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REGULATION

Regulatory reporting
– the road ahead

TEJ PATEL | MEHAK NAGPAL

CRISIS MANAGEMENT

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DEAR READER,

Recent events in the U.S. banking sector, and broader concerns around instability and contagion within the global financial services industry, have meant that crisis management is once more front of mind for many institutions.

In addition, the world of business and finance is facing broader geopolitical and socioeconomic challenges, ranging from conflict, climate change, inflationary pressures, and precarious energy resources. Factor in heightened regulatory and competitive pressures, and it becomes clear that financial institutions must prioritize risk management, within their own organizations and with their counterparties.

The papers in this edition of the Journal address the theme of crisis management through various lenses, including regulatory compliance and traditional risk management, as well ESG, the low carbon economy, and sustainable finance. Our authors also explore topics such as the impact of social change on the world of finance, the rise of artificial intelligence and virtual reality technologies, and cybersecurity.

Contributions in this edition come from a range of world-class experts across industry and academia, and showcase some of the very best expertise, independent thinking, and strategic insights within the financial services sector.

As ever, I hope that you find the latest edition of the Capco Journal to be engaging and informative. Thank you to all our contributors, and thank you for reading.

Lance Levy, **Capco CEO**

REGULATORY REPORTING – THE ROAD AHEAD

TEJ PATEL | Partner, Capco
MEHAK NAGPAL | Principal Consultant, Capco

ABSTRACT

The financial services industry continues to face a challenging regulatory environment, most notably within trade and transaction reporting requirements. In fact, given recent market developments, including the acquisition of a troubled European bank and failure of a U.S. commercial bank, firms may witness another wave of changes to further strengthen the resiliency of the global banking infrastructure and monitor potential market abuse. There are a number of key drivers behind regulatory reporting change programs, such as new and updated reporting rules, findings and fines from supervisory authorities, and internal initiatives to address operational inefficiencies. Given the increased focus on cost reduction and tight change budgets in the current environment, market participants should seek to adopt a strategic approach to regulatory reporting transformation with the aim of strengthening compliance while simultaneously reducing long-term costs. This includes adopting a hybrid operating model, establishing a mature data strategy, reducing manual processes by increasing automation, and leveraging third-party regtech products to deliver reporting solutions.

1. INTRODUCTION

Given the current macroeconomic environment, financial services firms are under considerable pressure to lower costs and manage spend, while continuing to address an ever-increasing list of regulatory requirements. As a result, a number of discretionary programs are being paused or delayed in order to free up already stretched budgets to deliver on mandatory change initiatives. While regulatory transformation programs typically dominate a lion's share of the overall budget, their non-discretionary nature continues to position them as a key item on firms' change agenda.

This paper focuses on trade and transaction reporting requirements, exploring key drivers for regulatory change across global regulatory regimes. It also outlines pragmatic recommendations on how firms can best prepare to achieve a favorable return on their regulatory investments while maintaining global compliance, but ultimately driving down long-term costs.

2. KEY DRIVERS FOR REGULATORY CHANGE

Across the financial services industry, different firms are at varying levels of maturity on their strategic regulatory reporting journey. As such, there is a huge variety of regulatory change programs underway across market participants with differences in associated costs, resourcing strategies, and overall complexity. Drilling down further into the key objectives of these programs, however, it is possible to identify three common themes that drive the bulk of regulatory change for most firms.

2.1 New and updated regulatory regimes

From a regulatory compliance standpoint, a number of global reporting regimes are going to see significant updates over the next 12 to 24 months. This includes additional changes to reporting requirements for the U.S. Commodity Futures Trading Commission (CFTC) and the Canadian Securities Administrators (CSA), which include the introduction of a "unique product identifier" (UPI) as well as revised reconciliation requirements for impacted firms. In the E.U.

and U.K., European Market Infrastructure Regulation (EMIR) Refit remains a key priority area for impacted firms. This is in addition to the U.K. wholesale markets reforms package, which continues to evolve as an attempt to differentiate the U.K. from the E.U. post-Brexit. In the APAC region, various regulators, including the Monetary Authority of Singapore (MAS), Australian Securities and Investments Commission (ASIC), Hong Kong Monetary Authority (HKMA), and Japan Financial Services Agency (JFSA), are introducing revised reporting requirements to promote global standardization and harmonization.

