Regulatory brief
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Derivatives: Global discord extends to Asia

Overview

Global entities struggling to navigate Dodd-Frank's and EMIR's derivative regulatory requirements are about to be hit by a third wave of regulations. Regulators in the Asia Pacific ("Asia-Pac") are beginning to enforce trade reporting requirements, and more requirements related to central clearing and electronic execution are not far behind. The jurisdictional differences in these reporting requirements are notable, and although substituted compliance is an option in some jurisdictions, its scope is limited and is not yet fully defined.

In Asia-Pac, trade reporting requirements enacted as part of the larger G20 OTC derivatives reform are at various stages of completion, with the four major jurisdictions being Australia, Singapore, Hong Kong, and Japan. Although regulatory efforts in Japan were finalized in 2012, reporting regulations in other jurisdictions are just beginning to take effect (i.e., in Australia on October 1st), remain in the proposal phase but are set to soon begin taking effect (i.e., in Singapore on October 31st), or await further regulatory clarification (i.e., in Hong Kong with limited obligations commencing on December 9th). As a result, within the region, derivatives reform has varied in breadth and depth and has a staggered phase-in timeline for conformance, which extends in some cases into 2015.

In light of recent cross-border guidance and relief from the CFTC[1], US swap dealers and non-US swap dealers must review their derivatives activity in these four key Asia-Pac jurisdictions in order to determine their US obligations. In three of the jurisdictions (all but Singapore), US swap dealers' foreign branches (and non-US swap dealers) are not required to comply with many Dodd-Frank requirements until December 21, 2013. By then, portions of the jurisdictions' rules may start governing in place of the Dodd-Frank because of the possibility of substituted compliance, i.e., the jurisdictions' rules may be used in place of the US's in some respects if the CFTC makes an affirmative substituted compliance determination. CFTC Chairman Gary Gensler recently indicated that by December 21st, the CFTC will have made substituted compliance determinations for "entity-level" rules (such as capital and risk management regulations).[2]

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[1] See PwC's *A Closer Look, Derivatives: Global convergence becomes global confusion* (September 2013); and PwC's *Financial Services Regulatory Brief, Derivatives: CFTC finalizes cross border guidance and extends timeframe for conformance* (July 2013).

[2] However, Chairman Gensler was less certain that substituted compliance determinations with respect to "transaction-level" rules (e.g., those related to execution and clearing) would be completed by December 21st.

Therefore, US firms will need to analyze the extent to which their foreign branches need to comply with jurisdictional obligations in Asia-Pac. These local obligations are generally driven by the type of entity engaged in trading, the type of asset class traded, and the "nexus" with the local jurisdiction (which is often established by booking or physically trading a derivative in an Asia-Pac country).

Similar to the CFTC's substituted compliance regime, some Asia-Pac jurisdictions (e.g., Singapore and Australia) offer limited exceptions for foreign entities that comply with substantially similar reporting obligations in their home jurisdiction. However, overall differences in scope, applicability, and reporting requirements in various jurisdictions preclude a one-size-fits-all strategy. Compliance with even the most flexible or aggressive single regulatory regime in the region will not cover a firm's entire product or customer data reporting obligations in Asia-Pac. This necessitates a flexible approach to compliance planning and requires improvements in data infrastructure and governance.

Chief among jurisdictional differences is the timeline of regulatory reform. The first mandatory phase of reporting has begun in Australia, while Singapore and Hong Kong are bracing for final rules. Market participants must be prepared to meet these new regulatory requirements as regulatory reform rolls out across the region, which require operational changes to manage and maintain. These changes are not only stretching resources but also necessitate data management improvements.

This **Financial Services Regulatory Brief** analyzes the key regulatory requirements and expected developments in three major Asia-Pac jurisdictions (Australia, Singapore, and Hong Kong), and suggests a strategic framework for meeting regulatory demands that includes elevating enterprise data strategy.

