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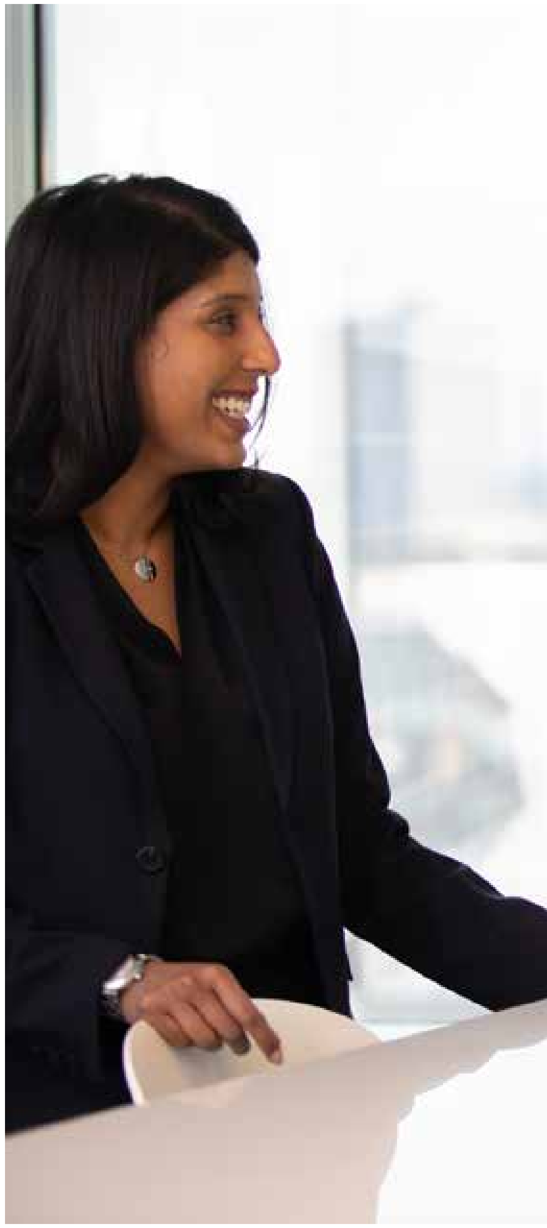
DTCC CHRIS CHILDS

The challenge of regulatory reporting across multiple jurisdictions

NUMBER 306

On the path to global regulatory harmonisation in trade reporting

The Depository Trust & Clearing Corporation (DTCC) has played a leading role in the implementation of post-2008 financial crisis reforms and is currently hitting the headlines for its advocacy of shorter settlement cycle in the US.



By **Luke Jeffs**

The global post-trade firm, that lists the world's largest banks, institutional investors, investment managers, custodians and many others as clients, is focused on delivering solutions that address the lack of harmonisation across different regulatory regimes in the Americas, the UK and Europe, and across the vast Asia Pacific region.

For Chris Childs, Managing Director, Head of Repository & Derivatives Services at DTCC, regulation has come a long way from the 2009 Pittsburgh-based G20 summit that vowed to introduce reforms to avoid a repeat of the preceding year's banking crisis.

Regulators in the key trading centres are now collecting and collating reports on firms' exposure to all manner of listed and over-the-counter derivatives while much more of these instruments are now being cleared through central counterparties.

Yet, the global "patchwork-quilt" implementation of regulation, where different authorities have adopted their own interpretations of generic laws and at different times, has created a unique set of challenges for this global market.

Childs said: "Clearly, there's been a huge amount of effort, and a lot of data is now being collected, although the data differs in each jurisdiction. If you look at the connectivity between the derivatives market participants, the trade repositories and the regulators,

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and the sheer amount of data that is being collected, you can view it through a positive lens and say that it has increased the transparency and the availability of data for the regulatory community.

That said, when you look at the flip side, the issue is, and we've been saying this from the outset with others in the industry including the Financial Stability Board [FSB], the implementation of the commitments made at the 2009 Pittsburgh summit was left to each individual jurisdiction without a global oversight structure.

