

ESMA Brief - 2017

The Importance of Effective Data Governance in Regulatory Compliance (governance)

The Financial Stability Board (FSB) established two sub-divisions focusing on data governance and data management, with the governance unit focusing on securities financing transaction data collection. Effective policies and procedures should be approved by relevant boards or senior management to establish a robust governance structure. Compliance with ESMA's requirements is facilitated by detailed governance reports involving system, technical performance, and reporting models. The open and transparent ISO standards are considered by ESMA to ensure robust governance and to facilitate reporting in the regulatory community. Consequently, organizations applying for trade repository registration should provide substantial information regarding their governance structures and internal controls to ensure compliance. The importance of adhering to recognized corporate governance codes is emphasized. Lastly, ESMA also reviewed the independence and adequacy of national competent authority resources in regulatory compliance, focusing on conclusive governance in the reporting and supervisory processes. Therefore, transparent and robust governance structures are fundamental for regulatory compliance and risk management practices.

Detailed Overview of Unit Measures and Commodity Classifications (environment)

The text includes an extensive list of unit measurements (including kilogram, ton, metre, and various energy measurements), as well as a compilation of commodity classifications and terms related to finance and environmental regulation. It also includes descriptions for various accounting policies related to environmental expenses, functional currency, and interest in funds. Additionally, there are references to a regulatory framework that places emphasis on transparency in securities financing transactions, climate-related expenses, accounting policies for fair value measurement and other financial reporting standards. There are also details about accounting policies related to the primary economic environment in which an entity operates and notes on decommissioning, restoration and environmental rehabilitation funds.

Legal Framework Challenges and Proposed Solutions for Securing Global Securities Financing Data (confidentiality)

Key issues include defining a legal framework for data sharing and transmission to global aggregators and implementing safeguards against potential legal obstacles for global level data collection. These barriers can be managed by establishing rules of access and publishing selected aggregated data protocols while maintaining data confidentiality. It's crucial that entities ensure confidentiality, integrity, and protection when dealing with data under the Security Financing Transaction Regulation (SFTR) and European Market Infrastructure Regulation (EMIR). ESMA proposes that Trade Repositories (TRs) provide detailed policies and procedures to protect data against cyber risks. They also highlight the significance of the collateral taker reporting on reuse and managing confidentiality risks effectively. ESMA believes that reconciling Securities Financing Transactions (SFTs) when reported to different TRs can remove potential confidentiality restrictions. ESMA emphasizes that while publishing granular data is possible, counterparty confidentiality management is non-negotiable.

Authorities must establish relevant internal procedures ensuring the confidentiality of data while enabling timely data provision. ESMA advocates for the use of electronic signature and data encryption protocols to maintain confidentiality, integrity, and protection of data. Reportedly, TRs should also utilize this method when providing access to data for authorities. The goal is to help the public understand the SFT market functioning without divulging confidential data. ESMA states that data exchange between trade repositories and authorities must be done securely to maintain data confidentiality.

Essential Requirements for Trade Repository Registration and IT System Resiliency (technology)

The document emphasizes that for Trade Repositories (TRs), a resilient and robust IT system is essential for regulatory compliance. ESMA states that at least one person with IT education and experience should be directly employed by the TR for managing its IT affairs. Further, ESMA makes clear that for SFTR reporting, the concept of a broker is not identical with the definition of a prime broker. Highlighting the importance of comprehensive and detailed information on IT systems and staff expertise regarding IT matters for the registration process, the document details the requirements of the application. Besides the data about the applicant's staff, it should include the information technology system's in-depth description, user facilities developed for users, investment and renewal policies for IT resources, and outsourcing arrangements. Specific focus is on providing details demonstrating the durability of systems and resilience against potential threats. Lastly, the document also touches upon the specificities of technology systems used across different entities and the advantages held by firms with up-to-date technology.

Implications of Business Model Change on Financial Assets Management and Governance (business model)

Managers are interested in understanding how a shift in business model influences the management of financial assets, specifically reclassification and its impact on financial statements. This pertains not just to measuring financial assets at fair value through comprehensive income, but also involves understanding the objectives of holding such assets and the nature of the cash flows they generate. Recognizing and assessing risks associated with diverse business models is vital. Guidelines are being developed to ensure that management committees take into account changes in business model, strategies and organization in their assessments. Continual training for members of the management body is advised to ensure they understand changes in legal and regulatory requirements as well as operations tied to the new business model. It is also recommended for overseeing bodies to conduct an annual adequacy assessment when there is a material change to the business model and strategy.

