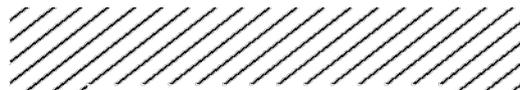


DECEMBER 2019
**REVIEW OF SPOT INSPECTIONS
EMIR REPORTING GOVERNANCE**



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INTRODUCTION

As part of its new Supervision#2022 strategy, the AMF announced at the beginning of 2018 its intention to conduct short, theme-based inspections known as "SPOT" (Supervision des Pratiques Opérationnelle et Thématique – operational and thematic supervision of practices) inspections, as well as its willingness to share the lessons learned from these exercises. It is now delivering a review of these short inspections carried out in 2019 with five investment service providers,¹ excluding asset management companies, on the subject of EMIR reporting governance (mandatory reporting of transactions to trade repositories).

These inspections covered the general organisation of the implementation of EMIR reporting and the governance regarding the exhaustiveness and quality of reporting to the trade repository.

This note aims to provide an overview of all the SPOT inspections on these subjects relating to EMIR reporting governance, carried out in the first half of 2019 in five institutions and announced in the supervision priorities. These inspections were conducted as an extension of three "traditional" inspections, which covered a broader area of the EMIR regulation (including risk mitigation techniques). This overview concerns the five institutions that underwent the SPOT inspections, and is supplemented if necessary by information recorded on the occasion of the three "traditional" inspections. It sheds light on the practices observed at the inspected investment service providers, the difficulties they face and possible ways to support them. Its conclusions on the internal control and compliance function of institutions should be assessed taking into account the volume and nature of the activities of each investment service provider, in accordance with the principle of proportionality. It is neither a position nor a recommendation.

OVERVIEW

Analysis of the information gathered during the inspections made it possible to identify good and poor practices on the subjects mentioned above.

The main good practices observed during these inspections are:

- Formalising a control grid under the responsibility of the Compliance function, to ensure that the regulatory obligations are covered;
- Including reporting delegated to third parties in the areas of reject management and controls;
- Perform regular reconciliation between the data coming from management systems and the data reported to trade repositories.

The main poor practices observed during these inspections are:

- Insufficient involvement, or even no involvement of the Compliance function in working out and monitoring controls;

¹ These inspections dealt with EMIR reporting of their own transactions and not as delegates of other institutions.

- Lack of monitoring indicators applying the regulations relating to EMIR reporting (exhaustiveness of reporting, compliance with deadlines, quality of reporting content).

1. RECAP ON THE REGULATORY ENVIRONMENT

1.1. PRINCIPLES AND SCOPE OF THE EMIR REGULATION

The European regulation known as EMIR (European Market Infrastructure Regulation) defines a framework for the various entities active on derivatives markets, namely financial and non-financial counterparties trading on those markets, and central counterparty clearing houses. It also introduces new market participants: trade repositories which are tasked with recording all derivative contracts entered into between two counterparties.

The EMIR regulation imposes the following obligations in particular:

- An obligation for all over-the-counter (OTC) derivatives considered by ESMA as being sufficiently liquid and standardised to be centrally cleared;
- The use of a set of techniques to mitigate operational and counterparty risk where contracts are not cleared;
- An obligation to report to trade repositories information on all derivatives contracts and any change in or termination of such contracts.

1.2. DETAILS REGARDING THE OBLIGATION TO REPORT TO TRADE REPOSITORIES

The transaction reporting obligations enable ESMA, the ESRB, the ECB and the national authorities to:

- Supervise the European financial system;
- Have the necessary data to implement an appropriate regulation policy;
- Cope better with crises by discerning the implications in the event of a counterparty default.

Article 9 of the EMIR regulation provides that counterparties must² report information on any derivatives contract that they have entered into and any change in or termination of the contract to a trade repository, at the latest one business day after the signature, modification or termination of the contract (hereafter "**EMIR reporting**").

EMIR reporting is required of all counterparties (whether they be a financial or non-financial counterparty) to a derivatives contract executed on a trading venue or over-the-counter.

