EMIR Trade Reporting - Time to Refine Processes

The second EMIR trade reporting deadline for collateral and valuation data has come and gone but many firms continue to struggle to report the data required and in a timely manner. In this DerivSource podcast, we speak to **Anthony Belcher** of **Interactive Data** and **David Broadway** of the **Investment Management Association (IMA)** about the emerging best practices around reporting of derivatives trade data so far and what elements of the ESMA Q&A for trade reporting which still requires interpretation.

Julia: **Hello and welcome to a DerivSource podcast. I'm Julia Schieffer, Founder and Editor of DerivSource.com.**

The second EMIR trade reporting deadline for collateral and valuation data has come and gone but many firms continue to struggle to report the data required and do so in a timely manner.

Most firms struggled with the first EMIR deadline for trade recording back in February and have since then been focusing on fixing problems with that first hurdle and also preparing for the second hurdle in August to report collateral and valuation data. As a result we have firms at various levels of readiness, and many face ongoing challenges in trade reporting. Increasingly, organisations are turning their attention to refining the trade reporting process to achieve operational efficiencies that perhaps may not have been a focus in the rush to comply with both the February and August deadlines.

In today's podcast I'm speaking to two industry experts about how firms are improving trade reporting processes, what best practices are emerging and where future challenges still remain.

With me today I have David Broadway. David Broadway is a Policy Adviser at the Investment Management Association, the IMA, in London. The IMA represents the UK fund and investment management industry and focuses primarily on regulation and practice impacting the post-trade operations of investment managers. For the last year or so David has been engaged with the IMA members on the specific subject of EMIR trade reporting through a regular discussion forum devoted to exchanging views and information on the challenges they have faced in meeting this reporting obligation.

Welcome, David, to the podcast.

David: Thank you, Julia, good to be here.

Julia: **I also have with me Anthony Belcher, Director Pricing and Reference Data at Interactive Data. Interactive Data is a trusted leader in financial information and a provider of fixed income evaluations, reference data, real-time market data, trading and infrastructure services, fixed income analytics and desktop and web-based solutions. At Interactive Data, Anthony is responsible for leading the company's pricing and reference data business in Europe, both from an operational and commercial basis.**

Welcome, Anthony, to the podcast.

Anthony: Thank you, Julia, good to be here.

Julia**:** **Anthony, can you give us an update on what has happened so far, and really paint a picture as to where we are now?**

Anthony: Thank you, Julia. Yes, as you outlined at the start, the initial reporting deadline in February for EMIR covered some of the items that were needed to describe the trade that was taking place. There was, however, a delay before the valuation aspects of the reporting were due to kick in, and they started in August.

From a reporting perspective, there are two main areas that firms now need to add to their reporting mechanism: one was the valuation of the trade and updating that throughout the life of the trade to be able to show what the valuation was. The second part was also to look at the valuation of the underlying collateral: what was being used to support the trade and what's the value of that, and how you look at that.

One of the aspects that are peculiar, or particular to EMIR if you like, is the fact that it is a mark-to-market requirement; the valuations of both the trade itself as well as the collateral are required, where possible, to be a market valuation. Therefore the question that firms need to think about is: how do they prove that? When the regulator comes to ask them exactly what that valuation is, where it has come from, how do they get that and what transparency can they provide to show what they've used to get that valuation?

Julia**:** **David, what about you? What did you see in the last month?**

David: Well, I've just really two points to add to what Anthony was saying just now. The first is that… and one of the key things that people have had to implement new with the valuation and collateral reporting from the middle of August, is that these reports have to be submitted every day. Valuation, historically, you've only had to report new trades and lifecycle events as and when they occur. With the valuation being introduced now it needs to be reported every single day, or every single business day rather. Although there is one exception to the community that need to submit the valuation and collateral reporting and that's the non-financial counterparties that are below the clearing threshold. In fact, are carved out of the additional requirements to report collateral and valuation.

Julia**:** **Let's talk a little bit about what is the most common way that firms have gathered the data required so far and how they've enriched it and submitted it to the trade repositories to meet this August deadline.**

David, why don't you tell us first what you're seeing amongst your members of the IMA?

