

On the left side of the page, there are two overlapping geometric shapes: a light green triangle pointing right and a light blue triangle pointing left, mirroring the colors in the FIA logo.

# Reporting Exchange Traded Derivatives under EMIR

Surveying the impact, challenges and recommending a path forward for ETD reporting in 2019



June 2019

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*FIA's mission is to:*

- *support open, transparent and competitive markets,*
- *protect and enhance the integrity of the financial system, and*
- *promote high standards of professional conduct.*

*As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.*

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## INTRODUCTION

This paper has been prepared to assist ongoing discussions about the efficiency of regulatory reporting in the EU and the possible streamlining of reporting obligations in the derivative markets. The paper briefly summarises the material issues and potential solutions, with a view to generating further debate and discussion with, and within, the legislative and regulatory communities.

Post-crisis financial reforms promoted transparent, safe and robust global markets. Regulatory reporting underpins these regulatory initiatives across global financial markets. In September 2009, G20 leaders met in Pittsburgh to discuss ways to safeguard against a repeat of the financial crisis, culminating in a statement calling for the risks of over the counter (OTC) derivative contracts to be mitigated. Unfortunately, materially different approaches have been taken across the globe with respect to risk mitigating initiatives, resulting in a complex, overlapping and conflicting regulatory framework.

This paper aims to highlight issues with the current reporting framework for exchange traded derivatives (ETDs) and suggests alternative solutions which will assist regulators to analyse the systemic risk of the ETD market, improve data quality and reduce existing inconsistencies which have plagued European Market Infrastructure Regulation (EMIR)<sup>1</sup> reporting obligations.

Following the Pittsburgh summit in 2009, policymakers in North America and Asia-Pacific set about establishing reporting requirements in line with the G20 commitments. EMIR was the European regulatory response. EMIR remains unique among its global regulatory counterparts in requiring both counterparties to the trade to report the contract to a trade repository - a **“dual sided”** reporting obligation. Furthermore, whilst the G20 statement focused entirely on risks associated with OTC markets, European regulators were unique in including ETDs within the scope of EMIR reporting requirements.

As such, in February 2014, EMIR Article 9 required European market participants to report various data components relating to both OTC and ETD derivative contracts. In line with the G20 commitments, EMIR reporting was designed to provide transparency into systemic risk within the OTC derivative markets. However, the application of a single reporting framework applying to both OTC and ETD contracts, which are fundamentally different products, has resulted in regulatory ambiguity and challenges to report complete and accurate data.

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1 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ('EMIR'); *OJ L 201, 27.7.2012 (as amended)* - references to EMIR should be read as reference to the same piece of legislation as they apply in the UK post-Brexit.

Reporting of OTC contracts ensures that regulators have oversight of the OTC derivative markets and can analyse market activity to identify a build-up of systemic risk before a major market event crystallises. Before the 2008 financial crisis, there was no transparency of the OTC markets as these contracts were not trading on exchanges nor cleared or reported to regulators. In contrast, however, prior to the financial crisis, the ETD markets were fundamentally more transparent than their OTC counterparts as they were traded, cleared and regularly reported to regulators.

Additionally, there are differences between the trading, clearing, processes and risks associated with OTC derivatives and ETD contracts. ETDs are centrally cleared, highly standardised instruments that offer little of the bespoke functionality seen in OTC contracts. However, the EMIR reporting technical standards cover both OTC and ETD transactions, with one set of prescribed attributes covering both derivative types. Whilst these attributes have been refined over time, this approach by regulators has led to significant ambiguity for the reporting of ETD contracts, which itself has contributed to large numbers of reconciliation breaks between successfully submitted ETD reports. In addition, the requirement to report transactions has placed an excessive burden on market participants given that, **for ETDs, systemic risk is only detectable at a netted end-of-day position level.**

FIA recommends modifying the legislative text in order to grant EU regulators the authority to allow reporting firms to satisfy the EMIR reporting requirements by **submitting ETD position reports and removing the obligation to report transaction-level details.** This would significantly reduce the number of reports submitted by entities trading in ETD contracts without impacting the regulator's ability to conduct analysis of systemic risk in ETD markets. Furthermore, this would reduce the operational burden faced by reporting firms, whilst enabling firms to enhance remediation capabilities on key data issues.

### PART I – ETD transaction reporting

ETD transactions are executed on trading venues, with the venue-matching orders registered by buyers and sellers of instruments. When matched, these orders are registered on a central limit order book and immediately and automatically cleared at a central counterparty (CCP) which intermediates between the buyer and seller of the trade. ETD transactions - which can either be long (buy) or short (sell) across the course of the day - are then “netted” at the end of each day, establishing end of day positions. These positions are held by clearing members who will maintain positions on behalf of both clients and their own account.

