United States Senate
Committee on Agriculture, Nutrition, and Forestry

"Dodd-Frank Wall Street Reform and Consumer Protection Act: 2 Years Later"

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Chairwoman Stabenow, Ranking Member Roberts, and Members of the Committee, thank you for inviting me today to testify at this hearing.

I am Larry Thompson, General Counsel of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is a participant-owned and governed cooperative that serves as the critical infrastructure for the U.S. capital markets as well as financial markets globally.

Through its subsidiaries and affiliates, DTCC provides clearing, settlement and information services for virtually all U.S. transactions in equities, corporate and municipal bonds, U.S. government securities, mortgage-backed securities and money market instruments, and mutual funds and annuities. DTCC also provides services for a significant portion of the global over-the-counter ("OTC") derivatives market.

I appreciate the opportunity to testify this morning on the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") two years after its passage and to provide insight from our perspective as a critical infrastructure provider, particularly as it relates to Title VII and the role of swap data repositories ("SDRs") and Legal Entity Identifiers ("LEIs") in the new regulatory regime.

Introduction

The DFA requires that all derivatives transactions, whether cleared or uncleared, must be reported to newly created SDRs. Based on our experiences over the last several years in developing such reporting systems, this is the right policy, and I am happy to report to you the progress that has been made from our perspective. Although the actual DFA reporting will not technically begin until sometime in September, following the credit crisis, regulators globally and the public have had access to significant amounts of data, particularly in the credit default swap ("CDS") market. The availability and accessibility of this information has helped bring greater transparency to what was previously an opaque market.

These voluntary efforts that DTCC has pursued have given us insight into the importance of such data to regulators and the public. We have every expectation that the SDR system DTCC and others are developing will help provide regulators the information they need to manage systemic risk and provide market oversight.

DTCC's efforts to date have shown that transparency truly does represent an important first step in giving regulators the tools they need to better understand systemic risk and more effectively perform market surveillance and oversight functions. The next step involves regulators acquiring the analytical tools to red flag excessive risk-taking or other anomalies so they can take action quickly to prevent or mitigate systemic shocks to the financial system.

Against the backdrop of the sovereign debt crises, corporate failures, credit downgrades, and significant losses by financial institutions as a result of OTC derivatives transactions, data transparency in the CDS market achieved through voluntary industry reporting has helped ensure market stability during times of volatility and given supervisors and the public the ability to more fully understand risk concentrations and levels of exposure.

For example, when the Greek government restructured its government debt earlier this year, it did not trigger extreme volatility in the markets as the restructuring might have in the past because regulators and the public had access to reliable and comprehensive information regarding the extent of market exposure to Greek debt. This experience, along with several other similar incidents, illustrates the value of SDRs for regulatory oversight, systemic risk identification and mitigation, and increased transparency for market participants.

Voluntary Initiative Benefits Mandated Trade Reporting, Depth of Repository Information

DTCC's ability to provide transparency into OTC derivatives markets predates the adoption of the DFA and reflects extensive experience operating an efficient and effective voluntary model for a trade repository. Since 2006, DTCC has operated the Trade Information Warehouse ("TIW" or "Warehouse"), which serves as a centralized, comprehensive global electronic data repository containing detailed trade information for the CDS markets. Today, as a result of this voluntary industry initiative, the TIW holds more than 98 percent of all credit derivative transactions in the global marketplace, including approximately 2.3 million separate contracts with a gross total notional value of $27 trillion.

Since the start of the financial crisis in 2008, DTCC has been providing market transparency to regulators and the public on credit derivatives transactions by leveraging data held in the TIW. In November 2008, in response to mounting concerns and speculation regarding the size of the CDS market following the collapse of Lehman Brothers, DTCC began public aggregate reporting of the CDS open position inventory. Today, this reporting includes open positions and weekly volume turnover, providing aggregate information that is extremely beneficial to both the public and regulators in understanding the size and level of activity in the market.

Comprehensive global market information is published by DTCC and made available at no cost to regulators or the public each Wednesday on our public website, www.dtcc.com. The data is robust and includes, 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 (top 1000 ranked by size of exposure). This allows market participants, regulators and the public to assess risks on the basis of timely comprehensive data, enabling them to develop informed views of market activity.

The published data also details broad categories of market participants and their positions in relation to important areas of the market, such as overall exposure to sovereign debt, corporate debt and other sector categories. Of note, details that would disclose the identity of position holders are withheld from the public website. Had this global and sector-based market 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.