David: Notwithstanding that there's actually quite a lot of delegated reporting going on, particularly from buy-side to sell-side… not every firm is doing that and a number of firms are reporting themselves, but there is a number of firms who are delegating to the counterparty so have less issues with having to gather the data, but certainly those who are reporting themselves, for them the key challenge is that they're having to pull data in from various different places: from front office, from back office, different systems, even third parties, whether that be pulling in trade prices for cleared contracts from the CCPs or their clearing members or even from the market, you may have third party collateral managers from whom you have to source the data in order to enrich what you have in your systems to then submit through your trade reporting.

There is a need, especially I think with exchange-traded derivatives to address some discrepancies between what the regulations (and we'll be talking about this later, I think) between what the regulations from ESMA appear to require and how these are valued by firms for business for usual purposes. These are all challenging in terms of trying to get the data, get the data correct for reporting purposes and for many firms there's a lot of hand-holding in the process, a lot of manual intervention and that it's not just inefficient, clearly it carries a degree of risk as well, simply as manual processes tend to do.

Anthony: I think, looking at it from the angle from Interactive Data and our clients, I think there's probably a couple of angles to add to that.

The first is, as David said, around the delegation of reporting. The only thing to note there is the fact that although the reporting itself may be delegated, separate from the earlier piece of the reporting, the responsibility and accountability for the valuation itself still remains with the buy-side firm. So although they may delegate that to the sell-side, what that also requires is the buy-side to retain some degree of ownership of valuation, and whilst that may not need to be actioned within the trade reporting timeframes, they will need to gather, manage and hold what they are saying is the value of those assets.

The other piece is, again to echo what David said, around the gathering and validating of the sources of information, especially for OTC derivatives where the valuation sources can be disparate and different. There's the need to be able to have that understanding of where you're going to be getting that information from and how it fits in with other sources, such as the CCP pricing. The other area around CCP pricing that firms are having to be aware of, and it's been a challenge for some, has been around the timing of that delivery and therefore how that timing fits in with the timing requirements for trade reporting. That causes some firms some challenges.

***Julia*: Moving ahead, what is the best way that firms can refine this trade reporting process to really reduce errors and improve the efficiency that maybe hasn't been gained in the last several months as people are more focused on meeting deadlines?**

David: I think possibly the first thing to mention here is that firms are afforded some help in that the… certainly, the main trade repositories, I'm not certain it applies to all of them but certainly the main ones that IMA members are using, they are providing separately, or for separate files for reporting valuation and collateral. Of course, that offers a little bit of flexibility that enables you to report from, or perhaps draw your reporting from, a different system maybe, or even from a different reporting entity from the one that's submitting your normal trade reports. You could, in theory, get your third-party collateral manager to report if they're willing to do so, or consume the data and report it yourself, but you don't necessarily need to bring all of the valuation and collateral data into whatever your main mechanism for trade reporting is. So, it does give them a certain amount of flexibility.

There are a number of different models out there, with some firms reporting everything themselves: the trade, the collateral and the valuations; some are delegating trade reporting but then submitting their own valuation and collateral data; and some are even delegating everything which comes back to the point that Anthony was making earlier on in terms of if you delegate then you're still accountable for the accuracy of the valuation that your counterparty, typically that's to whom you're delegating and is reporting on your behalf.

What we're seeing is firms looking increasingly at building what I would call regulatory reporting systems that basically will hold or be fed all of the necessary data and drive the reporting, not just for EMIR, but for their AIFMD reporting, their MiFID transaction reporting, further down the track we're going to have reporting on securities financing transactions, and firms are recognising that there are common data points in all of these reports and there's a degree of overlap. For the whole sake of efficiency and accuracy they're looking to bring that all together into one place so that they are reporting from a common and consistent data source.

***Julia*:** **Anthony, can you give us a wider context into some of the ways in which firms are further refining this trade reporting process, from your view, from a valuation and collateral data point of view?**

Anthony: I think we're seeing it in a number of different ways. Firstly, it's the taking it almost a step back and making sure that the processes they're putting in place to arrive and get to that valuation are better and more robust than perhaps some firms have had to put in place to meet the deadline. So, it's about looking and understanding, making sure that they are testing their methodologies, their workflows, especially for the OTC market where there will be differences in approaches, differences in valuation, differences in transparency, and how the firms look at and understand that will make a difference as to the timing, the workflow and to some degree the accuracy of their reporting. Firms are definitely looking at that side of things.

