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TRADE REPORTING ROUNDTABLE | April 2014

Trade reporting

Two months in and the industry
is still struggling to comply

 **CME Group**

Trade reporting: the lack of standards is hurting the industry's efforts to comply

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RB Robert Barnes, Manager, Regulation at FIA Europe.
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LJ: What was the experience from the LEI point of view, what might have been done differently?

DJ: There is concern for clients regarding the LEI situation. We thought LEIs were going to be simple because there was a process for clients to obtain an LEI and there were local operating units across multiple jurisdictions, but, as we're aware now, there are still firms that don't have LEIs -- those required to have them because they're captured by EMIR and also the third country entities.

That's causing problems with compliance. When you submit a trade to a trade repository you need two LEIs but some clients are struggling to say their counterparty is out of scope and then, when they talk to the regulators, there's this push for clients to talk to those counterparties.

There was a backlog of requests going into some local operating units. Some counterparties assisted by obtaining the LEIs for clients because it's a new concept they were probably not aware of.

The scope of the mandate impacted the TR industry. There has been talk around the problems with onboarding but it is important to consider the volumes and timescales. There was a huge, stressful situation where clients weren't compliant and relying on others to make them compliant.

JS: There's still a significant population of clients that don't have an LEI. This might cause a problem as particularly third country clients, don't feel the need to have an LEI at this stage and won't get one until there's EMIR type regulations in Asia.

Most clients are probably onboarded by now. Whether their reporting is correct is

the next phase. We're working with the trade repositories to look at current data issues and issues going back to February 12th. The focus is now on the next three, four months and trying to clean up reporting ready for the next phase.

There's this principle of identifiability -- number one is knowing the parties and number two is knowing the trades they are counterparties too. There are still problems with LEIs and UTIs and the value of the data will be low until those issues are addressed.

ST: The conversations I've had with the EMIR teams at the regulators have been helpful as far as they've gone but I've come away with the impression the people giving me direction don't have the information either.

It's disingenuous to put all the obligations on the clearing firms and CCPs because it means they could get it wrong if ESMA or the commission decides ex post facto that's not what they intended.

VM: What's important to bear in mind is that every user of derivatives is responsible for reporting. There may be practical issues with enforcement because it is difficult to monitor hundreds of thousands of end users of derivatives but ultimately it is an obligation of each end user to ensure reports are submitted, at least in Europe.

RW: It's interesting the FCA is pushing clearing members to get agreement from their customers, especially corporates who aren't regulated by the FCA. Similar to the third country issue, there are corporates in the European Union saying I'm not regulated by these guys so why should I bother? It's an extra cost, we're not going to do it.

Education, education, education

DJ: It is education. I even get asked, am I captured by this? We have to say, we're not offering legal advice here. This is the regulation, these are the solutions.

A lot of non-financial counterparties are struggling with this because the trades are a by-product of their business. One said they don't even trade derivatives anymore but they've got six trades from 2013 so they had to go through this whole process.

ST: You have to take responsibility. Anecdotally there are or were -- I'm sure they've been properly educated now -- a large number of firms who thought delegating reporting sorted out the problem so they wouldn't have to think about this ever again. This is definitely not the case.

DJ: They saw it as an outsourcing function but didn't realise if you're doing the delegated reporting the obligation is still on you. Clients we talk to now who say we're doing delegated reporting, one of the questions we ask is, do you have access to that data and are you receiving the acknowledgements?

RB: There's vast swathes of the corporates that aren't covered by the FCA and are never going to be covered by the FCA. The clearing members didn't want to offer a delegated service because until the last minute they didn't know what or how they had to report it so how



Daniel Jude, Global Head of Business Development Repository Services at CME Group

could they? But as soon as one person offered delegated reporting everybody had to have delegated reporting.

DJ: At the CME, we started producing proxy LEIs to get clients over the line. It's a case of let's get you onboarded, get the trades in and then once you get your LEI, we'll come back and enrich those trades.

We didn't even consider creating UTIs either but then we found corporate clients saying I've had inter-company transactions and I don't want to be a generator of UTIs because all of the other trades are against the street. So, again, we're now producing UTIs. The trade repositories, the sell side and the brokers are having to come up with solutions to assist clients to get them compliant.

LJ: John you have expressed some frustration about integrity constraints?

JS: We went live with reporting on February 12th but we don't have a complete population of LEIs, so we are reporting with an internal ID as required by the regulator. If we obtain the LEI for that client, in theory there's a set of positions and trades held against the internal ID.

