

House Committee on Financial Services

Testimony of

Don Donahue
Chairman and Chief Executive Officer

The Depository Trust & Clearing Corporation

February 15, 2011

Chairman Bachus, Ranking Member Frank and Members of the Committee, my name is Don Donahue. I am the Chairman and CEO of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is a non-commercial industry “utility” that, through its subsidiaries and affiliates, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities and money market instruments, as well as a significant portion of the global over-the-counter (“OTC”) derivatives market. In 2010, The Depository Trust Company (“DTC”), a wholly-owned subsidiary registered as a clearing agency under the Securities Exchange Act of 1934 (“Exchange Act”), settled more than \$1.66 quadrillion in securities transactions.

Since 2006, DTCC has operated the Trade Information Warehouse, (“TIW” or “Warehouse”) a centralized, comprehensive global electronic containing detailed trade information for the global credit default swaps (“CDSs”) markets. This was implemented in stages and reached full fruition in 2009. The TIW database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a gross notional value of \$29 trillion.

I very much appreciate the opportunity to share DTCC’s thoughts on the implementation of Title VII of the Dodd-Frank Act. In particular, I will focus on issues raised in connection with the Dodd-Frank Act’s creation of a swap data repository (“SDR”) system for providing regulators and the public with the necessary transparency into the global OTC derivatives markets as a means to mitigate systemic risk. DTCC shares Congress’ goal of ensuring more transparent markets for global regulatory oversight and systemic risk mitigation, protecting the public and ensuring liquid and efficient capital markets. Finally, it is our strong belief that while many of the regulatory aspects of Dodd-Frank Act remain in development, transparency is a policy option that is most ripe for implementation.

Summary of Critical Points

DTCC would like to bring two basic points to the attention of the Committee:

1. Transparency is Key to any Attempt to Mitigate Systemic Risk in the Swap Markets

DTCC is supportive of the principle in the Dodd-Frank Act that all swaps, whether cleared or uncleared, must be reported to SDRs. While there remains on-going debate about the causes of the financial crisis of 2008, there is broad consensus that, to the extent OTC derivatives contributed to the crisis, it was due to (a) the very large one-way positions that American International Group, Inc. (“AIG”) took in mortgage-related credit default swaps, which threatened the continued viability of a systemically important firm and went unreported until it was too late; and (b) the general lack of understanding with respect to the extent of the exposures across all of the swap markets, contributed to a lack of confidence in the creditworthiness of financial institutions at just the wrong time.

The infrastructure needed to protect against these types of situations has since been put in place for the global CDS market. This safety net was developed as a cooperative effort between the market participants and regulators worldwide under the auspices of the OTC Derivatives Regulators' Forum ("ODRF"), which is comprised of over 40 regulators and other authorities worldwide, including all of the major regulators and central banks in the U.S. and Europe. Although this effort began prior to the 2008 crisis, it wasn't until 2009 that a fully comprehensive global CDS data set was obtained through the cooperative efforts of the ODRF, over 1,700 participants in the CDS market from over 50 countries and DTCC, including the non-standardized mortgage-related swaps held by AIG. With the availability of a comprehensive data set, DTCC was able to publish comprehensive market-wide information free of charge to the general public. DTCC was also able to provide comprehensive standard position risk reports to appropriate authorities worldwide (as well as responding to over 100 *ad hoc* requests from such authorities).

More recently, DTCC launched an "on-line" regulator portal through which regulators and other authorities can directly access and query through secure interfaces detailed position risk data from a global data set relating to their regulatory requirements. At present, 19 different regulators worldwide have linked to this portal.

These position risk reports and the "on-line" portal, applied over that complete global data set (most of the systemically risky trades by AIG were executed in London) would have provided regulators with sufficient early warning of the build-up of risky AIG positions to have enabled them to take corrective measures before the positions became so large that they threatened the fabric of the global financial system.

