

Global securities reporting: Industry trends, challenges and future perspectives

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ABSTRACT

Prior to the financial crisis of 2008, international regulatory policy tended to promote the need for more efficient and stronger securities markets; however, the crisis underlined the need to find a balance between efficiency and safety. It also revealed problems arising from a lack of transparency, which has since led to a recalibration of regulatory objectives. As a result of this shift in policy objectives, reporting requirements have become a key component of much current and forthcoming regulation. This paper looks at the effects that regulatory reforms will have on two key reporting mechanisms: regulatory reporting and intermediated securities reporting. It outlines the challenges that lie ahead and explains how global standards are needed to harmonise requirements and improve the transparency of intermediated holding models across jurisdictions.

Keywords: standards, statements, regulation, reporting, transparency, ISSA

BACKGROUND

Reporting obligations in the financial industry have been in place for many years, but, almost without exception, recent regulation has made such obligations an inseparable part of securities market practice. Regulatory objectives have included risk mitigation and the reduction of information asymmetries between market participants, including regulators. The most recent financial crisis revealed, however, that the information gap was even greater than previously thought. The lack of transparency was not limited to complex sectors such as the over-the-counter (OTC) derivatives market, but also affected the equity and fixed income markets. The international regulatory programme that began following the crisis, driven by the G20 and enhanced at the 2009 Pittsburgh summit, has focused strongly on achieving the goal of greater transparency and the quest for this today is as critical as ever before.

THE CURRENT REGULATORY PROGRAMME

Much new regulation has been promulgated since the Pittsburgh summit and



Jonathan Ehrenfeld

much work continues to be dedicated to improving transparency through the aggregation, distribution and disclosure of data based on various reporting requirements. Dodd-Frank, the European Market Infrastructure Regulation (EMIR), Markets in Financial Instruments Directive (MiFID) I, II and Regulation (MiFIR), Securities Financing Transactions Regulation (SFTR) and Money Market Statistical Reporting (MMSR) all contain reporting obligations. But, what exactly is understood by the term ‘reporting’? How has reporting evolved in the post-crisis era? And, more importantly, what obstacles must be overcome in order to meet the objectives pursued by reporting requirements?

DIFFERENT TYPES OF REPORTING

The increase in market integration and liberalisation that preceded the crisis was defined by a rise in the importance of multi-market trading, highlighting the need for comprehensive, accurate and timely data on all cross-border flows and positions.¹ As a result, considerable analysis has been devoted to understanding the impact of the recent proliferation of regulatory reporting obligations. Less attention has been paid to analysing the effects of the post-crisis regulatory programme on other reporting flows, or to distinguishing between the different forms of reporting that are often carried out by the same institutions. For example, financial institutions — in their role as regulated entities — are required to regularly inform regulators about specific segments of activity. Such reports can be categorised as ‘securities regulatory reporting’, a category that includes trade, pricing and transaction reporting; risk and financial reporting; and client disclosure reports, among others. On the other hand, the same institutions — in their role as intermediaries or account ser-

vicers — also deliver huge volumes of accounting data to their account holders on specific periodic bases. These reports, which take the form of statements, provide transactional and operational information derived from an account’s activity and its holdings. While a generic term for these account reports does not exist, they can be categorised as ‘intermediated securities reports’, a category that includes statements of account holdings, portfolio valuation reports, updated lists of settled and pending transactions, status advices and allevation reports. Interestingly, this information also forms an important basis for the data contained in securities *regulatory* reporting.

INTERMEDIATED SECURITIES REPORTING

In recent years, as cross-border activity has continued to increase, financial markets have become increasingly global, dematerialised and integrated. In order to guarantee high levels of automation and operational efficiency in this environment, securities holding models have evolved substantially. Securities are now held and exchanged through a vast network of intermediaries in multi-tier holding patterns. Each intermediary holds its customers’ assets in one or more accounts maintained with other intermediaries down the chain, ultimately connecting to a central securities depository (CSD).² The number of intermediaries involved in the chain will vary from one jurisdiction to another and even from one transaction to another. In some cases, the CSD will be the only intermediary, while in other cases the number of intermediaries may be limited to a local agent or custodian, or not limited at all. As soon as securities are transferred across national borders, however, the holding chain invariably will involve several intermediaries.³ The differ-

ences between the various holding models for intermediated securities, as specified by national jurisdictions and local market practices, provides for lively debate on the benefits and pitfalls of direct holding versus indirect holding models. Nonetheless, most analysts and authors today agree on two key assumptions: (1) all dematerialised securities are *de facto* intermediated,⁴ and (2) regulatory reform should not necessarily distinguish between different holding models but rather concentrate on how to provide solutions that guarantee the transparency and surety of any account structure. Concrete proposals that address these challenges and are applicable to different account structures and holding models already exist within the industry. The *Financial Crime Compliance Principles for Securities Custody and Settlement*, adopted by the International Securities Services Association (ISSA) in 2015, are perhaps the most complete and compelling example to date.⁵