To then report correctly, a new set of trades against the correct LEI needs to be created whilst trying to update the previous reporting and make it correct ideally by using a cancel/modification process at the trade repository. But the trade repositories obviously have elaborate data models with data integrity constraints which make an ID change more complex and in some cases impossible.

RW: Would that apply at the ETD level for original trades or resulting positions?

JS: I think it's on the original trades.

RW: So you're cancel/correcting the trades and then all the positions.

JS: In an ideal world, the system would allow a classic find and replace so that from the moment a LEI is available an internal ID could be replaced by this LEI. This functionality is not available because the system took a snap of the data on say the 12th of February and froze it.

Position Reporting

RW: A record of all the trades doesn't give any of the regulators a sense of where the risk lies, and this will only be when the position reporting

and collateral valuations become mandatory on 11th August.

RB: Position reporting doesn't become mandatory. It's only valuations and collateral that become mandatory on 11th August. There is still no requirement at all to report positions until EMIR 2 comes out.

RW: There's so much data to look through to build up our position record, they're never going to be able to find it.

JS: It's got to be identifiable. Who are the parties to the trade, which trades are linked and are the two sides of the trade of the UTI matching up? At a very late stage, we had introduced the concept of the transaction reference ID to link all the different legs of a trade together.

RW: Which was ESMA's response to the industry saying the exchange isn't the right place to produce the UTI. But now they seem to have come back and they're trying to flog that again.

JS: We believe the CCPs have the responsibility to be generating UTIs and transactional reference IDs, and making them available via clearing feeds. If we look at day one of the EMIR reporting, however, very few CCPs were making that information available through feeds.

CCPs published algorithms describing their UTI generation logic and how to apply them if a member wanted to match these. They could have played a bigger role and hopefully will play going forward.

DJ: CME is producing UTIs but it was news to me to hear a couple of the others weren't doing that. We have levels of permissionings that somebody can come in and start amending, but an LEI and UTI, we really don't want someone just coming in the back.

A lot of the questions have been asked why the trades not matching but this is why. LEIs are meant to be the furthest ahead but we're still having problems with those.

And also then you look at the process of the trade and where do you go to find the UTI? At the execution platform or is it done over the confirmation platform if it's a bilateral trade? Or if it's a cleared trade do we wait for it to go down to clearing?

ESMA were trying to get them out of scope and then they suddenly came back in scope, although they never were out of scope but everyone thought they were out of scope.



Luke Jeffs, Editor of FOW

Delegated Reporting

JS: One advantage of delegated reporting is the consistency of the UTI which gives comfort to clients.

A lot of clients took delegated reporting to get them through day one. A whole population of clients came at this in January and some clearing firms developed delegated reporting as a tactical solution for their clients to help them meet regulatory obligations on day one. A number of clients will now monitor how the regulatory reporting space evolves and decide if an in-house solution or outsourcing is best for them.

ST: What about clients who have multiple clearing firms? One of the things they were talking to me about was double-checking what was being reported? If each clearing member is reporting to a different TR, the aggregation system and the reconciliation system becomes absolutely enormous. So the question is, have you got any clients asking you to change TR?

JS: We started off with a delegated reporting service where we submit on behalf of clients and then they could view and check the data. We have now enhanced our service with a data file made available every morning so clients could take that file and use it if they were using another trade repository. We did see clients



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Richard Wilkinson, Director of Post-Trade Solutions at Contango.

dealing with multiple clearing brokers who were looking at some of the consolidated trade repositories.

DJ: We're looking at building a translation services so you can take files from different formats. But if we get the likes of the Newedges and the big operating systems, all of the large ones for exchange traded and OTC, we would probably capture 60, 70% of the market and all we would need to do then is map unique values, additional data from that source.

ST: I hope it works. Some clients of mine who were pre-testing found different trade repositories would reject the same field filled in the same way. One would expect to see a blank, one would expect to see a non-applicable and another you could just make it up. They didn't care as long as it was filled in with something.

RB: With cross trade repository reconciliation, the big problem is data integrity and the back-filling of stuff that's incorrect. I had a conversation with a trade repository – not CME – earlier this week where they told me the file that contains the trades where they're looking for a match across TRs is now getting too big to send to one another.

DJ: One of the trade repositories decided they would send through an aggregate file rather than new trade file. So if you start taking from 12th February and you just continue aggregations and then you try to send all the trades even if they've been matched or paired before, that's a ridiculous amount of trades. But when you've got so many unpaired trades because of the other counterparty, some counterparties will just say they aren't reporting.

RB: But to go back and fix those would be a logistical nightmare. Not just on UTIs and LEIs, if you look at all the fields, the way forward is for the cross TR rec there's 12 or 15

must-match fields and they're the ones the TRs, regulators and industry need to start discussing. I can't believe we're two months in and nobody's actually sat down and started talking about that. That is the first step to fix something which is currently broken.

