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QUORSUS

Regulatory Reporting Newsletter

INTRODUCTION

Welcome to the second edition of Quorsus' Regulatory Reporting Newsletter.

This edition focuses primarily on **EMIR REFIT** but it is impossible to ignore the global impact of reporting changes as regimes seek greater alignment over the next two years.

The challenges of embracing **Critical Data Elements** (CDE), **Unique Product Identifiers** (UPI), **ISO 20022** messaging and alignment on **Actions & Events** are leading to industry pressure on regulators to consider reviewing implementation timelines. However, this could lead to significant **delivery risk** by requiring firms to consider major changes in a compressed time frame.

We are seeing more regulators refine their rules to better fit with other jurisdictions (e.g. closer alignment of actions and events, consistency of booking complex trades). Furthermore, there has been an uptick in fines issued, with the CFTC alone handing down $5mm in penalties as recently as last week.

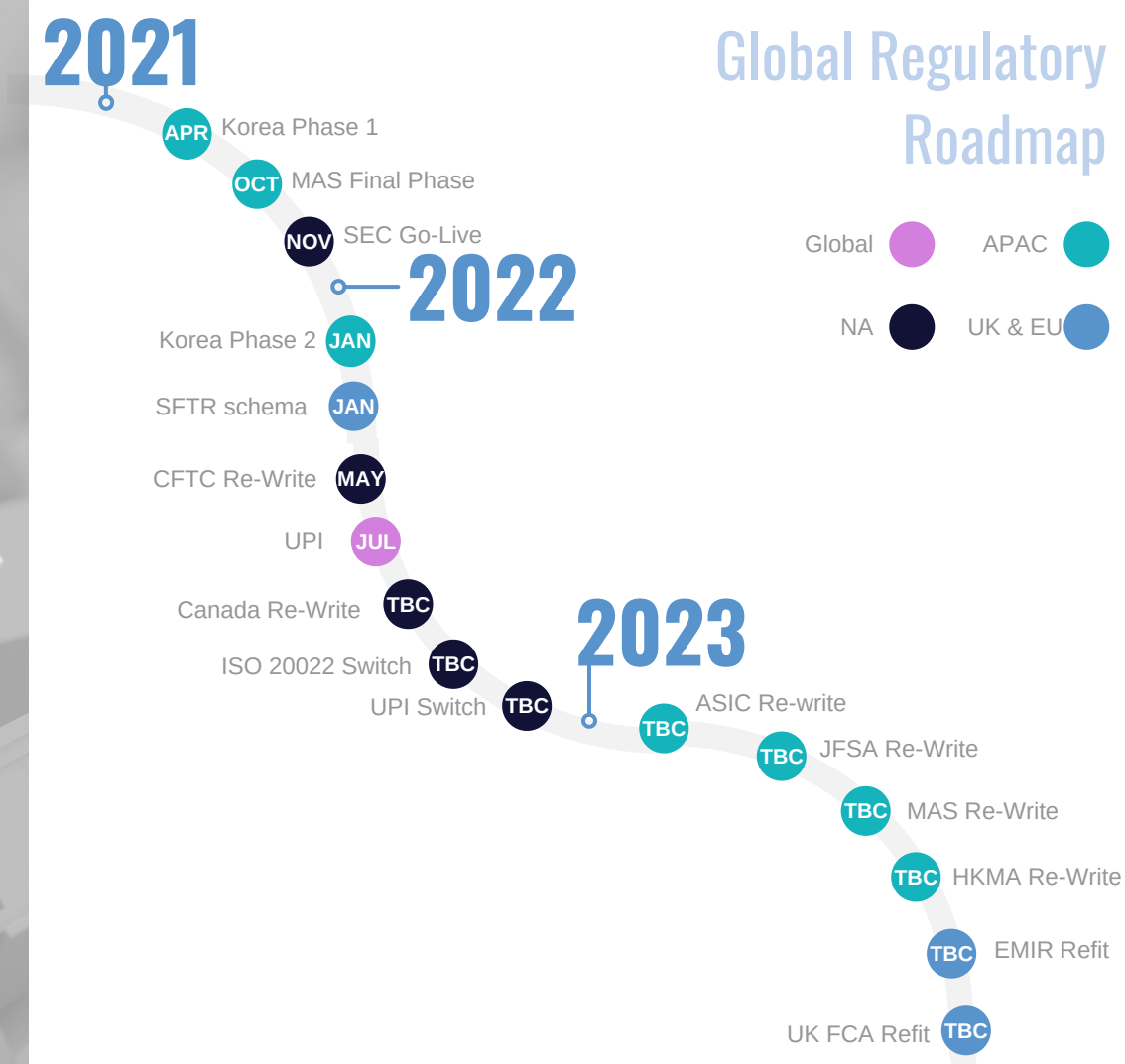
It's little more than a year since the **SFTR regime** went live. Changes are afoot in January 2022, with a Trade Repository (TR) exiting the market and an update to the current XML schema. We discuss some of the impacts.