Regulations in Asia-Pac

Australia

On July 9, 2013, the Australian Securities and Investments Commission ("ASIC") finalized OTC derivatives transaction rules for trade reporting in response to its G20 commitments. The rules impose trade reporting requirements on certain entities to disclose information about their OTC transactions and positions (including any changes) to a trade repository, beginning with the first reporting phase on October 1, 2013.

Which OTC derivatives are in-scope?

The trade reporting rules apply to five classes of OTC derivatives: commodity derivatives (that are not electricity derivatives), credit derivatives, equity derivatives, foreign exchange ("FX") derivatives, and interest rate derivatives. The definition of "OTC derivative" excludes derivatives traded on a financial market subject to ASIC supervision or on foreign markets subject to "sufficiently equivalent" obligations.[3]

To whom do the reporting requirements apply?

The trade reporting requirements apply as follows to the below entities:

- *An Australian entity* (i.e., an entity incorporated or formed in Australia) registered as a swap dealer with the CFTC must report all transactions in OTC derivatives to which it is a counterparty (regardless of where the OTC derivative is executed).
- *An Australian entity's foreign subsidiary* must similarly report all transactions in OTC derivatives to which it is a counterparty (regardless of where the OTC derivative is executed), but only if the Australian entity is an authorized deposit-taking institution ("ADI") or is licensed as a financial services provider.
- *A non-Australian company that is an ADI* (i.e., an entity that is incorporated outside of Australia but has an Australian branch) must report all transactions in OTC Derivatives that are either executed in Australia or booked to the profit and loss account of the Australian branch.
- *A non-Australian company* that is registered under the Australian Corporations Act[4] must similarly report all transactions in OTC Derivatives that are either executed in Australia or booked to the profit and loss account of the Australian branch.

Currently, trade reporting obligations do not apply to end-users.[5] However, ASIC is expected to issue more consultation on the treatment of end-users in 2014.

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[3] The list of "sufficiently equivalent" foreign markets has not yet been determined.

[4] Generally, foreign companies that are required to register under the Australian Corporations Act are those that offer (or serve as guarantors for) debentures within Australia.

[5] End-users are those entities that are not listed above, and are also neither (a) a Clearing and Settlement ("CS") facility licensee nor (b) an entity that provides derivatives-related financial services only to wholesale clients that is regulated by an overseas authority.

What is the timeline for compliance?

Transaction and position reporting requirements began with a voluntary opt-in period that opened on July 1, 2013. This period is followed by three mandatory reporting phases, the timing of which depends on the type of entity required to report, the asset class, and the type of reporting (i.e., transaction reporting or position reporting).

The **first reporting phase** applies to those Australian entities that are registered as swap dealers with the CFTC. They began transaction reporting on October 1, 2013 and must begin position reporting[6] on October 1, 2014 for five asset classes, as depicted in the below chart.[7]

Asset class	Transaction reporting start date	Position reporting start date
• Credit derivatives • Interest rate derivatives • Equity derivatives • Commodity derivatives[8] • FX derivatives	October 1, 2013	October 1, 2014

The **second reporting phase** applies to entities with greater than $50 billion in gross notional OTC derivatives outstanding (as of December 31, 2013), including non-Australian ADIs, Australian ADIs, entities licensed as financial services providers, CS facility licensees, and exempt foreign licensees.[9] They must begin transaction reporting on April 1, 2014 and begin position reporting on October 1, 2014, as depicted in the following chart.

Asset class	Transaction reporting start date	Position reporting start date
• Credit derivatives • Interest rate derivatives	April 1, 2014	October 1, 2014
• Equity derivatives • Commodity derivatives • FX derivatives	October 1, 2014	April 1, 2015

The **third reporting phase** applies to the same type of entities as those in the second phase when those entities have *less* than $50 billion in gross notional OTC derivatives outstanding as of December 31, 2013. They must begin transaction reporting on October 1, 2014 and begin position reporting on April 1, 2015, as depicted in the below chart.

Asset class	Transaction reporting start date	Position reporting start date
• Credit derivatives • Interest rate derivatives	October 1, 2014	April 1, 2015
• Equity derivatives • Commodity derivatives • FX derivatives	April 1, 2015	October 1, 2015

What type of data must be reported?