Global Electronic Database for Regulators

DTCC launched a "Regulatory Portal" in January 2011 for efficient regulator access to more granular trade data, utilizing a set of principles established by a consortium of regulators globally that enabled data information sharing amongst them. The taskforce created by the Committee on Payment and Settlement Systems ("CPSS") and the Technical Committee of the International Organization of Securities Commissions ("IOSCO") on regulator access to data is now reviewing these principles. DTCC will continue to coordinate and cooperate with these global efforts regarding regulator access to data.

The Portal provides automated counterparty exposure reports, query capability for market and prudential supervisors and transaction data for central banks with aggregate report views by currency and concentration. The guidelines developed by regulators globally ensure they have access to position and detailed transaction data so long as they have authority over one of the parties to the trade or authority over the underlying reference entity.

The Portal provides an unprecedented degree of market transparency by giving authorities the type of granular data needed to protect against systemic risk and also contains pre-determined filters to limit access to only that data in which the regulator has an appropriate interest. Today, over 40 regulators worldwide are accessing the portal, including U.S., European, and Asian authorities as well as regulators from other regions.

The experience of the TIW and voluntary reporting reinforces that the Dodd-Frank Act provisions related to post-trade reporting of all swaps – cleared and uncleared – does, indeed, yield a wealth of actionable information for regulators and market participants and will help achieve the public policy goals of the Dodd-Frank Act regarding increased transparency into OTC derivatives markets.

Readiness to Meet DFA Reporting Requirements

DTCC is fully prepared to meet DFA reporting requirements and has been working to comply with the Act since it was adopted in July 2010. Over the past two years, DTCC's investment has grown from tens of millions to hundreds of millions of dollars as we work to extend our global services to support swap data reporting for all five OTC derivative asset classes – credit, interest rate, commodities, equity and foreign exchange ("FX").

This infrastructure has been designed to allow regulators to leverage these resources in their efforts to ensure a safe and sound financial system. Based on DTCC's experience with the TIW, the infrastructure has been developed with maximum flexibility so that it can evolve over time to meet the changing needs of regulators and the industry. As new data fields are needed or other information becomes available to support market surveillance, the infrastructure can evolve to accommodate new needs and different priorities.

Two DTCC subsidiaries have applied for registration with the Commodity Futures Trading Commission ("CFTC") to operate as a "Swap Data Repository" for all CFTC-regulated asset classes. In addition, and upon the completion of corresponding rules by the Securities and Exchange Commission ("SEC"), an application will be submitted to operate a security-based SDR. Building on existing reporting relationships with market participants and by leveraging DTCC's infrastructure, the DTCC SDRs are already testing for necessary connectivity and educating market participants on how to report trade data in compliance with the regulations and technological protocols.

Given both the extensive developmental experience and the significant technology investment already made in the infrastructure, these new SDRs will be fully operational in August for interest rate and credit swaps, well in advance of the first DFA reporting deadline now scheduled for mid-September 2012. In addition, these platforms have already completed back-loading a significant share of the pre-Dodd-Frank swaps, or historical swaps data, which is just as vital for regulatory oversight purposes.

Important Next Steps to Meeting DFA Timeframe

Last week, the CFTC and SEC adopted joint rules defining a "swap" and "security-based swap," which will result in certain rules becoming effective 60 days after publication in the Federal Register. Several weeks ago, the SEC released a proposed implementation framework with rules to be implemented by category. As Dodd-Frank implementation moves forward, there are several fundamental steps that must take place.

First, it is vital that rules are put in place by all regulators to begin the reporting and collection of the raw data. These rules relate to reporting obligations and the registration of SDRs. The inflow of transaction information can be used to inform decisions related to other rulemakings, such as clearing determinations and block trade sizes.

Second, regulators must have the appropriate tools to analyze the data for both systemic risk oversight purposes and to identify potential abusive or manipulative market behavior. Having the raw data is important, but unless regulators are equipped with the necessary resources to understand and analyze the data, the full benefits of reporting swap transactions will not be realized. It is critical, for reasons of both time and money, that regulators leverage the capabilities of existing infrastructures to develop the necessary tools needed to identify certain risky behaviors on an automated basis.

Readiness to Meet Global Reporting Requirements

Regulatory bodies globally have also been working to establish similar trade reporting requirements to those contained in the DFA. At the moment, harmonization between the U.S., Europe and Asia remains an uncertain work in progress, although supervisors continue to hold discussions seeking to find common ground to avoid the inappropriate extra-territorial reach of sovereign regulation.

