Securities and Fund Services

Citi OpenInvestor℠

EMIR: Making Your OTC Data Work

The European derivatives industry has rallied remarkably of late, rising above the confusion and delay surrounding ESMA's new, looming trade repository reporting regulations. At the same time, it is a significant challenge to put in place the right solutions to comply with the new data reporting regulations. Some industry participants are meeting this confidently with in-house resources while others look to outsourced solutions.

The era of central clearing has truly arrived. The US is leading the way while Europe is aiming to roll out its new rules from 2013 onwards. But there are still several loose ends to be tied, especially when it comes to trade reporting for the region's USD633 trillion OTC market.

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The date that derivatives trade repository reporting was expected to begin in the summer 2013, but is now going live in February 2014. The remit of the requirements has also been extended to include listed derivatives. "One of the biggest challenges is the scope of the regulation and determining what has changed," says Martin Jufer, Chief Operating Officer at Swiss & Global Asset Management. "Some of the regulation in Europe is still a moving target and that makes implementation difficult. This is particularly true with the reporting requirements."

Cleaning the lens

John Read, Head of Alternative Investments Middle Office & OTC Services EMEA for Citi Securities and Fund Services adds, "With a February 2014 go-live date firmly in mind, and the fact that ESMA's trade repository reporting requirements are more extensive than the Dodd-Frank, the industry has a firm deadline to work towards. This has allowed firms to clarify their project spend and resource in order to comply. Advanced entities will be ready from January 2014."

In Europe, trade repository compliance is mandatory, but the regions diverge over the specific content and participants. For example, Dodd-Frank only mandates reporting on OTC, FX and listed derivatives while EMIR is seen as taking a harder line as it applies to both OTC and listed derivatives.

This means each trade repository report will include vast amounts of data that encompass credit, rates, commodities, FX and structured transaction types. For an active derivatives user this could mean sourcing data from numerous systems to report the data required.

In Europe there is more complexity as ESMA requires information on the individual life cycle events of each trade to be submitted to the repository daily. By contrast, the US relies to an extent on 'snap shots' of dealer positions at the end of each day being uploaded to the trade repository. The Exchange Traded Derivative component is also expected to add another layer of complexity even though there is a precedent for listed derivatives on exchanges such as NYSE Euronext's London-based Liffe and Deutsche Börse-owned Eurex.

"Having to report for both OTC and listed derivatives will mean having to maintain two separate processes that will need to be combined into one comprehensive report," says Edouard Auche, Chief Operating Officer at Lyxor Asset Management. "You will need to clarify 85 fields of data, which is why there needs to be more clarity on the trade repositories. We need to be able to connect with them."

There are issues faced by those seeking to register as repositories. To date, around seven trade repositories (TRs) have applied for authorisation including CME Group, the Depository Trust & Clearing Corporation, ICE, the Independent Trade Repository and, Regis-TR, a joint venture between Spanish stock exchange group Bolsas y Mercados Españoles and Deutsche Börse-owned international central securities depository Clearstream., and Unavista - which is part of the London Stock Exchange, and Poland's central securities depository, KDPW.

Even when they are approved it will take time to get the ball rolling. This is because EMIR frameworks dictate that 90 calendar days, plus five working days, need to pass after a repository has received the green light before it can start accepting transaction reports.

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Is outsourcing appropriate?

Perhaps it's no wonder that, against this background, institutions, many of whom are building or outsourcing this type of market infrastructure for the first time, are having difficulty devising a game plan. "You need quite some time to prepare, as demonstrated just by the length of time – close to six months – to choose your clearing brokers," says Auche.

"The other decision firms have to make is whether it is more cost-effective to outsource the reporting or to manage it internally. At Lyxor, we actually do both in that we decided a few years ago to outsource part of the middle office on our managed accounts platform but we also conduct in-house the functions for other funds."

But outsourcing is not a new movement. Many see the decision to hand over the custody and safekeeping of assets as the start of outsourcing. Now, this is an every occurrence, and asset managers mandate party providers to handle their transfer agency, fund accounting and increasingly performance and risk reporting solutions. The benefits of moving to a variable cost base from a fixed one and hiving off back- and middle-office functions to focus more intently on core competencies are expected to gain traction in the wake of Dodd-Frank and EMIR. However, many still believe you need to retain a core skill set in house.

Outsourcing collateral management to a custodian is about benefiting from the scale that that provider can bring and securing fit-for-purpose data that does not need further management.

Data management is the future

"The new regulations are making those trading derivatives re-evaluate their strategies and look at different options to pursue business opportunities," says Read. "Ultimately, it is a buy or build argument. For now, we are seeing people buy more than build. There is a decent derivative provider community, but not everyone has invested in data management."

Auche notes: "The first step is to look at the data infrastructure, evaluate the level of enrichment required and decide whether it will be performed at the source system or within a global data warehouse. To perform the trade reporting, you must first collect, clean and validate the whole set of data. It means that eventually, internal teams remain responsible for 80% of the reporting workload whatever the solution implemented (insourced or outsourced)."

Buy-side firms are grappling with the same issues on the collateral management front due to the more stringent margin requirements. A report in May 2013, *Maximising Collateral Advantage: A Survey of Buy Side Business and Operational Strategies* by Celent finds that it will cost the financial industry over USD53 billion in infrastructure and technology investments to upgrade and source new capabilities to achieve collateral and operational efficiency.

The report shows the same patterns for trade reporting, where participants who do not have internal resources are moving from in-house developed solutions towards third-party platforms or even outsourced solutions. The decisions hinge on the size of the derivatives book and the requirement to manage margin calls. For example, smaller firms with a limited scale, in terms of trading derivatives, will probably opt for the outsourcing solution, while more active firms may decide to bite the bullet and invest in the necessary systems and processes.

"It's a strategic decision about the value-add of the service" says Jufer. "If it doesn't add value, then we will not do it in house, which is why, as a management company, we decided to outsource our collateral management to a custodian. It is about benefiting from the scale that a provider can bring and securing fit-for-purpose data that does not need further management."

Getting the right teams in place in both entities, with the right solution, is crucial. Data quality and industry connectivity are the new panacea. Whether this is accomplished with in-house or external resources, managers need a team working on this that is capable of uniting the complex business goals, regulation and data management issues.

What qualities should your provider bring to the table?

Relevancy
With comprehensive solutions and a flexible approach, your partner can integrate with your systems as you require and provide you with the data you need when you need it.

Experience
With a deep understanding of the services you require, together with the capabilities to support those services, your partner will draw on a proven track record in servicing a broad range of structures and asset classes with a strong focus on OTC derivatives.

Network
A global technology platform, supported by subject matter experts and operations teams, ensures that your partner can support you wherever you are or choose to do business.

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