A service provider may delegate to third parties the reporting of its transactions, but its liability remains involved.

2. MAIN FINDINGS OF THE INSPECTIONS

2.1. INVESTIGATIONS CONDUCTED BY THE INSPECTION DEPARTMENT

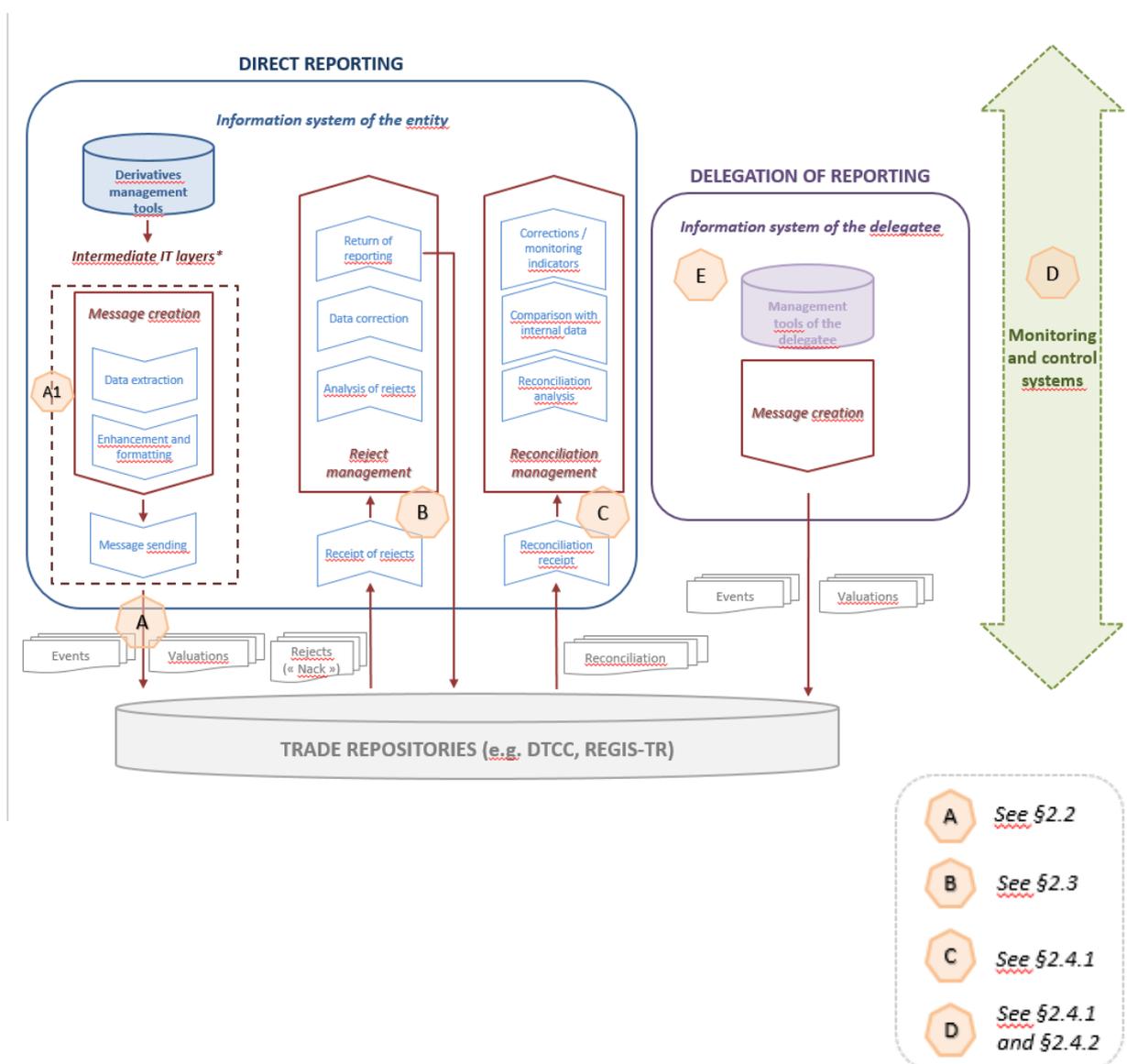
The investigations conducted (discussions, reviews of technical and operating documentation) made it possible to establish a simplified flow diagram in order to illustrate the practices of the institutions