2.1.1 CFTC AND CSA REPORTING

The Commodity Futures Trading Commission (CFTC) has updated its reporting requirements with an aim to standardize reported trade data:

Phase 1:

- Go-live December 5, 2022.
- Updated requirements adopt 71 percent of the critical data elements (CDE) outlined by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (CPMI-IOSCO).
- Revised rules also introduce requirements to report collateral valuation and adopt "unique transaction identifiers" (UTIs).
- Other important changes include new and updated validation rules as well as revised reconciliation requirements.
- A particularly notable update is a new requirement for reporting parties to correct any errors or omissions in their reports within seven business days, in the absence of which they will need to notify the CFTC's Division of Market Oversight and include a remediation plan.

Phase 2:

- Planned go-live January 2024.
- Additional requirements to adopt a "unique product identifier" (UPI) to classify derivatives at a level higher than International Securities Identification Numbering (ISIN) but lower than Classification of Financial Instrument (CFI) code.
- Once live, trade data reports across jurisdictions are expected to all link to a single reference data library for product data, simplifying supervisors' efforts in accurately monitoring derivative trades.
- The Derivatives Service Bureau (DSB), which already maintains the ISIN library for over-the-counter (OTC) derivatives instruments, is also responsible for the development and implementation of the UPI reference data system.

Following updated U.S. CFTC requirements, the Canadian CSA is also expected to align its reporting requirements to a large extent with an aim to ensure harmonization of CDE, UTI, and UPI rules.

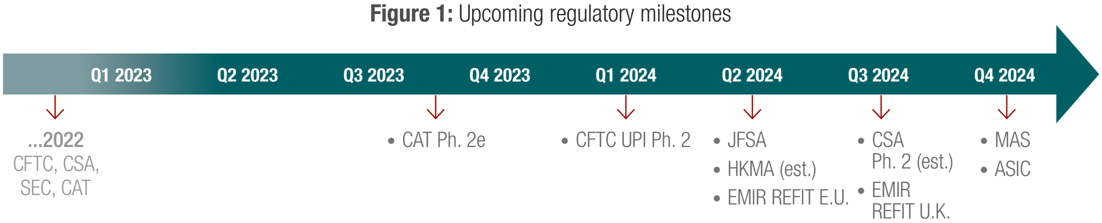
2.1.2 EMIR REFIT

The European Market Infrastructure Regulation (EMIR) introduced clearing and bilateral risk-management requirements for OTC derivatives, reporting requirements for OTC and exchange-traded derivatives, as well as uniform requirements for central counterparties (CCPs) and trade repositories. It also established definitive clearing thresholds for non-financial counterparties (NFCs).

Recent updates to this regulation, commonly referred to as EMIR Refit, cover a number of changes to these requirements:

- Updated requirements to determine when non-financial counterparties (NFCs) and financial counterparties (FCs) are subject to the clearing obligation.
- Expanded scope of FCs to include more entities that are deemed to potentially pose a significant risk to the financial system, e.g., alternative investment fund managers (AIFMs).
- Creation of a new category of "small financial counterparties" (SFCs) that are exempt from the clearing obligations but remain subject to risk mitigation obligations, including margin requirements.
- Updated reporting schemas in line with global standards, including adoption of ISO 20022 methodology, expansion of reportable data elements increasing from 129 in EMIR to over 200 under EMIR Refit, introduction of additional

Figure 1: Upcoming regulatory milestones



event types resulting in a total of 33 reportable action/ event types, and adoption of a harmonized approach to CDE, UPI, and UTI.

- Backloading obligation for all live contracts entered into within a period of six months prior to go-live date.