With respect to public market transparency, the comprehensive global market information that DTCC is now able to publish includes, among other things, net market-wide exposures to each CDS index and index tranche, as well market-wide exposures to each of the top 1,000 individual corporate and governmental entities on which CDS are written (ranked by size of exposure). With respect to more aggregated data, (e.g., overall exposure to sovereign debt, corporate debt and other broad categories) the published data also indicate which broad category of market participants holds what positions (these disclosures are made at this less granular level to protect the identity of position holders). Had this information been available and published in the run-up to the 2008 crisis much of the exposure uncertainty that contributed to market instability at the time, at least in the CDS market, could have been mitigated.

2. Providing Transparency is a Cooperative Effort.

My focus on the collective achievement -- and it was truly a collective achievement -- surrounding transparency in the CDS market is not with the intention of boasting about DTCC's contributing role, but rather to bring to the Committee's attention why this effort has been successful.

First, this achievement would not have been possible without the substantial and unusual degree of global regulatory cooperation achieved through the ODRF and the OTC Derivatives Regulators Supervisors Group (“ODSG”). Additionally, for this process to work, it was important that DTCC was not a traditional commercial entity and, as such, had no motivation for holding the data other than to help both the regulators and market participants by providing a central place for data to be reported and for regulators to access it *for both market surveillance and risk surveillance purposes*. DTCC believes it was critical to the success of this process to remove commercial concerns from what is and should remain primarily a regulatory and supervisory support function.

Finally, as a true industry-governed utility, with both buy-side and sell-side firms, not to mention self-regulatory organizations, as stakeholders, DTCC has so far been able to secure the cooperation of virtually all market participants and all clearers and trading platforms with any significant volume. If regulatory cooperation or the cooperation of market participants and their respective clearers and trading platforms fails, both the published and regulator accessible data would be fragmented, inevitably leading to misleading reporting of exposures and a very expensive “fix” for the regulators and the marketplace generally. Fragmentation of data will leave the task to regulators of rebuilding in multiple instances the complex data aggregation and reporting mechanisms (including extra-territorial trades on locally relevant underlyings) that had already been created. That task was one of the primary reasons that the industry and regulators themselves created a single place for the data within DTCC.

The challenge going forward is to bring similar regulatory and public transparency to other parts of the swap markets.¹ DTCC would like to commend the work of both the SEC and the CFTC in the thorough and thoughtful approach they have so far taken with respect to the very complex subject of swap data reporting, including their suggested improvements to the current structure for reporting credit default swaps and their proposals regarding which features of the current reporting structures would meet regulatory needs in other swap asset classes.

However, given the need to move expeditiously and to assure the continuation of the necessary cooperative attitude among regulators, market participants, clearinghouses and trading platforms worldwide, the focus should be on expanding upon the current cooperative achievements of providing both regulatory and public transparency to the swap markets. Such cooperative efforts take some minimal amount of time to implement safely and soundly (our experience suggests a minimum of 24-36 weeks if participants cooperate). If there is a lack of cooperation, it will take significantly longer.

¹ There are two other global swap repositories in existence today, one for OTC equity derivatives operated by DTCC in London and one for OTC interest rate derivatives operated by TriOptima in Sweden. These repositories, however, were designed solely as a means to facilitate certain high-level position reporting by the major global dealers and do not hold sufficient data to meet the regulatory needs specified by either the Dodd-Frank Act or the ODRF (including both market surveillance and risk surveillance), which have superseded the initial requirements set forth for these entities.

It is our sense, as a user governed and regulated utility servicing most of the major regulators worldwide, that the market participants and regulators globally are poised to undertake the significant cooperative effort necessary to provide complete transparency to these markets as contemplated by the Dodd-Frank Act. DTCC implores this Committee, in exercising its oversight function, to focus on removing obstacles to this process and to urge the continued use of proven infrastructure in a manner that distinguishes the SDR function from purely commercial considerations and jurisdictional quarrels, which could hinder the cooperative attitude that has made progress possible thus far.

