FS Regulatory Brief

Swap Data Reporting: Ready to Deliver?

This *FS Regulatory Brief* follows our *A Closer Look* on the impact of the Dodd-Frank Act on swap data reporting issued in June, 2011.

Swap data reporting is fast approaching in the United States as a leading edge of Dodd-Frank derivatives reform. The Commodity Futures Trading Commission's (CFTC's) complex dual-track regulatory regime that will require swap data reporting to a registered swap data repository (SDR) for real-time public dissemination under one rule and confidential regulatory use under another is almost complete. While the CFTC has set July 16, 2012 as the target date for this swap data reporting to begin, it seems this deadline will slip because some key regulations are not yet final. This CFTC data-reporting eventually will be followed by data reporting for security-based swaps (SBS), a smaller segment of the market, under Securities Exchange Commission (SEC) rules. The timing for SEC action is unknown.

Swap data reporting will impact the entire market place. Swap dealers and major swap participants (MSPs) need to consider multiple paths for reporting data from their swap books. Swap end-users need to consider whether they, or their counterparties, will have a duty to report. Market facilities, such as execution venues and clearing houses, eventually could shoulder much, but not all, of the reporting burden. In each case, an assessment and response is warranted. Inaction is not prudent.

Planning an operational response in such circumstances is challenging and requires a complex regulatory assessment that, for swap dealers/MSPs, must be paired with a major information technology (IT) build out. This places a premium on developing a reporting compliance strategy and running a dynamic implementation plan that anticipates and reacts to regulatory, IT and market challenges. We outline below some key action steps that you can take now to get ready to report swap data in a post-Dodd-Frank world.

When does swap data reporting start?

The CFTC plans to phase-in full swap data reporting by asset class and by type of counterparty over a six month period using three compliance dates. This requirement to report will apply to all swaps executed on or after the applicable compliance date.

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The table below outlines the compliance sequence for market participants.

Compliance sequence

Swap data reporting – CFTC Confidential and Real-Time Final Rules

Covered party	Asset class	Compliance date
SEF, DCM, DCO, Swap dealer, MSP, SDR	Credit swaps Interest rate swaps (IRS)	Later of July 16, 2012, or 60 days after rule defining "swap" is published in Federal Register
SEF, DCM, DCO, Swap dealer, MSP, SDR	Equity swaps Foreign exchange swaps Other commodity swaps	On or before 90 days after data reporting for credit swaps and IRS begins
Non-swap dealer /MSP	All swaps	90 days after data reporting for equity swaps and foreign exchange swaps begins

Key: SEF – swap execution facility; DCM – designated contract market; DCO – derivatives clearing organization

A separate reporting regime will apply to "historical swaps" - swaps executed before enactment (July 21, 2010) or after enactment but before compliance dates for real-time and confidential reporting. Rules regarding these "historical swaps" have recently been finalized and market participants need to prepare for reporting under either the full or historical reporting regimes.

Start dates delayed

The July 16, 2012, start date for swap data reporting will be delayed as the CFTC and SEC have not yet finalized the foundational product regulations. Swap data reporting (and most other US derivatives regulatory reforms) cannot begin until the regulations that define "swap" and "security-based swap," are finalized. Given the delay, the compliance start dates have slipped. ***This should not slow-down preparedness efforts, however, since the start date would roll forward unpredictably until both definition rules appear.***

Who has to report?

At a basic level, each counterparty to a swap could have a duty to report data regarding that swap under Dodd-Frank. However, the CFTC rules set up hierarchy for who has the duty to report swap data in a transaction to encourage on-facility swap execution and clearing and to lessen the burden for non-swap dealer/MSP counterparties. This hierarchy places the reporting burden on a swap facility (SEF, DCM, DCOs) first, a swap dealer/MSP counterparty second, and a non-swap dealer/MSPs counterparty third. If two swap counterparties have equal regulatory status, the duty to report must be determined by contract (likely during the on-boarding or re-on-boarding process). For transactions involving non-US counterparties, the hierarchy of reporting obligations would apply under all circumstances but one: in cases where both counterparties are non-SD/MSP counterparties and only one counterparty is a US person, the US person is required to report. Permitting counterparties to rely on swap facilities to meet some of the reporting burden does not obviate the need to prepare for direct reporting for off-facility swaps.

Are there any exemptions?

There are partial exemptions from real-time reporting for certain inter-affiliate swaps (internal swaps between wholly-owned subsidiaries of the same parent entity), for portfolio compression exercises and for Treasury- proposed exempt FX swaps and forwards. The confidential regulatory reporting rules do not provide these exemptions, however. As a practical matter, therefore, the real-time exemptions may mean very little to a reporting swap dealer or MSP since data reporting for one purpose requires a full IT build and compliance process and much of the same data is reportable for real-time and confidential regulatory uses.

The internal swap reporting exemption merits a closer look, however, because it is one of the few places where the CFTC has given special treatment to back-to-back swaps within an organization. Because the real-time data reporting rules seek to provide transparency into pricing and market terms, the CFTC has limited real time data reporting to “arms-length” transactions that result in a “corresponding change in the market risk position of those parties.” An internal transaction that moves risk between wholly-owned subsidiaries of the same parent is not an arm’s length transaction, according to an example provided in the rule. This exemption appears intended to avoid sending potentially distorting swap data to the market place.

