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July 26, 2011

Ms. Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: **S7–8–11 / Clearing Agency Standards for Operation and Governance– the "Clearing Agency Proposed Rule";**

S7-24-11 / Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps– the "July 16, 2011 Exemptive Order";

S7-28-11 / Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps– the "CCP Temporary Exemptive Order";

S7-27-11 / Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment– the "Security Temporary Exemptive Order"

Dear Ms. Murphy:

Markit[1] is pleased to submit the following comments to the Securities and Exchange Commission (the "***SEC***" or the "***Commission***") regarding the ***July 16, 2011 Exemptive Order***,[2] the ***CCP Temporary Exemptive Order***,[3] and the ***Security Temporary Exemptive Order***,[4] which relate to the implementation of certain requirements included in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "***DFA***").[5]

This letter also comments on the Commission's proposed rule titled Clearing Agency Standards for Operation and Governance (the "***Clearing Agency Proposed Rule***")[6] insofar as the above-listed orders pertain to that proposed rule.

[1] Markit is a financial information services company with over 2,000 employees in North America, Europe and Asia Pacific. The company provides independent data and valuations for financial products across all asset classes in order to reduce risk and improve operational efficiency. Please see www.markit.com for additional information.

[2] Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, 76 Fed. Reg. 36287 (published June 22, 2011).

[3] Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps, Release No. 34-34796 (issued July 1, 2011) (not yet published in the Federal Register).

[4] Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, Release No. 34-34795 (issued July 1, 2011) (not yet published in the Federal Register).

[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[6] Clearing Agency Standards for Operation and Governance, 76 Fed. Reg. 14472 (published March 16, 2011).

Introduction

Markit is a service provider to the global derivatives markets, offering independent data, valuations, risk analytics, and related services for swaps and security-based swaps across many regions and asset classes in order to reduce risk, increase transparency, and improve operational efficiency in these markets. Markit supports the objectives of the DFA, and the Commission's objectives of increasing transparency and efficiency in the OTC derivatives markets, of reducing both systemic and counterparty risk, and of detecting any market manipulation or abuse.

Comments

Below we discuss each of the applicable Commission orders as they relate to the operations of clearing agencies that do not provide CCP services.

(1) <u>The Clearing Agency Proposed Rule</u>

The Commission notes in the Clearing Agency Proposed Rule that the Securities Exchange Act of 1934 (the "***Exchange Act***") defines Clearing Agency ("***CA***") broadly to contain, in addition to providers of traditional central counterparty ("***CCP***") clearing services, certain entities that facilitate SB swap contract management (*i.e.*, non-CCP entities). Section 3(a)(23)(A) of the Exchange Act states:

> *The term "clearing agency" means any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who <u>provides facilities for comparison of data respecting the terms of settlement of securities transactions</u>, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities...*[7] [Emphasis added.]

The Commission stated in the preamble to the Clearing Agency Proposed Rule that it believes "Tear up/Compression" service providers will fall within this definition.[8] If the Commission codifies this determination, Compression service providers would be required to register as CAs under Exchange Act Sections 17A(b) and 17A(g).

We note that the DFA does not expressly require Compression providers or any other entities that do not provide clearing services to register as CAs or to comply with any requirements applicable to CAs.[9] We believe that a requirement for providers of Compression services for SB swaps to register as CAs may simply be too burdensome given the benefits of regulation. However, if the Commission determines that regulation of these services is appropriate, we support a limited registration requirement that is tailored to the specific concerns that regulation can address in this context.

As a provider of Compression services,[10] we do not believe that the wide-ranging registration and compliance requirements applicable to all CAs under the Clearing Agency Proposed Rule are justified given the differences

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[7] Exchange Act § 3(a)(23)(A).

[8] Tear up or Compression services consist of operating an algorithm, matching, and proposing terminations that are sent to a third party service provider for matching and are terminated in bulk. Such a Compression provider would act as an intermediary that provides facilities for the comparison of data.

[9] *See, e.g.*, DFA §763(b) (adding Exchange Act Section 17A(i)) ("To be registered and to maintain registration as a clearing agency *that clears* security-based swap transactions, a clearing agency shall comply with such standards as the Commission may establish by rule.") (emphasis added).

[10] Markit, in conjunction with Creditex, launched the first fully risk-neutral Portfolio Compression process for single name CDS in August 2008. To date, we have completed more than 200 weekly Portfolio Compression cycles in the United States and in Europe that included

between Compression service providers and traditional CAs. Moreover, we are concerned that requiring non-CCP CAs such as Compression providers to comply with a full set of CA requirements could have unintended and detrimental effects on the SB swap market. We therefore urge the Commission to: (i) consider the significant costs of regulation for providers of Compression services; and (ii) create different regulatory requirements for Compression service providers and CCPs to account for the relative significance of the costs of registration and their different market functions.