During this time, DTCC is moving forward with plans to provide Trade Repository ("TR") services in Europe and across the Asian-Pacific region:

- Europe: DTCC is actively involved in discussions with the European Securities and Markets Authority ("ESMA") on Europe's transparency needs and is working to comply with newly-issued technical specifications.

- Japan: DTCC has established a legal entity in Japan which is going through the regulatory application process, and will launch a trade repository with the intent to meet Japan's Financial Services Agency (FSA) November 1, 2012, initial start date for reporting.

- Singapore: DTCC has announced plans to operate a global data center in Singapore and will look to register as a trade repository by the end of 2012.

- Hong Kong: DTCC is in discussions with officials to establish a system for trades to be reported through DTCC, serving as an industry "agent" to the local repository under development by the Hong Kong Monetary Authority ("HKMA").

Compliance with DFA Reporting Requirements

Complying with the DFA reporting regime is consistent with DTCC's philosophy to leverage data globally to enable regulators worldwide to view a single, aggregated data set. Based on the current system of voluntary reporting of CDS transactions to the TIW, DTCC has long envisioned compliance with the new trade reporting requirements to look similar to existing voluntary market reporting.

However, I must caution that as final decisions for the establishment of SDRs and TRs are reached, there is great concern among supervisors globally over the possibility of fragmenting data across multiple SDRs in multiple jurisdictions. It is critical during the implementation process of new reporting mandates that 1) the reported data is complete and accurate and 2) a system is developed that allows for data aggregation.

New regulations should allow market forces to converge and support centralization, which is necessary for regulators to have a complete view of the market and the ability to perform market oversight and data analysis. A successful example of such convergence is the creation of the TIW, a single place for the collection of CDS data, created with encouragement of regulators and the support of the industry.

If other systems were to develop that do not ensure aggregation, both the published and regulator-accessible data could fragment, inevitably leading to misleading reporting of exposures. Quite simply, if regulators globally can only see data from one or two jurisdictions, they cannot obtain a full picture of the market. And if a regulator cannot see the whole market, the regulator cannot see the potential for systemic risk. Data fragmentation would leave the expensive task to regulators of rebuilding the complex data aggregation and reporting mechanisms (including extra-territorial trades on locally-relevant underlying positions) that have already been created.

Systemic Risk Oversight of Financial Services Industry

The Dodd-Frank Act extends beyond the OTC swaps markets – as does DTCC's role in enhancing transparency and supporting risk mitigation in global financial markets. To help anticipate a future financial crisis, governments and regulatory communities first need complete, timely position and transaction information across all asset classes transacted by systemically important financial institutions and their counterparties around the world.

Regulators should consider requiring the financial services industry to populate data hubs for regulatory access and allow the regulators to focus on developing the necessary analytical tools and processes to interpret data. It is critical that regulators have a method to find early concentrations and imbalances and to detect systemic problems before risky concentrations build up in the system. As has already been demonstrated, existing infrastructures can be leveraged and new infrastructures can be created very quickly through industry collaboration.

One major concern for the Committee's consideration is that the public sector is not currently in the position to allocate scarce resources and the extensive time needed to develop data collection and reference data efforts like the legal entity identifier ("LEI") initiative. The industry should shoulder these costs, which would free up the public sector to make investments in developing analytical tools and performing their oversight responsibilities.

The public sector should issue standardization and normalization criteria and demand that the industry quickly meet the challenge. The industry has the tools to accomplish this work in the most efficient way possible by leveraging a handful of regulated data stores across all asset classes that already process transactions and hold positions, including exchanges and other marketplaces, depositories, repositories and clearinghouses and other self-regulatory organizations.

Using a few highly regulated and supervised data hubs for information collection and normalization allows the public sector to concentrate on analysis. Having the data without having the most effective technologies in place to interpret it minimizes its value.

Conclusion

Madame Chairwoman, over the last two years, a significant amount of time, resources, and energy has been invested in the DFA legislative and rule-writing process. With the finish line rapidly nearing, it is incumbent upon industry participants to work closely with Congress and regulators to ensure that the rules are adopted and implemented consistently with the statute and in a way to effectively identify and mitigate risks to the financial system. Ensuring access to comprehensive, accurate, and timely data, along with regulators having the tools to analyze this information, are vital to the success of these efforts.

Thank you for your time and attention this afternoon. I am happy to answer any questions that you may have.