



SEF Discussion

August 19, 2010



markitSERV™

A joint service from DTCC and Markit

Agenda

- Trade processing SEF market utility functions
- MarkitSERV business description
- Business environment
- Interpretation of SEF definition under the Dodd-Frank Act (DFA)
- Implications of the scope of SEF functionalities
- The "Trading Requirement" waterfall
- Categories of SEFs – trading, execution and trade processing
- SEF Diagram
- Matters to consider in rulemaking
- Business conduct standards – confirmation of all trades
- Regulatory reporting / public reporting
- Appendix A: Table with SEF categories under the DFA

Trade processing SEF market utility functions

- Summary

- Perform trade processing (pre-confirmation and confirmation services)
- Fulfill the “Trading Requirement” for illiquid and non-competitively negotiated swaps
- Ensure transparency
- Electronically confirm all swap transactions
- Maintain an audit trail
- Provide position aggregation functions
- Perform regulatory and public reporting

MarkitSERV business description

- A trade processing facility
 - Facilitates electronic confirmation and affirmation of swap trades
 - Maintains an audit trail of trades and aggregates positions
- MarkitSERV processes
 - 99% of all credit default swaps for major participants
 - 77% of all interest rate swaps for major participants
 - 36% of all equity derivatives for major participants
 - Growing percentage of other commodity derivatives (fx, ag, energy)
- Interconnection for
 - 70 dealers, 70 inter-dealer brokers and 1,900 buy-side institutions
 - Clearing houses
 - Execution platforms and facilities
 - Swap data repositories
 - System vendors

Business environment

- Transition from paper and fax confirmation of trades to electronic confirmation
- Greater legal certainty of contract terms
- Drive toward almost instantaneous confirmation (T+0)
- Drive toward straight-through-processing
- Ability of market participants to monitor trade status during execution and life-cycle events
- Ability to report transactions and maintain the audit-trails

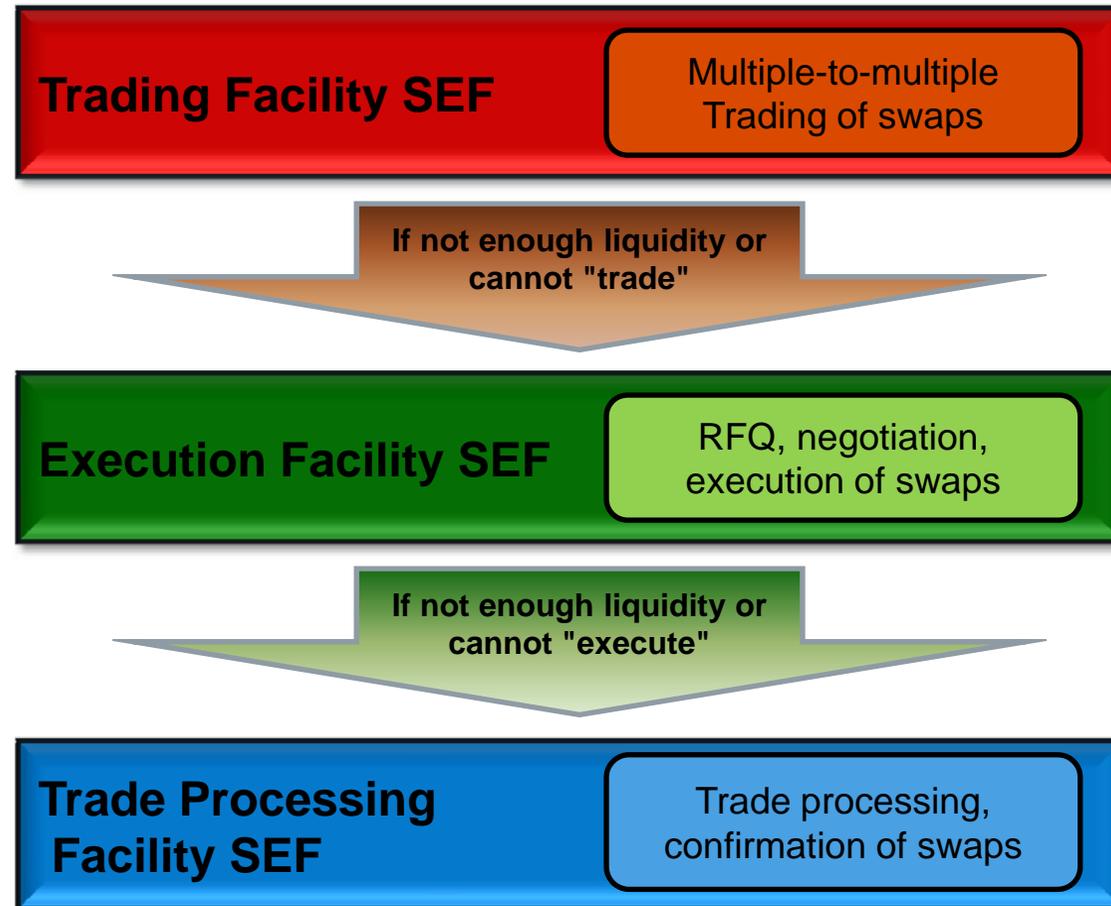
Interpretation of SEF definition under the Dodd-Frank Act (DFA)

