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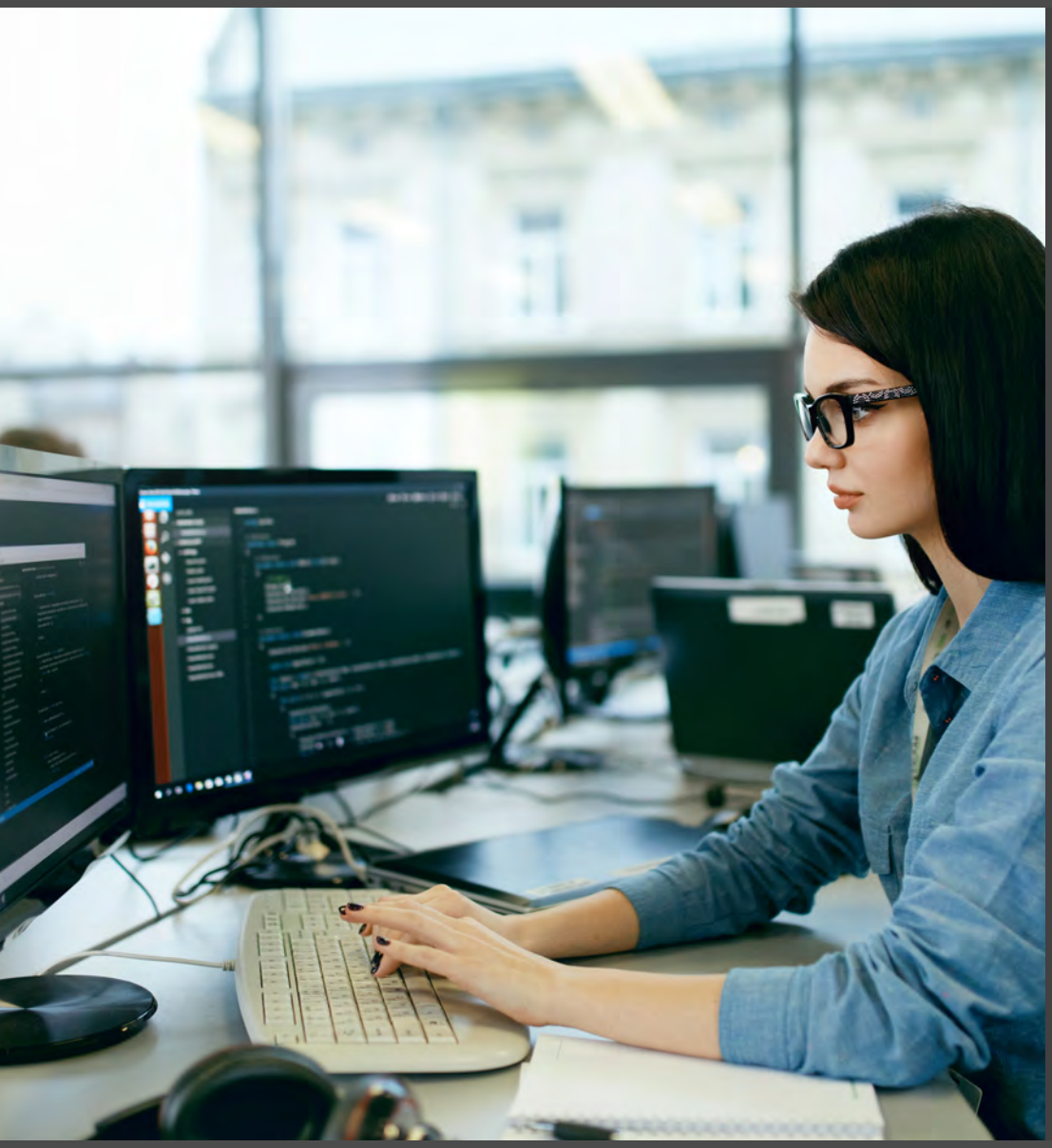
Adhering to Transaction Reporting Data Quality Requirements



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This is the second article in Synechron's thought leadership series on Transaction Reporting processes, this one focusing on quality management. This article sets out a set of quality control measures that institutions can adopt to meet regulatory expectations. It also highlights some challenges that institutions need to consider when approaching quality management objectives.

Is your firm reflecting on the effectiveness of its operating model for Transaction Reporting?

Are you struggling to balance increased regulatory scrutiny on Transaction Reporting data quality, whilst also onboarding new Transaction Reporting requirements and balancing what is an inherently complex operating process?