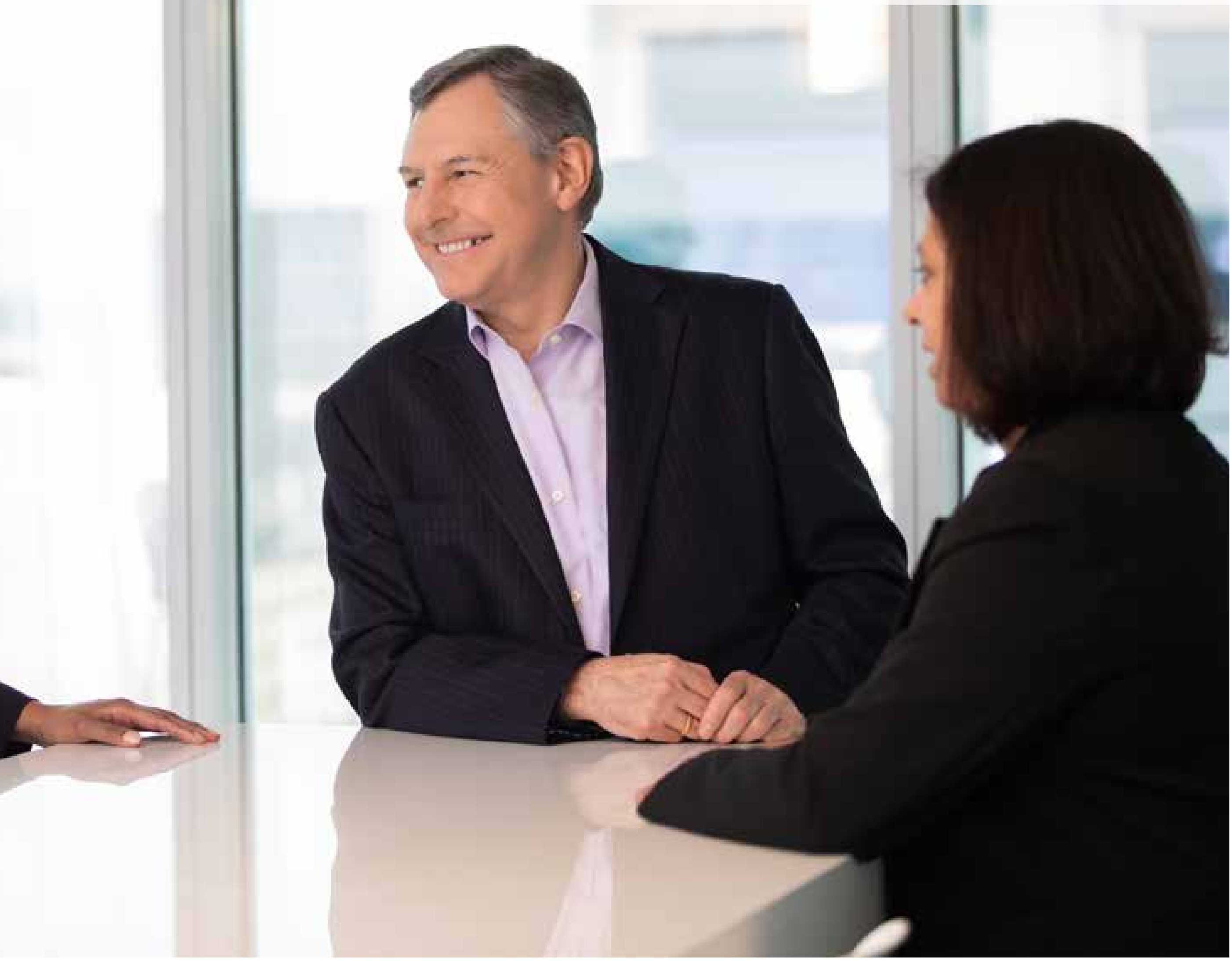
As a result, regulatory requirements have been fragmented, and the datasets being collected do not provide a global view of risk despite the cross-border nature of the derivatives markets," Childs concluded.