- Definitional section in the DFA (§ 721)
 - Appears to cover only “trading facilities” and multiple-to-multiple execution and trading facilities.
- **BUT**
- Registration / operative provisions section of the DFA (§ 733)
 - Requires any entity that operates a facility for the *trading **OR trade processing*** of swaps must register.
 - Note, this provision does not require a SEF to register, but “any entity” that conducts regulated activities, such as trading **OR** trade processing of swaps must register.
- The CFTC has the authority to further define the terms
- MarkitSERV is a classic example of a “trade processing” facility

Implications of the scope of SEF functionalities

- Compliance with the "Trading Requirement" in the DFA
 - For cleared swaps -
 - trade or trade process swaps on a SEF or a DCM,
 - provided that SEF or DCM makes them available for trading (subject to CFTC's specific designation)
- Implications
 - The broader the definition of SEF:
 - the broader the functionalities that SEFs can perform,
 - the more entities covered and supervised under CFTC / SEC regulation, and
 - the more swaps traded, executed and trade processed on SEFs
 - The narrower the definition of SEF:
 - the opposite is true
- Suitability of SEF or DCM for "trading"
 - Several illiquid futures contracts failed in the past
 - Inherent lack of liquidity for some swaps

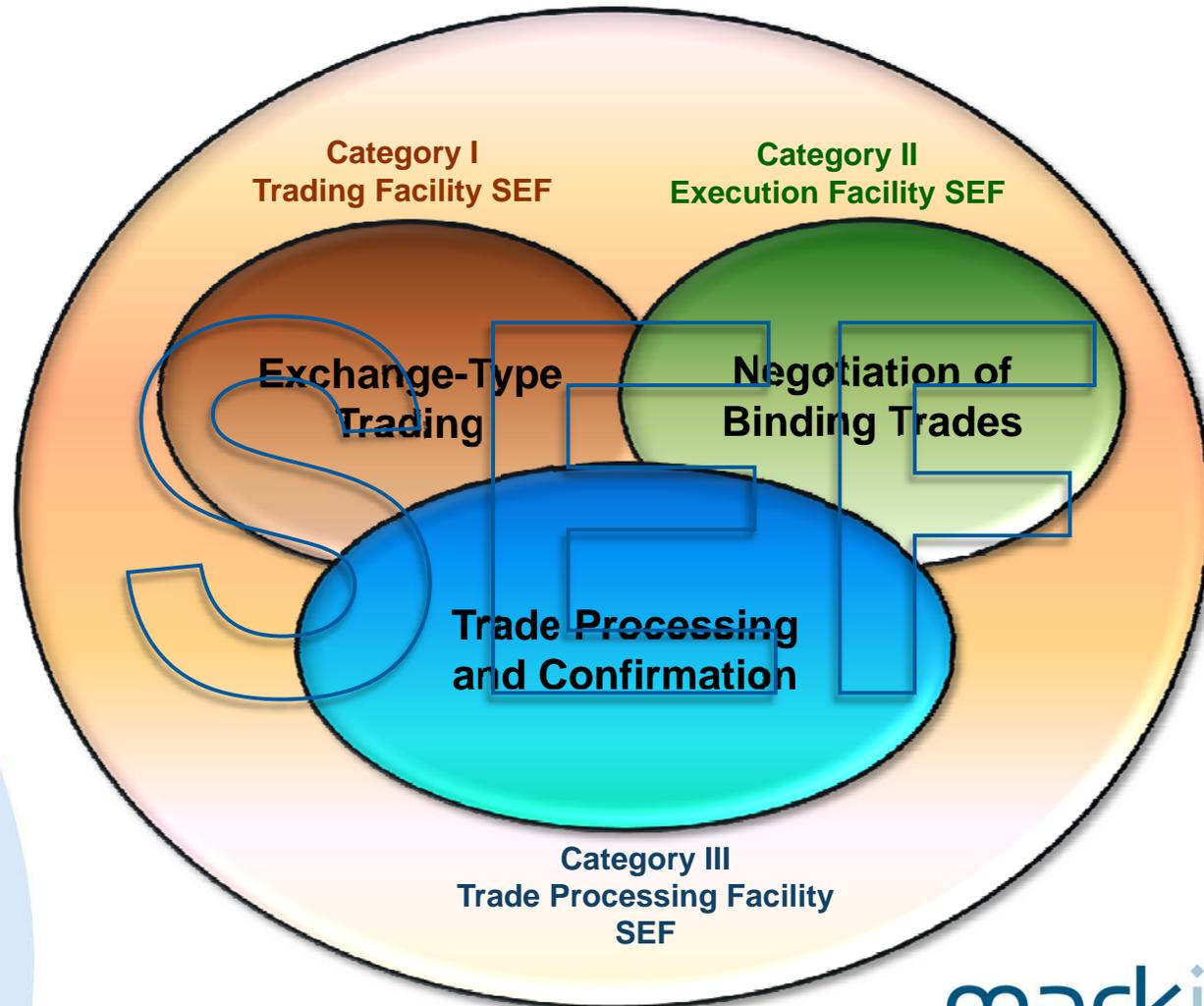
The "Trading Requirement" waterfall



Categories of SEFs

- Based on the DFA language, the following will likely qualify as SEFs:
 - Category I – “**Trading Facility SEF**”
 - Essentially equivalent to an exchange, open order book, many-to-many
 - Eligible to fulfill the "Trading Requirement"
 - Category II – “**Execution Facility SEF**”
 - An RFQ, inter-dealer system, many-to-many, 1-to-many, negotiation facility, other similar facilities where a binding swap is executed on the facility
 - Eligible to fulfill the "Trading Requirement" if cannot trade on Category I SEF
 - Category III – “**Trade Processing SEF**”
 - A trade processing / confirmation / affirmation facility
 - Eligible to fulfill the "Trading Requirement" if:
 - swap cannot trade on or be executed on Category I or Category II SEF, or
 - If non-competitively executed and posted on such SEF (e.g., block trade, ESS)
- One entity can register and qualify as all 3 categories, or can register as any separate category:
 - All trades must be confirmed through Category III SEF or by other categories of SEFs with Category III functionality and registration.

SEF diagram



Matters to consider in rulemaking

- Definitions
 - “trading”, “execution”, “trade processing”, “make available for trading any swap”; and “facilitate trade processing of any swap”

- Unintended consequences
 - Narrow definition of SEF will:
 - Leave many facilities unregulated
 - Limit participants’ ability to comply with the "Trading Requirement"
 - Reduce trade transparency below current levels

- Aggregation of positions