2.1.3 U.K. REGULATORY REGIME

Leaving the European Union (E.U.) has presented the U.K. with the opportunity to adapt the overall wholesale markets regulatory regime, and MiFID II (Markets in Financial Instruments Directive and Regulation) in particular, to ensure that U.K. markets remain fair, transparent, and competitive for global investors. As such, a number of initiatives are underway to help shape the future regulatory framework, such as the Financial Services and Markets (FSM) Bill and the "Edinburgh Reforms" announced by the Chancellor of the Exchequer in December 2022. Collectively, these measures aim to drive growth and competitiveness in the financial services sector by seeking to repeal and reform retained E.U. law, including the highly complex MiFID II regulation.

MiFID II

- Acute awareness of the complexity and administrative burdens of some regulatory provisions
- Apparent that not every requirement has had the desired consequences of improving transparency or enhancing investor protection
- Share trading obligation (STO) and double volume cap (DVC) already removed
- Proposals underway to simplify the transparency and Systematic Internaliser (SI) regime.

Accelerated settlement

- Consultation underway to explore accelerated post-trade settlement
- Potential transition from T+2 to T+1 settlement
- Initial report expected by end of 2023.

Consolidated tape

- Proposals to outline regulatory regime for U.K. consolidated tape (CTP)
- Expect increased emphasis on reporting data quality, including trades, transactions, and instrument reference data.

While these updates clearly mark the beginning of the U.K.'s divergence from the E.U. regulatory regime, they will certainly not be the only changes to come out of the U.K.'s Wholesale Markets Reform package. Being outside the E.U. legislative framework will allow the U.K. to move faster with some of these reforms, but they are expected to continue close monitoring of the E.U.'s approach to ensure they remain suitably aligned where necessary while still maintaining differentiation and ensuring U.K. markets remain open and attractive to global firms and investors. Additionally, measures such as the U.K. CTP, removal of STO and DVC, and proposed T+1 settlement increasingly indicate further alignment with the U.S. regulatory framework as opposed to the E.U.

2.1.4 ASIA PACIFIC

Regulators are undertaking significant updates to current transaction reporting regimes in APAC, with rewrites expected in Australia, Hong Kong, Japan, and Singapore. Though each of these regimes will have specific obligations that will need to be considered on a case-by-case basis, there are some clear common themes across all of these:

- Globally harmonized approach to reportable data and event types, including updated CDE
- Adoption of UPI and UTI
- Incorporation of ISO 20022 XML reporting standards
- Australian Securities and Investments Commission (ASIC) reporting deadline updated to T+2, but revised rules remove delegated reporting safe harbor
- Japan Financial Services Agency (JFSA) to approve reporting to independent trade repositories rather than directly to the FSA.

2.2 Regulatory findings and remediation

Global supervisors are increasingly focused on completeness, accuracy, and timeliness of transaction reporting. In its recent MarketWatch, the U.K. Financial Conduct Authority (FCA) observed that a number of firms are still not conducting sufficient data quality checks or end-to-end reconciliations. They have again reiterated the importance of transaction reports in enabling them to provide effective market oversight, combat market abuse, and support conduct supervision.

There is also a clear upward trend to global regulatory sanctions and fines issued over the past few years. This is not limited to the total amount of fines levied but also the number of supervisors and NCAs (national competent authorities) who have been issuing these fines.

In addition to supervisory findings, firms are also dealing with a considerable remediation backlog. These represent open reporting issues that need to be addressed at the root cause level with impacted transactions potentially needing to be re-reported to the relevant authorities.

2.3 Operational inefficiencies

Given the sheer volume of reporting requirements that firms have had to implement over the past five to ten years, it comes as no surprise that the majority of firms are now facing considerable technical debt and operational inefficiencies in their reporting and controls infrastructure. This not only drives up compliance costs, it also makes further change implementation incredibly complex, expensive, and cumbersome. Moreover, there is significant scarcity of regulatory skillsets and expertise globally. With ever-increasing demand and a highly-competitive market for regulatory reporting experts, talent sourcing and retention is a key challenge across the industry.