They are also continuing to review and look at, not necessarily so much within the trade reporting itself but in terms of breaks between the actual trade that's taking place, to understand independence of the valuation between the parties of the trade. We're seeing increasingly firms are looking to firms such as Interactive Data to be able to provide that independent value so both firms can agree upfront to try and remove any sort of disagreement as to the value of both the trade itself as well as the collateral that they are posting for that. That really helps the efficiency of the process that they are moving through on that.

If we broaden it out again and you start looking at the collateral management aspect, how they are making sure that that collateral is being used efficiently. We used to hear that *cash was king* and now I think we're hearing *collateral is king*, there's definitely an increased focus on the availability of collateral. As firms are looking to make sure they're efficiently using their collateral, hosting the best collateral for each of the trades, firms are working out how to do that and of course as they're changing the collateral that they're using for these trades their mediums will change how they are reporting on those collateral uses within the auspices of EMIR.

And definitely, we are seeing firms coming towards tools and options that firms like Interactive Data can do things to help with that.

***Julia*:** **Going forward, there seems to be still so much grey area within the ESMA Q&A itself that many firms are interpreting differently. My question to both of you is: what are the main grey areas that you see are creating the most challenge amongst firms as they prepare or as they continue to improve the trade reporting process?**

David: As you say, Julia, there are a number of grey areas in spite of ESMA's best efforts; they produced a Q&A which people still interpret differently, maybe sometimes they're not drafted in a way that particularly fits with the industry's understanding of how the market works, but I would possibly pick maybe five specific ones in relation to trade reporting.

The first is around the reporting of collateral. There is still some confusion, and I see this talking not just to IMA members but also with my colleagues at other trade associations, there is still some confusion about exactly what posted collateral actually means, with a number of firms still confused as to whether if you hold collateral today and you return it tomorrow, does that return constitute a posting of collateral, or is it only when you're actually posting your own funds with the other counterparty? That's still an ongoing discussion. I would see the Q&A as relatively clear, but there is still some discussion around whether or not you have initial margin flowing in one direction and variation margin flowing in the other whether they should be netted or whether each party reports what they deliver to the other.

The second one would be around valuation, so still sticking with collateral and valuation for these first two. There is a reference in the Q&A to 'reporting the absolute value' which what I'm hearing is the trade repositories' understanding perhaps even coming down from ESMA, is that the word 'absolute' is more in the technical sense of absolute number, ie. no negative values, which is causing confusion because that is simply counter-intuitive to the way many people would see the valuation of a particular contract depending on whether you are sort of in or out of the money. There's still an issue to resolve around there, as indeed as I mentioned earlier on, on the exchange traded side there's a question of whether it should be the trade equity valuation or whether it's the present valuation of the notional which some people seem to think is what ESMA is looking for, while that would be counter-intuitive to the way the market operates.

Looking slightly more widely, moving away from the collateral and valuation piece, I'm aware that there's a particular Q&A that talks about a methodology for determining the buyer and seller in a foreign exchange transaction, which is kind of counter to the normal market convention, which as I understand it firms are essentially continuing to follow the market convention, they're not building to change to follow this quite rigid approach that ESMA was suggesting around the alphabetical order of the currencies concerned. I think there's a whole area of work to be done here rather than necessary confusion around the Q&A, but if you're linking to a particular Q&A questions on trade repository 26 and 27 which talk about 'complex and multi-length contracts' there's still quite a lot of work to do to get consensus on how all the different types of contracts should be reported. A good example that we talk about a lot with our members is where you have FX swaps with a spot and a forward; some firms are reporting those as a single contract; others are reporting separately the spot leg and the forward leg as two separate contracts; others are saying the spot leg is out of scope so effectively we just report a forward. Different players are doing things in different ways and ultimately we need to get consensus and agreement as to how these should be done.

