February 2015

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Improving Regulatory Transparency of Global Derivatives Markets: Key Principles

Greater regulatory transparency is a key public policy goal that was codified at the September 2009 Pittsburgh Group-of-20 (G-20) summit. Over the past several years, much work has been undertaken to achieve this goal. Laws were passed. Regulations were issued. Trade repositories were established. Reporting processes were implemented. Today, the vast majority of over-the-counter (OTC) derivatives trades are in fact reported, and additional jurisdictions are still going live.

Despite this seeming progress, major challenges remain. Regulators, for example, continue to lack a true picture of risk in individual jurisdictions because of incomplete and inconsistent trade data. On a global level, this means that efforts to aggregate data (and risk exposures) remain little more than a dream. Market participants face costly, duplicative and conflicting trade reporting rules. Trade repositories have the unenviable task of collecting and standardizing data from multiple sources for multiple jurisdictions.

To help cut through the roadblocks and obstacles that are delaying further progress, ISDA has developed key principles and action steps that all stakeholders should consider and align with in order to improve regulatory transparency.

Improving Regulatory Transparency: Key Principles for Standardizing, Aggregating and Sharing Data Across Borders

1. **Regulatory reporting requirements for derivatives transactions should be harmonized within and across borders.** Toward this end, regulators around the world should identify and agree on the trade data they need to fulfill their supervisory responsibilities, and then issue consistent reporting requirements across jurisdictions.
2. **Policy-makers should embrace and adopt the use of standards – such as legal entity identifiers (LEIs), unique trade identifiers (UTIs), unique product identifiers (UPIs) and Financial products Markup Language (FpML) – to drive improved quality and consistency in meeting reporting requirements.** Unique global identifiers for legal entities conducting a trade (LEIs), for product types (UPIs) and for trades (UTIs/unique swap identifiers) have been developed. They should be expanded as necessary and their use should be adopted across reporting regimes. The governance of such standards should be transparent and allow for input and review by market participants, infrastructure providers and regulators.
3. **Where global standards do not yet exist, market participants and regulators can collaborate and secure agreement on common solutions to improve consistency and cross-border harmonization.** Market participants can, in an open and transparent process, establish a central source (a data dictionary) that defines and clarifies derivatives trade and reference data and workflow requirements for each reporting field that is required by each regulator. Regulators should review this work on an ongoing basis and facilitate its adoption on a cross-border basis.
4. **Laws or regulations that prevent policy-makers from appropriately accessing and sharing data across borders must be amended or repealed.** Regulators need to continue to work collaboratively to develop a framework that enables appropriate sharing of derivatives trade data across geographic boundaries. Roadblocks to the appropriate sharing of data should be removed either by regulatory or legislative action.
5. **Reporting progress should be benchmarked.** The quality and completeness of data provided to repositories should be tracked, measured and shared with market participants and regulators in order to benchmark, monitor and incent progress in reporting.

INTRODUCTION

Despite the seeming progress made in reporting derivatives trades, questions remain as to whether the mountain of data now being generated is helping to improve regulatory transparency in a meaningful way. ISDA believes the answer is a qualified 'yes'.

Transparency is unquestionably better now than before the crisis. But a number of key factors continue to stymie the progress that could potentially be made: data requirements differ across jurisdictions; some data requirements are not clearly defined; standardized reporting formats have been not adopted quickly or broadly enough; there is a lack of agreement as to how some data reporting requirements should be standardized or harmonized across jurisdictions; and there is a lack of commitment (for several reasons) among stakeholders in the process to drive and achieve consensus in these areas.

Fortunately, all of these issues have solutions. Some solutions will be easier to implement than others. And the active support and cooperation of a range of stakeholders – regulators, market participants and infrastructure providers – is vitally important to making these solutions a reality.

Key Principles

1. Regulatory reporting requirements for derivatives transactions should be harmonized within and across borders.

   At the most basic level, efforts to improve regulatory transparency of derivatives markets depend on the ability to consistently compile, aggregate and analyze a portfolio of data related to derivatives transactions within and across jurisdictions.

   Toward this end, regulators around the world should identify and agree on the trade data they need to fulfill their supervisory responsibilities, and then issue consistent reporting requirements across jurisdictions.

   There are, for example, over 40 separate fields of information required by the Commodity Futures Trading Commission (CFTC) in the US for each trade. But there are insufficient instructions as to how each of those fields should be populated in all cases.

   This lack of consistency is magnified on an international level. Regulators differ in their approaches as to whether one or both counterparties to a transaction are required to report. Regulators in different jurisdictions may also require different types of data to be reported and may mandate differing levels of specificity and granularity. Just as importantly, though, regulators may differ in how they define a particular field, so that an appropriate answer in one jurisdiction may be wrong in another.

   For these reasons, it is important for regulators to agree on the data they require of market participants, and then to ensure that their data definitions are consistent.

2. Policy-makers should embrace and adopt the use of standards – such as LEIs, UTIs, UPIs and FpML– to drive improved quality and consistency in meeting reporting requirements.

   Unique global identifiers for legal entities conducting a trade (LEIs), for product types (UPIs) and for trades (UTIs/USIs) have been developed. Electronic representation of trade and workflows for the confirmation and reporting processes is also well advanced, as evidenced by the FpML product and process representations.