Entities are required to report both transaction and position information on OTC derivatives. Required information includes a common data set for each transaction as well as an additional set of data specific to each asset class. Similar to Dodd-Frank and EMIR reporting requirements, entities under Australia law must disclose valuation, collateral, product/transaction/entity identifiers, and the economic terms of the transaction. Certain information relating to barriers, valuation, and collateral is not required to be reported by entities reporting in the first or second phases until October 1, 2014; and until April 1, 2015 for entities reporting in the third phase.

[6] On the date that position reporting commences, the rules require that position information also be reported going back to the date that transaction reporting became required for the particular asset.

[7] On October 1, 2013, ASIC provided temporary exemptive relief from Australia-specific trade reporting requirements to the five major Australian banks that are currently registered as swap dealers with the CFTC and are already reporting under CFTC rules.

[8] Commodity derivatives do not include electricity derivatives in any of the three reporting phrases.

[9] An “exempt foreign licensee” is an entity an entity that is regulated by an overseas authority, provides derivatives-related financial services only to wholesale clients, and is exempt from the requirement to hold an Australian license as a financial services provider.

Each counterparty to an eligible OTC derivatives transaction is required to report to a trade repository (i.e., two-sided reporting). However, until October 1, 2014, one counterparty is permitted to rely on the reporting of the other counterparty (or by another entity under foreign requirements) to satisfy its own reporting obligations (i.e., one-sided reporting, similar to the CFTC reporting regime). As with OTC derivatives reform in other jurisdictions, Australia permits delegated reporting by a third party, but responsibility for the accuracy of the report remains with the original parties to the transaction.

An Australian entity must report required information to a trade repository that is licensed by ASIC in Australia. However, since there are currently no licensed trade repositories in Australia, Australian entities are permitted to temporarily use foreign repositories designated by ASIC as "prescribed trade repositories" to meet reporting obligations until September 30, 2014. A foreign entity may also elect to report to a prescribed trade repository, subject to substitute compliance conditions.[10]

ASIC has designated the following eight prescribed trade repositories:

Prescribed trade repository	Location	Status
DTCC Data Repository (US)	USA	Operating
DTCC Derivatives Repository	UK	Operating
DTCC Data Repository (Japan)	Japan	Operating
DTCC Data Repository (Singapore)	Singapore	Seeking license; expected to become operational by year-end 2013
Chicago Mercantile Exchange	USA	Operating
INFX SDR	USA	Operating
ICE Trade Vault	USA	Operating
HKMA-TR	Hong Kong	Operating

[10] These conditions are met if a prescribed trade repository exists in the foreign entity's home country, and either (a) reporting is done under substantially equivalent reporting obligations in that jurisdiction, or (b) the entity is exempt in that jurisdiction from reporting obligations or there are no applicable reporting obligations in that jurisdiction.

What are the retention obligations?

For a period of five years from the date a record is made or amended, reporting entities must keep records that enable them to comply with trade reporting obligations, including records of all data that is reportable under transaction and position reporting rules.

Singapore

In November 2012, Singapore's Securities and Futures Act ("SFA") was amended to introduce the framework for G20 reform, including the reporting of certain derivatives transactions to a trade repository. Subsequently, the Monetary Authority of Singapore ("MAS") issued several draft regulations and consultation papers[11] proposing a framework for implementing trade reporting. Because this framework may change upon finalization of the draft regulations (based on outstanding consultations), the below analysis is subject to change.

Which OTC derivatives are in-scope?

Certain derivatives contracts that are traded in Singapore (i.e., executed by a desk located in Singapore) or booked there must be reported to a licensed local or foreign trade repository within one business day of execution, modification, or termination.[12]

Like Australia, the reporting regime will eventually apply to at least five assets classes (i.e., commodity derivatives, credit derivatives, equity derivatives, FX derivatives, and interest rate derivatives). As of now, however, the regulations only apply to those interest rate and credit derivatives that are executed either:

- On or after the date they are published in an implementation schedule maintained by MAS ("Date of Listing"), or
- Before the Date of Listing but have 1 year or more to maturity as of that date.