Application and Evaluation Procedures for Registration as a Trade Repository (internal controls)

The application process for becoming a trade repository requires extensive documentation regarding each member of the senior management and board. This information includes a CV, records of any criminal convictions specifically related to financial services or fraudulent activities, a self-declaration of good standing, and a statement of potential conflicts of interest. The applicant must also provide detailed records about the staff that will be directly employed by the trade repository, including their qualifications, roles, and training. This information extends to staff responsible for internal audit, internal controls, compliance and risk

assessment, and even those under outsourcing arrangements. The corporate governance structure and internal control mechanisms of the applicant are also taken into account in the evaluation process. Entities with sound corporate governance structures and robust internal control mechanisms are considered less risky, and thus, more likely to be successful in becoming a registered trade repository. The applicant's policies on discretion when contributing input data and its implementation also need to be documented meticulously. These policies shall cover the exact circumstances for discretion, who within the organization can exercise it, the relevant internal controls, and post-exercise evaluation. In short, becoming a registered trade repository requires stringent background checks, rigorous control mechanisms, thorough training programs, and a complete disclosure of staff qualifications and potential conflicts of interest.

Requirements for Trade Repository Registration and Management Integrity (fraud)

The information necessary for trade repository registration includes details regarding each member of the senior management and the board, such as their CV, criminal convictions related to financial services, fraud or embezzlement, and a self-declaration stating their reputation in relation to financial services. It also requires a declaration of potential conflicts of interest. Information regarding the company's staff, their roles, qualifications, and descriptions of the IT staff and the individuals responsible for internal audit, compliance, and risk assessment is also necessary. Past fraudulent behaviours and criminal offences, particularly related to financial activities, need to be disclosed. The CRA regulation imposes strict confidentiality obligations ensuring the protection of confidential information from theft, misuse, and fraud. The credit quality assessment methodology of the manager should refer to various relevant qualitative criteria like analysis of underlying assets, relevant markets, and governance risk associated with the issuer. Clarity on the liabilities of parties in case of error, compliance breach, or fraud is also required.

Regulatory Standards for Trade Repositories and Benchmark Providers (accountability)

The document discusses the regulatory standards for trade registering, the extension of registration of trade repositories (TRs), and the provision of benchmarks. Increased transparency, operation efficiency, accountability, and regulatory oversight are expected benefits. For compliance, providers need robust internal control structures, oversight and accountability frameworks including risk management policies and IT systems. Despite certain exceptions for non-critical or non-significant benchmarks, detailed information is necessary for registration application. ESMA has enhanced its own accountability through publishing a single programming document reflecting activities and work programs. Firm responsibilities in execution arrangements and policies are stressed for Meets MiFID requirements.

Analysis of Stakeholder Engagement Program for SFTR Requirements (interviews)

A consultant has performed a comprehensive cost-benefit analysis (CBA) on Security Financing Transaction Regulation (SFTR) requirements, based mainly on interviews and data collection. In-depth interviews were conducted with a variety of market participants including trade repositories (TRs) and reporting parties. These interviews, combined with an online survey, formed the basis of a structured stakeholder engagement program, aimed at understanding the potential impacts of ESMA's draft technical standards. The process ran through October to December, allowing participants to fully understand ESMA's proposals. The stakeholder

engagement program initially targeted TRs, reporting parties, and National Competent Authorities (NCAs) but later excluded NCAs and increased discussions with reporting parties. A total of 13 interviews were held, along with eight online survey responses. The participants highlighted the need for institutions to gather verifiable data and conduct suitability assessments, considering both hard and soft factors. The institutions should also manage possible conflicts of interest and evaluate previous board activities through interviews or administrative hearings where required. Notably, this assessment should take place within six months to enable thoughtful decisions.

Enhancing Audit Quality and Compliance with Standards (auditing standards)

The quality of audit opinions needs significant improvement, and the Audit Standards Framework (ASF) must take initiatives to collaborate with relevant authorities governing audit standards. Importantly, the historical annual financial information should be independently audited, ensuring it gives a true and fair view in accordance with applicable auditing standards, regardless of the applied member state's rules or equivalent standards when the audit directive and audit regulation are not applicable. In case of any deviation from international auditing standards, the registration document should state which auditing standards were applied and explain significant departures. This extends to independent audits or reports on historical annual financial statements for the purposes of the prospectus. For instances where the Audit Directive and Regulation do not apply, the same level of compliance is expected in auditing the annual financial statements.

Review of Accounting Statement Changes & Disclosures (accounting estimates)

The discussion mainly revolves around the importance and nature of various key accounting elements, namely: disclosure in cash flow statements, changes in accounting policies and estimates, and disclosure of related errors. The subject matter includes the presentation and disclosure of changes in accounting policies, estimates and errors, clarifying the relationship between categories in a statement and presenting how they complete the table. An example of the collateral disclosure is given, highlighting how this represents a standard value for the 'accounting estimates' axis, if no other member is utilized. The impracticality of estimating future effects due to changes in accounting estimates is also outlined. Insight is provided into the disclosure of changes in accounting estimates with explanations, tables, and line items to represent concepts included in the table. The text also mentions the varied roles such as managing cash flows, accounting for changes in estimates and errors, and the accounting responsibilities in a co-operative entity. Cases are presented that explore issues in intangible assets, impairment of assets, and changes in accounting estimates. Symbolic scenarios of value-in-use methodology application in impairment testing, the purchase of a car fleet with a buyback agreement, and restatement of comparative amounts are outlined establishing set standards for regulating business finance decisions.

