

# Technology Advisory Committee

Review and Assessment of Interim Recommendations of the  
Subcommittee on Data Standardization

Working Group #2: Machine-Readable Legal Documents

March 29, 2012

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# Background

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# Background – Joint CFTC/SEC Survey

The CFTC and SEC conducted a joint survey on the “Feasibility of Mandating Algorithmic Descriptions for Derivatives”, as required by Section 719(b) of the Dodd-Frank Act. The joint survey discussed the issues around i) electronically representing derivatives with sufficient precision and detail to facilitate collection, reporting, and analysis of risk exposures, including calculation of net exposures; and ii) the possible implementation of standardized, computer-readable descriptions for all derivatives.

Working Group #2 was assigned to propose data standardization approaches for the machine-readable representation of legal documents. This working group presented interim recommendations that suggested initiatives to further progress the development of algorithmic descriptions for derivatives, with consideration given to the conclusions contained in the Report.

# Background – Working Group #2

Working Group #2 Members	Working Group Coordinator and Government Representatives
Pierre Lamy, Goldman Sachs	Nancy R. Doyle, CFTC
Paulo Rodela, BlackRock Solutions	Walter Hamscher, SEC
Michael Will, Innodata docGenix LLC	Bill Nichols, Office of Financial Research, U.S. Treasury

# Background - Promontory Financial Group

- Promontory Financial Group, LLC (“Promontory”) is a financial services consulting firm headquartered in Washington, D.C. with 14 offices around the world.
- Commissioner O’Malia requested Promontory’s assistance in vetting the interim recommendations of Working Group #2.
- Promontory does not have a proprietary interest in the Working Group #2 interim recommendations nor in their implementation. We did not approach the review of these recommendations from any one client’s perspective. Our clients include, or have included, the CFTC, existing DCOs and DCMs, and entities that will register as SDRs, swap dealers and major swap participants, as well as many institutions that are financial and commercial end-users of swaps.

# Review Process

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# Considerations

Promontory conducted the review of Working Group #2's interim recommendations by assessing the recommendations against the following considerations:

- Consistency with Dodd-Frank Act Title VII statutory provisions and rulemakings and international standards
- Cost and ease of implementation by SDRs and reporting Swap Entities
- “Time-to-market”
- Consistency with current industry initiatives
- Actionability

The following slides identify these specific considerations where applicable to the assessment of the particular recommendation.

# Promontory Assessments and Conclusions

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# Interim Recommendation - 1

**Adopt the Generic Product Representation (“GPR”) for reporting of complex and bespoke products to equip regulators with an appropriate level of information while preserving the ability of the marketplace to innovate**

## Assessment

### Consistency with regulatory requirements:

- Reporting rules require regulatory reporting of Creation Data and Continuation Data as detailed 17 CFR Parts 45 and real-time transaction data as detailed in 17 CFR Part 43
- The GPR may not contain all of these required data fields for complex and bespoke products
- In the case of Confirmation Data, CFTC rules permit entities to submit an image of the confirmation in lieu of an electronic report in the first 180 days following the reporting compliance date.

### Cost and ease of implementation:

- Most reporting parties are likely to already be using the FpML data format
- The cost and time involved to develop a full representation for complex and bespoke swaps would be considerable

### “Time-to-market”:

- Approximately six months to implement the FpML GPR

### Current industry initiatives:

- Industry stakeholders confirmed this recommendation is in line with current market practices
- The existing DTCC Copper Record is a type of GPR

### Actionability:

- The FpML Standard CSA Working Group has started developing version 5.3 of the FpML standard which is intended to include the GPR

## Conclusion

We support this recommendation as, in our view, it is an appropriate solution to the ongoing reporting of complex and bespoke products. However, the reporting rules would need to be modified to allow this solution to be implemented. We believe that as new complex and bespoke products are developed over time, there will be continuing challenges in the reporting of all the required data. In order to accommodate the evolution of the markets and the development of new products, we believe that the TAC should recommend that the CFTC:

