South African Reserve Bank - Comments on the consultative paper “Report on OTC derivatives data reporting and aggregation requirements”
2011-09-23

The paper is very comprehensive and there is little to add to the contents from a technical perspective. The drafters clearly put a lot of effort and thinking into it, and most of the issues and challenges are covered in the discussions. Our comments are, therefore, more on a conceptual level.

As described in the report, in order to measure systemic risk, there would have to be an integrated system of TRs into which all information is fed in a standardised way. The paper describes the difficulties that would be encountered in capturing and aggregating all this information. In order to conduct any reliable assessment of systemic risk, counterparty exposures would have to be calculated in a system-wide, integrated way, taking into account continuous valuations of individual transactions as well as all unique characteristics of a transaction, such as set-off, netting arrangements, collateralisation, physical hedging, contractual intricacies, daily valuations, related parties, and so forth. In our view, in order to derive maximum benefit from the repository with regards to systemic risk identification and mitigation, this data would probably have to be supported by an integrated, global valuation and risk-measurement model as well as internationally harmonised information sets and encoding, to enable the calculation of net exposures among counterparties.

Although such information would have been ideal, and we in principle support the greater transparency of the OTC derivatives market, we are sceptical that some of the options proposed in the document are over-ambitious. Risk assessment requires complete information across markets, jurisdictions and asset classes, which may not be practical. At best, it would take a very long time to develop. Information is also likely to be incomplete, which would make any systemic risk assessment less reliable. Therefore, unless all data gaps (as described extensively in section 3.1.4 of the report) can be overcome, regulators could end up with a vast amount of data that may not be very useful in terms of systemic risk assessment. The collection of data and making it available to regulators does not automatically reduce systemic risk. Rather, it is the ability of regulators/supervisors to sensibly interpret data, overcome data gaps, accurately assess risks and enforce risk-reducing measures that could potentially address systemic risk.

The collection of a complete set of data on OTC derivatives potentially implies huge additional costs to the OTC derivative market participants (e.g. additional systems, staff, controls), the TRs themselves (e.g. establishment cost, staffing, systems, governance) and the regulators/supervisors (systems, extracting and analysing the data, staffing). We are concerned that huge cost and effort could be incurred, without making a commensurate contribution to understanding and quantifying systemic risk. We therefore recommend that the appropriate cost/benefit analyses be conducted before the G20 adopts any firm international standards in this regard.

It is also imperative that the purpose of/reasons for gathering information should be clearly defined, whether it is to have statistical information on the OTC market, or risk-based information. Such clarification would determine the extent of detailed information that should be gathered.

One approach could be for TRs to collect standard transaction data according to a data field approach. Such data would give system-wide statistical information about the major participants in the OTC derivatives market, the types of products in which they trade, market shares, notional amounts, prices, etc. This information would enable regulators to identify trends and to initiate deeper investigations into the activities of individual institutions within their supervisory scope. This seems, as an initial step, a more practical approach than aiming for global systemic risk-assessment through an integrated system of TRs.

Alternatively, the 80/20 principle could be applied by requiring only the major participants in the OTC derivatives market, perhaps the 10 to 15 largest dealers, to submit detailed information to their regulators or national trade repositories, or by focusing on specific types of OTC derivatives that are either more risky or more systemic due to their size.

We have two more comments:

Firstly, what could be the role of existing organisations, such as ISDA? Can their roles not be extended to address some of the issues raised in the document?

Secondly, the role of physical assets/hedges in reducing the risk exposures emanating from OTC derivatives is generally underemphasised. This should also be added to the data gaps.