March 11, 2013
(c. online)

Shift to mandatory clearing for swaps strengthens CME's hand in swaps data reporting

By Joel Poelhuis

Regulations requiring the clearing of credit default and interest rate swaps between the largest participants may help CME Group Inc. gain an edge over Depository Trust & Clearing Corp. in each firm's efforts to build out an industry-leading data repository for reporting information on swaps.

March 11 is the first day for mandatory clearing of swaps under Dodd-Frank rules for swap dealers, major swap participants and "active funds" — private funds that trade at least 200 swaps per month.

CME Group and Depository Trust & Clearing have sparred over whether CME Group can choose to report customer's trades cleared through its derivatives clearing organization to its own swap data repository report. Many industry players had already spent significant resources establishing the necessary connectivity with Depository Trust & Clearing, and Citigroup Inc. and JPMorgan Chase & Co. filed comment letters asking the commission to preserve the authority of market participants to decide where to send the data about their transactions. IntercontinentalExchange Inc., which, like CME Group, operates both a clearinghouse and a data repository, supported CME Group's position.

CME Group won the CFTC's approval for the practice March 6. The Chicago exchange operator did agree that if a CME Group clearinghouse customer so desires, CME Group will report the same data to the swap data repository chosen by the customer, as well as to its own reporting facility.

This duplication of efforts was one factor in CFTC Commissioner Scott O'Malia's abstention from the commission's vote to approve CME Group's proposition. O'Malia believes existing rules unnecessarily complicate the reporting process and could create problems of multiple conflicting data sets. He argued that the agency should further clarify regulatory language that makes it unclear whether it is the traders or the derivatives clearing organization that has the right to choose the data repository.

"While the preamble and rule leave open the possibility that reporting parties and registered entities may decide to have DCOs choose which SDR will receive swap data, the rule does not definitively state which party has the authority to make that decision," he said in a March 6 statement.

Depository Trust & Clearing, which is jointly owned by several of the largest swap dealers, is reportedly considering a lawsuit to challenge the decision.

While he said it remains to be seen whether legal action can overturn the CFTC's decision, Gary DeWaal, a former group general counsel at Newedge who now runs his own consulting firm, told SNL that the move cleared up one of the large remaining uncertainties in a rulemaking process that has been plagued by delays and missed deadlines.

"Firms that had been making arrangements to do their reporting directly through DTCC or somebody else — that's not going to happen," he said. "The reporting is going to be made through the clearinghouses," he said.

Most major participants had already been clearing on a nonmandatory basis to prepare for the new regulations. Swap dealers were already required to report data on interest rate and credit swaps on Dec. 31, 2012. The three remaining asset classes of swaps — on equity, foreign exchange and other commodities — fell under the reporting requirements for swap dealers Feb. 28. This date also marked the start of required reporting of all asset classes of swaps for major swap participants. As of March 1, swap dealers comprise the 73 firms provisionally registered as such with the CFTC. More than half of provisionally registered swap dealers are entities associated with the G16 — the group of large banks that dominate the derivatives market. The CFTC has only provisionally registered two major swap participants as of March 1, listing Cournot Financial Products LLC and MBIA Inc.'s MBIA Insurance Corp. under the designation. Entities that are not swap dealers or major swap participants must report swaps on all asset classes by April 10.

One firm that is responding to the necessities of Dodd-Frank reporting standards is **Nastel Technologies Inc.**, a New York-based IT firm geared largely to monitoring trade infrastructure for financial services clients. Charles Rich, vice president of product development at Nastel, told SNL that the firm's new reporting product, Nastel Autopilot for Dodd-Frank Compliance, was built at the request of a major client. He said the tool works with all the major trading environments, including Murex, Summit and Calypso, and has been running at the client level for several months.

Nastel Autopilot will be available for sale to others beginning April 30. Rich said that in addition to banks and brokerages, he anticipates interest from end users in the oil and gas space.

Rich said as of March 11 his client base is still reporting swaps transactions to Depository Trust & Clearing, as far as he is aware. He said it has sometimes been a "scramble" to keep up with new CFTC rulemaking under Dodd-Frank, as many definitions and rules have suffered significant delays. DeWaal pointed out that one of the stickiest remaining questions — that of coordinating compliance with other jurisdictions — still needs to be addressed.

One result of this uncertainty, according to DeWaal, is firms spending a good deal of money to move toward compliance with a regulatory standard that turns out to be a moving target. While he said CFTC enforcement is not rushing to prosecute people who are trying to comply in good faith, he pointed out that firms that have shelled out for an initiative such as establishing connectivity for reporting to the Depository Trust & Clearing can find that money going to waste if a new model prevails.

On a more fundamental level, market participants could see diminishing returns on the whole regulatory shift toward increased transparency and centralization in the swaps market if futurization ultimately standardizes many of the trades currently conducted over the counter. With capital requirements making OTC swaps more expensive and exchanges introducing new products that provide comparable exposures, some have pointed to futurization as the next major shift in derivatives.

"What we're going to be looking for next is whether a lot of the stuff is going to migrate into the futures markets," DeWaal said.