

25 May 2012

National Treasury of the Republic of South Africa
120 Plein Street
Cape Town
South Africa

Submitted to lusanda.fani@treasury.gov.za

Re: **Reducing the risks of OTC derivatives in South Africa**

Dear Sir/Madam:

MarkitSERV¹ is pleased to submit the following comments to the National Treasury of the Republic of South Africa (the "**Treasury**") in response to its concept paper on *Reducing the risks of over-the-counter derivatives in South Africa* (the "**Concept Paper**" or "**CP**").²

Introduction

MarkitSERV is a provider of confirmation, connectivity, and reporting services to the global OTC derivatives markets, making it easier for participants in these markets to interact with each other. Specifically, we provide trade processing, confirmation, matching and reconciliation services for OTC derivatives across regions and asset classes, as well as universal middleware connectivity for downstream processing such as clearing and reporting. Such services, which are offered also by various other providers, are widely used by participants in these markets today and are recognized as tools to increase efficiency, reduce cost, and secure legal certainty. With over 2,400 firms globally using the MarkitSERV platforms, including over 25,000 buy-side fund entities, our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in Europe, the United States, Asia, and elsewhere.

MarkitSERV has provided its services to market participants in South Africa for many years. Today, all of the major market makers and inter-dealer brokers are using the platform, and we probably process around 75% of the volume transacted in ZAR-denominated interest rate swaps. More recently, we have also onboarded a number of smaller dealers and an increasing number of buy-side clients.

By integrating electronic allocation, trade confirmation and portfolio reconciliation MarkitSERV provides a single gateway for the processing of OTC derivatives transactions. Based on our experience as provider of connectivity and processing services, we have been actively and constructively engaged in the debate about Regulatory Reform of the global OTC derivatives markets and the implementation of the Pittsburgh G20 commitments.³ Over the last 18 months we have submitted over 23 comment letters to regulatory authorities around the world and we have participated in numerous roundtables. We regularly provide the relevant authorities with our insights on current market practice, for example in relation to the electronic confirmation of OTC derivatives transactions, efficient ways of reporting them to Trade Repositories ("**TRs**"), or the reconciliation of existing portfolios of such transactions. We have also advised regulatory authorities

¹ MarkitSERV, jointly owned by The Depository Trust & Clearing Corporation (DTCC) and Markit, provides a single gateway for OTC derivatives trade processing. The company offers trade processing, confirmation, matching, and reconciliation services across regions and asset classes, including interest rate, credit, equity, and foreign exchange derivatives. MarkitSERV also connects dealers and buy-side institutions to trade execution venues, CCPs, and trade repositories. In 2011, over 20 million OTC derivative transaction processing events were processed using MarkitSERV. Please see www.markitserv.com for additional information.

² National Treasury of the Republic of South Africa: Reducing the risks of over-the-counter derivatives in South Africa. 27 March 2012.

³ "Leaders' Statement: The Pittsburgh Summit" (Sept. 24-25, 2009), available at http://www.g20.org/pub_communiques.aspx.

on appropriate approaches to enabling a timely and cost-effective implementation of newly established requirements, for example through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying regulatory requirements.

We welcome the Treasury's consultation regarding possible regulatory and legislative reforms for the South African OTC derivatives market and we appreciate the opportunity to comment on the Treasury's proposed requirements. Please find below our comments on the following issues: (1) portfolio reconciliation and dispute resolution as part of the proposed code of conduct, (2) global vs local TRs, (3) accuracy of the data captured in TRs, (4) timeliness of the reporting of the data, and (5) the required data to be reported. We believe the Treasury should also consider using a phased-in implementation of any reporting requirements.

Question 3: Which of these provisions should the code of conduct include?

The CP lists "dispute resolution" as a possible provision to be included in the code of conduct. Given the importance of timely and reliable mechanisms to resolve disputes in the OTC derivatives markets to reduce systemic risks, we believe that the Treasury should consider including portfolio reconciliation in its code of conduct as an efficient means to achieve dispute resolution.

