Challenges with Identifier Exchange for trading Flows with no Central infrastructure (including Foreign Exchange)

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Overview

- Broadly, there are two central cases to consider for UTI exchange:
  - 1) Trade flow utilising central infrastructure; and 2) Bilateral trade flow without central infrastructure

- Trade flow involving central infrastructure makes implementation of a single UTI easier as both parties can “consume” a common UTI from central infrastructure for reporting

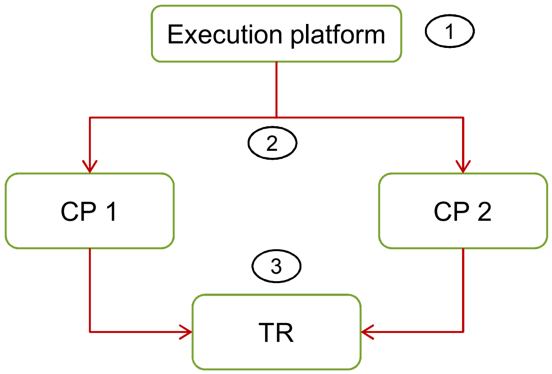
- **Bilateral flow without central infrastructure is problematic - there is no central point to issue/agree a single UTI**
  - This becomes more complex when considering reporting for multiple jurisdictions
  - FX must accommodate a far higher number of trades and participants than other asset classes
  - It also has a significantly higher proportion of bilateral trade flow that does not utilise central infrastructure
  - However, all asset classes will experience the same challenge for this type of trade reporting

- This document distinguishes centralised and non-centralised trade flows and proposes a method of dual identifier exchange for non-centralised bilateral flows which:
  - Could be adopted by other asset classes for their non-centralised flows
  - We do not believe prejudices the policy aims of ESMA
  - Facilitates multi-repository reconciliation both within Europe and globally
  - Puts no additional burdens on TRs that do not wish to adopt this methodology
- **The solution only requires ESMA to be comfortable with trade records showing <u>two identifiers</u> and not requiring one to be specifically designated as a UTI**
  - It achieves pairing (and avoids duplication) by cross referencing these identifiers, as described here

We wish to discuss whether the proposal outlined here is acceptable to ESMA

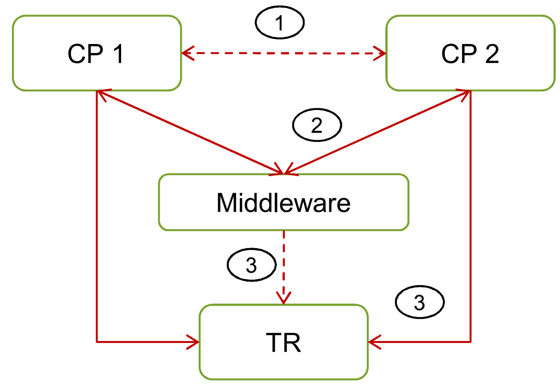
Generic workflows – central infrastructure

Execution



1. Counterparties execute trade via a central execution platform
2. Platform assigns a common UTI and communicates as part of trade details to each counterparty
3. Counterparties report to the TR using the common UTI (or may delegate reporting to an agent)

Middleware

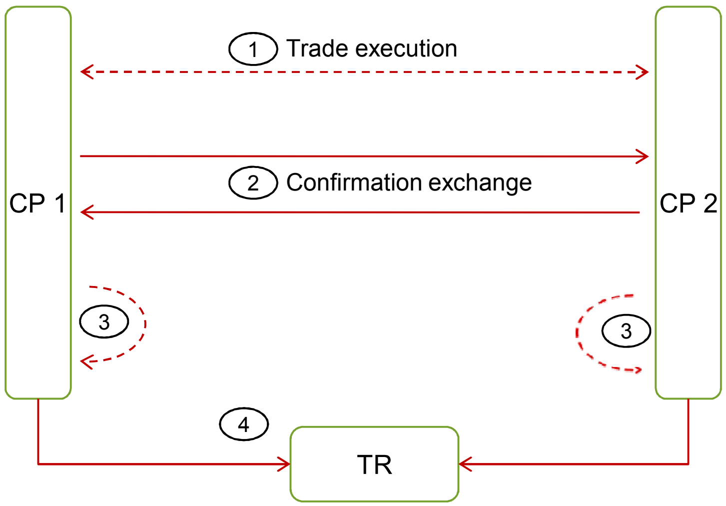


1. Counterparties execute trade bilaterally e.g. via voice
2. Trade details are submitted to central middleware which matches / affirms / confirms the trade. Once matched, the middleware generates a common UTI and passes this back to each counterparty
3. Counterparties report to the TR using the common UTI (or may delegate reporting to an agent e.g. middleware in this example)

Trade flows with central infrastructure facilitate single trade identifiers

Generic workflows – no central infrastructure

Exchange of UTI at confirmation	Comments



1. Counterparties execute trade bilaterally e.g. via voice. CPs internally process trade instruction. This *may* include a trade recap or affirmation
   - Impractical to agree and exchange UTI at this point. High risk of error e.g. if manual exchange of UTI by voice between traders.

