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Consensus is crucial for global OTC ground rules

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INSIGHT

European and US authorities are moving forward with adopting oversight reforms to ensure financial markets have greater protection from systemic risk and provide tighter supervision of the global over-the-counter derivatives market. As legislators and regulators grapple with these proposed policies, several important questions must be addressed.

Most crucially, how can necessary improvements be implemented in a way consistent with the global nature of these markets? Can global infrastructures for these instruments be preserved? Can a global set of transparency requirements governing these markets be agreed upon, across multiple regulators and jurisdictions?

The necessary components of the solution are clear in proposals on both sides of the Atlantic. Standardise OTC derivatives, where possible. Where there is sufficient standardisation and liquidity, require the use of central counterparties to collect margin and guarantee trades. Ensure that all OTC derivative trades are centrally reported to provide appropriate transparency to supervisors and to markets generally.

Yet as clear as these components may be, implementing a consistent solution globally will be challenging. The global nature of these instruments must shape the solution.

In contrast to securities markets, where local jurisdictions govern activities, there is no natural way to divide the OTC derivatives markets to serve different geographical regulatory and supervisory interests.

Many regulators will have different legitimate reasons to want access to data on the same trades in their jurisdictions, involving counterparties from many countries. At the same time, accurate public reporting of gross and net open interest and turnover can only be achieved by analysing all of the data for a particular asset class.

But providing more detailed information to regulators to meet their own responsibilities will not be easy without a consensus on global ground rules for information disclosure.

The OTC Derivatives Regulators' Forum – which comprises global market regulators, supervisors and central banks – has been working quietly to come up with a solution.

The Depository Trust & Clearing Corporation (DTCC) has worked with these regulators and market participants to develop and operate a central trade repository for the global credit default swap (CDS) market.

Our CDS repository holds contracts of more than 17,000 counterparties and reference entities in more than 90 countries, representing 95 per cent of all CDS contracts.

Since November 2008, the DTCC has publicised aggregate information on CDS contracts on its website. While the forum is formulating consensus on ground rules for more detailed information disclosures, the DTCC recently reached agreement with global regulators on an approach ensuring that supervisors with a legitimate regulatory interest can obtain detailed information.

These challenges are similar to those that will inevitably be faced by repositories for OTC interest rates and equity derivatives.

But at times regulators and supervisors need even more detailed information to meet their responsibilities in their own jurisdictions, and this will not be easy without a consensus on global ground rules for information disclosure – hence the forum's efforts.

Crucially, our recent agreement with global regulators provides for comparable access to data for regulators interested in specific trading patterns, regardless of location. The standards for release of CDS data maintained in the US to European regulators are the same as those for release to US regulators.

The value of a trade repository is that it has all the relevant trading data, including more detailed information that supports a thorough understanding of the net open interest relating to reference entities. It does this on a market-wide basis that allows it to provide the markets and regulators with a single view of risk from a central vantage point. Fulfilling these different perspectives in a global market is only achievable with a global source, regardless of the asset class involved.

Recognition of the importance of a single trade repository for each asset class has grown in Europe and the US. But some legislative proposals still stop short of recognising the full value of such repositories because these proposals only require a subset of data to be reported to them, in contrast to current market practice of reporting both cleared and uncleared trades to a repository.

If these proposals go ahead, they will fragment reporting and have the unintended consequence of preventing a comprehensive view of risk for regulators.

Global policymakers must be assured that the markets have access to a solution that addresses systemic risk concerns.

Given the global nature of the derivatives market, that solution must involve global infrastructures – particularly trade repositories – that can respond to market and supervisory demands with a global view.

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