Whilst this is encouraging, late changes to rules create further challenges and uncertainty: the industry needs sufficient time to analyse, develop, test and implement. All of which are steps that Quorsus is well placed to assist with.

WHAT'S INSIDE THIS ISSUE:

WHO WE ARE

Quorsus provides consultancy services to financial institutions facing a range of challenges and constraints across the post-trade landscape. We offer **unparalleled expertise in post-trade technologies, operations, regulatory solutions, and market infrastructure, helping our clients to achieve their goals through intelligent reengineering of platforms and process**. We pride ourselves on the strength and character of our consultants. This, combined with decades of industry expertise, ensures that our clients meet their objectives, however steep the challenge



EMIR REFIT

ESMA INTEND TO CONTINUE WORKING ON THE GUIDELINES ON REPORTING, AS WELL AS XML SCHEMAS AND VALIDATION RULES, IN ORDER TO PROVIDE THESE IN TIME TO ENSURE A SMOOTH TRANSITION TO THE NEW RULES

Background & Timeline

In December 2020, the European Securities and Markets Authority (ESMA) published a final report on the draft technical standards under the EMIR REFIT Regulation (EMIR REFIT). The report itself contained a number of key proposals, including:

- Alignment with international standards
- End-to-end reporting in ISO 20022
- Standardised process for data access

ESMA also made clear their intention to continue working on the guidelines on reporting under REFIT, as well as XML schemas and validation rules, with the intention of providing these in time to ensure a smooth transition to the new rules.

In July 2021, ESMA issued a Consultation Paper on the 'Draft Guidelines for reporting under EMIR', which ESMA state will apply to financial and non-financial counterparties as well as TR and CCPs. The guidelines seek to provide clarification on the following aspects:

- Transition to reporting under the new rules
- Product eligibility
- Reporting responsibilities & exemptions
- Reporting logic
- Ensuring high data quality
- Data access

EMIR REFIT

ESMA expect to publish a final report on the guidelines towards the end of 2021 or early 2022 (subject to the adoption of the draft technical standards by the European Commission).

The timeline for implementation of the technical standards is 18 months from the date of their publication in the Official Journal. This makes it unlikely that implementation will take place before Q2 2023.

The Draft Guidelines

The guidelines are a useful and necessary supplement to the technical standards. They contain more fulsome explanations to help counterparties and TRs implement the current and draft technical standards and include sample XML messages to support the explanations.

The closing date for responses to the consultation was 30 September 2021. ESMA will consider responses with a view to publishing final guidelines in Q4 2021 / Q1 2022 (subject to the adoption of the draft RTS and ITS on reporting by the European Commission).

The Quorsus regulatory subject matter experts have been reviewing the draft documentation in detail and we have identified a number of challenges.

Our analysis has uncovered several areas where implementation is likely to be highly challenging. In the following pages we highlight just a few of the key areas of focus within the proposed guidelines that clients should be aware of and need to consider their responses to. The list is not exhaustive, but the examples should give a flavour of some of the challenges raised in the draft documentation.