2. CPs exchange confirmation messages
   - All firms have an expectation of external exchange of trade details – hence our members plan to adopt this as a mandatory point of exchange for trade identifiers
   - Market practice is that only sophisticated FIs and large corporates confirm trades, typically electronically via SWIFT
   - Other FIs and corporates sign and return their counterparty's confirmation or work on a deemed acceptance basis
3. Each CP internally matches the received confirmation message to its own record of the trade
   - **Key issue – how to determine which party should issue a UTI (or which party's identifier should be used as a UTI)**
4. Under ESMA each CP would report the trade to the TR
   - Note – trade may be reported before match occurs e.g. where real time intra-day reporting is required
5. There may be a final step, depending upon the functionality of the TR, in which an "allege" message is sent from the TR to each CP detailing the key attributes of the trade that has been alleged against them
   - This *may* include the trade identifier.

Where no central infrastructure is involved, the key issue is agreeing which identifier should represent the UTI – and doing so in a manner that is timely and consistent across multiple jurisdictions

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Designating the UTI - options

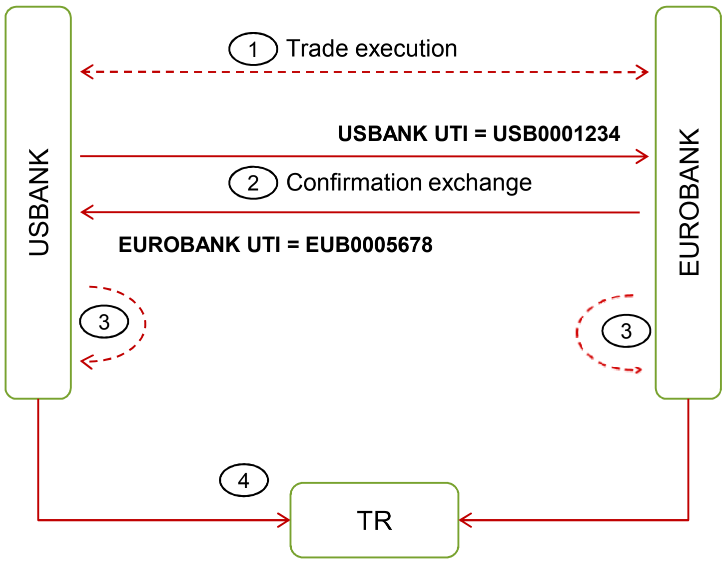
- There are three broad options for designating a UTI:
  - **Option 1: Dual identifier exchange**
    - Each party would assign a trade identifier that is unique to that party and make this available to the other counterparty
  - **Option 2: Industry protocols**
    - Develop industry rules that all participants and TRs would have to implement but which would “choose” a UTI-assigner
  - **Option 3: Trade repository functionality**
    - Trade repositories would develop tools to determine what should be the UTI on a trade

- The primary objectives in developing a solution are to:
  - Maximise flexibility to allow for reporting in multiple jurisdictions
  - Minimising the number of identifiers that parties and TRs need to maintain
  - Minimise the additional build required for all participants and to reduce the burden on smaller counterparties
  - Avoids duplication of data and facilitates reconciliation across repositories and jurisdictions

- We believe Option 1 is additive to the current workflows envisaged
  - It would be optional for TRs and market participants
  - It facilitates the proposed reporting flows developed by our members
  - However, the solution does not preclude or require that other market participants and TRs develop the same workflow – it only requires that neither identifier be specifically called a UTI

Option 1: dual identifier exchange

Exchange of identifiers at confirmation



Comments

- Workflow is as described before. However, at confirmation exchange, each counterparty would assign its own UTI and communicate this to the counterparty
  - Note – industry is currently working on a proposal to develop a common UTI format that can be used in multiple jurisdictions. This would likely comprise of a centrally coordinated namespace + trade identifier, to guarantee uniqueness
- Each counterparty is then able to do either of the following:
  - Consume the opposing counterparty's UTI and include this in its report to the trade repository