[11] The most recent consultation paper was released for comment on June 26, 2013. See MAS's *Draft Regulations Pursuant to the Securities and Futures Act for Reporting of Derivatives Contracts* (June 2013).

[12] Trades that are marketed, originated, or arranged in Singapore but not executed or booked in Singapore are not currently included in the scope of the reporting obligations.

To whom do the reporting requirements apply?

The trade reporting requirements apply to the following three categories of entities:

- Banks (i.e., banks licensed in Singapore[13], subsidiaries of banks incorporated in Singapore, and merchant banks approved as a financial institution by MAS)
- Other financial entities (e.g., listed finance companies, registered insurers, and certain trustees)
- Non-financial specified person ("NFSP") (i.e., a resident of Singapore other than those listed above whose aggregate gross notional amount of specified derivatives contracts booked or traded in Singapore has exceeded $8 billion over the previous year)

MAS has published a schedule of entities that are exempt from trade reporting obligations including central banks or agencies of central governments not incorporated for commercial purposes and certain multilateral agencies (e.g., the Asian Development Bank and the Bank for International Settlements).

What is the timeline for compliance?

MAS has proposed a two-phased approach for implementation based upon type of entity and asset class. The proposed first phase will cover the reporting of interest rate and credit derivatives. This phase was initially set to begin on October 31, 2013, and a second phase scheduled to begin in 2014 will cover FX, equity, commodity, and certain other derivatives. However, the October 31, 2013 deadline will likely be pushed to 2014 due to MAS's concerns regarding industry readiness, availability of trade reporting infrastructure, and international developments.[14]

MAS has proposed to allow substitute compliance with comparable reporting regimes in foreign jurisdictions; however, this is conditioned on MAS having full access to data reported under a comparable regime. Further clarification is needed regarding which jurisdictions MAS considers as comparable.

What type of data must be reported?

Similar to other jurisdictions, Singapore requires reporting of transaction and counterparty data, as well as asset-class specific information. Information is contained in two schedules referred to by MAS as the "Second Schedule" and "Third Schedule." Most reporting entities will use the Second Schedule for both the reporting of current information and historical information. However, MAS understands that certain NFSPs may not have the adequate infrastructure to keep records and to report all data required by the proposed regulations, and has instead allowed NFSPs to report a simplified set of data fields for back-loading purposes only.

What are the retention obligations?

All relevant books and other information required by MAS under the SFA, including derivatives transaction information reported to a trade repository, must be retained by reporting parties for five years following the expiration or termination of the underlying contract.

Hong Kong

In the summer of 2012, Hong Kong regulators issued a consultation paper outlining the proposed framework for trade reporting in Hong Kong.[15] However, the final legislation required to establish a trade reporting regime for OTC derivatives is still under consideration by the jurisdiction's lawmakers. With this final legislation pending, the Hong Kong Monetary Authority ("HKMA") exercised its supervisory powers in June 2013 to enact interim trade reporting requirements but only for "Licensed Banks," causing a somewhat stilted approach to trade reporting requirements.

Entities must report to the HKMA's trade repository ("HKMA-TR").

Which OTC derivatives are in-scope?

As of now, compared to Australia and Singapore, Hong Kong's reporting requirements impact fewer types of assets; however, more OTC derivative products will likely be included in the future as the OTC regulatory regime expands (as the regulators' outstanding consultation paper has indicated). Currently impacted products are the following:

- FX non-deliverable forwards ("NDFs")
- Plain vanilla interest rate swaps

Within these two assets classes, the following are explicitly excluded: swaps with embedded options or any other derivative feature (e.g., cancellable swaps, amortizing/accreting swaps, etc.), cross-currency swaps, and FX spot.

[13] Singapore-licensed banks include branches of US entities located in Singapore.

