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Trade repositories key to understanding exposures and flagging hazardous market activities

Since the 2008 crisis, efforts to enhance global market transparency have seen trade repositories become an essential tool to help regulators more effectively manage systemic risk and rebuild public trust.

By Michael Bodson
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Asia's share in the $648 trillion over-the-counter (OTC) derivatives market, currently at around 8%, is expected to grow significantly in the coming years. The region's ability to manage the risks often associated with these instruments will play an important role in protecting the Asian markets from repeating the mistakes of other financial centres. The regulators have clearly watched this drama unfold and have already begun taking action on this front.

The 2008 crisis showed that the then-opaque nature of OTC derivatives could lead to market participants and regulators overlooking excessive levels of risk in the system. A key lesson from the crisis emerged well before the dust had settled: to effectively manage systemic risk, regulators need transparency into the market.

Trade repositories, essentially giant databases that hold detailed trade information on derivatives transactions, were quickly identified as central to understanding exposures and to flagging risky market activities. This solution was crystalized in the wake of the Lehman Brothers' bankruptcy, when credit default swap (CDS) data housed in a repository operated by The Depository Trust & Clearing Corporation (DTCC) gave regulators and the markets an accurate picture of CDS exposures to Lehman. When this data was made public, the panic that had gripped the markets quickly dissipated.

This watershed moment established trade repositories as an essential tool to help regulators manage systemic risk and to give the public transparency into position and activity levels in the CDS market. Not surprisingly, financial reforms proposed in Asia, the US and the EU have embraced this concept.

Today, as a result of voluntary reporting by the financial industry, our global trade repository holds data on more than 98% of credit default swaps, 70% of interest rate derivatives and 60% of the equities derivatives traded globally -- and it is expanding to support foreign exchange and commodities derivatives in the near future. More than 40 regulators globally, including Asian authorities, now rely on this information to monitor systemic risk, ushering in a new era of greater information sharing and cooperation among supervisory agencies.

This collaboration is particularly important because, trade repositories will only be able to deliver their full value by presenting a holistic view of the market – and this can only be achieved if data is collected and aggregated on a global basis. This is particularly important during times of crisis. As derivatives are a global business, the ability to provide regulators with immediate access to a global data set is crucial to ensuring risk exposures are fully transparent. If the data is incomplete or dispersed across multiple locations, aggregating it quickly would be virtually impossible.

However, this does not mean that one approach fits all. It is critical that the right balance is struck between standardizing data to ensure global consistency and gathering the data in a manner that meets the particular needs of local markets and regulatory structures. For example, both the Japan Financial Services Authority and the Monetary Authority of Singapore have been exploring using DTCC's global trade repository capabilities domestically and internationally as a data source for OTC derivatives. On the other hand, the Hong Kong Monetary Authority is building its own repository to maintain local data and is only working with DTCC to ensure interoperability and the collection of global data.

In the four-plus years since the start of the financial crisis, Asia has made significant progress in advancing financial reforms that will bring greater stability to its markets. It is also clear that the region is learning from the US and Europe and leveraging what they consider the best elements of the rules being put in place globally. Building on the lessons learned, Asia is well positioned to seize a greater share of the OTC derivatives market, while at the same time having the right tools in place to protect it from the risks that nearly led to the collapse of the global financial system.

Giving regulators the data and information that enable them to perform their jobs more efficiently will result in greater confidence in the marketplace, more effective regulation and more stable global markets – all critical for re-establishing public trust in the world's financial institutions.

**Michael C. Bodson is president and CEO of The Depository Trust & Clearing Corporation.*

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