(a) *The Cost of Regulation Could Cause Compression Providers to Discontinue Compression Services*

The Commission has recently indicated that it might amend its proposed registration requirements for non-CCP CAs.[11] In considering revisions to the Clearing Agency Proposed Rule, we urge the Commission to ensure that any regulatory structure applicable to entities that provide Compression services does not unduly burden such entities because doing so may lead to a situation where it is uneconomical to offer Compression services at all.

Compression activities only generate limited revenues today and most would expect demand for these services to be reduced in the future. While compression has played a key part in reducing notionals and risk in the derivative markets over the past few years, the emergence of clearing and the progress made by Compression services has significantly reduced the amount of benefit from offering Compression services, especially because much of new volume traded gets cleared soon after execution.

The additional cost of operating Compression services as registered entities, therefore, could have a significant impact on their viability. We believe Compression will continue to play a useful role in the markets, but recognize that the benefit offered to market participants has diminished (and will likely continue to do so) because Compression is only one part of a wider solution available to market participants. Therefore, imposing regulatory burdens on Compression providers may render these services uneconomical. In the extreme, these services might be discontinued. Such consequence could result in market disruption and an increase in risk in the SB swap markets.

(b) *Regulations Applicable to Non-CCP CAs Should be Tailored to Non-CCP Business Models*

To the extent that the Commission determines to regulate non-CCP CAs, we believe that the final rule should limit the requirements applicable to non-CCP CAs, including Compression providers, in order to account for the significant differences between such entities and traditional CCP CAs. The Commission could do so by tailoring the requirements applicable to these non-CCP CAs (as opposed to traditional CCP CAs) or by providing appropriate exemptive relief for non-CCP CAs in line with the exemptions previously provided to entities such as Omgeo[12] and Thompson Financial Technology Services, Inc.[13]

Specifically, we believe that the following rules should not apply to non-CCP clearing agencies if they are required to register as CAs: (i) the ownership limitations and public director requirements in rule 17Ad-22(b)(8); (ii) governance standards for the board of directors in rule 17Ad-26; (iii) the requirement to establish procedures to identify conflicts of interest in rule 17Ad-25; and (iv) provisions in section 17A of the Exchange

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a total of 900 single name CDS and successfully removed a total notional amount of close to $7 trillion of economically redundant transactions.

[11] *See* July 16, 2011 Exemptive Order, 76 Fed. Reg. at 36302 n.217 ("Temporary relief for such persons would provide time for the Commission to consider comments from industry on the issue of registration of these non-CCP clearance and settlement service providers, and to consider possible alternatives to full registration as clearing agencies.").

[12] *See* Global Joint Venture Matching Services—US, LLC; Order Granting Exemption From Registration as a Clearing Agency, 66 Fed. Reg. 20494, 20498 (April 23, 2001).

[13] *See id.*; Self-Regulatory Organizations; Thomson Financial Technology Services, Inc.; Order Approving Application for Exemption From Registration as a Clearing Agency (Exchange Act Release No. 34–41377), 64 Fed. Reg. 25948, 25949 (May 13, 1999).

Act requiring clearing agencies to assure fair representation of shareholders and participants, equitable pricing, and fair discipline of participants.[14] These laws and regulations are all designed to curb potential problems that might have relevance for CCP CAs but are inapplicable to non-CCP CAs such as Compression service providers and would add burden and expense for no apparent benefit. For example, issues related to conflicts of interest in general have little relevance to Compression service providers. "Participation" in compression services is driven by industry commitment for product, processing, and legal standardization, and the goals of these entities are to mitigate risk and attain the highest standards of operational efficiency. The implementation of Compression services for swaps, for example, is based on an industry collaborative process that is open to all market participants after thoughtful analysis related to product and process based on an overall cost-benefit analysis. We therefore believe that no conflicts of interest will arise relative to participation in these entities that would require the type of scrutiny that will be applied to security-based SEFs, SDRs, and CCPs.[15]

(c) *The Non-CCP CA Rules Should be Consistently Applied*

Finally, we urge the Commission to ensure that any regulations applicable to non-CCP CAs under its rules are equally applicable to the same or similar entities under rules promulgated by the Commodity Futures Trading Commission (the "***CFTC***") in order to avoid regulatory gaps and in order to harmonize the SEC and the CFTC regulations under the DFA. We believe that such regulatory gaps could damage competition for Compression services in the SEC-regulated market.

