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Course correction: Derivatives trade reporting

Finding a new path to global data harmonisation

Chris Childs

For the past decade, individual jurisdictions have fallen short of achieving the standardisation in trade reporting that would enable regulators to reach the level of transparency and global risk monitoring in the over-the-counter (OTC) derivatives markets as originally envisioned by the Group of 20 (G20) at its historic 2009 summit in Pittsburgh.

Insufficient coordination of reporting requirements among regulators has impeded the global aggregation and analysis of OTC derivatives transaction data reported to trade repositories across multiple jurisdictions. This has created a serious challenge of regulators lacking market transparency across jurisdictions, which inhibits their ability to fully monitor systemic risk.

Regulatory bodies are now embarking on the adoption of critical data elements (CDEs) for derivatives trade reporting as identified by the Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organization of Securities Commissions (IOSCO) working group on harmonisation (Harmonisation Group). This initiative was designed to promote the data harmonisation critical to enabling data aggregation and transparency across jurisdictions.

Note: The Harmonisation Group recognised that its technical guidance on CDEs was not to tell regulators which CDE should be required

to be reported in their jurisdiction, but to gather a set of common data elements necessary to understanding derivatives transactions that would form the basis of the CDE that each jurisdiction could decide to adopt. The important point was that when a jurisdiction determines which CDE it requires to be reported, that CDE would be reported using the same definitions, format and allowable values.

As jurisdictions adopt CDEs, universal product identifiers (UPIs), universal transaction identifiers (UTIs), and legal entity identifiers (LEIs) in the coming years, the industry will go through an ongoing cycle of rules updates.

Adoption of these standards is the right approach in moving toward increased transparency across jurisdictions. However, because regulatory bodies have not completely aligned on the reporting standards they require, the G20's risk-mitigation objectives cannot be achieved, and market participants will face complex implementation burdens.

With two regulators in large derivatives markets, the European Securities and Markets Authority (ESMA) and Commodity Futures Trading Commission (CFTC), now proceeding with extensive rule changes, one aspect of which was allowing more harmonised trade reporting across jurisdictions, policymakers have reached an important crossroads in their progress to mitigate systemic risk across the global OTC derivatives market.

ESMA and CFTC deserve tremendous credit for taking the lead

in moving to adopt the CDEs defined by the Harmonisation Group. Additional regulatory bodies are now in the process of doing the same. Unfortunately, these efforts fall short of aligning trade reporting rules across the globe.

As each jurisdiction implements rules updates that do not align in terms of standard data elements, firms remain in a cycle of updating their reporting systems to meet new rules that do not lead to a common data set across jurisdictions. This is both operationally inefficient and fails to achieve the goal of transparency.

We are at a critical juncture. The current path continues with a cycle of revisions to trade reporting rules that differ across jurisdictions. This results in less efficiency and greater complexity in capturing a clear view of global systemic risk in the derivatives market. We have identified an alternative approach that can achieve the G20 mandate—and do so in a more efficient, timelier and cost-effective manner.

What policymakers need to do

To accomplish this level of transparency and trade-reporting consistency, policymakers must enforce the following:

- Identify a universal shortlist of CDEs for trade reporting in order to easily access views across multiple jurisdictions as well as domestically.
- Ensure adequate resources are available to enable the Legal Entity Identifier Regulatory Oversight Committee (LEI ROC) to serve as the central governance body for data standards. LEI ROC should oversee a review of which CDEs can be removed to create a shortlist of CDEs that can be universally and uniformly implemented.
- Ensure CDEs are universally and uniformly adopted by all regulators, with additional jurisdictional non-CDE fields if a particular regulator determines additional data is necessary to meet its local mandate.
- In the event that a particular regulator cannot uniformly adopt all CDEs, the CDEs that are adopted should be implemented consistently.
- Ensure that an ISO 20022 CDE message scheme for OTC derivatives uniformly defines the CDE attributes but also allows for the regulators to enhance and version the message while not combining non-CDE data attributes with CDE attributes.

Where we are

In late 2020, CFTC issued final rules revisions for OTC derivatives, which mandated several dozen CDEs for trade reporting. ESMA has also published its technical standards, including CDEs, under the EMIR Refit regulation which is in the process of being approved by law-

makers. Meanwhile, the Monetary Authority of Singapore, Japan's Financial Services Agency, the Australian Securities and Investments Commission and Canadian regulators (all provinces and territories) are considering rules revisions or updates to their reporting rules, adoption of uniform transaction and product identifiers and the incorporation of CDEs.

These rules revisions have been necessitated by jurisdiction-specific rules and standards that have been promulgated over the past 10 years around what and how data is reported, resulting in fragmented data sets that impede regulators' ability to see and supervise systemic risk.