Portfolio reconciliation today consists of four main components: (1) the exchange and normalization of position details; (2) the pairing (or reconciling) of the counterparties' records; (3) the identification of discrepancies; and (4) the communication and resolution of those discrepancies. It thus allows market participants to identify any issues related to their counterparty exposure at an early stage and minimizes the effort required to correct any such discrepancies in the future. MarkitSERV is one of several independent third party entities that currently provide portfolio reconciliation services. Portfolio reconciliation and other similar reconciliation services are widely used by investment managers, hedge funds, and fund administrators to automate the pairing of counterparty records and to identify economic or valuation differences for OTC derivatives portfolios.

While portfolio reconciliation is an important tool in the dispute resolution process we believe that the Treasury should ensure that any required reconciliation is not overly operationally burdensome in light of the benefit it provides. We believe the Treasury could do so by (a) requiring reconciliation to occur less frequently for smaller portfolios and to only require reconciliation for material disputes; (b) permitting parties to a transaction to use qualified third parties for the reconciliation process and (c) establishing timeframes for the resolution of disputes that reflect, among other factors, the complexity of the trade and dispute.

We believe that parties to an OTC derivatives transaction should be required to engage in portfolio reconciliation with varying frequency based on the size of their portfolios with different counterparties. Such approach would be in line with other jurisdictions that have proposed requiring counterparties to engage in reconciliation once every quarter, week or day based on the size of the party's portfolio and the types of counterparties.⁴

We also recommend that the Treasury follow the lead of other jurisdictions and adopt limitations on when parties would be required to resolve discrepancies in the valuation of the OTC derivatives transactions. For example, the CFTC proposed to only require resolution when the difference between the lower valuation and the higher valuation is 10% or greater of the higher valuation.⁵

⁴ See Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519, 81531 (published Dec. 28, 2010). SDs and MSPs are required to engage in portfolio reconciliation either once per quarter, week, or day with all counterparties, but the thresholds to determine the frequency of required reconciliation is higher for portfolios with non-SDs or MSPs. See *also* Letter from MarkitSERV to the CFTC at 11-14 (Feb. 28, 2011) (responding to the CFTC's proposed rule on Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants).

⁵ Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. at 81531. See *also* Letter from MarkitSERV to the CFTC at 11-14 (Feb. 28, 2011).

We believe that, if the Treasury determined to require portfolio reconciliation and to impose time frame restrictions on dispute resolution, the Treasury must create realistic and tiered time frames which provide for differing amounts of time based on several factors (as ISDA proposed in 2009). Specifically, we believe that resolution time frames should differ based on the complexity of a given trade, the complexity of the dispute, and the magnitude of the dispute in relation to the counterparties' portfolio as a whole. Nonetheless, we note that best practice would dictate that parties should resolve even complex disputes as soon as reasonably possible.

Questions 10 and 22: Should regulation allow for a foreign trade repository, and if so, why? What should be the minimum regulatory requirements in this instance? Should South Africa license only one trade repository or should multiple repositories be allowed?

We note that the CP is not entirely clear about whether the Treasury expects the relevant TRs to be locally based or whether local market participants would be permitted to use international providers to satisfy their potential reporting requirements. However, the CP states that “the bill further provides for an independent clearing house/central counterparty and TR *to be set up*”⁶ which seems to suggest that a local solution might be considered. That said we believe that the Treasury should very carefully analyse the benefits and drawbacks of such approach before establishing any regulation that would explicitly require the use of a local TR.

Transparency in financial markets is most useful if it is provided in a consolidated fashion. We are therefore concerned that the creation of various national TRs for OTC derivatives could result in duplicative reporting of transactions and might create information that is not sufficiently harmonized to be aggregated. Any data fragmentation or duplicative reporting will reduce the benefit of transparency in the OTC derivatives market, so the Treasury must avoid fragmentation and duplication wherever possible. We believe that the most cost-effective and efficient approach to capturing, storing, and providing information about OTC derivatives transactions to regulatory authorities around the globe would be the establishment of global TRs that feed the relevant data to local regulators or, where necessary, into other TRs. Such approach would not only be preferable because of cost and efficiency considerations, but the use of a global TR structure will also be essential to avoid the dangers of double reporting and data fragmentation.⁷ We therefore believe that the creation of local TRs should be avoided where possible.