Overview of DTCC

As stated above, DTCC, a user owned market utility, through its subsidiaries, provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities and mortgage-backed securities transactions and money market instruments and for many OTC derivatives transactions. DTCC is also a leading processor of mutual funds and annuity transactions, linking funds and insurance carriers with their distribution networks. DTCC does not currently operate a clearing house for derivatives. However, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC (“NYPC”), which has been granted registration as a derivatives clearing organization (“DCO”) by the CFTC.

DTCC has three wholly-owned subsidiaries which are registered clearing agencies under the Exchange Act, subject to regulation by the SEC. These three clearing agency subsidiaries are DTC, National Securities Clearing Corporation (“NSCC”) and Fixed Income Clearing Corporation (“FICC”). DTCC is owned by its users and operates as a not-for-profit utility with a fee structure based on cost recovery.

DTC currently provides custody and asset servicing for 3.6 million securities issues from the United States and 121 other countries and territories, valued at almost \$36 trillion. In 2010, DTC settled more than \$1.66 quadrillion in securities transactions, which amounts to the equivalent to the full value of the annual U.S. Gross Domestic Product every three days. NSCC provides clearing, risk management, central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and/or central counterparty services (through its Government Securities Division) in the fixed income, mortgage backed and government securities markets. Thus, DTCC, through its subsidiaries, processes huge volumes of transactions – more than 30 billion a year – on an at-cost basis.

Overview of the Trade Information Warehouse

DTCC began automating the derivatives market in 2003, in response to the Federal Reserve’s desire for an industry solution to mitigate risk. At that time, just 15% of CDS trades were being matched. DTCC’s Deriv/SERV system now matches and captures critical data for over 98% of these trades. In November 2006, at the initiative of swap market participants, DTCC expanded further to launch the TIW to operate and maintain the centralized global electronic database for virtually all position data on CDS contracts outstanding in the marketplace. Since the life cycle

for CDS contracts can extend over five years, in 2007, DTCC “back-loaded” records in the Warehouse with information on over 2.2 million outstanding CDS contracts effected prior to the November 2006 implementation date. As stated above, the Warehouse database currently represents about 98 percent of all credit derivative transactions in the global marketplace; constituting approximately 2.3 million contracts with a notional value of \$29 trillion (\$25.3 trillion electronically confirmed “gold” records and \$3.7 trillion paper-confirmed “copper” records).

In addition to repository services, which include the acceptance and dissemination of data reported by reporting counterparties, the Warehouse provides legal recordkeeping and central life cycle event processing for all swaps registered therein. By agreement with its 17,000+ users worldwide, the Warehouse maintains the most current CDS contract details on the official legal or “gold” record for both cleared and bilaterally-executed CDS transactions. The repository also stores key information on market participants’ more customized CDS swap contracts, in the form of single-sided, non-legally binding or “copper” records for these transactions, to help regulators and market participants gain a more clear and complete snapshot of the market’s overall risk exposure to OTC credit derivatives instruments.

DTCC’s Warehouse is also the first and only centralized global provider of life cycle event processing for OTC credit derivatives contract positions throughout their multi-year terms. Various routine events, such as calculating payments due under contracts, bilaterally netting and settling those payments and less-common events, such as credit events, early terminations and company name changes and reorganizations, may occur, all requiring action on behalf of the parties to such CDS contracts. DTCC’s Warehouse is equipped to automate the processing associated with those events and related actions. The performance of these functions by the Warehouse distinguishes it from any swap data repository that merely accepts and stores swap data information.

The Indemnification Provision and Its Impact

Consistent with our discussion about the need for global regulatory cooperation in ensuring access to the data necessary to protect against systemic risk, DTCC is deeply concerned about the indemnification provisions in Sections 728 and 763 of the Dodd-Frank Act. The Dodd-Frank Act requires that repositories obtain indemnifications from foreign regulators before sharing information with them. There was no legislative history behind this provision, which was incorporated late in the legislative process, without having been considered in the hearing process. As a result, it was not subject to extensive discussion and consideration prior to the enactment of the Dodd-Frank Act, and its negative consequences must not have been clear to legislators or the relevant regulatory bodies. DTCC believes that the indemnification provision will significantly impede global regulatory cooperation.