In response to this issue, CPMI-IOSCO several years ago formed the Harmonisation Group to devise standardised terminologies and identify which CDEs of swaps are most important, no matter where the trades are reported. Their final list of CDEs has 110 items, but the adoption of the CDEs is under the remit of the local regulatory authority.

While the latest efforts by ESMA and the CFTC are commendable, a closer look at their revised rules and at what is still missing from the industry's data harmonisation work reveals shortcomings.

First, governance and standard definitions were not in place before the rules revisions began. LEI ROC was only recently appointed as the governance body for the implementation of UPIs, UTIs and CDEs.

Further, the ISO 20022 ["A multi-part International Standard prepared by ISO Technical Committee TC68 Financial Services, which describes a common platform for the development of messages"] message definition for CDEs, advocated for by CPMI-IOSCO, is underway but far from being finalised. Important to note is that the ISO 20022 Derivatives SubSEG working group, of which DTCC is a part, is actively working on establishing the message definition. It is our perspective that it is imperative that the working group build from the industry's years of experience reporting in structured XML standards.

For example, the proposed ISO 20022 CDE schema is modelled after a message created in 2018 that was not designed for reporting CDE data attributes. In addition, with this particular schema, the technical definitions do not always align with the CDE CPMI-IOSCO technical guidance. This creates an opportunity for inconsistent adoption across regimes.

The industry needs to act carefully to ensure that the first ISO 20022 CDE schema uniformly defines the CDE attributes and simultaneously allows regulators to enhance and version the message while not combining non-CDE data attributes with CDE attributes.

Additionally, where CDE attributes have not been uniformly adopted by regulators, we are concerned that this non-uniform adoption will introduce additional complexity to the CDE elements within the ISO 20022 schema. This increases the operational burden on trade repositories to manage validations for CDE attributes separately for each jurisdiction.



The quote

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Second, under its rules revisions, the CFTC and ESMA are adopting varying subsets of CPMI-IOSCO's recommended CDEs. Most critically, of these subsets, CFTC and ESMA agree on only 51 CDEs to be reported in a standardised format across both jurisdictions. A more detailed analysis can be found in the next section of this paper.

While these revisions are a positive step toward consistency in global reporting, the lack of harmonisation around the use of a consistent set of CDEs will result in more of what we have today—non-standardisation across jurisdictions that prevents true harmonisation and frustrates global data aggregation. If other regulators follow this early pattern, it will lead to continual revisions and costs without reaching the ultimate goal.

Analysis of CFTC and ESMA rule changes for CDEs

DTCC conducted a detailed analysis in order to gauge the potential success of CDEs in achieving data aggregation and transparency. The good news is that the two regulators are fully aligned on the most important CDEs for trade reporting—including UTI, UPI Code, Effective Date, Expiration Date, Notional Amount, Counterparty 1 (reporting counterparty) and Counterparty 2.

However, there are a number of differences in reporting fields and approaches, which suggests opportunities for them to revisit their plans with the objective of eliminating differences. By aligning their CDEs and reporting approaches, the CFTC, ESMA and the markets' other regulatory bodies can enable consistent views across multiple jurisdictions as well as domestically.

Both the CFTC rules revisions and ESMA's EMIR Refit adopt a

majority of the CDEs as per CPMI-IOSCO guidance without any deviation or with only a difference in naming. Specifically, CFTC adopted 71% (78 out of 110) and ESMA adopted 75% (82 out of 110) of CDEs without deviation. More importantly, though, of their adopted and aligned CDEs, only 51 matched exactly and are shared between both regulators. An additional 26 CDEs partially matched and were adopted by both but are not aligned in format, values and definition. Ten CDEs were not adopted by either regulator, and 23 CDEs were adopted by only one regulator. This begs the question as to whether all 110 CDEs are necessary.