However, we acknowledge that some jurisdictions might see sufficient reason to establish their own local TRs. Where that is the case, it will be essential that the relevant regulatory authorities ensure the accuracy of the data that is held in any domestic TRs and its consistency with data that is held in foreign TRs. We believe this can best be achieved if international providers of Independent Verification Services (“*IVS*”)⁸ are tasked with reporting of transaction data when reporting is required in multiple jurisdictions.⁹ Further, one should recognize that OTC derivatives transactions are often entered into between international counterparties that might be subject to multiple reporting obligations. We therefore welcome the approach

⁶ Concept Paper, Extending the scope of South African regulation, page 7.

⁷ The ability to consolidate global derivatives data will be complicated by differing regulatory requirements and domestic practices. Two of the complications that are likely to arise due to differing reporting requirements are double reporting and data fragmentation. Double reporting will happen if more than one jurisdiction requires data reporting for cross-border transactions (and possibly even for transactions that do not stretch across any borders if that data had to be reported to multiple TRs). Data fragmentation occurs if the reported data is stored and/or disseminated by various entities, and cannot be easily consolidated. Both double reporting and data fragmentation can endanger the value of the transparency that is provided to regulators and the public.

⁸ We define IVS as “entities that act independently from and on behalf of the counterparties to the transaction to facilitate the agreement of a verified record of the complete transaction details that is used for subsequent processing.”

⁹ Because many derivatives transactions are cross-border, the processing of such transactions is often facilitated by IVSs who operate internationally. We believe that using these entities for reporting, as well, would provide benefits to the international regulatory authorities, as well as market participants. We therefore believe it is important for counterparties to be able to delegate their various regulatory obligations to internationally-operating third party service providers. These entities tend to operate across jurisdictions, so it will often be easier and more efficient to task them with ensuring the compliance of participants across various national requirements than for counterparties to handle such responsibilities themselves.

taken by regulatory authorities in some countries¹⁰ that accepts the reporting of the OTC derivatives transaction by the foreign counterparty to a foreign, recognized TR.¹¹

Questions 11 and 21: In terms of the reported data, what should the trade repository's responsibilities be? To ensure accuracy of data, should repositories be required to confirm trade to a counterparty or counterparties who have reported the trades?

We believe that, as a general principle, the Treasury should design any requirements to report transactions in OTC derivatives to a TR to permit the relevant parties to simplify the task of reporting as much as possible, while, at the same time, ensuring the accuracy of the data that is reported to the TR.

We therefore believe that the Treasury should explicitly allow for the actual reporting of the relevant details of the OTC derivative transaction to the TR to be performed by just one entity, as agreed between the parties. The reporting entity could be either one of the counterparties to the transaction or a third party that the reporting task has been delegated to. Such approach will be helpful not only to achieve timely implementation, but also to avoid the need for TRs to reconcile data that they have received from several parties. Importantly, to ensure the accuracy of the reported data reporting by one party would only be acceptable if the reported data had been previously verified by both counterparties.

The Treasury should note that such approach would be consistent with requirements that have been established in other jurisdictions.¹²

Questions 15 and 55: Should the trade information be captured in real-time? Should a 10-minute reporting time be imposed for all OTC derivatives transactions, or should a longer period be given, perhaps in the form of two or three windows per day during which reporting must take place?

We believe that the timely availability of high-quality data to regulatory authorities is critical to achieving the goals of improving transparency and reducing the systemic risks inherent in the OTC derivatives markets.

However, while the timely availability of comprehensive transparency of derivative transactions and positions to regulatory authorities is important, we do not believe that time lines for reporting to TRs that are as aggressive as those proposed in some jurisdictions are appropriate.¹³ That said, we believe that reporting to TRs according to requirements in South Africa should happen only "as soon as possible once the relevant information is available", not in "real-time" or within 10 minutes post execution. Any specific deadlines that apply to the reporting of confirmation data should be linked to the deadlines that the Treasury might set for the confirmation of the transactions.¹⁴

Questions 26, 27, 32, and 33: What information should be reported to the trade repository to assist the regulator in its monitoring of systemic risk and to determine current exposure? What information should be reported to the trade repository to assess the size, interconnectedness and substitutability of financial markets, instruments and market participants? What level of detail should be reported to the trade repository for purposes of assessing the integrity, fairness and transparency of the OTC derivatives market? What level of detail should be reported to enable the Financial Services Board to monitor potential market abuses in the OTC derivative market?