Finally, there's one on the exchange-traded side which again is something I think firms are not really adhering to because they don't have the information at this stage. This is the point ESMA made about wanting the transaction reference number, not the UTI, this is what in the Technical Standards is essentially defined as the firm's unique reference for the transaction, but ESMA is suggesting where you have a transaction chain around an exchange-traded derivative, so you might have CCP out to a clearing member and then another trade between the clearing member and the client, that they should all be linked with a common transaction reference number that will be allocated initially by the vendor or the CCP. As far as I am aware, that simply isn't happening.

So, some of these aren't confusion with the Q&A, but some of them are just Q&As that are out there that nobody is really implementing at this stage.

Anthony: I think if we look on a broader basis, there are still a number of uncertainties out there over sources of valuation for example. So we spoke earlier about the use of CCPs as sources of valuation, but what if there are multiple CCPs with different valuation points? How should you look at those and how should you treat those? And how are you consistent within the valuations that firms use across the board, especially amongst, for example, David your members amongst the IMA, if they're using a certain value within a fund net at an NAV point, how are they being consistent with the valuations that they are reporting and ensuring, again being consistent with a fair valuation approach, which may not necessarily be consistent with a CCP price for whatever reason?

There are still some open questions as to what prices they should use and how they should best check and understand what they are.

***Julia*: My final question for both of you is really looking ahead. I'm curious what the next steps are that firms should be taking to ensure that they continue to enrich their trade reporting processes.**

Anthony, from your perspective at Interactive Data, what steps do you think are most crucial that firms need to focus on?

Anthony: I think the main areas that we're expecting clients to focus on from here on in… one is again coming back to the point we've made a couple of times on this podcast, which is around the delegation of responsibility and how are the firms that are doing the delegation confident that what is being undertaken on their behalf is correct and accurate? That's around understanding and being able to validate and check pricing on instruments and to be able to have that independent view as well as the transparent view. That's where firms would be able to use tools such as Interactive Data's *Vantage* product.

We are also looking at understanding, again coming back to the management of the underlying collateral, how are they understanding and maximising the collateral that's being used for this, and how are they reporting and capturing that as we look at the reporting side of it?

Finally, the last thing we're seeing is again around exposure management and how they are gathering information that comes out from the trade reporting to be able to understand and look at their exposure to certain instruments or institutions, or even sectors or markets, to understand that.

I think those are the main areas that we're seeing at the moment.

***Julia*: Thank you, Anthony.**

David, what about you? What steps should firms take to enrich their trade reporting processes?

David: I would actually start with an industry level, and this is as much for the trade associations such as the IMA to facilitate with our colleagues across the industry, is to work to reach consensus on the way to report different types of trade and trading scenarios. I mentioned that earlier on and I think that's quite important for us to do collectively and it's we Trade Associations that need to take the lead in facilitating those discussions, bringing our respective memberships together on that.

Looking at the level of firms themselves, I think the main thing is to look at the automation and efficiency issue I raised earlier on in terms of how you collate the data and actually be able and willing to respond to developing guidance or consensus on these various areas that are still under discussion because it's almost certain that as consensus develops and guidance gets refined, everybody somewhere is going to find that they're reporting something not in line with where we end up and they need to be willing and able to respond to that and make necessary changes to their systems.

That brings me to the final point which is that firms have actually got a significant challenge: I'm already hearing from individuals and firms that development resources that have been applied to trade reporting, particularly in the run up to 12th February and then again up to 11th / 12th August, we're now starting to see some of those facing redeployment onto other projects, maybe people starting to look more at clearing for example, or indeed just being released all together. There's a concern there, obviously the work is not yet done and yet some of the resources are already being moved elsewhere.

Julia: **I think, David, your comment, "…the work is still not done" sums up the comment and insight shared throughout the podcast today. Although many firms have breathed a huge sigh of relief following the recent August deadline, it is very clear that there is still much work that needs to be done.**

I think it is very important for the firms listening out there to this podcast, including those who delegate, to heed the advice that both David and Anthony shared and as processes and trade reporting will need refining going forward, not just in the areas where there might be some confusion, such as an ESMA Q&A, but also because the derivatives market is evolving now and will continue to do so in the years ahead.

I want to thank my guests, so thank you to David Broadway of the IMA and Anthony Belcher of Interactive Data for sharing their expertise with us today, we really appreciate their comments and them taking the time.

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