As Transaction Reporting regulations have become embedded, regulators have shifted focus from ensuring financial companies develop the required reporting infrastructure to examining quality control and the content of regulatory submissions. This is to be expected as otherwise data quality issues impede regulators from utilizing Transaction Reporting outputs to support their underlying regulatory objectives. This includes detecting instances of market abuse. Recent examples of this heightened regulatory focus include ESMA's 2021 published 'EMIR and SFTR data quality report 2020', and an FCA 2020 published 'Market Watch', along with a range of recent regulatory enforcement fines relating to Transaction Reporting process deficiencies.

Challenges impacting quality control objectives

There are several key challenges that collide with quality control objectives. These include:

1. System landscapes are always evolving

Transaction Reporting is fundamentally about systems and digital tools recording and transferring data. For large financial institutions it is normal for upwards of 25 internal and external systems to play roles in Transaction Reporting processes, and, in some instances, transferring hundreds of data points, from Front- and Back-Office systems to reporting engines, to external trade repositories, Approved Reporting Mechanisms (ARMs) and Approved Publication Arrangements (APAs). Effective quality control outcomes require that these systems and the relationships between them be actively managed on an ongoing basis. A common challenge here is that institutions find themselves being required to utilize legacy systems and heritage tools to support Transaction Reporting processes, when these infrastructures were not designed for these purposes.

Another related common challenge is having to operate in an environment where the institution is almost always in a process of simultaneously offboarding and onboarding multiple impacted systems and tools.

2. Transaction Reporting processes are still inherently complex

The task of developing and maintaining fit for purpose Transaction Reporting processes is inherently complex. Process design inputs will typically come from diverse internal stakeholders, including compliance experts interpreting regulations, Front-Office traders with product level expertise, and project teams and IT engineers designing and implementing system modifications. Furthermore, each regime will have its own requirements with potentially different reporting processes and systems required, and these requirements keep evolving.

Due to the inherent complexity in designing and maintaining Transaction Reporting processes, institutions can face staffing challenges in the Transaction Reporting area. This can lead to institutions placing reliance on third-party consultants, a practice which can be an indicator that the Business as Usual (BAU) process has not yet bedded down.

3. Institutions are still in 'thinking mode' about their end-state target operating models

For the reasons outlined, existing BAU processes for Transaction Reporting do not yet look very much like typical BAU processes. It is only now that institutions are beginning to mature their strategic-level ideas of what their Transaction Reporting operating models should look like into the future, taking account of lessons learned and likely future regulatory requirements. This includes thinking about whether Transaction Reporting Departments should be centralized or dispersed within business units, the extent to which firms should engage in outsourcing, and the different ways of building knowledge and capability internally.