   This work is vital to ensuring regulators have access to the information they need. As a result, it should be expanded as necessary and its use should be adopted across reporting regimes. The governance of such standards should be transparent, internationally coordinated and allow for input and review by market participants, infrastructure providers and regulators.

   Areas where standards exist and could be more broadly adopted include:

- **LEIs** unambiguously identify a party to a trade at the legal entity level, and are broadly used in many regimes to identify the parties in trade reporting. But there are still industry participants that have not yet obtained an LEI and are reluctant to do so, often because they are not compelled to do so by their primary regulator or they are not convinced of their obligation to do so.

- **UPIs** are accepted or required for reporting in most jurisdictions in order to provide a product classification mechanism for data analysis. Unlike LEIs, UPIs have not benefitted from an advanced global regulatory initiative; rather, most regulators have either established their own interim standards or deferred to trade repositories to create or apply an existing industry standard.

  In the absence of a global regulatory standard for product identification, ISDA developed the ISDA OTC Taxonomy, which is widely used as the basis for UPIs. Regulators need to work together with trade organizations and the industry to adopt and develop existing product classification standards like the ISDA OTC Taxonomy[1] or collectively develop and transition to a variant or alternative approach.

- **UTIs**, including the CFTC's unique swap identifiers, allow parties to identify and report a transaction via the same reference ID. UTIs are essential to trade repository administration of the data pertaining to a particular transaction. But their greater potential is as a tool for global data aggregation. Unfortunately, UTIs have also suffered from a lack of global regulatory coordination. Regulators should forego individual UTI approaches and consider endorsing existing industry standards for a global UTI that have developed in absence of a global regulatory standard (such as ISDA's best practice[2] regarding the generation and communication of UTIs).

- **FpML** is the open source standard for electronic dealing and processing of OTC derivatives. It establishes a protocol for sharing information electronically and dealing in derivatives and structured products. Market participants and ISDA should ensure that standardized trade representations and reference data are reflected in the FpML architecture and continue the expansion of FpML to cover all OTC products. The FpML standard should be tightened and documentation further enhanced to allow for a consistent normative implementation by all participants.

3. Where global standards do not yet exist, market participants and regulators can collaborate and secure agreement on common solutions to improve consistency and cross-border harmonization.

   Even where regulators require the same trade data, common standards do not yet exist for the format and the content of trade data to be provided. This leads to variability that hinders transparency.

   To address this issue, market participants can, in an open and transparent process, establish a central source (a data dictionary for harmonized global repository standards) that defines and clarifies derivatives trade and reference data and workflow requirements for each reporting field that is required by each regulator. Direction and support from regulators on this initiative is critical. Regulators should be clear about their priorities and set timetables for reform. They should also regularly review this work and facilitate its adoption on a cross-border basis.

   The use of reference data, which refers to those elements of a transaction based on a reference source, is a case in point. Sources of reference data are not defined centrally and not used consistently. Some firms, for example, use internal reference data for their trades. A data dictionary that includes and centrally defines references sources and related terms would therefore be an improvement over current practices.

[1] ISDA *OTC Derivatives Products Taxonomies*, http://www2.isda.org/functional-areas/technology-infrastructure/data-and-reporting/identifiers/upi-and-taxonomies/.

[2] *Unique Trade Identifier (UTI): Generation, Communication and Matching*, ISDA Study, http://www2.isda.org/functional-areas/technology-infrastructure/data-and-reporting/identifiers/uti-usi/

Establishing a central source that defines and documents the trade data, reference data and reporting workflow requirements that can be used by all reporting parties and infrastructures will improve data consistency. This central dictionary could be a powerful tool for the industry and regulators to improve data quality and understand and clarify discrepancies in data reported in different jurisdictions. The central source will be a key element to facilitate data aggregation across jurisdictions.

4. Laws or regulations that prevent policy-makers from appropriately sharing and disclosing data with each other across borders must be amended or repealed.

Many regulators across the globe have taken swift action to implement trade reporting rules. However, the sharing of this data between regulators has not occurred in any meaningful way. Data sharing has been significantly undermined by the swap data repository indemnification requirements under the US Dodd-Frank Act. Regulators have been unwilling or unable to provide repositories with indemnification, restricting the ability to share US data across or within jurisdictions. In addition, laws prohibiting counterparty identification disclosure to regulators unnecessarily restrict regulatory transparency and should be changed.

Regulators need to continue to work collaboratively to develop a framework that enables appropriate sharing of derivatives trade data across geographic boundaries. Roadblocks to the appropriate sharing of data should be removed either by regulatory or legislative action.

5. Reporting progress should be benchmarked.

The quality and completeness of data provided to repositories should be tracked, measured and shared with market participants and regulators in order to benchmark, monitor and incentivize progress in reporting. How accurate is the data that is being reported? How completely are data fields being populated? The ideal end point for the benchmarking process is the ability to demonstrate the advancement in data quality that results from industry and regulatory commitments to standardization. For these reasons, the quality and completeness of data provided to repositories should be tracked, measured and shared with market participants and regulators. Benchmarking can be a tool for regulators to drive the data quality and standardization priorities. The investment in standardization is motivated, and ultimately justified and rewarded, by the positive results of the benchmarking.

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ABOUT ISDA

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.