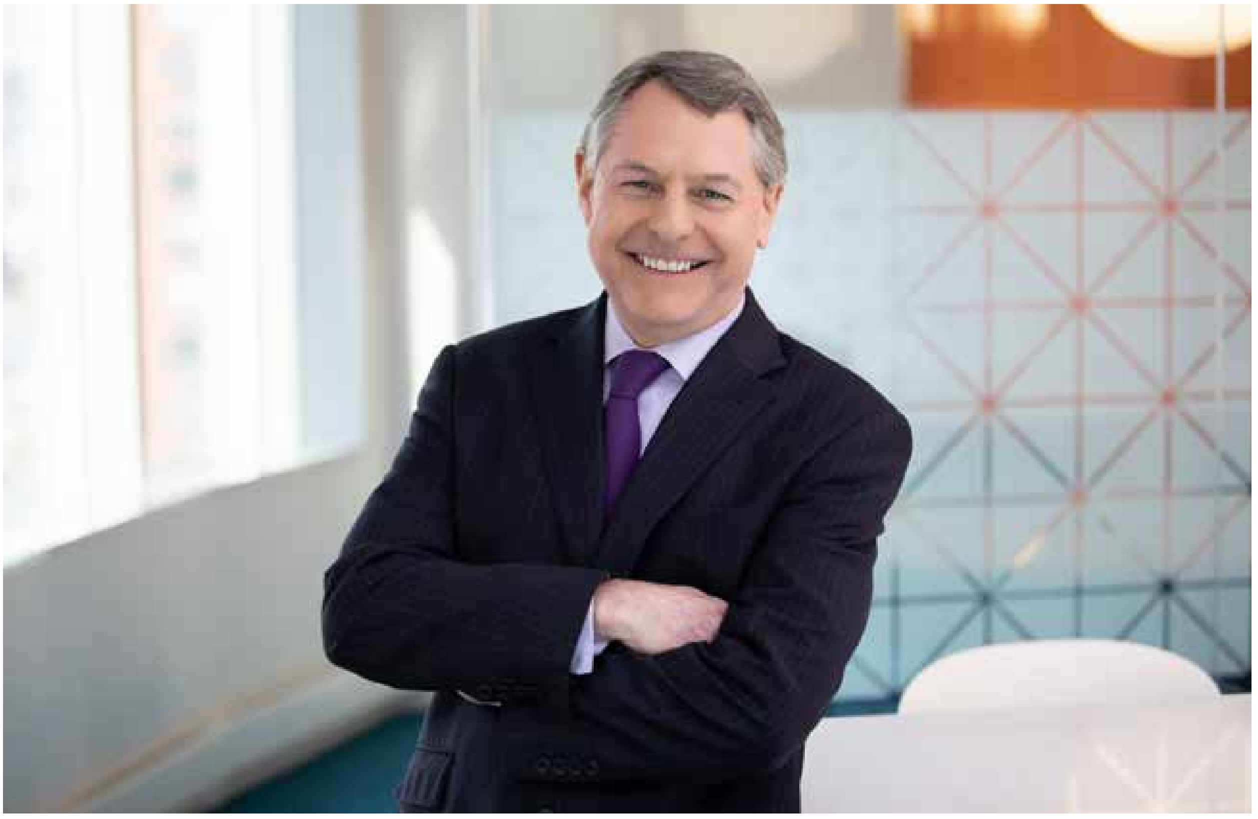
DTCC feels that being able to create a single global view of a firms' exposure or a potentially dangerous build-up of positions in a particular asset class is complicated by a lack of standardisation, making harder the work of prudential regulators charged with tracking these risks.

Childs said: "We've been lobbying for more harmonisation of data, including fewer data fields, so the ability to take data from various jurisdictions and piece it together can be better facilitated to achieve a holistic view of the data. That is where we think the regulators need to focus their attention going forward."

The DTCC MD said the FSB has rightly flagged the issue but the problem again is in the implementation of these standards.

Childs: "Regulatory requirements have been fragmented, and the datasets being collected do not provide a global view of risk despite the cross-border nature of the derivatives markets."





Childs: "We see a desire from the regulators to harmonize and standardize a bit more but it's still very much being administered on a local basis."

"Based on recommendations from the FSB, CPMI and IOSCO provided recommendations on the definition and adoption of global standards. We're now seeing the implementation of these recommendations as each of the regulators work through a rewrite of their initial rules. You're going to see over the next 12 to 24 months an awful lot of change for reporting firms, the trade repositories and for the regulators that receive this data.

"We see a desire from the regulators to harmonize and standardize a bit more but it's still very much being administered on a local basis. Looking at recent regulatory proposals from ASIC, CFTC and ESMA, our analysis indicates that out of the 110 critical data elements identified by CPMI and IOSCO, only about 50% of the elements will be implemented in a consistent manner by all regulators. The other 50% are either not being adopted or are being adopted but not consistently in terms of the same definitions, format and allowable values."

Childs said the direction of travel is towards harmonisation and this is to be encouraged.

"It's true to say in this round of rewrites we'll be more harmonised than the prior set of rules. And based on those 50% of elements that are consistently adopted, we will be able to start to amalgamate data if required from the various jurisdictional data sets."

One of the recommendations that the CPMI and IOSCO proposed was to have a global governance structure. They suggested, and this has been adopted now, that the Regulatory Oversight Committee [ROC] which oversees the legal entity identifier, would provide the governance for the maintenance and implementation of critical data elements.