As a result, a number of firms are opting to leverage the overall alignment of global regulatory reporting requirements as an opportunity to also significantly streamline their existing reporting architecture and associated operating model. This includes reconsidering resourcing and location strategies to ensure appropriate staffing is in place to fully support regulatory reporting and monitoring across all entities, businesses, and reporting jurisdictions. Measures such as these will significantly enhance governance and reduce regulatory risk, ultimately driving down the overall cost of achieving and maintaining compliance on an ongoing basis.

3. STRATEGIC RESPONSE TO REGULATORY CHANGE

Impacted firms will need to adopt a strategic approach to navigate the extensive and complex regulatory landscape they are currently facing if they are to streamline and, ultimately, reduce the volume of change they are facing over the longer term. This should include significant uplift of existing operating models to move towards a centralized, federated, or hybrid framework. In addition, deployment of a mature data strategy, establishing a robust control framework, increased automation, and adopting cutting-edge regtech tooling will all go a long way in positioning firms to ultimately reduce the overall burden of regulatory change.

3.1 Operating model, horizon scanning, and governance

Deployment of a sophisticated, scalable, and flexible global operating model will be a critical element of successfully achieving and maintaining regulatory compliance. While this may be fully federated or fully centralized, most firms would typically opt for a combination of the two. In any case, it is essential to clearly define the scope, roles, and responsibilities for various global regulatory operations teams to ensure end-to-end coverage of all applicable reporting obligations. This should be supplemented with continuous training and upskilling of relevant resources to ensure they are well positioned to support continuously evolving and overlapping global regimes.

Another key component of the operating model is establishing a comprehensive horizon scanning capability to ensure any regulatory updates are reviewed and assessed in a

Figure 2: Strategic response to regulatory change

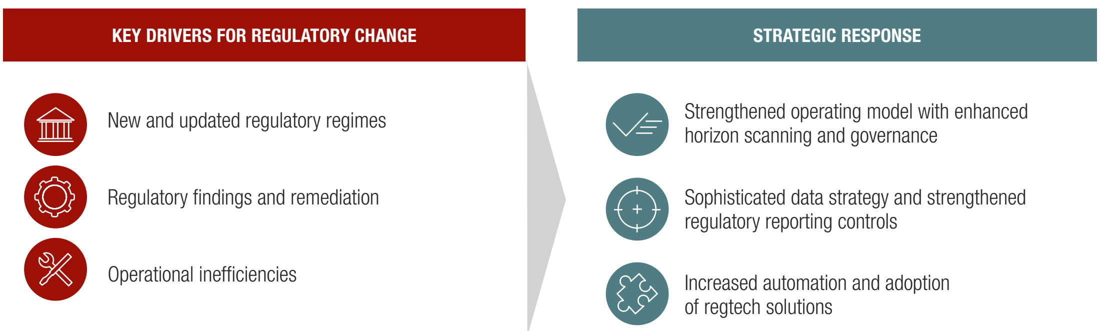
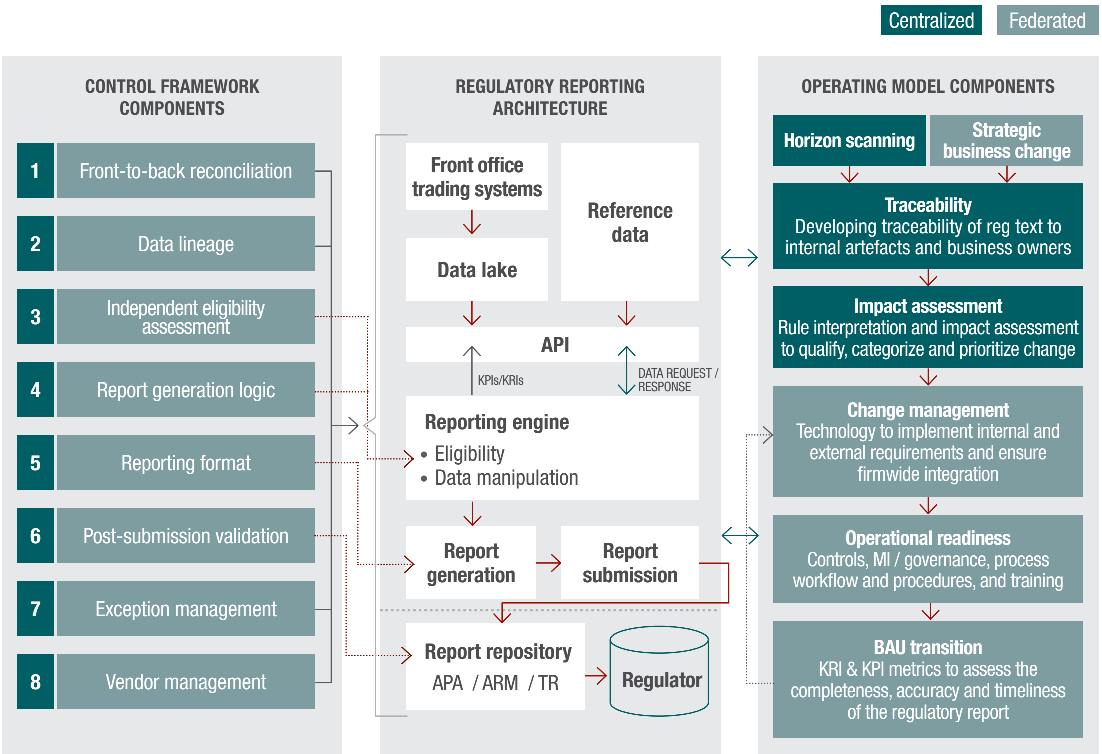


