ESRB
European Systemic Risk Board
European System of Financial Supervision

Commissioner Mairead McGuinness
European Commission
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ESRB's view regarding data quality issues and risks for financial stability 12 July 2022

Dear Commissioner McGuinness, dear Mairead,

I am writing to you with regard to the ESRB's view concerning persistently poor data quality and the risks that this poses for financial stability.

This letter, together with its annex, represents the ESRB's view on the matter, and the final letter was approved by the ESRB General Board as part of the written procedure on 11 July.

Reflecting the ESRB's mandate to contribute to the prevention or mitigation of systemic risks to financial stability, this letter highlights the difficulties that persistent data quality issues pose for the adequate monitoring of financial stability risks and how they may relate to underlying risk management problems. More specifically, poor data quality: (i) impedes the adequate monitoring of (financial stability) risks by authorities, which was one of the goals of the post-crisis reforms; (ii) compels policymakers to devote substantial resources and time to follow up on data quality; (iii) creates blind spots due to the exclusion of entities reporting implausible values from monitoring; and (iv) may be symptomatic of a more fundamental problem of poor risk management among certain reporting entities.

The letter contains proposals to address these issues and at the same time to strengthen the supervisory framework for central clearing in the EU and increase the attractiveness of EU clearing.

Context

In view of the European Commission's intention to publish legislative proposals to amend the European Market Infrastructure Regulation (EMIR) to: (i) increase the attractiveness of EU clearing; and (ii) strengthen the supervisory framework for EU central counterparties (CCPs), the ESRB would like to take this opportunity to put forward proposals that could help to improve the quality of the data reported and that require intervention by the European Commission in the form of legislation.

In the view of the ESRB, any improvement in data quality will effectively complement the main goals of the upcoming changes to EMIR, i.e. making clearing at EU CCPs more attractive and their supervision more robust, as better data create more transparency for authorities and market participants alike and allow (financial stability) risks to be monitored at an earlier stage, before they have had the chance to manifest themselves.

The ESRB is in close contact with the European Securities and Market Authority (ESMA) and has discussed these proposals with the respective staff. While ESMA and the ESRB both feel that improvements in data quality can be expected with the entry into force in 2024 of the amended Regulatory Technical Standards (RTS) that were approved in 2020[1], the ESRB is also of the opinion that further structural improvements in data quality are called for, as the reasons for misreporting are not only attributable to the reporting RTS. The proposals seek ways to change the legal and regulatory environment so that it provides the right incentives for CCPs, clearing members and clients to provide information of the appropriate quality and on time. The ESRB would also like to refer to other international initiatives to improve the quality of data reported, such as those of the International Monetary Fund (IMF)/Financial Stability Board (FSB) and ECB Banking Supervision, to highlight the global importance of having accurate and timely data and to ensure coordination between the various initiatives for maximum effectiveness.

Overarching view of the ESRB

The ESRB notes that ensuring data quality is the responsibility of reporting entities (banks, CCPs, funds, etc.); in this vein, the ESRB also notes that financial and non-financial counterparties should already possess high-quality data for their own risk management. The reporting of these data should therefore not give rise to the issues the ESRB has observed in the context of its monitoring activities. Accordingly, the ESRB proposes several approaches that could help achieve better data quality. Some of these proposals may be taken into consideration by the European Commission in the context of the targeted EMIR review, while others more generally encompass the scope of other reporting frameworks as well, such as Securities Financing Transactions Regulation (SFTR) and Public Quantitative Disclosure (PQD) data. Finally, the role of supervisory authorities is confirmed as being fundamental. The annex to this letter provides more detailed information.

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1 End-to-end reporting in ISO 20022 will help eradicate many data quality issues at source, while comprehensive provisions on ensuring data quality for trade repositories and counterparties will substantially support the supervision of data quality.

A) Changes to EMIR (Level 1, Level 2 and other corresponding regulations)

Extension of reconciliation requirements to centrally cleared transactions

EMIR's risk mitigation requirements, such as confirmation, reconciliation and compression, so far apply only to non-centrally cleared over-the-counter (OTC) derivatives. The ESRB suggests that reconciliation requirements between CCPs and clearing members also be introduced for centrally cleared exchange-traded derivative (ETD) and OTC contracts in order to improve the reporting quality of these contracts.