Regulators are not likely to grant DCOs or SDRs indemnification in exchange for access to information. Accordingly, regulators may be less willing to access the aggregated market data, resulting in a reduction of information consumption, domestically and internationally, which jeopardizes market stability.

This provision gives foreign jurisdictions an incentive to create their own local repositories in order to avoid indemnification. Proliferation of local “national” repositories around the world will make it very difficult to obtain a full picture of a particular asset classes, impair market and regulatory oversight, create inconsistencies in data, frustrate data analysis and increase systemic risk.

Further, the provision could have an immediate negative impact on the ability of U.S. regulators to obtain information from repositories located in foreign countries should reciprocal indemnification provisions be enacted in foreign laws. U.S. regulators, like foreign regulators, might be legally or practically precluded from signing such agreements.

In light of the existing indemnification requirement, this Committee should encourage regulators to waive indemnification in situations where foreign regulators are carrying out their regulatory responsibilities *in a manner consistent with international agreements* which includes maintaining the confidentiality of data.

Alternatively, removing this provision of the Dodd-Frank Act in technical corrections bill may be appropriate in order to avoid undermining the ability of U.S. regulators to obtain information in derivatives markets on a global basis.

Regulatory Status of Trade Repositories – Global Cooperation

Derivatives markets are inherently cross-border, as participants in a transaction are often located in more than one jurisdiction. From the outset, DTCC has understood that the TIW serves a global function, and the information held by the Warehouse is relevant to regulators in many locations. DTCC believes it is important to support regulators around the world and has effectively done so since the end of 2008.

The SDR regime established under the Dodd-Frank Act must recognize the global characteristics of OTC derivatives markets and, for that reason, regulators and SDRs should ensure international harmonization. DTCC has worked closely with the ODRF and, with DTCC’s support, the group agreed to criteria for the sharing of data, recognizing the need to have critical data on CDS accessible across geographic boundaries and regulatory jurisdictions. DTCC has implemented regulatory disclosure processes using those criteria and urges the same approach for other asset classes going forward.

DTCC hopes that global regulators will eventually recognize the overwhelming advantage of understanding risks globally from a central vantage point, thereby avoiding the data fragmentation, which critically detracts from the management of systemic risk. Preventing the exchange of information between regulators will frustrate efforts to mitigate international financial risk and fragment regulatory oversight on a jurisdiction-by-jurisdiction basis.

As the system for the use of repositories is developed internationally, it is very important for the U.S. to facilitate a result that will place U.S. regulators and foreign regulators on an equal footing

in their ability to obtain information from repositories quickly and without barriers. In implementing the Dodd-Frank Act, U.S. standards should be developed to be compatible with those standards still under development in other countries, meeting the needs of both U.S. and foreign regulators. Given the risks to U.S. financial system can be impacted by transactions occurring virtually anywhere in the world, it is essential that the SEC and CFTC's final regulations create SDRs that meet the immediate needs of U.S. regulators and the long-term need of harmonization with the requirements of regulators in Europe and other major financial markets.

One major philosophical and pragmatic question that arises with respect to global cooperation is whether market data should be collected and held by the private sector and made available to regulators on an as-requested basis or, alternatively, whether governments themselves should collect the data and disseminate as a result of treaty and information-sharing agreements.

DTCC urges Congress to consider whether the goal of addressing systemic risk can be reasonably met through the U.S. relying on other governments throughout the world to share information with U.S. regulators. DTCC is skeptical of such an approach, which has been explored by U.S. regulators in the rule-making process. Instead, DTCC recommends that Congress urge U.S. regulators to rely on regulated private sector entities to collect information and disseminate it as appropriate, under a common system that is acceptable to the U.S. and other countries. The experience in the market today supports this approach, as it currently works well at the Warehouse.

Repositories' Role in Promoting Transparency and Reducing Systemic Risk

By aggregating information, repositories collect and compile all relevant data in order to assure appropriate market transparency and effective monitoring of systemic risk. Global repositories have been or are being established for each OTC derivatives asset class, which can provide regulators in the US and around the world real-time access to the data necessary to monitor and safeguard financial markets.