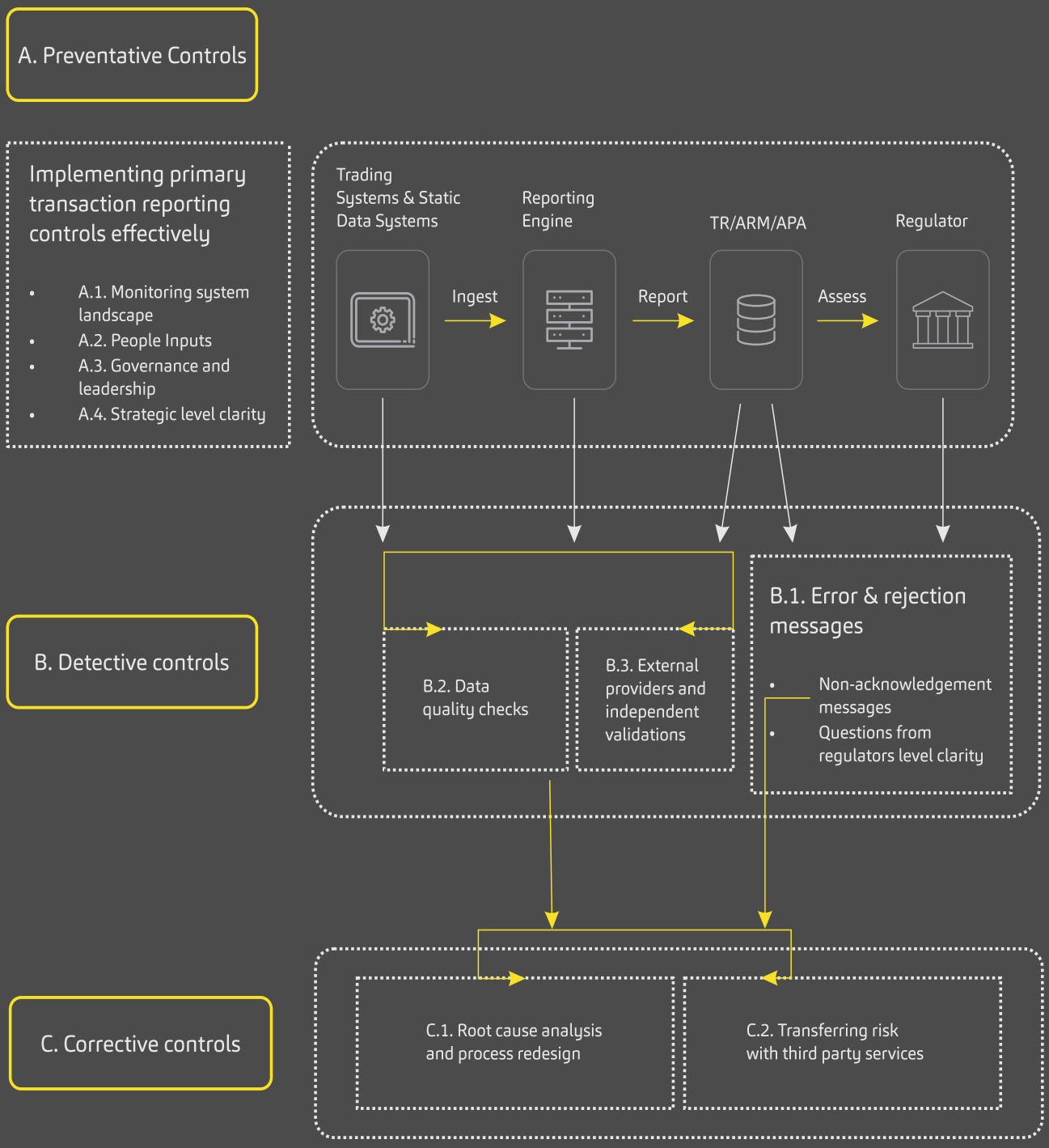
Further, strategic process and system redesign can be expected before stable final BAU positions are arrived at. As long as operating models are still being designed, it is difficult to scale up to the extent where data quality issues can be addressed in an efficient manner.

How to address data quality objectives in Transaction Reporting submissions

The following section sets out some key value adding measures that firms can use to guarantee the effectiveness of Transaction Reporting processes.

The following graphic provides an overview of the processes and systems that typically play roles in the Transaction Reporting process. The content is expanded upon in the text below.

Transaction Reporting Processes: An Internal View



A. Preventative controls

Preventive controls seek to ensure that adverse events or process deficiencies do not materialize in the first place. In the context of Transaction Reporting processes, core tasks involve ensuring that regulatory requirements are understood, and internal systems are configured correctly to transfer data effectively. For this reason, a key preventive measure is to manage the Transaction Reporting Department's dependencies on internal stakeholders:

1. **Monitoring the system landscape:**
   The Transaction Reporting area should monitor the institution's process of maintaining the underlying trading systems, to ensure that these systems continue to be able to facilitate effective Transaction Reporting. This includes: (1) ensuring that required transaction and static data points are defined accurately; (2) ensuring eligibility logic and mapping rules are implemented correctly; and (3) maintaining 'gate-keeping' controls to block incomplete transaction records from being included in reporting submissions. It requires validating the system documentation relative to the regulation, and the validation of source code relative to the system documentation.

2. **People inputs:**
   A range of business units will contribute expertise to the design of both systems and business processes (e.g., to make sure that different business scenarios are correctly captured in the systems) and it is important that these business units are properly represented throughout.

3. **Governance and leadership:**
   The Transaction Reporting Department should ensure it has appropriate senior level ownership and escalation pathways to address stakeholder engagement challenges. As diverse stakeholders contribute to internal data flows it is important to have a clear Data Governance policy that adequately addresses data quality roles and responsibilities.

4. **Strategic level clarity:**
   While operational controls are important, these must be underpinned by a strategic level vision of the desired operating model, with short-, medium- and long-term positions. Otherwise, the institution risks having an uncoordinated strategy, where, as an example, it continues to invest in aging system infrastructure when it would be efficient to replace them.

B. Detective controls

It is not always possible or efficient to prevent process deficiency incidents from occurring. Detective controls operate after the event to identify these incidents or reporting breaches.