A sound information exchange framework is all the more important in the wake of the losses experienced by investors during the financial crisis, given the enormous volume of cross-border transactions with intermediated securities carried out today. In addition, the new regulatory regimes drafted in the aftermath of the crisis place much stricter constraints on intermediaries in terms of information flows. They require more frequent reports that compile and aggregate increasingly granular data, and also call for the adoption of global standards to better identify underlying transactions, beneficial ownership and legal entities, among other essential items. Together with new provisions on asset and account segregation, stricter anti-money laundering (AML) and ‘know your customer’ (KYC) requirements have sharpened the focus on the need for transparency in the financial sector.⁶ At the same time, enhanced clear-

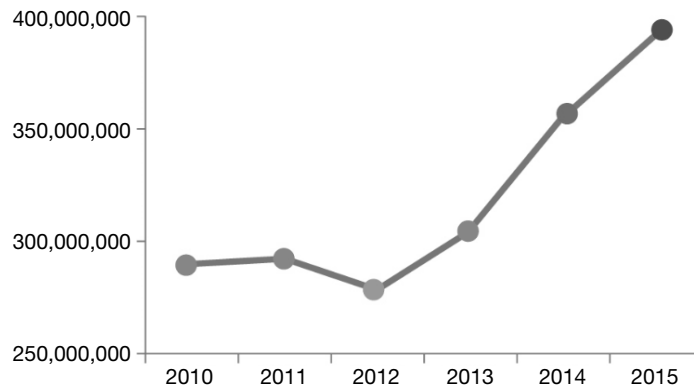
ing and settlement discipline regimes have been implemented to address post-trade inefficiencies.

The consequences of these focus areas are already visible. First, intermediated securities reporting flows, exchanged between each intermediary and its account holders, are growing exponentially (see Figure 1). Requirements for more frequent reporting and additional account segregation could be the catalysts behind this growth. Any change of structure in the holding model or the frequency in communication between an intermediary and its own clients and providers has an important effect on reporting volumes. Secondly, participation in global KYC utilities has become an essential requirement for financial institutions as a means of conducting due diligence and protecting themselves from providing services to customers that are subject to sanctions. This was demonstrated by a 2015 survey conducted by Coventry University via the SWIFT Institute and commissioned by ISSA, which found that 41 per cent of financial institutions complied with KYC/AML policies and 98 per cent indicated that they actively implemented sanctions screening practices.⁷ Finally, current obligations under EMIR, and upcoming rules under the CSD Regulation (CSD-R), are imposing stricter regimes to reduce counterparty and operational risk, and improve settlement efficiency rates, respectively. These regimes include, for example, a complex system of fines for erroneous reporting, as well as cash penalties for institutions that fail to deliver securities on time.

SECURITIES REGULATORY REPORTING

The current regulatory landscape continues to intensify the need for financial institutions to collect and maintain increasingly granular data and report it to

Figure 1 Traffic volumes of portfolio valuation reports and accounting statements sent over the SWIFT network, YTD September 2015



Source: SWIFT

their competent authorities with greater frequency. Following Dodd-Frank and EMIR, the MiFID II requirements and those of its corresponding regulation, MiFIR, have extended the mandate of disclosures included in MiFID I to a broader range of markets, instruments and institutions. To meet the resulting reporting requirements of this vast array of regulations, financial institutions first need to interpret the provisions of each regulation, and later source, manage, store and of course generate and deliver the relevant data to regulators, or delegate specific reporting requirements to approved third-party providers when necessary. Furthermore, with the evolution of the intermediated securities holding models described earlier in this paper, it has become vital for institutions to understand the relevant legal frameworks affecting different markets in the jurisdictions in which they are active; however, even this piecemeal approach is not enough. As stated in the key principles for standardising, aggregating and sharing data published by the International Swaps and Derivatives Association (ISDA) in February 2015,⁸ policymakers should promote the adoption of global standards