These requests are elaborated upon in our letter to the Commission filed on April 29, 2011 in response to the Clearing Agency Proposed Rule (the "***Markit Comment Letter***").[16]

(2) **The July 16, 2011 Exemptive Order**

To implement the new provisions under the DFA, and to clarify which of these provisions become effective on July 16, 2011, the Commission has promulgated its July 16, 2011 Exemptive Order. Many of the issues raised in the Clearing Agency Proposed Rule are also addressed in the July 16, 2011 Exemptive Order. In this Order, the Commission states:

> *Section 17A(g) of the Exchange Act, 15 U.S.C. 78q-1(g), will not require compliance as of the Effective Date because Section 17A(i) and (j) of the Exchange Act, 78q-1(i) and (j), require rulemaking regarding registration of clearing agencies that clear SB swap transactions.*[17]

The Commission also states that, with regard to the currently-existing registration requirement for clearing agencies under Section 17A(b) of the Exchange Act:

> *On March 2, 2011, the Commission proposed exempting certain market participants from the definitions of clearing agency as part of its clearing agency standards release. As noted above, the Commission also intends to separately consider temporary relief from section 17A(b) of the Exchange Act for persons that provide non-CCP clearing agency services in connection with SB*

[14] *See* Exchange Act § 17A(b)(3); *see also* Clearing Agency Proposed Rule, 76 Fed. Reg. at 14476 ("Also, the clearing agency's rules must provide adequate access to qualified participants, fair representation of shareholders and participants, equitable pricing, fair discipline of participants, and must not impose any undue burden on competition.").

[15] Additionally, we question the utility of requiring non-CCP CAs to comply with requirements related to, but not limited to: (i) custody of assets and investment risks in rule 17Ad-22(d)(3); (ii) money settlement risks in rule 17Ad-22(d)(5); (iii) default procedures in rule 17Ad-22(d)(11); and (iv) many of the requirements related to chief compliance officers in rule 3Cj-1.

[16] *See* Letter from Markit to the SEC (April 29, 2011), *available at* http://www.sec.gov/comments/s7-08-11/s70811-22.pdf.

[17] July 16, 2011 Exemptive Order, 76 Fed. Reg. at 36302 n.217.

> *swaps so that those persons are not required to be registered as a clearing agency on the Effective Date.*[18]

Markit supports Commission's efforts in clarifying the requirements of the DFA in its Clearing Agency Proposed Rule as well as in delineating the DFA's implementation timelines in the July 16, 2011 Exemptive Order. Given that several provisions of the Clearing Agency Proposed Rule applying to non-CCP clearing agencies require further revisions by the Commission as discussed in greater detail in the Markit Comment Letter, we request that the Commission clarify in its July 16, 2011 Exemptive Order that, under that Order, none of the provisions in the DFA that may arguably apply to non-CCP CAs, including Section 17A(g), will become effective on July 16, 2011.

Further, in the July 16, 2011 Exemptive Order, the Commission also requests comment on whether there are any other provisions of Section 17A of the Exchange Act for which the Commission should grant temporary exemptive relief.[19] If, on July 16, 2011 any of the CA-related provisions of the Exchange Act apply to entities that might qualify as non-CCP CAs, these entities would become subject to a developed regulatory regime without adequate guidance from the Commission on how to comply (*see* below our further comments with respect to the Security Temporary Exemptive Order).

Thus, subjecting non-CCP CAs to some but not all provisions of Section 17A would create significant uncertainty that would be detrimental to these entities' business. This uncertainty would be exacerbated by the Commission's indication that it might amend the registration requirements of these entities in its final rule regarding CAs.[20] Therefore, subject to our discussion below, we request that the Commission specifically state that the July 16, 2011 Exemptive Order provides a blanket exemption for non-CCP CAs from all requirements in Section 17A of the Exchange Act.

(3) **<u>The CCP Temporary Exemptive Order</u>**

We appreciate and welcome SEC's efforts in clarifying some of the matters in the July 16, 2011 Exemptive Order and proposing the CCP Temporary Exemptive Order in combination with the Security Temporary Exemptive Order (discussed below). The CCP Temporary Exemptive Order temporarily exempts entities from the registration requirements in Section 17A(b) of the Exchange Act to the extent that such requirements would arise solely as a result of providing, among other things, trade matching services, collateral management services, tear up and compression services, and/or substantially similar services for SB swaps (the "***Exempted Activities***").[21] These are the same services that would require entities to register as non-CCP CAs in the Clearing Agency Proposed Rule[22] except that they also include "substantially similar services."