Figure 3: Reporting architecture and operating model (representative example)



timely manner. The assessment would typically cover rule interpretation and applicability assessment followed by a front-to-back impact assessment for applicable rules and in-scope entities, products, and lines of business. Defining end-to-end traceability back to regulatory text will allow impacted firms to demonstrate compliance with new or updated rules. Complementing this with a mature change management capability will facilitate appropriate definition and prioritization of implementation changes across people, processes, data, and technology, which will determine the associated delivery roadmap and go-live timelines.

Firms will also need to establish robust governance and management information (MI) reporting, including clearly outlined ownership and accountability as well as defined escalation mechanisms in case of reporting issues. A key component of this governance structure is regular engagement with relevant regulatory authorities to ensure continuous alignment on supervisory expectations as well as timely notifications of any reporting breaches.

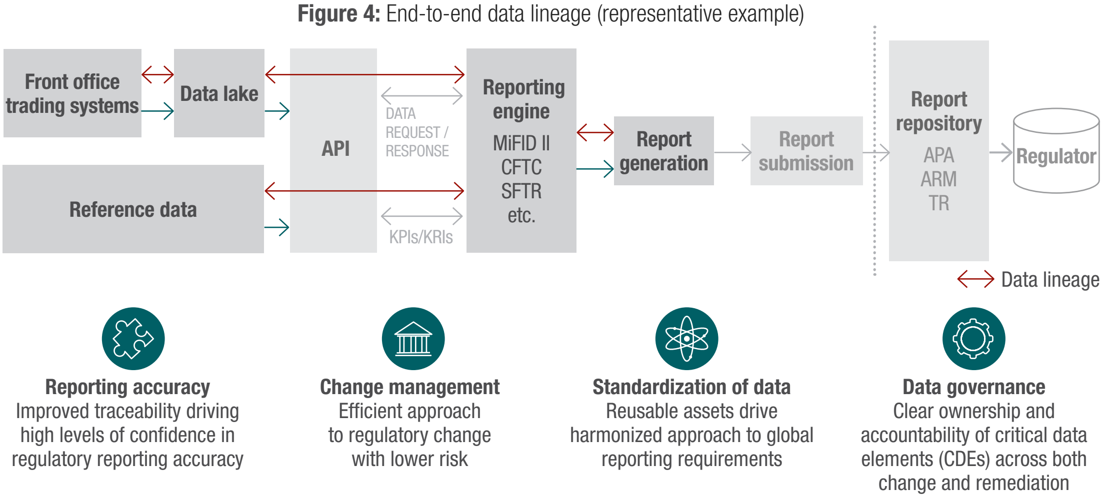
3.2 Data strategy and control framework

Given the strong correlation between accuracy of regulatory reporting and that of underlying data, it should come as no surprise that a mature data strategy is absolutely crucial to overall regulatory compliance. Yet, a number of market participants continue to underinvest in their data capabilities, which in turn results in significant overheads when it comes to root cause analysis and remediation of reporting issues.