² Subject to certain exceptions set out in Regulation 2019/834 of 20 May 2019 amending the EMIR regulation.

inspected. This diagram summarises the key stages in reporting transactions to the trade repository, and the processing of returns from said repository:

- Creation and sending of messages (cf. Part A of the diagram);
- Processing of returns from trade repositories (cf. Part B);
- Processing of reconciliation with the data in the trade repositories (cf. Part C);
- Monitoring and control system (cf. Part D);
- Creation and sending of messages delegated to third party service providers (cf. Part E).

Simplified diagram of the key stages in transaction reporting



* Intermediate IT layers: IT resources inserted between the institution's various derivatives management software programs and the trade repositories.

Source: Diagram produced by the inspection department.

2.2. SYSTEMS FOR REPORTING TO TRADE REPOSITORIES

This stage is illustrated in Part A of the simplified diagram (cf. §2.1).

The table below summarises, for the five institutions inspected during SPOT inspections, the various stages from entering the transaction to sending of the corresponding message to the trade repository.

	ENTITY 1	ENTITY 2	ENTITY 3	ENTITY 4	ENTITY 5
Derivatives management tools	The transactions are entered by front-office operators in dedicated tools The data are discharged, automatically and in order of occurrence, into the back-office management tools		The transactions are entered by front-office operators in integrated tools (front- to back-office)		
Intermediate IT layers (cf. A1 simplified diagram - §2.1)	The data are discharged, automatically and in order of occurrence, into the intermediate layer			No intermediate layer	The data are discharged, in batches, into the intermediate layer
Eligibility of the transaction³	Eligibility is verified by the intermediate layer		Eligibility is verified via an independent repository	Eligibility is verified directly in the front- to back-office tools	
Automatic control of data	No control ahead of message sending		Two controls ⁴ performed in the intermediate layers	No control ahead of message sending	Two controls ⁵ performed in the intermediate layers
Message creation and sending	In order of occurrence from the intermediate layer for event reporting. By batches from the back-office tools for valuation reporting.	In order of occurrence from the intermediate layer (event and valuation reporting)	By batches from the intermediate layers (event and valuation reporting)	By batches from the front- to back-office tool (event and valuation reporting)	In order of occurrence from the intermediate layers (event and valuation reporting)

All the institutions except one have put in place one or more intermediate IT layers (between their various derivatives management tools and the trade repositories - cf. A1 of the simplified diagram in §2.1), enabling them to make centrally controlled changes without having to change the settings of each management tool individually (for example: criteria adopted to verify the eligibility of transactions for EMIR reporting).

These intermediate layers have also enabled three institutions (two inspected during SPOT inspections and one during a "traditional" inspection) to establish automated controls before message sending, making it possible, in particular, to:

³ Eligibility consists in verifying that the derivatives are indeed reportable within the framework of EMIR reporting.

⁴ These controls aim to check the substantiation of reporting performed directly by the institution, and to make sure that there is no duplicate reporting by the institution and by a delegatee.

⁵ These controls aim to identify errors in message generation (e.g. missing data).

- Avoid duplicate reporting of direct and delegated transactions;
- Check the correct status of the reported event (creation or change or termination of contract);
- Identify reports having missing data.

In the event of changes in the information systems, the five institutions inspected during SPOT inspections plan to perform "non-regression" tests designed to make sure that this change results in no deterioration in terms of either the scope (number of derivatives reported) or the information reported (content of reports).

For one of these institutions, however, it was noted that these tests lacked effectiveness, since they were unable to predict a substantial number of rejects observed during a migration in 2018 to a new IT environment.