We agree that a TR should be in a position to provide data that is relevant for various regulatory purposes that differ in their nature and data needs, e.g. both for the monitoring of systemic risk and for the detection of insider trading or market abuse. However, we believe that the Treasury should not attempt to define

¹⁰ Monetary Authority of Singapore Consultation Paper P003-2012: Proposed Regulation of OTC Derivatives. February 2012.

¹¹ See Monetary Authority of Singapore Consultation Paper P003-2010 Section 4.7.

¹² Real Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012) and Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

¹³ See Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012).

¹⁴ For example, reporting of the confirmation data to the TR should happen "as soon as possible following confirmation of the transaction and, in any case, no later than the working day following the conclusion, modification, or termination of the contract."

different datasets that would be used for different purposes. In contrast, we believe that the approach that has generally been taken in other jurisdictions, i.e. the reporting of primary economic terms in electronic format plus reporting of the full confirmation in the appropriate format to the TR, should suffice to allow the TRs to provide data for *all* desired purposes. Our more specific comments in relation to the data that should be reported to the TR are as follows:

Determining which data fields have to be reported to a TR is complex and challenging. We note that a number of regulatory authorities have spent significant amounts of time aiming to capture all the intricacies of the almost infinite variety of products that trade in the OTC derivatives market. These efforts often resulted in the creation of numerous and complicated lists of data fields that differentiate both between asset class and product categories. However, we believe that this issue can be addressed in a fairly straightforward manner.

To enable a timely and cost-efficient implementation of the reporting requirement, the Treasury should follow a two-pronged approach in defining what data sets have to be reported to the TR:

- (1) A basic data set that contains key economic terms in normalized data fields should be reported to a TR for every derivative transaction. Such data set could be applicable across asset classes and products, and the number of additional fields that are asset class specific would be very limited. The Treasury should take the views of TRs into account when making any determination about the appropriate data fields.
- (2) All relevant elements of the transaction need to be captured in TRs so they can be made available to regulatory authorities if required. The Treasury should therefore require counterparties to also report the full set of transaction confirmation data (either in normalized data fields or as a copy/electronic image of the paper confirmation where appropriate) to the TR for each OTC derivatives transaction.

We believe that the combination of reporting a limited set of key economic terms as normalized data fields in addition to the full confirmation will be an efficient way of achieving the regulatory goals of data reporting to TRs. Such approach also seems in line with requirements that have been established in other jurisdictions.¹⁵ We recommend that international regulators coordinate their efforts to establish a verified set of minimum key economic terms. This harmonization would significantly aid parties in their attempts to satisfy the reporting requirements that are established by regulators globally.

Question 50: Should both counterparties assume the reporting obligations of OTC derivative transactions to the trade repository? If not, which counterparty should be obliged to report to the repository?

We believe that, when designing the requirement to report to TRs, the Treasury should take into account the market practices that were established in the OTC derivatives markets globally over the years. Any newly designed regulation for these markets should be designed as such that such practices can continue to be used in the context of the upcoming regulatory regime in the Republic of South Africa. Such approach would enable the most timely and cost-efficient implementation of any new regime.

Firstly, it will often be most effective if the actual task of reporting to a TR is not performed by the counterparties to the transaction, but by a third party that is specialized on this task. Allowing counterparties to use third-parties for the reporting to TRs will enable a cost-effective and timely implementation of the reporting requirements proposed by the Treasury. We therefore believe that it will be in the interest of the relevant counterparties if the Treasury explicitly allowed them the choice of how to best satisfy their reporting obligations, including the use of third parties.

¹⁵ Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

Secondly, according to current market practice, counterparties would confirm any OTC derivative transaction before the verified record of the transaction is reported to the TR, either by one of the counterparties or by a third party. Such approach is essential to ensuring the accuracy of the data that is reported to the TR, while it avoids the need for the TR to reconcile several records it might otherwise receive for each transaction. We believe that the Treasury should therefore not only permit, but encourage the reporting by one party only of transaction records that have been verified by both counterparties. Ultimately, such approach can significantly reduce the burden to counterparties, and it will also limit the need for costly and time consuming reconciliation that will be created by double reporting. It also reflects current market practice and is in line with regulation proposed in other jurisdictions.¹⁶

Question 60: Should different timelines apply to different contracts, and data reported, for example transaction data, valuation data and confirmation data?