DJ: I was going to say you'd be surprised, but you're probably not going to be surprised, to hear the first meeting we had across the TRs to discuss the fields we should reconcile, one trade repository said we should rec on every single field and they must be a required field. We said there's no way these fields can reconcile because of their nature.

The 85 dataset fields has to come down, to maybe 60 dependent upon whether you've got the UPIs.

The file is getting bigger and bigger but that goes down to the beginning of the process.

Regulatory Oversight

RB: This comes down to the regulators fundamentally not understanding what they want the data for and how this stuff was going to reconcile. It was just too big. There should have been a phased approach with investment banks going first. It should have been 20 key fields, expand it out to the next 15 fields and so on. What you had is the big bang approach with everyone from the farmer in France sitting on his tractor with one interest rate swap to the big investment bank that trades hundreds of thousands a day, it's simply been too much, too quickly. Everyone can see that now but it's how you draw a line in the sand and start saying: "We're going to use the data from this date."

JS: The FCA has given guidance on the type of information they're more interested in being clean by a certain date than others, which is helpful.

We're being clearly guided on learning from the MiFID experience, that is a robust control framework around the data is needed. You need to show if you've reported incorrectly that you know you've reported incorrectly, you know how big your problem is and you have a plan which can be put in front of a regulator to fix it in a timely manner.

RB: MiFID was implemented badly in 23 countries around Europe and they're trying to fix the transaction reporting regime with a systemic risk reporting regime, which is fair because regulators want to use that data for a number of purposes and it's understandable.

JS: If you're submitting a million trades today and 50% is on internal ID and not on LEI, this makes the data less worthwhile for the regulator. The regulator can't actually use that data to monitor systemic risk on both sides.

Regulatory forbearance

ST: So on regulatory forbearance, how long will that last?

JS: We're getting lots of hints about what the future is going to look like and we're being given the opportunity to address some of those issues before the regulators become firmer in their approach to policing it.

ST: So when do we think that's going to happen? I hear estimates from 6 months to 18 months, from February this year.

VM: One of the very few regulators who has made any public statements about the deadlines is the FCA and the only hard deadline they have introduced is 30th April. Every entity subject to EMIR should have a detailed and realistic plan to achieve compliance with the new rules by then.

It's the level one regulation that imposes these rules. It's difficult for ESMA or anybody else to decide that we are going to change how to implement them. We are where we are. Some of these good ideas could be introduced through revisions to the level one regulation, which obviously would be a lengthy process.

Since every end user is responsible for the quality of the data reported to the repository, the only way for a corporate to be comfortable the reports are being submitted is to build systems that allow them to check the data that are being reported. To be able to do that, they need to have access to the trade repository and for that they need to pay.

Once people start going through the trade repository on-boarding process, they often realise they are very close to being able to



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report on their own. Since the requirements to be able to check your service providers is such that you have to do quite a bit of homework in setting up internally your compliance systems to have access to and be able to review these reports on a regular basis, at some point people might question whether they simply report themselves.

DJ: When clients look across multiple TRs, they have to have aggregational reconciliation across those files, so you're now looking at three or four different formats and you're thinking if I'm paying somebody, I could do the reporting, then I know it's accurate and the only thing I need to worry about are the breaks.

The problem is there's so much inaccurate data everyone's tripping up over themselves. So we are hoping the regulators come up with some dates because until such a time you're going to get people who are not going to be meeting the obligation. The FCA did say they would be looking at the larger players first and working down.

Fine tuning

ST: What are they going to be fining people? I heard something between 10 euro cents and 20 euro cents, but is that per misreported trade?

DJ: The regulation that captures the alternative investment funds comes in July. I think they were thinking this was nice for them because everybody else would have all these problems and then it should be ironed out. But at the moment, it doesn't look like that.

But that goes back to the known knowns and the known unknowns. So I know that this is right, I know this is wrong but it's the unknown unknowns that are causing the big problem, that clients aren't understanding what they don't know.

The lack of standardisation is a problem. Each trade repository was given a certain amount of specifications they had to build to but

we built what we had according to our systems, which has caused a real problem because every spec is different.

RW: It almost makes you want to be a socialist and say, why isn't there one trade repository? This is a utility so it was interesting ESMA said you can all apply. It's created problems with inter-TR recs and UTIs.

LJ: Is it too early to talk seriously about switching TRs??

DJ: We thought a month ago more clients would but they said they were going to get through this and review when they came up for air. Some buy side firms are already looking at operating systems for the clearing requirement, so they are look at adding versions for reporting.