As such, defining centralized authorized data sources that should be used consistently across the firm, whether this is for pricing, risk management, or regulatory reporting, would help achieve front-to-back standardization and harmonization. In addition, developing and maintaining end-to-end lineage for critical data elements (CDEs) will significantly reduce the effort required for root-cause analysis, remediation, as well as change implementation. This will need to be accompanied by a robust data governance framework that outlines the roles and responsibilities, processes, and policies to successfully manage enterprise data.

Firms should also uplift existing control frameworks to ensure these are well placed to support global compliance monitoring. This should include pre-submission checks, reporting format checks, post-submission validations, as well as end-to-end reconciliation from front-office trading systems all the way through to report submission engines. In fact, the U.K.'s FCA has again reiterated that reconciliations should not be limited to certain fields, or to data samples that do not adequately

Figure 4: End-to-end data lineage (representative example)



reflect the trading scenarios and asset classes traded by a firm. Ultimately, the implementation and operationalization of regulatory controls will need to accompany any regulatory change implementation, whether this is for new reporting rules or updates to existing ones. This is especially critical to help firms evidence intent when notifying regulators of reporting breaches, should these still occur.

3.3 Automation and regtech

In an attempt to transition from siloed implementation to a more strategic global reporting framework, a number of firms are now undertaking a front-to-back review of their regulatory reporting architecture and associated controls and operating models. This would help identify re-platforming and workflow automation opportunities, thereby reducing manual intervention, enhancing operational efficiency, and lowering overall regulatory risk.

To achieve these gains, a majority of firms are turning towards third-party regulatory technology (regtech) products as reliable alternatives to investing in in-house solutions. In fact, the regtech landscape has significantly evolved in recent years, thus presenting firms with a variety of third-party products that could align with their specific regulatory requirements, technology capabilities, and cultural fit. A number of these solutions offer improved performance and reliability, potentially boosting the efficiency of in-house solutions or, in some cases, replacing them entirely. Moreover, the increasing maturity of regtech solutions has made pricing more competitive, rendering in-house implementation as a high-cost alternative with limited benefits. In addition, a well-established regtech solution can offer accelerated deployment, reduced implementation effort, alignment with industry standard approach, as well as ongoing support, all of which make the overall commercial offering even more attractive.

Recently, a number of global supervisors, including the U.K.'s FCA, the E.U.'s ESMA, and the U.S. Fed have all increased their interest in regtech solutions. Many are working together with vendors in "regulatory innovation sandboxes", to find more optimal ways of achieving and maintaining compliance. This has provided an additional layer of trust, thus boosting mass adoption of third-party solutions. Moreover, firms that are deemed to be on the cutting edge of digital technology are more likely to invite a wider range of clients, as well as internal talent. The current landscape, therefore, presents a huge opportunity for organizations to leverage adoption of cutting-edge regtech as a platform for driving regulatory innovation. This would help improve brand perception, enhance automation, reduce regulatory risk, and ultimately drive improved business outcomes.

4. CONCLUSION

The financial services industry continues to grapple with complex and continuously evolving reporting regimes. Combined with an ever-increasing focus on compliance from supervisory authorities and significant pressure to reduce costs, these challenges will continue to perplex even the most sophisticated market participants. It is, therefore, increasingly important for firms to transition towards a strategic approach to global regulatory reporting by overhauling their current operating models and enterprise-wide data strategy. This should be complemented with upfront investment in reporting architecture and processes including increased automation and adoption of market-leading regtech tooling. This will help deliver innovative and efficient reporting solutions, thereby strengthening global compliance while driving down regulatory risk and overall costs.

ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy focused in the financial services industry. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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