Good practices

- Centralise message creation and automated controls, by establishing an intermediate stage in the reporting system (intermediate IT layers between the institution's derivatives management tools and the trade repositories).
- Perform non-regression tests in the event of changes in the IT environments that could have an impact on EMIR reporting, in particular by anticipating the risk of increased rejects.

2.3. PROCESSING OF RETURNS FROM TRADE REPOSITORIES

This stage is illustrated in *Part B* of the simplified diagram (cf. §2.1).

The table below summarises the procedures for processing files returned⁶ from the trade repositories (receipt, analysis and then return of messages).

	ENTITY 1	ENTITY 2	ENTITY 3	ENTITY 4	ENTITY 5
Receipt of reject files	Discharge of the files into a dedicated processing tool (without archiving or traceability)	Automatic integration of the files into the derivatives management information systems (intermediate layers or front-to-back tools depending on the institution) allowing their archiving and traceability			
Analysis of rejects	Daily analysis and correction of rejects by a bespoke team (employees in another EU Member State and administrative reporting to Paris)	Daily analysis and correction of rejects by bespoke teams having the same geographic location and the same functional reporting line	Daily analysis and correction of rejects by bespoke teams Plan for automated analysis of rejects ⁷	Weekly analysis and correction of rejects by bespoke teams	

⁶ These files received from the trade repositories contain the status ("accepted" or "rejected") of each of the reports.

⁷ This plan concerns the establishment of analysis and automatic return of transactions rejected by the trade repository (deadline of end-2019 for all listed derivatives).

Return of corrected messages	Manual return on D+1 once the error has been corrected. In some cases, the change is not made in the systems but only the message to be returned is corrected (lack of traceability)	Automatic return in order of occurrence, once the error status has been corrected	Automatic return via bespoke modules within 1 hour or on D+1 ⁸	Automatic return by batches on D+2 ⁹	Automatic return by batches on D+1
Reject processing for delegated reporting	Receipt and analysis performed by the institution (hence visibility over delegated reporting rejects)	No visibility over processing performed by the delegateses. Reject processing provisions in contracts with delegateses.	Receipt and analysis for three delegateses and follow-up by email for the fourth delegatee	N/A	No visibility over processing performed by the delegateses. No provision in contracts with delegateses.

A single institution does not automatically enter the files returned from the trade repository in its derivatives management information system or in a reject monitoring database (which results in an absence of traceability and archiving). The institution is therefore unable to know whether the rejects have been processed or not. Therefore, those rejects which are not processed on the day will never be processed.

Regarding the analysis and correction of rejected messages, one institution has taken measures to have its bespoke teams (including the IT teams) grouped together at the same location and with the same functional reporting line. This organisation allows improved coordination of the teams in charge of processing returns.

Moreover, one entity has put in place a plan for automated processing of rejects for all its listed derivatives. This plan, launched in March 2019, involved defining 12 scenarios¹⁰ in order to put in place automatic reject processing modules in the tool for sending EMIR reports. This automated system makes it possible to analyse corrected messages and return them automatically to the trade repository.

Moreover, even though the obligation to report again in the event of a rejection is not provided for explicitly by Article 9 of the EMIR regulation, the complete rejection of the report sent by an entity constitutes de facto an absence of reporting. In this sense, it appears essential that the entities in question should establish a system for correction and repeat sending of reporting, which would be able to ensure compliance with the deadline stipulated in point 1. of the aforementioned article.

⁸ Within 1 hour via the intermediate layer (for non-economic data) or on D+1 in the front-office tools (for economic data).

⁹ This institution has no system enabling it to report rejected transactions again the next day. Moreover, analysis of rejects is performed only on a weekly basis. Accordingly, rejected transactions are reported to the trade repository again between 2 and 7 business days after being rejected.

¹⁰ Examples: 'missing underlying identification', "invalid LEI status", "the price multiplier must be greater than 0".

For example, one entity stated that it performed analysis of returns only once a week instead of every day (temporarily due to a change of IT environment), which constitutes a shortcoming relative to the provisions of Article 9 of the EMIR regulation.