 - An interconnected SEF can perform a critical function of aggregating open positions for swaps per asset category

Business conduct standards – confirmation of all trades

- Consider
 - Requiring that all (either cleared or non-cleared) swaps be trade processed and electronically confirmed by swap dealers and major swap participants (between themselves and for and on behalf of end users)
 - To follow the requirement of reporting of all swaps
- Quality of data and legal certainty for all asset classes
 - Requirement to confirm will ensure that transaction data (in addition to open positions) is captured on all trade levels and for all life cycle events (e.g., novations, unwinds, amendments, terminations, corporate actions)
- Universal audit-trail
 - This requirement will ensure that:
 - all swaps will be accompanied with an audit-trail
 - in addition to the mandatory reporting requirement of swaps open positions

Regulatory reporting / public reporting

- Differences in data capture between SEFs (with Category III functionality) and SDRs
 - SEFs:
 - Capture dynamic data, create an audit trail, document corporate life cycle events
 - (e.g., detailed account statement for your checking account)
 - SDRs:
 - Capture a snapshot of an open position
 - (e.g., monthly ending balance of your checking account)
- SEF of Category III
 - Can act as a universal adapter for all other SEFs, CCP / DCOs, DCMs, SDRs, swap dealers and major swap participants and other market participants in fulfilling regulatory and public reporting functions
 - All trades on Category I or II SEFs must be confirmed on a separate Category III SEF or as part of their own Category III SEF business.



Appendix A: SEF Categories

(table attached)

Disclaimer

- The content, information and any materials (“data”) provided by MarkitSERV and/or its group companies ("MarkitSERV") in this presentation is on an “as is” basis. MarkitSERV expressly disclaims all warranties, expressed or implied, as to the accuracy of any data provided, including, without limitation, liability for quality, performance and fitness for a particular purpose arising out of the use of the data.
- MarkitSERV shall not have any liability, duty or obligation for or relating to the data contained herein, any errors, inaccuracies, omissions or delays in the data, or for any actions taken in reliance thereon. In no event shall MarkitSERV be liable for damages, including, without limitation, damages resulting from lost data or information or lost profits or revenue, the costs of recovering such data, the costs of substitute data, claims by third parties or for other similar costs, or any special, incidental, or consequential damages, arising out of the use of the data.
- Any unauthorised use, including but not limited to copying, distributing, transmitting or otherwise of any data appearing may violate the intellectual property rights of MarkitSERV under any intellectual property laws such as copyright laws, trademark laws and communications, regulations and statutes.