Childs said: "The ROC has now established that governance structure, which is a positive thing. That said, the ROC doesn't have authority over each of the local regulators and so its role will be one of observation, comment, and influence. The lack of a powerful governing oversight to push for co-ordinated regulations is evident in the standards that apply to firms reporting their trades in different jurisdictions.

"You've got two-sided reporting versus single sided reporting, which is different from one jurisdiction to the next. Delegated reporting is mandatory in Europe, which is not required in other jurisdictions. Also, in Europe, trade repositories are required to reconcile trades reported by counterparties to different trade repositories, which is not needed in a single sided regime."

Childs acknowledges that the problem of regulatory disharmony is of low concern to its clients that operate in only one market, but to those that operate in multiple jurisdictions a lack of harmonization is more problematic.

"Any firm reporting to multiple regulators has to understand all of the rules in each different jurisdiction, and they need to code and develop systems for those different regimes. That is expensive. In addition, institutions trading in multiple jurisdictions not only have coded for the original rules, they now must develop new code for all the rewrites. And to the extent that those rewrites are not on a globally consistent regime, it's much more expensive."

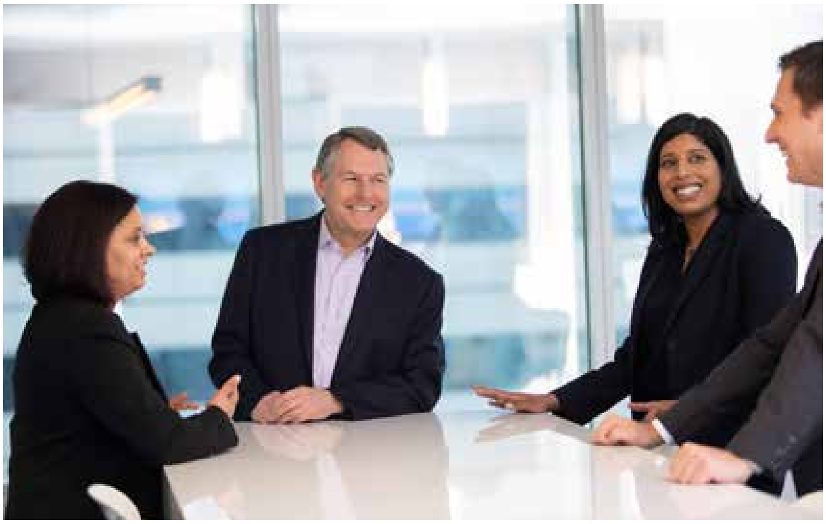
Greater harmonisation is not only beneficial to reporting firms however, Childs added.

"From the regulatory perspective, the more harmonised the data is, the more useful the data is. If you're trying to look at trading activity globally and holistically as a prudential regulator trying to understand systemic risk would do, then you may need to work with other prudential regulators and share data sets. The shared data would only be helpful if it is the same across the jurisdictions. Otherwise, the prudential regulator will need to go to some lengths to amalgamate and interpret the data. The prudential regulatory environment, therefore, is enhanced by harmonised data."

Childs said an important area of focus for clients going forward is the message format mandated by national regulators.

"All firms, whether they're reporting to a single jurisdiction or multiple jurisdictions, should pay close attention to the rules as they're being rewritten. One area of particular focus is whether a regulator is mandating the message format that the reporting party must adhere to.

"We're expecting ESMA Refit will mandate the inbound submission message to follow an ISO 20022 format, which is a similar approach they took with Securities Financing Transaction Regulation (SFTR). Currently, the trade repositories administer the inbound submission message, so we'll have to adjust to a new message format if mandated. Right now, we use a combination of CSV or FPML inputs."



Childs: "We have concerns around the regulatory implementation of ISO 20022. It looks like most of the regulators, whether they mandate it or not, will at least have a version of an ISO message."

Childs said that other regulators are now looking at mandating ISO 20022, so it's important that clients understand whether they are going to have to adhere to a single message format eventually. In fact, the CFTC rules and the recent ASIC and MAS consultations suggest ISO 20022 will be implemented when its available.

"We have concerns around the regulatory implementation of ISO 20022. It looks like most of the regulators, whether they mandate it or not, will at least have a version of an ISO message.

DTCC has lobbied for an individual ISO 20022 message based on the critical data elements. "We believe that to be the easiest to implement, not just for those that are reporting, but for the regulatory community as well. However, at this moment in time, it appears the regulators are going down a path of stipulating their own ISO message version for each jurisdiction."