[14] See ESMA's *Technical Advice on Third Country Regulatory Equivalence Under EMIR – Singapore* (October 2013) indicating that trade reporting for interest rate and credit derivatives in Singapore may begin April 1, 2014.

[15] See HKMA's *Joint Consultation Conclusions on the Proposed Regulatory Regime for the Over-the-counter Derivatives Market in Hong Kong* (July 2012).

To whom do the reporting requirements apply?

Due to the HKMA's taking action before Hong Kong legislators, trade reporting requirements in Hong Kong will come into effect in two segments: first through interim requirements that only apply to Licensed Banks, and then through more comprehensive final rules covering multiple entity types.

- *Interim trade reporting by Honk Kong Licensed Banks:* A Licensed Bank[16] that is a counterparty to a plain vanilla interest rate swap or NDF with another Licensed Bank must report if the transaction is booked in a Licensed Bank's Hong Kong office or branch.
- *Final trade reporting requirements:* If the final legislation is adopted as proposed, then many more financial entities will be required to report. These entities will be licensed corporations, authorized money brokers or institutions, and "Hong Kong Persons." Hong Kong Persons are counterparties that originate or execute derivatives transaction with a Hong Kong "nexus."

What is the timeline for compliance?

The requirements for interim trade reporting became effective on August 5, 2013; however, a grace period is currently in effect until December 9, 2013 to allow Licensed Banks more time to comply. Transactions that were entered into on or after August 5, 2013, or were executed before but remained outstanding as of that date, are reportable, and Licensed Banks will have until February 4, 2014 to back-load them. Additionally, Licensed Banks must have registered with the HKMA-TR by September 5, 2013, even if they did not have derivatives positions to report.

We expect final trade reporting rules to come into effect in 2014, which will establish a conformance timeline for entities beyond Licensed Banks.

What type of data must be reported?

Similar to Dodd-Frank reporting requirements, reporting entities must disclose, at a minimum, trade identifying information, product and asset identifying information, entity information, including reporting party, trading parties and floating rate payer parties, and trade valuation.

[16] A Hong Kong "Licensed Bank" includes branches of US entities located in Hong Kong.

Meeting regulatory demands

Compliance prioritization

Because regulations in the region are in various stages of finalization and implementation, firms should consider a flexible approach to addressing their trade reporting obligations – for example, a single team which monitors and interprets trade reporting rules and their implications as they become final will streamline project management and compliance efforts. Although global financial institutions are no strangers to dealing with multiple jurisdictional requirements, coordinating such efforts simultaneously could become more challenging given a general lack of regulatory harmony among Asia-Pac nations.

Disparate reporting requirements may also mandate additional investments to support infrastructure enhancements required for compliance. These investments will demand significant budgets to enable reporting to data repositories in other jurisdictions. Rationalizing these investments against the current business and client base is critical to justifying the associated costs.

Enterprise data strategy

The need for centralized, customizable, and readily accessible derivatives data has never been greater. Although reporting requirements in many Asia-Pac jurisdictions are based upon asset class and entity type, classifications are not standardized across the region. As a result, firms may be required to classify their counterparties and products on a jurisdiction-by-jurisdiction basis. The numerous trade reporting requirements and staggered compliance dates therefore provide an opportunity to improve data governance via standardization, enhanced quality and access, and usage management.

Data reporting could quickly become unmanageable given the sheer volume of data required to be tracked and given the need to track different types of data for each country. This challenge necessitates strategic data management, for example via centralization. A centralized repository can be used as the foundation for effective reporting in Asia-Pac jurisdictions (as well as under Dodd-Frank and EMIR). A centralized enterprise repository will also reduce data redundancy and facilitate functions such as searching, analyzing, auditing, and classifying customers.

Leveraging substituted compliance

Several jurisdictions such as Singapore and Australia offer limited exceptions for foreign entities that comply with substantially similar reporting obligations in their home jurisdiction. Affected entities should evaluate their reporting obligations on a global scale, leveraging any existing reporting platforms and processes where possible.

Additional information

For additional information about PwC's Financial Services Regulatory Practice and how we can help you, please contact:

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