We believe that the approach that has been taken in other jurisdictions can generally provide the Treasury with some useful guidance in this respect.¹⁷ For example, regulatory reporting rules that have been finalized by the CFTC¹⁸ reflect the fact that different categories of users are to different degrees prepared for reporting to TRs, while significant differences exist between asset classes in the level of their electronification. Differentiated timing requirements between datasets are also required to reflect the workflow of a transaction, where primary economic terms become typically available before the fully executed confirmation details, which itself will be available before a valuation is performed.

In addition to providing different time frames for reporting of various data sets once the regime has been established, we believe that the Treasury should also consider the phasing-in over time of parties' obligations to report their derivative transactions to TRs. Based on our experience in assisting market participants with their preparation for reporting requirements in various jurisdictions, we know that the introduction of such requirements creates a significant burden for them. This is particularly true given that such reporting requirements are being introduced in numerous jurisdictions at almost the same time. We therefore recommend for the Treasury to consider a phased-in implementation of any reporting mandate in order to reduce the burden it creates for market participants and enable a timely and cost-efficient implementation.

Specifically, we believe any requirement to report transactions to a TR should be phased-in by asset class, reflecting the varying degrees of electronification and standardization. Our experience in facilitating confirmation of derivatives transactions across asset classes and regions has shown that standardization as well as electronification differs significantly between asset classes, for a variety of reasons. We therefore support the approach that has been taken in other jurisdictions where, for example, compliance for foreign exchange, equity and commodity derivatives will be required only some time after compliance for interest rate and credit derivatives has started.¹⁹

We believe that, in addition, the Treasury should consider providing a phase-in by participant category and a phase-in of any of the timing requirements.²⁰ This way one can reflect the varying levels of preparedness, depending on whether the counterparties are active dealers, banks that are occasional users of the product, or commercial entities that use derivatives only occasionally to hedge. Further, a phase-in of the timing deadlines over time will allow all market participants to adjust to the newly introduced requirements. It would

¹⁶ See Swap Data Recordkeeping and Reporting Requirements 77 Fed. Reg. 2136 (Jan. 13, 2012).

¹⁷ Please note that, while we are supportive of the concept, we are not necessarily embracing the aggressive timelines that have been proposed by regulatory authorities in other jurisdictions.

¹⁸ Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

¹⁹ For example, the CFTC will require first reporting in the asset classes of credit and interest rates first, reflecting their higher degree of standardization and automation, to be followed by equity, FX, and commodities only several months later. See Real Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012) and Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

²⁰ Such phase-in would initially allow longer time periods post-execution of a transaction for reporting that would be reduced over time, hereby allowing market participants to adjust to the new requirements.

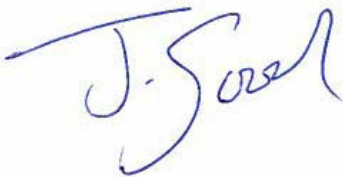
also allow the Treasury to observe the effect of any newly introduced reporting requirement on market functioning before imposing any more demanding requirements.

The Treasury should note that such multi-dimensional phase-in approaches will be used in other jurisdictions.²¹ Based on our experience, we believe that their use could also be appropriate in the Republic of South Africa.

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MarkitSERV appreciates the opportunity to comment on the Treasury's Concept Paper *Reducing the risks of OTC derivatives in South Africa*. We would be happy to elaborate or further discuss any of the points addressed above. In the event you may have any questions, please do not hesitate to contact the undersigned or Henry Hunter at henry.hunter@markitserv.com.

Yours sincerely

A handwritten signature in blue ink, appearing to read "J. Gooch".

Jeff Gooch
Chief Executive Officer
MarkitSERV

²¹ In the United States, the CFTC's final real-time and swap data reporting rules phase-in compliance with the reporting requirements by category of market participant, by asset class, and over time. See Real Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012) and Swap Data Recordkeeping and Reporting, 77 Fed. Reg. 2136 (Jan. 13, 2012).