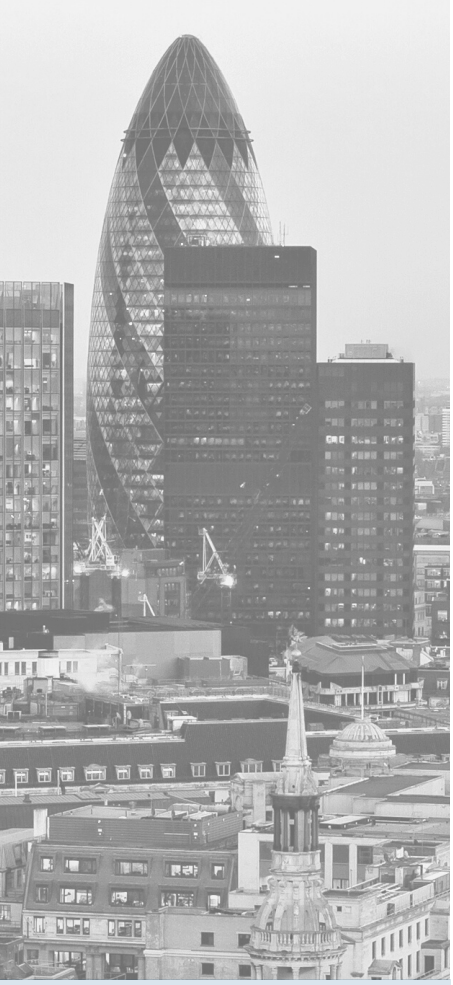
Some questions will be resolved in the final documentation, but it is clear that challenges will remain and there is a lot of work to be done before we achieve the data quality and alignment that all stakeholders seek.

ESMA WILL CONSIDER RESPONSES TO THE CDONSULTATION WITH A VIEW TO PUBLISHING FINAL GUIDELINES IN Q4 2021/Q1 2022 (SUBJECT TO THE ADOPTION OF THE DRAFT RTS AND ITS ON REPORTING BY THE EUROPEAN COMMISSION)

EMIR REFIT CHALLENGES

Key to some of the terms used within the newsletter:

- **RSE** Report Submitting Entity
- **ERR** Entity Responsible for Reporting
- **UTI** Unique Transaction Identifier
- **FC** Financial Counterparty
- **NFC** Non-Financial Counterparty



180 DAY TRANSITION PERIOD

BACK REPORTING NEEDS TO BE CAREFULLY PLANNED

ISO20022 INGESTION WITH PRESCRIBED ERROR CODES

Transition Period

ESMA proposes a 180-day window following implementation for firms to update to the new standards trades that have not had a reportable lifecycle event since the implementation date, using a specific 'update' event.

Updated trades must retain the existing UTI.

Challenges

- *Firms need to consider **when and how to perform back reporting.** In one upload? By asset class? During the transition period it will be difficult to accurately monitor the reconciliation status of legacy trades as firms update to their own schedules.*
- *Leaving developments to the **last minute puts firms at risk of breaching the deadline.***
- *Once the transition period expires, supervisors will expect to see an increase in the number of matched trades.*

Exception Management

TRs must use predefined error codes specified in the validation rules, when communicating rejections, which will be communicated in ISO 20022 format – firms must address any such errors within the reporting timelines.

TRs are also required to provide details of missing valuations, missing margin information and abnormal values by 06:00 UTC on T+1.

Challenges

- *Firms will need to ensure their **controls** are adjusted to handle specific **error codes**, which are grouped into: Schema compliance, RSE permissioning, Logical (action type), Business validation.*
- *Can firms **consume ISO 20022** messages and are controls set up to manage the **new classification approach**?*
- *Are firms able to investigate and **correct errors within the reporting timelines** and able to **identify abnormal values**?*

EMIR REFIT CHALLENGES (CONT.)