1. **Error and rejection messages:**
   Data validation checks can be carried out at various stages as Transaction Reporting data flows through the end-to-end process. including: (1) when data enters the reporting system from trading systems (signal: reporting engine flags the transaction as not fit for reporting); (2) when data is received by trade repositories from the reporting system (signal: Negative acknowledgement or 'NACK' message indicates that the data has not been successfully transferred); and (3) when data is received by regulatory authorities (signal: data quality questions from those authorities relating to the submission).

   Reporting errors identified through these signals can be analyzed to identify and address specific process deficiencies. However, these are understandably the least preferable option, where reporting errors reach the stage of being submitted to regulators. It is better to at least have that insight.

2. **Data quality checks:**
   Regulatory texts specify the permitted Transaction Reporting input values on a field-by-field basis. Firms can combine their own institution-specific trading process knowledge and trading system information with regulatory requirements to design business rules and validations to check the accuracy of reported data. For instance, it can run reconciliations between reported data and the source systems.

3. **External providers and independent validations:**
   It may be insufficient to rely solely on internally developed validation tools. It is possible that the firm has failed to fully incorporate certain aspects of requirements into its processes. Internally designed validation checks will not be useful in such instances, as the knowledge used to develop the primary process would also be used to design the validation tool. Also, while reconciliation might identify mismatches on the level of individual fields, it will usually not assess the logic of field population between different fields (e.g., if field A has value X, then field B should not have value Y). Utilizing an external validation service to independently validate reported data can best support in such instances.

C. Corrective controls

Corrective controls are used to remediate process deficiencies that are identified through detective control measures.

1. **Root cause analysis and process redesign:** While exception reporting can identify adverse reporting outcomes, identifying underlying causes may not be so straightforward. The same consequence or reporting error could be attributable to a process failure at any point in the process chain -- from an incorrect interpretation of regulations to incorrect inputs from traders and other SMEs to system issues at any point in the data transfer process. Designing an efficient operating model for remediation work can be challenging owing to the potential complexity of the causal explanations involved. But is essential for ensuring underlying root causes are being resolved. Identifying the precise causes and designing appropriate modified processes can require inputs from a range of stakeholders with expertise in relation to diverse products, regulations and systems (similarly as with the initial design process).

2. **Transferring risk with third party services:** One way to address quality control deficiencies is to outsource aspects of the Transaction Reporting process to third-party providers. A market of third-party offerings exists that include services whereby providers can administer and maintain Transaction Reporting systems and carry out reconciliations and control checks to identify reporting errors. Providers will be able to leverage economies of scale and they will possess capabilities in relation to regulatory requirements and system-level reporting language requirements (like XML or FpML). Such offerings can be attractive to financial institutions who have not yet made the required investments to meet quality management objectives internally. Such third parties can also be retained to independently assess the maturity of a firm's control framework.

What can Synechron offer?

Synechron has, on multiple occasions, been tasked with setting up and improving Transaction Reporting processes for our financial services industry clients. This provides us with an excellent understanding and vision of the most relevant pain points and improvements needed to ensure a proper Transaction Reporting implementation -- from the regulation all the way to system implementation. This includes control frameworks and creating data hubs. With our industry-focused regulatory domain knowledge, hands-on change specialists and technology leadership, we are uniquely positioned to assist you in any capacity -- from analysis to implementation, and program management to development.

Want further, in-depth information and insight about our capabilities and vision on Transaction Reporting?

Connect with us and let's talk:

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Check out our website:
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Interested in joining our Digital Transformation journey?

Synechron is a leading digital transformation consulting firm focused on the financial services industry and is working to Accelerate Digital initiatives for banks, asset managers, and insurance companies around the world. Synechron uniquely delivers these firms end-to-end Digital, Consulting and Technology capabilities with expertise in wholesale banking, wealth management and insurance as well as emerging technologies like Blockchain, AI, and Data Science. The company has 22 offices around the globe, with over 13,000 employees producing over $800M+ in annual revenue.

Want to know more? Please contact our colleague working in the regulatory reporting domain:

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Resources:

https://www.fca.org.uk/news/press-releases/fca-fines-goldman-sachs-international-transaction-reporting-failures

https://www.fca.org.uk/news/press-releases/fca-fines-ubs-ag-276-million-transaction-reporting-failures#:~:text=UBS%20AG%20(UBS)%20has%20been,November%202007%20and%20May%202017.&text=If%20firms%20cannot%20report%20their,'

https://www.cftc.gov/PressRoom/PressReleases/8428-21

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