The Dodd-Frank Act has identified SDRs as central to helping U.S. regulators maintain the safety and soundness of derivatives markets. DTCC has urged regulators, and urges this Committee, to focus on three objectives in moving forward with regulations covering SDRs:

- 1) Enhancing market transparency for regulators and market participants;
- 2) Reducing systemic risk by ensuring regulators can determine a firm's underlying position and exposure in an integrated fashion; and
- 3) Promoting coordination and efficiency in the supervision of global capital markets.

DTCC urges Congress, as well as regulators, to think carefully about the implications of fragmenting information about outstanding contracts into different repositories, in different countries, on different continents.

If French regulators have to examine a dozen different trade repositories to determine what kind of credit default swap contracts may be outstanding on French companies, the likelihood is that

they will never find all of the contracts, at least not quickly. Contract records could be scattered across repositories in the U.S., in Europe, in Japan, in Dubai, in Hong Kong and elsewhere. Nor is it likely to be apparent to the regulators what they are looking for, since the offsets to contracts residing in one database might be residing elsewhere. A contract could easily have been written between a Swiss financial institution and an Australian financial institution on an underlying French entity, only to be sold or assigned to another party located in Brazil. Even if all of the data is eventually located, a system to verify and analyze it would still be required.

All of the information detailed above is currently collected in the DTCC CDS Warehouse globally, and data is published weekly on all of the contracts held, including a breakdown by currency. DTCC has consistently stated that all interested regulators should have access to the data they need and, for approximately the past year, DTCC has made such data available as appropriate to the regulators involved in accordance with the global criteria adopted by the ODRF. All of this functional transparency will be undermined if regulators move ahead with an approach that does not provide for globally consolidated data.

Global regulators need consolidated reporting across international markets. International regulatory guidance for derivatives regulation has recognized that aggregated data is vital to provide a comprehensive view of derivatives markets. For example, last October, the Financial Stability Board suggested that a beneficial solution to the needs of regulators throughout the world would be the establishment of “a single global data source to aggregate the information from [SDRs].”

The Rule-Making Process

The regulatory implementation of Title VII has been extremely demanding, both on regulators and on market participants. DTCC has filed comments on a number of proposed new rules governing SDRs. Copies of DTCC’s comments filed to date are appended to this testimony, and I request that they be entered in full into the hearing record, as they address many technical issues in detail that goes well beyond what is appropriate to cover in this statement.² I will cover the highlights of our comments on the major issues that DTCC believes are most likely to be of interest to this Committee, beginning with proposed standards for repositories.

²They include comments on the CFTC’s Interim Final Rule for Reporting Pre-Enactment Swap Transactions; the CFTC/SEC request for general comments on SDRs and mitigation of conflicts of interest; the CFTC Proposed Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest; the SEC’s Proposed Rule on Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies; Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC; the SEC’s Interim Final Rule on the Reporting of Security-Based Swap Transaction Data; the SEC Proposed Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information; the FSOC Advance Notice of Proposed Rulemaking Regarding Authority to Designate Financial Market Utilities as Systematically Important; the SEC’s Proposed Regulation on Security-Based Swap Repository Regulation, Duties and Core Principles; the OFR Statement on Legal Entity Identification for Financial Contracts, the CFTC Proposed Regulation on Real-time Public Reporting of Swap Transaction Data, and the CFTC Proposed Regulation of Swap Data Recordkeeping and Reporting Requirements.

Proposed Standards for Swap Data Repositories

DTCC has recommended that the regulations implementing Title VII set high standards for SDRs so that they meet the needs of regulators and the markets, serving as an industry utility for both. DTCC also recommends that the rules be refined to only cover entities that are actually acting as repositories, rather than entities merely providing ancillary functions. Some of the major principles include:

Neutrality. DTCC urges regulators to adopt standards for SDRs that foster neutrality and “open access” to all market participants. Regulators must ensure that the public utility function of SDRs is separated from potential commercial uses of the data. SDRs should operate objectively and impartially, with an arms-length and non-discriminatory relationship to any and all clearing, confirmation and execution facilities, affiliated or otherwise.