Structured Trades & Linkages

There are a number of new rules relating to how to represent some trades, not all of which align to industry practice.

Where possible, multi-leg trades should be included in one report. Alternatively, trades should be linked using 'package identifier'.

FX Swaps should be reported as a single product.

Challenges

- *FX Swaps are typically recorded as a pair of linked trades. Mandating that they are presented as a single report will cause challenges: not least **inconsistency with other reporting regimes,** despite one of the re-write objectives being to perform global aggregation.*

Non-Reportable Elements

ESMA makes clear that where a package contains non-reportable elements, these should be included in a report.

Challenges

- *Not all non-reportable trades can be reported using the **EMIR templates** – firms will need to consider how to report such trades, but there must be **consistency between parties** to ensure successful data reconciliation.*

Collateral

Margin reporting is comprehensively revised and largely aligned to CDE. With CFTC also mandating CDE aligned collateral reporting, there is now greater global consistency.

Both pre- and post- haircut values to be reported and the collateralisation categories are expanded in order to capture the collateralisation by both counterparties.

Challenges

- *Challenges relate to the increased **complexity, cost and effort** required to implement.*

- *Firms need to consider how to provide the additional data and the impact on their existing reporting logic, how to **clearly message where collateral is recorded** at portfolio level.*

Reconciliations

ESMA now provides detailed technical standards relating to data quality. This covers rules for reconciliations, including fields to be reconciled, tolerance levels and when to commence reconciling (e.g. valuation reconciliation begins two years after implementation).

Challenges

- *Whilst the reconciliation rules are relatively straightforward, firms need to consider the **impact of a phased approach** and the need to have **written internal procedures in place** relating to resolution of reconciliation breaks identified by the TRs.*

MULTI-LEG TRADES SHOULD BE INCLUDED IN ONE REPORT

FX SWAPS SHOULD BE REPORTED AS A SINGLE PRODUCT

MAJOR CHANGES TO COLLATERAL REPORTING

WRITTEN RECONCILIATION PROCEDURES MUST BE IN PLACE

EMIR REFIT CHALLENGES (CONT'D)

Data Quality

FCs can provide their NFC counterparties on regular basis (e.g. monthly) the information concerning trades outstanding at the TR.

This is because ESMA considers it to be 'of utmost importance' that both parties are in possession of complete and up-to-date information.

Challenges

- *This is a **new obligation on the FCs**. How will they provide the reports and how will NFCs consume and process the data?*

Other Payments

For cross currency swaps, firms are required to report the initial principal exchange as part of a new trade. However, the guidelines do not make clear how or when to report the final exchange, and there are a number of possibilities.

Challenges

- *The challenge here is that **the rules are not always clear**: there are multiple ways the final exchange could be reported (if at all). Different interpretations could lead to reconciliation issues for firms.*

- *Firms need to be wary that, even after guidelines are published, there will be **multiple interpretations of some of the rules** and guidelines.*

Action Sequencing

Reports sent by one party to the trade do not impact allowable action types reported by the other party. This could be significant from a data integrity point of view and will have an impact on reconciliations.

For example, if one counterparty submitted ‘Error’ for a given UTI and has not subsequently ‘Revived’ the trade, it will prevent the other counterparty from timely reporting relevant lifecycle events.

Challenges

- ***UTI is a key field for the TRs**, so the impact of this needs to be carefully managed.*

- *Indeed, it would be beneficial to have clear examples of the processing of trades ‘errored’ by one party but not the other, along with the subsequent reporting of revives (for example interim events, and valuations).*

- *There are **no clear guidelines on how to manage a flat ETD position** that is subsequently re-opened. Retaining the UTI would necessitate running a flat position. Alternatively, a **closed position can be re-opened with a new UTI**.*

- *The absence of clear rules will lead to inconsistent approaches and reconciliation challenges.*

FC CAN PROVIDE NFC WITH INFORMATION OF TRANSACTIONS ON A REGULAR BASIS

REPORTING OF 'OTHER PAYMENTS'

HOW TO MANAGE A 'FLAT' ETD POSITION

EMIR REFIT CHALLENGES (CONT.)