Appointment of a responsible reporting officer

To ensure that the quality of data is clearly on the radar of reporting entities, the mandatory appointment of an officer responsible for all reporting could be included in EMIR. EMIR refers to derivatives, CCPs and trade repositories, where this improvement is most needed, but of course this responsibility could also be applied across a broader spectrum. This function could be made independent (for larger reporting entities) or could be included in the responsibilities of a CRO or CCO, for instance (at smaller institutions). The most important aspect is that this officer is known to and can be contacted by the supervisory authorities.

Scope of reporting

Although the main objective of this letter is to bring to the European Commission's attention the need to improve the quality of the information already published and ways of doing so, there is also the fact that certain information is currently still missing from the reporting requirements. Adding this information to the set of reporting requirements could help improve the monitoring of risks. Most importantly, information on default fund contributions is missing from the EMIR data. The ESRB suggests adding these data fields to the EMIR reporting requirements and, in addition, making the reporting of PQD data mandatory and subject to data quality standards. This would lead to more transparency and is line with the recommendations following the FSB's consultative report[2].

Furthermore, data on non-EU subsidiaries of EU groups could be improved to better estimate the systemic importance of third-country CCPs and monitor them more effectively. To achieve this, the ESRB suggests extending the reporting obligation to financial and non-financial subsidiaries of EU groups.

[2] **Review of margining practices - Consultative report by the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).**

Quick check

Before submission, all reporting entities should perform a quick, aggregative-level check on the data they are sending to the trade repository. An example of such a quick check and what it should entail is provided in the annex and could be implemented by amendments to Level 3 legislation. The ESRB believes that performing quick checks would help to filter out many of the obvious mistakes that are made at an individual level.

Reporting handbook

There is currently some ambiguity as to how certain data need to be reported, and a common understanding of certain reporting fields needs to be established. A so-called reporting handbook would provide more clarity on the reporting specifics. This reporting handbook could be introduced via Level 3 legislation (as a handbook would be subject to frequent adjustments and changes, it would be too burdensome if the text is in Level 2). While the upcoming changes to the RTS will be accompanied by comprehensive guidelines on reporting under EMIR REFIT (which will be published shortly after the publication of the technical standards in the Official Journal), guidelines may not be the appropriate tool for such type of reporting, as they should be relatively easy to update regularly. Importantly, a reporting handbook would allow the authorities responsible for supervision, which have been very much involved in trying to obtain reporting data of better quality and have done more than could be expected of them, to be more effective in their actions; indeed, with a reporting handbook in place, they could impose the correct way of reporting data to a trade repository, with significant benefits for the overall quality of data.

B) Supervisory action

Responsibility for good data quality lies with the reporting entities. Supervisors have been very much involved in trying to obtain reporting data of better quality and have done more than could be expected of them, but data quality issues remain. We understand that supervisory authorities have many priorities and limited resources, but in the ESRB's view – and due to externalities – a reprioritisation of the supervisory attention given to data quality is called for. One possibility could be to link supervision to the previous point, for example by allowing authorities to impose the correct way of reporting data through a reporting handbook and be more effective in assessing/verifying data quality around common guidelines and within the same framework.

C) Other issues

Machine-readable/automated reporting

The ESRB suggests that the European Commission consider whether there are legal obstacles to the introduction of machine-readable and/or automated reporting. In this context, the ESRB would refer to the European Commission's strategy on supervisory data in EU financial services[3], which also investigates the possibility of making reporting requirements readable and executable by machines. This could be used for a broad range of reporting requirements and is not just limited to EMIR and SFTR reporting. It would require the reporting entities to adapt their internal risk management and reporting systems, but it is expected to contribute to an improvement in the quality of available data more generally and thus to facilitate the monitoring of financial stability risks.

Flexibility of reporting requirements

The ESRB has noted that during times of crisis and when trying to monitor risks, additional information is often needed that is not included under mandatory reporting. Therefore, more flexibility to request additional information, if needed from a supervisory and/or monitoring standpoint, would greatly improve the signalling and monitoring of risks. The ESRB is mindful that frequent and ad hoc amendments to the reporting requirements impose costs on reporting entities and that any additional requirements should be reasonable and justified from a prudential risk management perspective.

Publication

The ESRB will publish this letter after it has been sent to the European Commission.

Yours sincerely,

Francesco Mazzaferro

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Head of the ESRB Secretariat

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[3] **Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Strategy on supervisory data in financial services**.