Round-the Clock Operations. Markets never sleep and neither should repositories. Regulators should require every SDR to operate on a 24/6 basis, process transactions in real-time and maintain redundancy.

Real-Time Processing. Market participants and regulators need repositories to perform their functions without delay in order to facilitate accuracy and the completeness of market information.

At-Cost Fee Structures. Because SDRs operate as utilities, they should be required to maintain non-profit fee structures, with at-cost operating budgets, rather than providing sources of revenue for commercial enterprises.

Redundancy. It is a material weakness for any SDR to fail to maintain adequate redundancy sufficient to protect data bases in light of catastrophic events. Significant and extensive requirements for redundancy for every SDR, consistent with long-established U.S. and global standards for business continuity and resilience, are essential for proper function and mitigation of systemic risk.

No Reductions in Registration Requirements or Performance Requirements. SDRs should be required to meet proposed standards fully, even during the temporary registration phase. The proposed regulations allow for temporary registration for SDRs while regulators assess an SDR’s capabilities. To protect safety and soundness, DTCC recommends that appropriate due diligence be conducted during the temporary registration process to ensure that new entrants have adequate operational capabilities, including 24/6 operation, real-time processing, multiple redundancy and robust information security controls.

Phase In for Existing Repositories. Existing repositories, such as the TIW, already provide important transparency to regulators and markets. Final regulations need to ensure that the existing operations of any entity that intends to register as an SDR are not interrupted through the

registration process. This can be achieved with phase-in transition arrangements for existing repositories whose services need to be amended to conform to final rules and the effective date of the Dodd-Frank Act.

Regulatory Harmonization. While comprehensive and thoughtful, proposed CFTC and SEC regulations governing repositories are not identical and, in some areas, differ materially. To avoid creating conflicting standards and imposing unnecessary costs, Congress should urge regulators to harmonize the regulations overseeing SDRs.

Implementation Issues

The proposed regulations issued under the Dodd-Frank Act place substantial demands on existing repositories, and those substantial demands apply to anyone who seeks to become a repository.

DTCC recommends that appropriate transitional arrangements be made to avoid market disruption in the implementation process of the proposed regulations. This can be done through a phase-in period for existing service providers like the Warehouse and by allowing a longer period for registration of new service providers who wish to become repositories, enabling them to put in place adequate systems and appropriate controls to meet the Dodd-Frank Act standards.

The implementation of the Dodd-Frank Act also places a significant burden on regulatory agencies. DTCC is merely one participant among a great number of entities consulting regularly with the CFTC and the SEC as these regulators seek to carry out their statutory mission. In meeting with these regulators, it is clear that they feel heavily burdened and are doing their best to meet the demands placed on them by the implementation of this monumental legislation.

Conclusion

Generally, the Dodd-Frank Act established an appropriate framework for the further development and use of repositories in the United States and internationally. DTCC does, however, recommend that Congress review the Act's indemnification requirement. As contemplated, could create substantial problems for the U.S. regulators by giving foreign jurisdictions the incentive to establish separate repositories that operate on a local or national basis, rather than an international standard.

International coordination is critical to achieving the level of transparency necessary to mitigate systemic risk in swaps markets. DTCC also urges that legislators and regulators focus on the use of consolidated repositories, or single repositories by asset class, to counter the risk of fragmentation. Finally, it is critical that in implementing the Dodd-Frank Act, regulators build on existing systems and processes to address the policy goals of the Act. Building on existing systems will result in the most cost-efficient, effective and immediate solutions.

As I stated at the beginning of my testimony, risk mitigation is central to DTCC's mission. As regulators and legislators across the globe write the rules under which the OTC derivatives

markets will operate, DTCC is actively engaged in the dialogue. DTCC has a unique perspective to share and appreciates the opportunity to testify before you today.

I look forward to answering any questions the Committee may have.