I have large sell side firms and intermediaries speaking to me about porting. The last couple of weeks we have been talking to middleware that can provide this service.

RB: The specifications are different across each repository so moving across repositories isn't straightforward.

DJ: That's what we're looking at building, to translate the outbound file from another trade repository, reformat it and put it into our trade repository. It would be better if we had one trade repository.

I hope to have a solution in place by June, in time for the alternative investment funds and collateral and valuations.

Collateral and Valuations

RB: From an ETD perspective on valuations and collateral, you don't have to report positions but I don't know anyone that values or does collateral on anything other than a position level. You're not going to provide valuations on an individual trade level, it just doesn't happen in ETD. So firms that aren't reporting positions are probably going to have to report positions to provide the valuations and collateral on those positions. So it's got the potential for a bit of a nightmare.

RW: Nobody's reporting valuations, mark to markets and collateral on trades so it's got to be at the position level. ETD is one-way collateralised, which is in the ESMA text, but for customers that have opted for delegated reporting when the valuation comes in they're not going to see a valuation report on their

output file because it's one way so it's up to the customer to report the value that posted to the GCM. The GCM has no obligation to send that information back to the customer for delegated reporting and it's the GCM that has to report the value of its position with the CCP.

It's just something that's not been thought of by the regulators when they were writing the stuff.

RB: Everyone will admit ETD is probably the biggest area of breaks and differences. Even ESMA realised it wasn't fit for purpose and wanted to give us a year but the Commission said no. The problem they've got at the moment is you're not going to see systemic risk on ETD from trade data only, you need the positions, which is why ESMA wanted to give industry another year to get there.

DJ: From a client's perspective, if I've done delegated reporting for exchange traded and over-the-counter, is that entity I've delegated to, are they capable of doing this for me?

I thought some clients would rush towards delegated reporting but some are now stepping away. The FCA said they are happy for clearing members and other entities to provide valuations and collateral figures but are the client's compliance officers happy allowing somebody else's methodology to produce valuations reported on their behalf?

We've been asked will there be still six trade repositories and is there going to be diversification across asset classes with trade repositories? We can cater for the cleared OTC bilateral and exchange traded, which is a relatively unique position to be in. But I think unless we have some movement in regards to collateral and valuations, it is going to be a relatively tough ask so that's where for cleared and exchange traded you'd go to the clearing house and see if they can provide you with that. They're doing the valuations and calling for collateral on a daily basis. That could be a route for moving away from your clearing member to

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TRADE REPORTING ROUNDTABLE



your clearing house if the clearing house were to offer that.

RW: It could work on a segregated environment because the CCPs know the underlying account but if it's an omnibus account, the CCP would still have to rely on the clearing member to provide that information.

DJ: That's the conversation clients are looking at when clearing comes into play in Europe. If I was to go into an individual seg, that would be a bit more costly. If they do the delegated reporting for me would that outweigh the omnibus structure where I'd have to do it myself because there is no transparency. This will be a question again when clearing comes in, to see which clearing house and account structure they select.

The role of the clearing houses

JS: In a perfect world the CCPs would have got organised earlier and we could have let

them report because they have the majority of the trade attributes needed to meet this reporting obligation. As a clearing broker we've got no appetite to invest in systems to meet reporting requirements and pass those costs on to clients where we don't need to do it. It was really a tactical solution to help our clients meet their regulatory obligations. We expect the CCP offerings to mature in this space, they came very late to the delegated reporting.

LJ: So we expect to see fewer clearing brokers offering these types of services?

ST: There's probably going to be natural wastage anyway. The appetite for delegating is going to become lower.

RB: The regulators' forbearance is going to come to an end because for a very good reason they've got all this data, if something goes wrong and they don't spot it they're going to look quite silly. It's one thing Nick Leeson doing what he did when they didn't have access to any

of the information on the trades. The world and the press might take a different view if they had the data at their fingertips. That's the primary reason why the regulators will come down on this at some point.

DJ: All of the TRs are being contacted by all of the regulators. A couple of dozen of them have spoken to us and that's the same across the TRs. So they are looking at the data. They are struggling themselves, I think that would be a fair comment.

At some point they're going to have to come up with a solution to aggregate this data, view it but then what are we actually looking for?

So all of this is going to have to go down that route. There has to be end of forbearance sometimes, and pretty soon. If we're imaging the clearing mandate comes in and we're still in the situation where we're still struggling with trade reporting in early next year, I think operational teams are probably going to keel over with getting clients onboarded for clearing and all of that for OTC products and still having these problems. 

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