  OR:

  - If timing of reporting requires (e.g. intra-day, real time reporting) it may report immediately to the TR with its own identifier and subsequently update the trade record with the opposing counterparty's identifier as an additional data element once established.
- This optionality removes any dependency on another counterparty that may cause one side to miss its deadlines for reporting e.g. If also reporting to another jurisdiction.
- The next slide examines reporting to single and multiple TRs

Option 1: dual identifier exchange example

Trade representation (reported to same repository)

	USBANK		EUROBANK
Our Ref	USB0001234		EUB0005678
Your Ref	EUB0005678		USB0001234
Amount	Xxx		Xxx
Currency pair	xxx		xxx

Assumes TR supports dual identifiers

- Each CP records its own UTI as "Our Ref". Upon exchange it will record the other counterparty's UTI as "Your Ref"
- The TR will pair the two trades by looking for a diagonal match under our ref / your ref fields
  - Achieves the objective of avoiding duplication
- Only one party is actually required to update / include the "Your Ref" field for diagonal matching to occur
  - Overall, less burdensome and reduces regulatory risk vs agreeing the UTI prior to reporting
- ESMA can interrogate the TR using either reference

Trade representation (reported to different TRs)

	TR1 record		TR2 record
	USBANK		EUROBANK
Our Ref	USB0001234	UTI	EUB0005678
Your Ref	EUB0005678		N/a
Amount	Xxx	Amount	Xxx
Currency pair etc	xxx	Currency pair etc	xxx

Assumes only one TR supports dual identifiers

- TR1 is assumed to support dual identifiers whilst TR2 does not
- In this example, parties will exchange UTIs at confirmation, as before
  - However, EUROBANK reports to a TR that does not support dual identifiers (this would most likely be referenced in TR2 as the UTI)
  - It therefore only reports EUB0005678 as the UTI
- Reconciliation across TRs is still maintained as the EUROBANK reference can be paired under "Your Ref" in TR1

A dual identifier system for bilateral trades would work in a multi-repository scenario provided that neither identifier need necessarily be called the UTI

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Option 2: Industry protocols

- In this scenario, market participants would agree a method of determining which identifier should become the UTI
  - For example, under DF, for participants at the same level of hierarchy, FX market participants will be using a simple rule (the “cash rule”) linked to the seller of the lowest alphabetic currency
    - E.g. For an AUD / ZAR trade, the seller of AUD would report the trade
- However, this rule minimises multiple identifiers per jurisdiction only insofar as the same logic can be applied in each
  - Taking the US and European examples, reporting party logic in the US (and hence determination of USI) is partly dependent on counterparty classifications
    - For example, in a trade between a US swap dealer and a European bank, the US bank will be required to be the reporting party and hence will utilise its own USI
  - However, applying the cash rule for the European context may result in the European bank’s ID being designated as the UTI
  - This problem may be multiplied across jurisdictions, hence proliferating multiple “unique” identifiers
- In addition, we expect that there may be instances where certain clients will simply wish to designate their identifier as the UTI irrespective of any protocols
  - For example, where technologically they are not able to agree the UTI up-front or implement logic in their systems because it is not cost-effective to do so
  - In these scenarios, we believe it is right that more sophisticated participants should deal with identifier exceptions

An industry protocol will work but depending on counterparty classifications , local reporting rules and behaviour of market participants may not meet the objective of minimising build complexity and identifier management

Option 3: Trade repository functionality

- Similar to option 2 but market participants to rely on trade repositories to determine or select a UTI
  - In the dual reference scenario, both parties would submit their references
  - The TR would select one as the UTI
- Works best where both parties are reporting to the same repository
  - However, additional workflow and build is required for each participant to receive the UTI back from the TR and update its records
- Suffers from similar drawbacks as Option 2 and may result in multiple UTIs for different jurisdictions
  - Also requires TRs to agree a similar logic to support the multi-repository environment
  - Otherwise reconciliation across repositories is not possible

Relying on trade repositories to select the UTI may be the least attractive option in a multi-SDR scenario

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Summary

- Of the three options, we believe that Option 1 would allow bilateral trades to be most easily dealt with
  - However, we acknowledge that not all TRs may wish to develop this functionality
- We believe Option 1 is additive to the current case that ESMA is envisaging
  - It would be optional for TRs and market participants: it does not preclude or require that other market participants and TRs develop the same workflow
  - Our members wish to support this to facilitate their reporting flows
- The solution only requires ESMA to be comfortable with trade records showing two identifiers and not requiring one to be specifically designated as a UTI