Errors impacting a significant number of reports

Firms are required to advise competent authorities of errors that impact a 'significant number of reports'. They must include details of the errors.

What constitutes a 'significant number of reports' is to be defined for the first time, by ESMA and could be based on a number of factors relating to reporting volumes and further classified by report category (e.g. margin updates and valuation reports are assessed separately to core trade reports).

The logic is further complicated when an entity reports on behalf of multiple clients.

Challenges

- *Firms will need to consider how to track this, and how they will report to authorities.*
- ***Monitoring of reporting errors** will need to be a core component of KPIs.*
- *Ideally this would be **tracked monthly for more meaningful** (less volatile) metrics.*

Crypto-Assets

ESMA introduces a simple field to indicate whether a derivative is based on a crypto-asset or not. This may be of limited use going forward and is likely to evolve as the number of crypto-asset derivatives expands.

Challenges

- *What if a **crypto-trade is physically settled?** How should this be represented?*
- *Firms typically consider crypto-assets as NDFs.*

Reviving Trades

A trade that has been cancelled or terminated by mistake can be re-opened using the action type 'revive', and such message should contain the trade details as they now stand. However, this must be performed within 30 days - otherwise a new UTI must be used to report the trade.

Challenges

- ***Creating a new UTI goes against guidelines**, which are that a UTI should not change.*
- *There appears to be little benefit in limiting the window to 30 days.*
- *Firms will need to consider the **impact of reviving trades** after 30 days have expired and and the need to share a new UTI with their counterparty.*

ERRORS IMPACTING A SIGNIFICANT NUMBER OF REPORTS TO BE ADVISED

QUESTIONS RELATING TO CRYPTO-ASSETS

REVIVING A TRADE AFTER 30 DAYS HAVE EXPIRED REQUIRES A NEW UTI

GLOBAL ROUND-UP

Our first newsletter discussed in more detail some of the challenges introduced by the global changes, and how Quorsus can help, as our experts are closely tracking each jurisdiction and the global alignment plans. Here we summarise the main points:

North America

On 8 November, 2021, we will see the go-live of Security-Based Swap Reporting to the SEC, whose rules were published in December 2019. This will be followed six months later by the CFTC re-write, in May 2022, which will also impact messaging for SEC and Canada trades.

We expect some relaxation of the original proposals to limit reporting to a single standard (pending ISO implementation), with CFTC permitting Swap Data Repositories (SDRs) to accept reporting in multiple formats and allow the translation of data.

However, reporting to all North American regimes will involve a change to messaging standards, back reporting of existing positions, changes to data quality and validation controls. Subsequent changes following the go-live date will include a messaging upgrade to ISO 20022 and a migration to UPI. All of these will bring their own challenges to reporting parties.

UK

We expect the UK to bring out a Consultation Paper on its own rules revision later in 2021. We do not expect this to diverge greatly from ESMA's proposed rules, especially given the FCA's heavy involvement in drafting EMIR reporting standards prior to Brexit.

However, the challenges, as ever, will be on the nuances. 'Intelligent Alignment' suggests the FCA will take their own approach where it believes it makes sense.

MOST JURISDICTIONS ARE PLANNING TO ALIGN REPORTING WITH GLOBAL STANDARDS

THERE COULD BE CHALLENGES WITH MANY UPGRADING AT SIMILAR TIMES

APAC

Singapore brings FX, commodity and equity OTC derivatives into scope for all firms in Q4, not just banks.

In January 2022, **Korea** will complete its initial Implementation and expand the scope of reporting to all derivative products.

Both **Australia** and **Singapore** have issued Consultation Papers and it is clear that they are both moving to embrace CDE, UPI and XML messaging.

Both **Hong Kong** and **Japan** are expected to follow suit, with **Japan** looking to move away from direct reporting.