ETDs can be executed and cleared by completely different parties. Under EMIR, if an entity is only involved in the execution of a trade and holds no end-of-day

risk, that entity has no reporting obligation under Article 9 of EMIR. This is implicit recognition that **the key metric in assessing systemic risk for ETDs is the end-of-day position, rather than executed intra-day transactions.** Where positions are held on behalf of clients at the CCP, the clearing member will see two separate positions in its books and records; one “street-side” position against the CCP, and one equal and opposite “client-side” position against the ultimate beneficial owner of that position<sup>2</sup>. Margin requirements and other obligations are calculated based on the end-of-day positions, and lifecycle events - even simple increases or decreases to the quantity - will occur at a position level. The end-of-day position, rather than the transaction, is the true reflection of the systemic risk posed by a default of a clearing member.

The CCP remains the source for “street-side” transactions and positions, regardless of what appears in a clearing member’s books and records. As such, requiring that clearing members report the street-side leg is duplicative. While “client side” information is not held in the CCP’s books and records, it is not clear that this client data enhances regulatory oversight of *systemic risk* in ETD markets. It is clear, however, that **transaction-level reporting of ETDs under EMIR does not aid regulators in assessing systemic risk** yet results in the overwhelming majority all reports submitted under the regime. This inevitably results in most remediation efforts being spent on data enhancements which do not serve the key purpose of uncovering systemic risk.

FIA’s recommendation is that, at a minimum, ETD transaction-level reporting is removed. Adopting a position-level, as opposed to a transaction, reporting regime will more accurately reflect the nature of ETDs, which are standardised contracts that are “compressed” into a net position at the end of each day. A position-level reporting regime would also provide a more accurate representation of ETD lifecycle events and margin/collateral changes given that these take place at position level and cannot be reported at transaction level.

<sup>2</sup> This paper does not consider the EMIR reporting requirements as they apply to indirect clearing arrangements, as defined in EMIR Article 4 and MiFIR Article 30.

## PART II – EMIR and other regulatory regimes

As noted in this paper, EMIR reporting was designed to provide transparency into systemic risk within the derivative markets. Additional European reporting regimes have been implemented to serve different purposes. For example, MiFID II/MiFIR<sup>3</sup> reporting, alongside REMIT<sup>4</sup>, are designed to detect market abuse and price manipulation. For MiFID II/MiFIR, the transaction data is key to allow regulators to conduct oversight, as it provides execution-level information that is vital in assessing whether the market has been manipulated. Reports submitted in-line with obligations set out in MiFID II/MiFIR allow regulators to know exactly when, where and who executed the trade. In contrast to this, however, EMIR reports are submitted after the transaction has already been cleared and allocated to clients.

Whilst an ETD transaction entered into on a European trading venue is reportable under both EMIR and MiFID II, the parties obliged to report this transaction differ under each regime. Under MiFID II, the entity that executed the transaction must report, whereas under EMIR the entity that holds end-of-day risk (the clearing member in almost all cases) must report.

Whilst we would argue that ETD transaction data is not required for regulators to perform analysis of systemic risk, any data which the regulator deems is relevant may be extracted from reports submitted under MiFID II, rather than duplicating across EMIR, thus intensifying the operational burden faced by reporting firms. Submitting a similar data set for the purpose of complying with multiple reporting obligations is inefficient and impacts the effectiveness of regulation within the derivative market.

FIA's recommendation is that EMIR transaction-level reports be discontinued. This discontinuation can occur without loss of regulatory oversight for systemic risk purposes because it is the end-of-day position that is the most relevant and not the individual transactions. In the event that ETD transaction level data is required by regulators, this should be sourced from MiFIR transaction level data.

Furthermore, FIA welcomes the European Commission's Fitness Check of supervisory reporting requirements, which sets out to review whether reporting

<sup>3</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("MiFID II"); OJ L 173, 12.6.2014.

<sup>4</sup> Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency ("REMIT"); OJ L 326, 8.12.2011.

requirements are meeting their objectives, if the different reporting frameworks are consistent with one another and if the cost and burden of reporting is reasonable and proportionate.

### PART III – Previous advocacy and reconciliation

FIA previously advocated for the reporting of ETDs under EMIR to be performed at position-level rather than transaction-level<sup>5</sup>. This issue is further problematic, however, given that in addition to requiring market participants to report ETD contracts at transaction-level, regulators also impose reconciliation requirements on reporting counterparties and trade repositories for ETD transactions. This reconciliation process has proved onerous for market participants, whose focus for the purposes of clearing operations and assessing risk is based primarily on net exposure by position and client.

Furthermore, as referenced in this paper, given that EMIR was originally designed with OTC derivatives in mind, there is significant regulatory ambiguity around some reporting attributes that are clearly designed for OTC contracts. For example, most market participants engaged in ETD trading and clearing populate the “maturity date” attribute with the last trading date of the contract, whereas several CCPs populate this with the settlement date of the contract. This ambiguity continues to exist more than five years after EMIR reporting came into effect.

