trades and facilitate handling of various lifecycle events, such as settlement and credit event processing. In the midst of the crisis, the process of having to glean and coordinate the necessary information from more than one repository would have been a frightening prospect.

Enhancing Transparency

As the only source of key data on the CDS market, DTCC recognizes and supports the public policy goals articulated in U.S. Treasury Secretary Geithner's May 13 Letter to the House and Senate Leadership on the need to promote transparency in the OTC markets.

DTCC has been working closely with market participants and regulators to achieve that vision. Since November 2008, DTCC has been publishing weekly on its website, key statistics and data from the Warehouse on the size and turnover of the CDS market.

Increased public disclosure on CDS data has been instrumental in bringing better clarity to the market's true risk exposures to credit events, which first surfaced following the Lehman Brothers bankruptcy filing in September 2008. At the time of the Lehman crisis, rampant speculation valued the market's CDS risk exposure from the bankruptcy to be as high at $400 billion, causing unease and a sense of panic in some quarters. Since we held the vast portion of information on CDS positions in our Warehouse, we took the unprecedented step to issue a press release on a Saturday in mid-October to clarify that based on our Warehouse records, the exposure to Lehman was closer to a net notional value of about $6 billion. Ultimately, at the close of this credit event, $5.2 billion changed hands between counterparties.

Over the summer, we issued a similar press release following the GM bankruptcy, reportedly the largest for an industrial company in U.S. history, surpassed only in dollar value by the Lehman bankruptcy CDS numbers.

In the June 8 *New York Times'* Breaking Views column, the Warehouse was praised for bringing greater transparency on CDS exposure following the GM bankruptcy:

"The vague guesses of four years ago have been replaced by hard data. The Depository Trust & Clearing Corporation, which now collects trading information, was able to say last week that the $35.3 billion in outstanding swaps trades on GM netted down to possible payments between market participants of an unremarkable $2.2 billion."

Today, when credit events such as GM occur, having this data more readily accessible to the public through our weekly postings has helped demystify CDS instruments somewhat and help avoid the market anxiety that was so pervasive during the Lehman crisis.

Working with Global Regulators

The marketplace for OTC derivatives is truly global in nature, but we would express caution about the proliferation of trade repositories. When we originally designed the Warehouse with market participants, we spent a long time making sure there would be no duplication of data and that the transfer of information happens when it is supposed to. None of those control mechanisms would work very well in a context where there is more than one Warehouse. Additionally, every regulator in the world, if it was seeking to ensure the soundness of firms under its purview, would need access to *all* global central repositories in order to effectively supervise the risks firms were taking. The risks associated with the market for OTC derivatives will not be easily managed, if you can not see the positions globally.

To this end, we regularly provide information to regulators worldwide in support of their own regulatory missions, including the European Central Bank and the Financial Services Authority in the U.K.

Here at home, we also recently filed an application with both the Federal Reserve and the NY State Banking Department to create a new subsidiary to operate the Warehouse, as a regulated member of the Federal Reserve System, aligning ourselves with the direction that our regulators have set and formalizing the interaction that we are already having with regulators in the U.S. and abroad. Regardless of our current regulatory status, DTCC is prepared to come under the regulatory purview of any regulator that you deem relevant to overseeing our activities.

International regulators demonstrated their own commitment to increasing cooperation on a global basis with the announcement this week that they have established the OTC

Derivatives Regulators' Forum, a group comprised of central banks, market regulators, government bodies and others that have jurisdiction over OTC derivatives market infrastructure providers or OTC derivatives market participants. The Forum will be charged with developing a global framework for regulatory cooperation and to share ideas and information on CCPs and trade repositories serving the OTC derivatives market. DTCC supports this effort because we recognize that in the OTC derivatives market, there needs to be a global solution with a regional approach versus a regional approach that doesn't provide a global perspective. In other words, a global marketplace demands a coherent set of regulations that apply on a global basis.

DTCC to Support All CCPs in OTC Derivatives Market

While DTCC supports the role of central counterparties (CCPs) in OTC derivative trading to provide trade guarantees, the CCPs do not obviate the need to retain the full details on the underlying trading positions in a central trade repository to support regulatory oversight and transparency in this market. As an organization that provides CCP services in other markets, like equities and government securities, we support and recognize the value a CCP can bring to the derivatives markets. In fact, we've stated publicly that our Trade Warehouse will support all efforts to create CCP services planned in the U.S. and overseas, on a non-discriminatory basis.

At the same time, we are concerned that some in the OTC derivatives market may assume once a trade guarantee is provided through a CCP, there may be less need for a central registry to track the underlying position data. We reject this view, based on our long experience managing the risk flowing from the failure of a single member firm. At the critical juncture of a firm failure, knowing the underlying position data of multiple transactions in a timely manner will be significant in providing transparency to regulators—and in protecting confidence in the market itself.

And so, as I wrap up my remarks, I would like to reiterate the importance DTCC places on the progress made to-date with market participants and regulators to foster a sound, safe and transparent OTC derivatives market. As the operator of the only global trade repository, we have a unique perspective on its value in helping regulators mitigate systemic risk during a crisis.

Our Trade Warehouse or central repository connects and services over 1,400 global dealers, asset managers, and other market participants, providing a central operational infrastructure covering approximately 95% of all current credit derivatives traded worldwide. This trade repository was designed to combat the risk of fragmentation of information in the financial markets. Unfortunately, the approach adopted in the different proposals under consideration would put at risk this comprehensive source of information that is now in place and ably serving regulators and the public. We, therefore, strongly recommend that the Discussion Draft be revised to ensure that all swap trades, regardless of whether they are cleared or not, be reported to a single swap repository, which exists to provide regulators and the public with the consolidated information they need during normal times, and, especially, at times of crisis.

DTCC remains ready to work with Members of Congress, the Administration, global regulators and market participants to help accomplish our shared vision of greater transparency, risk mitigation and resiliency in this dynamic market. Thank you.