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3 "Rs" of Monitoring Dodd-Frank Trade Reporting

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Dodd-Frank Trade Reporting isn't coming ... it's here. February 28, 2013 was the date that Major Swap Participants (MSPs) were required to begin reporting equity, foreign exchange and other commodity swaps. And this is just the beginning of a series of milestones in the regulation that was designed to prevent future "too big to fail scenarios," such as what occurred during the Global Financial Crisis of 2008. But, there is a bigger story here around regulation and compliance and how IT is used to ensure transparency, accuracy and accountability in reporting.

Regulation, Regulation and more Regulation

While Dodd-Frank is a U.S. regulation under the supervision of the Commodities Futures Trading Commission (CFTC), any financial institution doing business with a U.S. bank will need to comply. Hot on the heels of Dodd-Frank is a regulation in Europe called EMIR, the European Market Infrastructure Regulation, which applies to members of the European Union. EMIR is phasing in during the latter half of 2014 and like Dodd-Frank will require trade reporting for Over the Counter (OTC) Derivatives. Although U.S. requirements specify same day reporting, the European version will be a T+1 implementation.

Regulation is being specified across many parts of the world by the countries that are members of the Group of 20 (G20) global economic and financial initiative. There are four main themes associated with this regulation:

- market transparency
- systemic risk
- regulatory complexity
- straight-through processing.

Each of these four themes will have an impact on business and will require changes in technology to support them.

Market transparency improvements will be stressed by the expected migration of OTC trading relationships to electronic venues and increasing trade volumes. IT will have a capacity planning challenge as it plans to handle vast data volumes at the same time as delivering the transparency required by the business.

Systemic risk reduction will require greater connectivity and aggregation of data from multiple locations by IT in order to support the business' requirements for increased capital, clearing and margin.

Regulatory complexity will grow as more jurisdictions come into play and the onus will be on IT to implement a rule-based approach to ensure that the right dealers are cleared with the appropriate regulator.

Straight through processing will demand more efficiency from the business as IT handles the movement from batch to real-time at the same time the reporting windows continue to shrink.

Easier Said Than Done

But, as we learned from the adoption of the Information Technology Infrastructure Library (ITIL), agreeing to support a standard is a long way from an effective implementation. Unfortunately, the specification of standards often skip describing how to best implement them. As a result, financial institutions will have their work cut out for them in meeting the regulations associated with Dodd-Frank Trade Reporting, especially with the aggressive timelines stipulated.

How Am I Doing?

"So, how am I doing?" a famous NYC mayor use to say when he met the public. In the case of the late Mayor Ed Koch, most though he was doing well. But in the case of Dodd-Frank Trade Reporting, eh, not so much.

Why?

There is an ongoing search for clarity in just what these regulations mean and how to comply with them. The regulations are very complex, especially when handling activities that span regulatory bodies. There are lots of folks out there with their "hair on fire" trying to get this done, but there are many who are not even sure where to begin and are desperate for clarity.

What You Need To Do

It's back to the three "R"s. The first "R" corresponds to ***real-time monitoring*** of trading activities. You will need to ensure that your firm complies with regulatory obligations and be able to follow up on all reporting errors and false positives, as fast as technologically possible. The second "R" is about ***reconciling positions*** across all legal entities. This means reporting and preventing problems such as over, under and misreporting. The final "R" handles ***responding to requests*** for information from regulators about issues that impair operations, trading or other critical functions. This necessitates a real-time and historical query function for the business to search for swaps that meet certain criteria.

Getting Down To It

Swap dealers are required to report all Swaps to a Swap Data Repository (SDR) within 30 minutes of execution and when trades are rejected, they must be corrected and resubmitted within that same time span. The challenge for these organizations is to ensure compliance and detect potential breaches in responsibility before they happen. The situation increases in complexity as EMIR goes live. Multinational banks will need to comply with both sets of regulations. These banks will need real-time visibility in order to overcome these continuously evolving challenges.

Technologies have been available for years that help institutions monitor trades. But new rules have ratcheted up the need for more sophisticated tools that track trades in-progress, visualizing their activities in-flight across the swap dealer infrastructure, to the Global Trade Repository (GTR) and back -- what is known as the reportable lifecycle of a trade. And these are needed for use by the business. They also must anticipate problems before they occur, reducing risk. Using real-time analytics, problems in these trades must be detected, the business alerted and early course correction enabled.

But, traditional IT monitoring of networks, servers and middleware can't provide the transparency the regulation requires. They provide a silo-based view of the area they monitor and are designed to assist IT practitioners. Even the monitoring that comes with trading systems only provides a narrow view of their own systems and cannot address these requirements.

What is necessary is a system that can provide visibility in real-time to the business about actual or even potential breaches in responsibility across the reportable lifecycle of a trade. Given the small time windows, predictive notification is essential to maintaining compliance. This means a real-time capability to track a trade and correlate all the steps from execution time through to its acknowledgement by the GTR. There may be many steps in that flow spanning from your trading systems to your messaging bus, multiple sources of data enrichment, process and transformation before they are sent to the GTR and a response returns.

The users of the system will be the business who will monitor mandatory data, handle negative acknowledgements (NACKs), correct issues such as double reporting, missing fields, Unique Swap Identifier (USI) problems and manage derivative swaps that have not received an acknowledgement (ACK). Some of the challenges here are specific to the nature of OTC, such as the requirement to monitor that the correct "execution time" is reported. Execution time occurs when the primary economic terms are exchanged and not when the trade is electronically captured. As this is an OTC trade, it is most likely accomplished during a phone conversation.

Another important challenge is ensuring that when a trade reported to the GTR has an exception it is resolved immediately. Unlike U.S. sporting events, where when the penalty whistle is blown the clock stops, here the 30 minute "timer" continues after the GTR sends a NACK. That means you need to find the root-cause of the problem, be it a business issue such as double reporting or a missing field or an IT issue with a backlogged queue, fix it and resubmit before 30 minutes is up. That puts a lot of pressure on IT. If you only monitor each of the silos in your swap infrastructure and only log whether each swap received an ACK from the GTR, you will be in a difficult position when you receive a NACK or even worse, no response. What will you fix?

And The Changes Keep Coming

As more jurisdictions come online such as the Depository Trust Clearing Corp. (DTCC), CME and international regulators, the trade reporting process will increase in complexity. When there are multiple **Swap Data Repositories (SDRs)** there will need to be logic to be sure the correct SWAP was sent to the appropriate SDR. And, then there is the issue of time zones and calendaring necessary to handle multiple reporting windows. You will need both time and event-based service level agreements (SLAs) along with understanding of country-specific holiday calendars in order to be sure reporting occurs within the required window.

Conclusion

Anyone who believes they have completed their monitoring implementation for Dodd-Frank Trade Reporting must be mistaken as the rules are lacking in clarity and in flux. But, what is clear is the need for improved visibility and the capability to correlate in real-time each activity in the lifecycle of a reportable trade. Taking this approach will help ensure compliance and enable you to take the appropriate action to maintain it.