It's expected that most regimes with have implemented at least part of their re-writes by the end of 2023.

CFTC ISSUES $5MM IN FINES

Sanctions

In a significant escalation of supervisory activity, the CFTC has issued a total of $5mm in fines for swap reporting violations in the past week alone. The four firms sanctioned had issues ranging from submitting incorrect counterparty identifiers (LEIs), to inaccurate submission of mark-to-market valuations.

One such firm even received a fine for failing to remediate (and back-report), an issue for which it had already been penalised.

We expect many reporting firms will be anxiously reviewing their own processes to assess where they are experiencing similar issues. Ultimately, this action calls into sharp focus the need for firms to consider a robust control framework for their trade and transaction reporting procedures.

Remediation

Having the right level of oversight to ensure that remediation activity is prioritised is clearly critical. Allowing remediation items to sit in a prioritisation queue, with errors piling up on a daily basis, can present a huge challenge when it comes to correcting the historic errors (or “back-reporting”).

Data Quality

Regulators now expect a higher quality of data than ever before from firms submitting data to Trade Repositories or ARMs, with pre-submission validations now commonplace at a large number of firms.

However, rejections do happen; having a robust exception management and error correction process is vital to ensure issues are quickly dealt with when they occur. This is particularly important given the CFTC’s expectation under their re-write that firms correct any issues within one week of them being discovered.

FOUR FIRMS FINED A TOTAL OF $5MM FOR SWAP REPORTING VIOLATIONS

A STRONG CONTROL FRAMEWORK IS KEY TO SUCCESSFUL COMPLIANCE

FIRMS WILL NEED TO CORRECT ISSUES WITHIN ONE WEEK OF DISCOVERY

SFTR CHANGES IN JANUARY

It's just over a year since SFTR's delayed implementation, in July 2021.It would be fair to say that it has been successful in many ways, with much higher levels of paring and matching than expected. However, there is no room for complacency, as two significant events will occur on 31 January 2022.

Quorsus' experts have analysed the impact of these changes and are ideally positioned to assist you in responding to the challenges they present.

Revised Validation Rules

ESMA has announced that there are new validation rules and an updated messaging schema coming into effect in January. The current SFTR schema embeds a considerable amount of validation, which ESMA has used to augment the validation rules. This caused some confusion in the early days of SFTR reporting, as the schema allowed some values that were not permitted under the validation rules.

It's important to recognise that the validation rules are paramount; if the schema allows values to be reported that go against the validation rules, the submission will be in error.

The revised schema will address a number of these anomalies, including changes to some field optionality, the impact of which needs to be properly understood.

UnaVista SFTR Services

In July 2021, Unavista (owned by the London Stock Exchange Group) announced that it will cease to offer SFTR services (including the services offered by its rules engine) on 31 January 2022.

This has led to a substantial number of submitters looking for a new TR. Given that DTCC has the lion's share of the market, many firms appear to be heading in that direction, including some of the largest SFTR counterparties.

More firms on the same TR will have a positive impact on pairing and matching of submissions, as there will be a reduced reliance on the inter-TR data reconciliation process.

This process is only able to take place at the end of the day, leaving limited time for firms to perform remediation before the next day's updates are submitted. There are other issues including, for example, fields such as "Collateral Quantity" and "Nominal Amount" for which the inter-TR schema does not support negative values, resulting in significant reconciliation breaks.

DTCC already performs intraday reconciliation for all submissions where both sides of the trade are reported to its TR, so there is expected to be a resultant uptick in pairing and matching rates.

We would expect regulators to be looking at this more closely going forward, given the good submission rates of SFTR.

REVISED SCHEMA TO RESOLVE A NUMBER OF DATA VALIDATION ISSUES

A CHANGE TO THE TR LANDSCAPE

SHOULD LEAD TO IMPROVED PAIRING AND MATCHING

If you would like to discuss more please reach out to our regulatory reporting leads:

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WHO WE ARE

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