For banks in particular, this internal swap exemption is narrowed, however. The arm’s-length principle that drives this exemption led the CFTC to conclude in a footnote that the internal swap exemption would not apply to a bank’s “covered transactions” with an affiliate under Section 23A of the Federal Reserve Act. Covered transactions must be on arm’s length terms and therefore are reportable as they will support the price transparency goal of real-time reporting.

The CFTC also extended an exemption to any FX swaps or forwards that are deemed exempt from treatment as swaps by the US Treasury Department. It underscored, however, that FX options and non-deliverable forwards are not potentially exempt swaps and will require full real-time swap data reporting.

Preparing now

Preparing for swap data reporting will require a complex compliance assessment and roll-out strategy and, for swap dealer/MSPs, a major systems review and IT build. This exercise translates into four core steps that future swap dealers and MSPs should be taking now. Other market participants – such as non-swap dealer/MSPs that trade with other non-dealer/MSPs – also should conduct an analysis along these lines, at least to assess their exposure to reporting duties and to develop a strategy for responding.

No. 1: Identify your reporting duties and your reportable asset classes

Given the hierarchy for reporting data and the phased-in roll out by asset class, market participants should evaluate when a reporting duty might arise from their swap activities. Swaps that are off-exchange and not cleared create the most reporting duties for a swap counterparty. To the extent that swaps migrate onto exchanges and into clearing, then most data reporting will shift to those intermediaries. However, for swap dealers and MSPs, on-exchange and cleared transactions will not eliminate counterparty reporting altogether. They may still have to report valuation data and certain life-cycle data about on-facility swaps. Plus this migration to on-facility trading will occur over time, suggesting that swap dealers and MSPs must have a data reporting plan and operational capability per asset class by the time swap data reporting begins.

No. 2: Identify your data capture processes and available project personnel

The real-time and confidential data reporting rules describe detailed reportable data fields that change depending on asset class. These fields do not necessarily match current trade capture and recordkeeping systems and processes. The data fields also might be located in multiple information systems and accessing the data for reporting can span multiple technologies. Locating the reportable data is step one to building out a reporting infrastructure, and a rigorous gap analysis is essential. Finding personnel that can conduct this assessment and develop business requirements for a significant IT build out is also critical.

No. 3: Assess your current systems and plan your reporting strategy

Once you have located the data in the various organizational systems, a cross-functional team needs to assess how to build out a data reporting capability.

IT should become a core owner of this project, but operations, compliance and legal must play a role in developing a data reporting strategy across asset classes.

Operations staff should drive trade flow assessments to determine when and where the reportable data appears in a system and how to meet reporting timing requirements.

Compliance should validate and support reporting decisions to ensure that the program meets regulatory standards.

Legal should weigh in across the spectrum from evaluating agreements with SDRs or third party reporting services, to developing a principled basis for addressing core ambiguities in regulations, such as how to handle jurisdictional questions about swaps executed outside of the United States that nonetheless have a US nexus.

The core role of the IT department in this undertaking needs to be emphasized. IT must build data reporting capacity within the institution - to capture all the required fields and establish connectivity with one or more SDRs to ensure delivery of those fields. Several future swap data repositories (such as Depository Trust Company Corporation) have highly sophisticated exercises and detailed specifications available to support connectivity.

No. 4: Build out data reporting functionalities, test and plan timing for go-live

The IT department will take center stage in automating an institution's swap data reporting capacities. A validated gap analysis of the data fields needs to be mapped to a reporting strategy and translated into actionable business requirements for IT to execute upon. IT must undertake the complex exercise of extracting information from current systems in reportable formats, identifying and acting upon specifications for connectivity to the SDRs, establishing connections and testing capabilities. In addition, the lack of clarity surrounding the make-up of some of the new data fields, such as the unique identifiers, creates challenges to the build out process.

This is a multi-step process that can take considerable lead time just to execute. Staffing this exercise with personnel that have both time and expertise presents a key challenge and potential compliance risk. Institutions need to evaluate these factors and adapt on an interactive basis to the technological and personnel challenges as this project unfolds.

Many troublesome questions with few clear answers

Building a swap data reporting functionality that complies with Dodd-Frank will present many tough questions with few clear answers. Universal identifiers are a core feature of future reporting, yet it is not clear how or when identifiers will be integrated into the reporting architecture. Registered swap dealers with global operations should consider whether or how to report data on swaps executed abroad that have a US nexus, if they can determine what type of US nexus is sufficient. Timing considerations for reporting data in a global book that follows the sun present challenges for identifying reporting touchstones. Privacy concerns in certain jurisdictions may impact an institution's ability to report data to a US repository. The potential for duplicative data reporting either on a per swap basis or to more than one SDR also needs attention, at least from the regulator's perspective.

Given the short time frames and expectations for data reporting go-live, time is of the essence for action. PwC has multi-disciplinary teams of experts who can help you assess and respond to the many compliance, technology and operations challenges in this and other aspects of the fast emerging Dodd-Frank derivatives regulatory regime.

Additional information

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