- i) Consider providing long-term exemptive relief from the requirement to report all Confirmation Data in an electronic format for complex and bespoke products, which is currently limited to 180 days after the compliance date. This will provide the industry with the flexibility to continue to innovate and develop new complex and bespoke products for which It would be difficult to immediately report all the transaction economics in a standardized electronic format. If a long-term exemption is provided, the CFTC should periodically review products in the market to determine if data standards have been developed or evolved sufficiently to adequately capture the required information for certain complex and bespoke products. Upon a determination that a product may be fully represented electronically, the CFTC may then want to take appropriate action to mandate electronic reporting for those particular complex and bespoke products; and
- ii) Allow the other required reports (Primary Economic Terms, Continuation Data and real-time transaction data) to be submitted without the data fields that relate to payoff streams and that are not supported by the GPR for those complex and bespoke swaps that require use of the GPR.

# Interim Recommendation - 2

Leverage the ISDA Standard Credit Support Annex (“SCSA”) initiative to create a highly “standardized” data representation of the ISDA SCSA. Explore possibility/options for electronic execution.

## Assessment

### Consistency with regulatory requirements:

- Although it is an essential metric in performing risk analysis and prudent market surveillance, there is no statutory requirement that the CFTC calculate valuations or net exposure for swaps
- The CFTC/SEC joint survey concluded that machine-readable legal agreements are feasible

### Cost and ease of implementation:

- Currently electronic representation of legal documents is done only on an as-needed basis
- Ensuring a machine-readable document is legally sound will require a legal analysis and opinion

### “Time-to-market”:

- No estimates as to how long this will take

### Current industry initiatives:

- The framework for an SCSA has been largely developed by ISDA, which is expected to be finalized in 2012
- FpML has put together a working group to develop an electronic representation of the SCSA

### Actionability:

- The CFTC/SEC joint survey determined technological feasibility
- Acceptability by the industry, the most important factor of this effort, may take some time

## Conclusion

Of the documents currently used to document swaps relationships and transactions, the CSA probably provides the most value in terms of information necessary to calculate net exposures of swaps counterparties, and we agree that it is an appropriate place to start. Therefore, we support this recommendation. The TAC should recommend that the CFTC continue, outside of the formal rulemaking process, to encourage the development of the SCSA and, thereafter, a machine-readable representation of the SCSA. It should be noted that the SCSA would primarily be used by large firms that have numerous counterparty relationships, and can only be adopted once it is accepted by the industry internationally.

# Interim Recommendation - 3

Regarding legacy portfolio legal agreements, finalize an industry-wide survey to identify legal agreement information relevant to systemic risk. Survey will confirm scope, feasibility and collate information relevant to a cost-benefit analysis.

## Assessment

### Consistency with regulatory requirements:

- No statutory or regulatory requirement for the electronic representation of legal documents, whether future or legacy
- The CFTC/SEC Report concluded that a public-private collaboration would be most beneficial to furthering this effort

### Cost and ease of implementation:

- Cost will be known only following the outcome of the survey

### “Time-to-market”:

- If conducted soon, this survey may not receive the attention that it warrants due to the industry's current focus on other regulatory compliance activities

## Conclusion

We agree with the approach suggested, i.e., finalizing a survey to identify the potential impact of legacy portfolios on systemic risk, assess the scope and feasibility, in order to perform a cost-benefit analysis of converting legacy legal agreements into machine-readable form. Given the importance of the survey and the need to obtain sufficient intelligence relating to legacy portfolio legal agreements, we believe the timing of the survey is key so that it receives the attention from industry that it warrants. Due to the substantial effort being undertaken by industry participants to comply with Title VII rules in 2012, we suggest that the TAC recommend that the CFTC consider delaying the survey until after industry participants have completed their initial compliance efforts.