We support the Commission's proposal to temporarily provide these entities with relief from any CA registration requirements until the compliance date for the Commission's final rules relating to registration of CAs (the "***Compliance Date***"). However, we believe that narrowly defining the list of Exempted Activities to include only those services that are listed in the Clearing Agency Proposed Rule might be read to limit the Commission in the final definition of non-CCP CA services to those specific categories that were originally proposed. For

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[18] July 16, 2011 Exemptive Order, 76 Fed. Reg. at 36303.

[19] *See id.* at 36303 ("Are there any provisions of section 17A of the Exchange Act for which the Commission should grant temporary exemptive relief?").

[20] *See id.* at 36302 n. 217 ("Temporary relief for such persons would provide time for the Commission to consider comments from industry on the issue of registration of these non-CCP clearance and settlement service providers, and to consider possible alternatives to full registration as clearing agencies.").

[21] *See* CCP Temporary Exemptive Order 8, 12.

[22] *See* Clearing Agency Proposed Rule, 76 Fed. Reg. at 14495. This list is the same with the exception of the services which are "substantially similar services."

example, if the Commission were to decide that some post-trade service providers which are not included in the list of Exempted Activities, must register with the Commission,[23] doing so after July 16, 2011 might cause such entities to automatically be in violation of Section 17A retroactively unless such entities were granted some exemptive relief. This would likely prove to be an untenable and an unintended result.

Therefore, we believe that the Commission should temporarily exempt a broad category of potential non-CCP CAs from regulation so that it will be easier to implement the final rules regarding clearing agencies.

(4) **<u>The Security Temporary Exemptive Order</u>**

As the Commission identified in the Security Temporary Exemptive Order, as of July 16, 2011, the "Exchange Act definition of 'security' will expressly encompass security-based swaps."[24] As a result, any entities that potentially provide "clearing" services for SB swaps (that will become "securities") will be subject to the full panoply of CA regulations for two reasons.

First, existing CA regulations, including the CA registration requirement in Exchange Act Section 17A(b), apply to any entity that performs "the functions of a clearing agency with respect to any security,"[25] which will include SB swaps on July 16, 2011. Second, newly-added Exchange Act Section 17A(g) specifically applies CA regulations to entities performing the same functions with respect to SB swaps[26] (*i.e.*, even without referencing the term "security").

We appreciate the temporary relief from CA regulations which the Commission provided for in the Security Temporary Exemptive Order and the other orders discussed above. Specifically, we note that the Commission largely exempted SB swaps from Exchange Act regulations in the Security Temporary Exemptive Order, exempted entities that might potentially be classified as non-CCP CAs from Section 17A(b) in the CCP Temporary Exemptive Order, and stated that CAs will not be required to register as CAs under newly-added Section 17A(g) on July 16, 2011 because that Section requires Commission rulemakings.

However, for the avoidance of doubt, we request that the Commission specify that these orders will work concurrently so that any entities that will potentially be classified as non-CCP CAs will not be subject to any Exchange Act requirements in Section 17A or other CA regulations on July 16, 2011 and that these rules are applied consistently to all affected entities (*i.e.*, non-CCP CAs engaged Exempted Activities, or activities functionally similar to Exempted Activities). In this way, the Commission would facilitate an orderly implementation of the rules over an agreed compliance period without significant disruption to existing market practices during the DFA implementation phase, as it stated was the intention of the exemptive orders.[27]

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We appreciate the opportunity to provide these comments on these proposed regulations.

We thank the Commission for considering our comments. In the event you may have any questions, please do not hesitate to contact the undersigned or Marcus Schüler at marcus.schueler@markit.com.

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[23] *See* July 16, 2011 Exemptive Order, 76 Fed. Reg. at 36302 n. 217 ("Temporary relief for such persons would provide time for the Commission to consider comments from industry on the issue of registration of these non-CCP clearance and settlement service providers, and to consider possible alternatives to full registration as clearing agencies.").

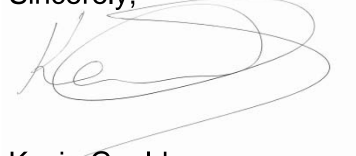
[24] Security Temporary Exemptive Order, Release No. 34-34795 at 5.

[25] *See* Exchange Act § 17A(b)(1).

[26] *See* DFA § 763(b).

[27] *See* Security Temporary Exemptive Order, Release No. 34-34795 at 5.

Sincerely,



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