Innovations, Risks and Regulatory Responses in European Financial Markets. (innovation)

The summary of the presented information highlights the focus on principles such as investor protection, market transparency, innovation, and reduction of administrative costs in financial markets regulation by the Commission. The risk analysis is actively scrutinizing the advantages and disadvantages attached to financial innovation in the EU financial markets. ESMA is instrumental in developing a framework for product intervention for monitoring and assessing

financial activities through a formal program. Consumer protection gets special attention, with achievements like submitting draft Regulatory Technical Standards on bundled retail and insurance-based investment products. Financial institutions are urged to consider product complexity, risk features, innovation and potential conflicts of interest when designing their services. ESMA has a framework to ensure coordination and supervision for innovative financial activities, identify and mitigate risks with a fee structure that does not discourage industry involvement or prevent innovation. Inspections may also result from proposals submitted by various financial bodies.

Regulatory and Financial Requirements for Trade Repository Registration (international standards)

People are interested in understanding the financial and business information required for registering as a trade repository. This includes a comprehensive set of financial statements complying with international accounting standards, a provision for statutory audits on these financial statements where applicable, and the mandatory inclusion of the external auditor's details if the applicant is audited. This application process also requires the trade repository to grant specific entities access to aggregate level data, which must be calculated as per the international standard on SFT data collection and aggregation. The registration document must further disclose the auditing standards used and any significant deviations from global auditing standards. These requirements center around ensuring high-quality audits and, therefore, reliable financial information. ESMA's guidelines on stress testing of MMFs also reference these EU/International standards, emphasizing a flexible approach to accommodate continually evolving international standards.

Trade Repository Registration and Financial Reporting Requirements (going concern)

Companies seeking to register as a trade repository must detail their available resources, procedures to mitigate risks, liquid net assets funded by equity to cover potential losses, and business continuity plans. This application should also include their financial strategies to manage operational costs in case of restructuring or wind-down over a minimum of six months. Complementing this, financial reporting standards demand specific labeling and marking requirements for financial years starting January, highlighting company identification, details of entity, mandatory reporting elements, IFRS compliance, statement on entity's ability to continue as a going concern, and explanation of non-comparison of financial statements. The role of competent authorities differs from the direct management, specifically regarding an institution's financial sustainability and going concern status, primarily in unfavorable economic conditions.

Maintaining Objectivity and Managing Conflicts of Interest in Credit Rating Activities (objectivity)

The key proposition is that the oversight function must include measures for managing potential conflicts of interest at the administrator level, stemming from its ownership structure or other sources. The focus is also on ensuring that objectivity prevails when diverse stakeholders with competing interests are acting as members. Objectivity brought about through quantitative analysis is emphasized as equally important. The ESMA views the goal of the conflicts of interest management in the CRA regulation as ensuring objectivity, independence, integrity, and quality of credit ratings, as well as the transparency of these ratings. Furthermore, these regulations aim to protect investors and financial markets. The

overall objective of these organizational requirements is contributing to the pertinent, independent, and quality-driven credit rating activities.

Understanding Financial Investment and Translation Adjustments (esg)

People are interested in various factors related to financial investments and currency translation adjustments. They focus on the adjustments for losses or gains resulting from the disposal of non-current assets and unrealised foreign exchange, which provide necessary inputs to reconcile profit or loss to net cash flow used in operating activities. Details of investments in the employer held by retirement benefit plans as well as details of guarantees given or received for outstanding balances in related party transactions are equally important. The gross carrying amount of financial assets with modified contractual cash flows also garner attention, particularly when there have been changes in the loss allowance during the reporting period. The effect of net exchange differences on goodwill and other undisclosed changes that result in an increase or decrease in goodwill are other areas of interest. These considerations form the basis for understanding the financial performance and position of an entity.

Technological Advancements in Fintech and Impact on the Financial Sector (fintech)

The sector is witnessing rapid advancements in fintech, manifesting the potential to revolutionize the delivery of financial products and services. Three key areas of interest include distributed ledger technology (DLT), big data and robo-advice. Regulators, such as the EBA, EIOPA and ESMA, are monitoring the fast-paced growth of fintech and its implications on the financial sector. While fintech brings about changes in business models and presents new opportunities, it also raises concerns about data privacy, vulnerability to cyber-crime, and related legal issues. Remedial measures are being worked on by fintech firms and financial intermediaries to address these challenges in governance, privacy, and interoperability.

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