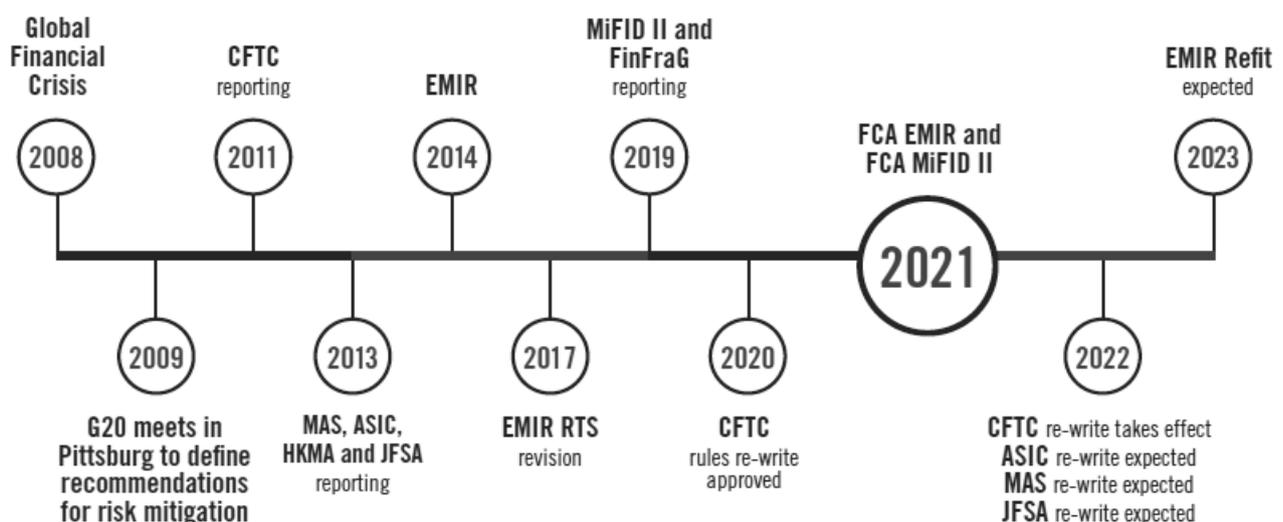
CDE adoption figures are summarised as follows:

- 71% adoption (78 out of 110), CFTC
- 75% adoption (82 out of 110), ESMA
- 46% adoption (51 out of 110), shared CDEs
- Additional 26 CDEs, partially match*
- 10 CDEs, not adopted by either regulator
- 23 CDEs, adopted by only one regulator.

*Adopted by ESMA and CFTC but not aligned in format, values and definition

Not only do the rules revisions differ on a number of CDEs, we uncovered differences beyond specific fields, such as the reporting approaches at the transaction and post-trade-event levels. These divergent approaches arise because, even when both regulators adopt a particular CDE field, guidance permits variances in reporting approaches.

Figure 1. Timeline of OTC derivatives reporting



Legend:

Australian Securities & Investments Commission (ASIC)
 Hong Kong Monetary Authority (HKMA)
 Japanese Financial Services Agency (JFSA)
 Switzerland's Financial Markets Infrastructure Act (FMIA),
 also known as 'FinfraG'

Commodity Futures Trading Commission (CFTC)
 European Market Infrastructure Regulation (EMIR)
 Markets in Financial Instruments Directive (MiFID)
 Financial Conduct Authority (FCA)
 Monetary Authority of Singapore (MAS)

Source: DTCC

A final discrepancy we found between the CDEs adopted by CFTC and ESMA is their incorporation of additional data elements that are not CDEs. In terms of these non-CDE fields, CFTC and ESMA are generally aligned on six fields and not aligned in format, values or definition on nine fields.

Individual regulators may want and need to collect additional data that is useful to them. However, if additional data is to be required, it should be reported using the same definitions, formats and allowable values as the CDEs. In addition, non-CDE elements that are shared across regulators should be considered for inclusion in the CDEs.

A better way forward

Although the regulatory mandates have been unable to achieve the transparency and systemic risk monitoring goals envisioned by the G20, right now represents a unique moment to make progress against this objective.

First, eliminating cross-jurisdictional differences now will avoid ongoing re-harmonisation efforts and future regulatory amendments, resulting in reduced implementation burdens for market participants and providers.

Such re-evaluation should result in paring the CPMI-IOSCO list of 110 CDEs to a smaller number that can be used to aggregate data across jurisdictions. Individual regulators can collect additional data beyond the universal CDE for their own purposes, but that data would not be included in the aggregated data sets used for systemic risk monitoring purposes.

Given there are only 51 of the 110 CDE being consistently adopted across ESMA and CFTC, a re-evaluation should be conducted and overseen by LEI ROC, focused on what the right number of CDE across jurisdictions should be. This would enable regulators to turn data into genuine and valuable information for oversight purposes.

Second, with the help of the ISO 20022 Derivatives SubSEG working group, the industry must complete the ISO 20022 CDE message scheme for OTC derivatives, setting a definitive timetable for this completion, and adopt ISO 20022 universally as the common data standard and format for reporting to trade repositories (TRs). A common messaging standard would help drive data consistency across TRs and jurisdictions.

Third, the industry must furnish LEI ROC with adequate resources so that it can succeed in serving as the central governance body for CDEs, UPIs and UTIs, as designated by the Financial Stability Board on 1 October 2020.

Conclusion

Time is of the essence. If the goal of the G20 commitment to improve the transparency of OTC derivatives activity in order to mitigate systemic risk in global financial markets is to be met, policymakers must embark on these reforms now, before market participants begin another round of system updates to conform to the latest rules revisions, some of which are set to take effect in 2022. **FS**