Childs said DTCC believes that is a mistake. "We're concerned that over time, if there are individual ISO messages per jurisdiction, the message formats may move out of alignment.

"On the other hand, if you have a standard ISO message based on critical data elements and there are any changes required within those critical data elements, they could be put into that one message."

Firms also need to think about the timing of regulatory changes and ensure they are allocating resources effectively, for example with respect to the implementation of a unique product identifier [UPI].

"Implementation of UPIs won't only change trade reporting, it means that at the time of execution, counterparties are going to need to make sure they have a unique product identifier for whatever is being traded. That could change trade execution or trade capture processes," said Childs.

DTCC is also watching the implementation of UPIs, "likely to go into production in Q2 or Q3 next year."

Childs said: "UPIs include data elements which are currently required to be reported. What is not clear is whether there will be duplication of reporting where you need to report the UPI and the underlying fields. The question is, will the onus be on the trade repository to make sure the data within the message that relates to a specific trade ties to the UPI? Does the regulatory community plan on requiring data elements that are also included in the UPI to be reported to TRs? If so, what is the expectation when the data is contradictory (the value in the UPI differs from the

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submitted value)? Should the TR reject the transaction? Should TR ignore the submitted data elements? All of this needs to be ironed out as the UPI for trade reporting is implemented."

DTCC provides trade reporting services through its licensed trade repositories in 22 jurisdictions, servicing approximately 8,500 clients.

"We're one of the few institutions that has a global perspective, in as much as we provide trade repository services in all of the large jurisdictions, so that gives us a uniquely broad view on these issues. Since day one, we've been highlighting, through thought leadership pieces, panels, working groups and providing comments back to regulatory proposals and consultation papers, where there are differences between jurisdictions that create issues for the whole trade reporting ecosystem."

He added: "It's highly unlikely we'll ever get to a truly single global implementation of trade reporting, so our approach is to continue to point out those areas that are more problematic than others."

The world's major economies are only now emerging from the worst of the COVID-19 pandemic and DTCC, its clients and the rest of the financial services industry are still adjusting to new ways of working.

Childs said the pragmatism shown by some regulators in response to the pandemic was welcome and the industry would like to see this attitude continue in future.

"An example of that was the European launch SFTR where ESMA agreed to push back the go-live date by three months due to the pandemic. If other unexpected events occur in the future that could make meeting compliance deadlines problematic for the industry, hopefully, that pragmatic approach will continue."

Childs said DTCC is looking at its services more broadly as its clients return to a more normal environment.

"In terms of DTCC services, we have been thinking more holistically about the trade reporting mechanisms from start to finish, not just running a trade repository. Where does the data come from within the firms? How do they report? How do they deal with multiple jurisdictions? And then after they've reported, how do they reconcile the data back to their own books and records to make sure the information that they've provided to the regulators is accurate? The answers to these questions drove us to look at the whole pre and post reporting space and provide additional services to our clients to help ease the burden of trade reporting."

According to Childs, DTCC launched the DTCC Report Hub® service, a highly efficient solution for pre and post trade reporting that can help firms manage the complexities of meeting multiple regulatory mandates across jurisdictions. The service offers comprehensive jurisdiction, regulation, and mandate coverage, and can help firms mitigate compliance risks, enhance operational efficiencies, and drive down costs.

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He explains that DTCC Report Hub®'s "robust functionality and flexible integration provides firms with access to a wide range of pre and post trade reporting capabilities, including pre reporting data normalization and exception management, assessment of reporting eligibility, automated reconciliation, and compliance analytics creation. The service also interfaces with registered trade repositories [TRs] and approved reporting mechanisms [ARMs] to facilitate trade submission and approved publication arrangements [APAs].

In terms of the trade repositories, he added: "The focus is going to be on readying our systems for the rewrites and with these enhancements we'll introduce a simplified and consistent client experience, for example, with respect to how clients access their data and the portal.

For firms who need guidance on readying for the swathe of regulatory changes, we recently launched DTCC Consulting Services, which helps clients with challenges related to trade reporting and control frameworks, and assists them with their reporting infrastructure set up to facilitate successful compliance, especially given the swathe of regulatory changes in the global derivatives landscape rolling out over the next couple of years."

The continuing evolution of derivatives reporting following the financial crisis of 2008 into the current stream of refreshed regulations looks likely to keep DTCC and its clients busy for years to come. ■