to improve the quality and consistency of reporting requirements. Without them, the industry faces costly, duplicative and potentially conflicting reporting rules. If, as suggested by recent studies, 80 per cent of data requirements are common across multiple regulations⁹ and there are clear interdependencies between them (a single transaction can be subject to reporting obligations under EMIR, MiFID II/MiFIR, SFTR and even Dodd-Frank), then financial institutions cannot manage reporting requirements in isolation.¹⁰ On a positive note, the trend appears to be shifting towards more harmonisation, particularly in the European Union (EU) with the adoption of legal entity identifiers (LEIs) under EMIR for derivatives reporting and for a broader scope of financial products under MiFID II/MiFIR. EU authorities also have established a set of principles to minimise duplication in those cases where a single transaction falls within the scope of different regulations. Further context on these overlaps and the challenges they represent was provided by Julien Jardelot and Martin Mitov (2015) in the *Journal of Securities Operations & Custody*, Vol. 7, No. 4.¹¹

STANDARDISATION OF REPORTING REQUIREMENTS GOING FORWARD

The adoption of standard LEIs and the recognition of overlapping requirements by EU authorities are major steps towards more consistent reporting practices; however, the most significant milestone in the harmonisation roadmap is the adoption of ISO 20022 as a methodology for standardising the reporting of market and transactional data to competent authorities, as outlined in MiFID II/MiFIR. Under these requirements, reports must be submitted in the ISO 20022 format one working day after the transaction. This reporting must be undertaken by the regulated financial institution itself, by the approved reporting mechanism (ARM) acting on its behalf, or by the trading venue in whose system the transaction was concluded. A similar concept of responsibility is found in EMIR where trade repositories take the place of ARMs. It is clear that a number of underlying instruments and transactions to be reported are excluded from the MiFID II/MiFIR requirements. MiFID II/MiFIR-related reporting obligations cover virtually all instruments except those explicitly covered by other EU reporting regimes (ie EMIR for derivatives contracts) or instruments that will be covered by other regimes in the future (ie SFTR for securities financing transactions).

The introduction of distinct reporting obligations, which often require similar data, underscores the need to agree on a set of business elements derived from a central data repository that can be reused to comply with different regulatory requirements across multiple markets. This would guarantee the consistency in terms of format and content for data reported under various regulatory requirements and jurisdictions.¹² If implemented across regulations, the use of a common methodology and a central data dictionary would

enable financial institutions to significantly reduce cost and mitigate risk associated with securities regulatory reporting. Time and effort spent on reconciliation and maintaining dual reporting data repositories then could be allocated to conducting intelligence analytics and data quality reviews. The amount of time currently spent on data collection and reconciliation was highlighted in a 2015 Federal Reserve regulatory reporting survey, which found that financial institutions in the USA spend 50 per cent of their time preparing their regulatory reports versus performing analysis or reviews.¹³ This figure is quite striking as the Federal Reserve encourages institutions to spend 80 per cent of their time on analytical reporting, knowing that upcoming reforms might include reporting programmes more focused on data aggregation and analytics and less on the creation of reports based on raw transactional data.

CONCLUSIONS

Considerable progress has been made in the quest for greater market transparency through data collection, analysis and reporting; however, as outlined in this paper, a number of important challenges continue to impede the progress expected by both the market and regulators. Reporting obligations differ across regulatory regimes, and financial institutions are obliged to comply while at the same time continuing to provide value to their customers. The effects of this situation are multiplied by the fact that most assets are intermediated and transferred across jurisdictions with different legal requirements that are often incompatible and lack opportunities for interoperability. Going forward, the key to successful regulatory reforms will involve finding the right balance between improving market transparency while not affecting operational

efficiency or hampering innovation. A closer examination of the potential benefits of combining and synthesising securities regulatory reporting data and intermediated securities reporting data is also warranted. At the same time, it seems clear that the adoption of global standards, aligned with harmonised market practices (such as those concerning financial crime compliance solutions applicable to different holding models or those advanced by EU authorities to address the overlaps between reporting requirements) and common methodologies, is the most reliable way to achieve more efficient and transparent securities markets. The evolving regulatory landscape will continue to impose the need for financial institutions to collect, analyse and report on increasingly granular and specific data sets with greater frequency, governance and oversight. In this context, the usage of standards will continue to yield substantial economic and operational benefits.

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