Good practices

- Archive the return files and enter them in the derivatives management information system, to prevent rejects which are not processed on the day from never being processed.
- Correct the data in the management systems before returning any messages (thereby making it possible to ensure the traceability of corrections).
- Effectively coordinate the various teams in charge of processing returns (including the IT teams), possibly via a common administrative and/or functional reporting line.
- Keep a view of the processing of delegated reporting rejects, either by including direct reporting in the reject management system (cf. *Part B* of the diagram in §2.1), or by establishing detailed monitoring provided by the delegatee.

2.4. CONTROL AND MONITORING GOVERNANCE

2.4.1. Control system

This point is illustrated in *Part D* of the simplified diagram (cf. § 2.1).

Level 1 and 2 control plans

Two institutions have formalised a control grid (levels 1 and 2) under the responsibility of the Compliance function, applying the themes of the EMIR regulation and the corresponding controls established or to be defined. These grids enable the Compliance function to have a precise and comprehensive view of the adequacy of its control system to fulfil the EMIR reporting obligations.

In addition, two institutions have included in their control plan transactions for which reporting is delegated to third parties.

On the other hand, four institutions have no formalised control and/or traceability of their results. For two service providers (inspected during SPOT inspections), the controls resemble verifications or lists of tasks to be performed (check-lists), and not real controls capable of assessing a level of quality or risk. Two institutions inspected during "traditional" inspections had no control relating to EMIR reporting.

The table below gives an overall view, for the five institutions inspected during SPOT inspections, of the controls performed by the institutions on three fundamental aspects of EMIR reporting:

		ENTITY 1	ENTITY 2 ¹¹	ENTITY 3 ¹²	ENTITY 4	ENTITY 5
Reporting deadlines	Level 1	None	None	Yes	None	None
	Level 2	None	None (planned for end-2019)	None	None	None
Exhaustiveness of reporting	Level 1	Yes, except on commodities	Yes	Yes	None	None
	Level 2	None	None (planned for end-2019)	None (planned in 2019)	None	None
Content of reporting	Level 1	Yes	Yes	Yes	None	None
	Level 2	None	None (planned for end-2019)	None (planned in 2019)	None	None

Except for one institution, the service providers inspected during SPOT inspections perform no control on reporting deadlines.¹³

Moreover, one of the main anomalies noted for most of the institutions inspected during the SPOT and "traditional" inspections was the lack of level-2 controls. However, these controls are already in force for one institution (inspected during a "traditional" inspection) or planned by the end of 2019 for two institutions (inspected during SPOT inspections).

Finally, it was noted for three institutions inspected during SPOT inspections and two entities inspected during "traditional" inspections that there was insufficient commitment or even an absence of the Compliance function in its role of independent assessment of the system employed to control compliance with the EMIR reporting obligations.

Good practices

- Establish a control grid (levels 1 and 2) applying the themes of the EMIR regulation and the corresponding controls established or to be defined, under the responsibility of the Compliance function, to ensure that the regulatory obligations are covered.
- Establish controls relating to rejected reporting management.
- Make sure that the controls on reporting delegated to third parties meet the same quality standards as the reporting controls performed directly by the institution.

Poor practice

- Insufficient involvement, or even no involvement of the Compliance function in working out and monitoring controls;

¹¹ Following a general inspection performed in 2017, this institution provided for the establishment of level-2 controls by the end of 2019 regarding the 3 control areas mentioned in the table.

¹² This institution provided for the establishment of level-2 controls by the end of 2019 on 5 themes relating to the exhaustiveness and content of EMIR reporting, including for delegated reporting. In 2020, the institution plans an annual review of level-1 controls.

¹³ Shortcoming also noted for the 3 entities inspected during "traditional" inspections.

Periodic control

Three institutions inspected during SPOT inspections and two entities inspected during "traditional" inspections carried out general inspections or internal audits on compliance with the EMIR reporting obligation, which enabled them notably to identify shortcomings in the control system. This assumes that the recommendations resulting from General Inspections are acted on, which was not the case in two institutions.