The huge volumes of reports resulting from transaction-level reporting and the requirement for pairing and matching transaction reports, as well as the optionality of position-level reporting, means that most industry effort focuses on the reporting of transactions. If this industry effort were directed solely at position-level reporting, this would enhance the quality of reported data and ensure the most consistent representation of listed derivative exposure and systemic risk across the industry.

The proposal under ESMA Q&A on EMIR TR Question & Answer 17<sup>6</sup> to introduce **position-level pairing and matching** will further exacerbate the issues market participants currently face in ETD reporting as outlined in this paper. With the introduction of position-level pairing and matching, obligations on firms reporting and reconciling ETD contracts at transaction and position level would exceed the required reporting for OTC contracts. It is worth reiterating here that OTC

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5 [FIA's response to EC's Fitness Check on Supervisory Reporting](#)

6 [https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52\\_qa\\_on\\_emir\\_implementation.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf)

contracts were the original catalyst and primary focus of the G20 commitments and EMIR Article 9 reporting. In addition, when considering how this would work in practice, Trade IDs will be generated by CCPs, which in turn determines the shape of the position that must be reported by clearing members in order to “pair and match.” In practical terms, this means that clearing members must replicate the exact positions held by CCPs in order to prevent many reconciliation breaks. **This replication renders the street-side reporting of positions by clearing members redundant, as it is a restatement of a position that has already been reported,** rather than a genuine snapshot of the clearing member’s books and records.

FIA’s recommendation is that position-level pairing and matching is only required if the transaction-level reporting, and thus reconciliation of transaction-level reports, is removed.

### PART IV – Back-reporting

The correction of inaccurate submissions and remediation of under-reported transactions and/or positions, forms part of the remediation process for reporting firms. Changes to the validations applied to these submissions, together with uncertainty caused by Brexit, has led to significant issues.

Changing levels of validation on ETD reporting, culminating in the latest “RTS” tranche of changes in October 2017<sup>7</sup>, and those supporting MiFID II reference data in January 2018<sup>8</sup>, have meant that new submissions must adhere to different standards to those reports submitted previously. The volume and type of fields subject to trade repository reconciliation have subsequently evolved, such that, for trades subject to reconciliation, re-submission of pre-RTS trades will result in new breaks even if existing breaks are resolved, unless both counterparties resubmit. Counterparties that are not required to remediate their submissions are not incentivized to do so, thus creating intractable reconciliation issues.

It is FIA’s understanding that the primary tool of regulators to conduct surveillance are the Trade State Reports (or equivalent) produced by trade repositories. Trade State Reports provide a snapshot of the end of day position, and thus, the systemic risk profile, for reporting counterparties. Back-reported transactions do not appear in this file and cannot be used for assessing systemic risk in any event.

7 <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/C-2016-6801-F1-EN-MAIN.PDF>

8 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0065>



In addition to the above, given the proposed split of reporting requirements between the Financial Conduct Authority (FCA) and ESMA post-Brexit, it is unclear to whom reporting corrections should be sent. ESMA have indicated<sup>9</sup> they would like to avoid historic data residing in their reporting database, and although the trades were originally reported to ESMA under EMIR, reporting to this database would prevent the FCA from viewing any corrections.

For the reasons set out above, FIA's proposal is that transactions and positions entered into prior to January 2018 should not be subject to back-reporting requirements.

### CONCLUSION

FIA fully supports the G20 commitments and commend the efforts of regulatory authorities to implement regulatory change in order to embrace transparent, safe and robust global derivatives markets. Furthermore, FIA agrees that reporting requirements established under EMIR and other reporting regimes have contributed to improving financial stability. Prior to the implementation of EMIR, National Competent Authorities (NCAs) did not have adequate oversight from a systemic risk perspective of OTC derivatives. The introduction of a reporting requirement under EMIR has therefore improved the transparency of OTC derivatives. However, **this has largely led to the EMIR reporting regime being primarily designed with OTC derivatives in mind and not necessarily being fit for purpose for the reporting of ETDs.**

Different approaches should be adopted for the reporting of OTC derivatives and ETDs due to the fundamental differences in nature of the products, as well as the way in which lifecycle events take place. EMIR transaction level reports, and subsequent reconciliation conducted at transaction-level, can be discontinued for ETDs without loss of regulatory oversight, as for systemic risk purposes it is the position that is the most relevant and not the individual transactions.

FIA encourages policymakers to acknowledge the recommendations set out within this paper and support the modifications of the EMIR Reporting regime for ETDs, which remains under review, as envisaged in the recently published text of EMIR Refit<sup>10</sup>. FIA stand ready to assist policy makers and legislators as required.

<sup>9</sup> [https://www.esma.europa.eu/sites/default/files/library/esma70-151-1997\\_statement\\_brexit\\_emir\\_data.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-1997_statement_brexit_emir_data.pdf)

<sup>10</sup> Regulation (EU) No 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories (*EMIR Refit*); OJ L 141/42, 28.5.2019.



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