Good practice

- Perform General Inspections or internal audits including compliance with the regulations relating to EMIR reporting and allocate sufficient resources for implementation of the resulting recommendations within a satisfactory deadline.

Reconciliation of the data from trade repositories

The establishment of data reconciliation with the trade repository plays an essential role in controls on the content and exhaustiveness of reporting. This phase is illustrated by *Part C* of the simplified diagram (cf. § 2.1).

A first type of reconciliation observed in two institutions involves analysing the results of "pairing"¹⁴ and "matching"¹⁵ controls performed by the trade repository.

This practice makes it possible to identify:

- derivatives which might have been reported by only one of the counterparties or reported by both but with a different transaction ID ("pairing" controls).
- any differences in the content of transactions' economic data, reported by the service provider and the counterparty respectively ("matching" controls).

A second type of reconciliation noted in three institutions inspected during SPOT inspections and one institution inspected during a "traditional" inspection involves comparing the data from the management databases of the service provider with those that it actually reported to the trade repository. This practice makes it possible to ensure the exhaustiveness¹⁶ and quality¹⁷ of reporting performed. One institution performs this control every day on 43 EMIR reporting fields, via a bespoke tool. The control performed by two other entities on a weekly basis, for its part, concerns a more limited number of fields.¹⁸

¹⁴ The trade repository verifies the transaction IDs, comparing the data reported to it by the institution (directly or by delegation) and the data reported to it by the institution's counterparties.

¹⁵ The trade repository verifies the characteristics of the transactions (for those for which pairing was conclusive), by comparing the data reported to it by the institution (directly or by delegation) and the data reported to it by the institution's counterparties.

¹⁶ By making sure that all the transactions which had to be reported have been reported and that all those which have been reported were supposed to be reported.

¹⁷ By making sure that the reported data are accurate and complete.

¹⁸ 6 to 11 fields for one institution and 5 or 6 fields for the other (depending on the asset classes in question).

Good practices

- Process, on a weekly or even daily basis, the results of pairing and matching controls performed by the trade repository;
 - Establish regular reconciliation between the data coming from the management systems of service providers and the data actually reported to the trade repository (by the service providers or their delegates).
- Make sure that the EMIR reporting fields covered by the reconciliations are sufficiently numerous and significant (e.g. identification of the transaction and the counterparty, details of the transaction, etc.).

2.4.2. Monitoring system

Four of the five institutions inspected during SPOT inspections have defined monitoring indicators relating to EMIR reporting depending on the entities in which they are reported. These indicators and entities are summarised in the table below.

	ENTITY 1	ENTITY 2	ENTITY 3	ENTITY 4	ENTITY 5
Main monitoring indicators	- Reporting success rate - Main reasons for rejection - Pairing and matching rates ¹⁹ - Data quality ²⁰	- Reporting reject rate - Main reasons for rejection - Pairing and matching rates	- Reporting reject rate (including after resubmission) - Data reconciliation rate	None	Reporting reject rate

One institution has no monitoring indicator or entity dedicated to EMIR reporting. For another institution, monitoring is performed by aggregating EMIR and REMIT reporting,²¹ which does not make it possible to have a precise view of the compliance with each regulation.

Moreover, no institution has established indicators on compliance with reporting deadlines.

Lastly, two institutions have indicators on the quality of reporting content. These indicators extend to all asset classes.

¹⁹ Excluding listed derivatives.

²⁰ Only for equity derivatives.

²¹ "Regulation on Energy Market Integrity and Transparency". Regulation (EU) No. 1227/2011 of the European Parliament and of the Council of 25 October 2011 which in particular imposes mandatory reporting of transactions on wholesale energy markets.

Good practices

- Include in the monitoring system:
 - Indicators on the controls performed by the trade repository (pairing, matching);
 - Indicators on reject management (volume, reasons, deadlines for reporting again, etc.).
- Extend the monitoring indicators to all asset classes.

Poor practice

- Not having monitoring indicators applying the regulations relating to EMIR reporting (exhaustiveness of reporting, compliance with deadlines, quality of reporting content).