SOLVING THE SFTR DATA CHALLENGE

Europe's new rules on securities financing transactions require firms to collect and report a mass of new data. This is a challenge, but also an opportunity.

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A spike in market volumes and volatility caused by COVID-19 prompted regulators in Europe to postpone the rollout of a new reporting regime for securities lending and repurchase agreements in March.

The Securities Financing Transaction Regulation (SFTR) introduces complex new reporting requirements for financial counterparties aimed at addressing shadow banking risks and increasing transparency in European markets, but the unprecedented trading conditions at the start of the pandemic created the need for some breathing room.

While market participants were well advanced in their preparations for the implementation of SFTR by the time the WHO declared a pandemic in mid-March, the industry asked for a grace period from the European Securities and Markets Authority (ESMA) to cope with the operational challenges of COVID-19.

“As with any disruption to markets or workforce, the primary duty is to run-the-bank activities, which of course has a causal impact to change-the-bank projects,” says Adrian Dale, director of regulatory policy and market practice at the International Securities Lending Association (ISLA). “SFTR development, whilst well underway after receiving critical guidance on key aspects, was about to begin full-scale testing and firms expressed concerns about COVID impacts.”

Among other things, participants were worried about either not being sufficiently advanced by the April 14 go-live date or, worse, having to pause testing altogether. In conjunction with other industry associations, ISLA wrote to ESMA asking for a six-month delay to allow final SFTR development and testing to be completed in time for an October deadline.

“The impact on personnel involved in SFT implementation programs compounded by pressure on firms caused by the associated surges in market volatility and volumes, has reached a point where firms believe their capacity to ensure compliance with the requirement as of April 14 has been critically compromised,” said the letter.

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A compromise three-month delay saw the first two phases of the rollout combined into a single day, July 13, when banks, investment firms, central securities depositaries and central counterparties all went live — and without much of a hitch.

“The start of reporting seems to have gone well, with nearly 1.5 million trades being successfully reported in the first week,” says Pauline Ashall, capital markets partner at Linklaters in London.

Indeed, trade repository statistics and industry feedback to ISLA suggest that the delayed implementation has been a vast improvement on previous regulatory reporting launches.

“Pairing rates are high and matching low, as expected, as counterparties work through issues such as reviewing reference data,” says Dale. “However, the SFTR go-live story is not over yet.”

ESMA’s removal of its backloading requirement for SFTR reporting as part of the COVID-19 concessions certainly helped firms to get ready. The original regulatory technical standards had required firms to report transactions that were open before the go-live date and still open 180 days later, but in March, ESMA scrapped that requirement for all phases of reporting.

What is SFTR?

In the wake of the 2008 global financial crisis, regulators sought to mitigate some of the inherent risks in the $51 trillion shadow banking system. The Financial Stability Board and European Systemic Risk Board recommended a package of measures to increase transparency, which resulted in the European Commission publishing the SFTR in January 2016.

The rules are intended to capture data on transactions where securities are used to borrow cash, or vice versa. This mostly includes repos, securities lending and sell/buy-back transactions, whereby ownership of the securities or cash temporarily changes hands and then reverts back, leaving both counterparties holding their original asset, plus or minus a small fee depending on the purpose of the transaction.

The regulation applies to all institutions involved in nonbank financial intermediation, including credit institutions, investment firms, central counterparties, central securities depositories, insurance companies, funds, pension funds and nonfinancial counterparties. The regulation has broad global reach, as it also applies to any third-country counterparties involved in SFTs through subsidiaries in the EU.

Under the regulation, firms need to report their SFTs to a trade repository (TR) registered by ESMA.

SFTR reporting

SFTR poses significant data challenges for firms, with granular daily reporting requirements for repos and other types of SFTs.

Overall, the SFTR reporting template contains 155 reporting fields, and firms will have to report any modifications, terminations or corrections throughout the life cycle of a trade and report on collateral market values, collateral reuse and margins on a daily basis. All data must be reported to TRs through the ISO 20022 messaging standard.

Four trade repositories are approved for all types of SFT reporting:

- DTCC
- Krajowy Depozyt Papierow Wartosciowych
- Regis-TR
- UnaVista

SFTR requires dual-sided reporting, which is to say that both borrower (the collateral provider) and lender (the collateral receiver) need to report their side of the SFT to an approved TR within one day of the trade. A unique transaction identifier must be included to match reports from each counterparty, and participants must also use legal entity identifiers to identify their counterparties and a number of other parties, such as agent lenders, involved in the transaction.

According to ESMA, many types of corporate actions that involve a corporate loan may potentially fall under the definition of an SFT, such as:

- Mergers, acquisitions and takeovers
- Joint ventures
- Spin-offs and carve-outs
- Divestitures
- Reductions of capital
- Share buybacks

Data providers such as Refinitiv offer regulatory reporting solutions that meet SFTR requirements. Refinitiv already provides reference data fields that could be used to classify any underlying security or collateral referenced by an SFT as required by SFTR, and has added new SFTR-specific fields to help reporting firms comply with the regulation. It also actively provides support by dynamically amending the fields values in line with evolving ESMA regulations. All these fields are delivered to its customers through Refinitiv® Datascope Select and Refinitiv® Datascope Plus.

"Refinitiv will continue to adopt a horizonal view of the regulatory landscape to ensure it is aware of the challenges that the industry will face in advance of the implementation dates, enabling it to work with impacted firms and develop or adapt strategic solutions," says Russell Ironside, pricing and reference services propositions manager at Refinitiv. "In the shorter term, this includes services related to the ongoing interbank lending rate transition as well as the EU taxonomy for sustainable finance."

Datascope Plus offers customers the ability to access bulk cross-asset content in regionalized packages — for example, reference data for all corporate bonds within Europe, the Middle East and Africa. The utility of Datascope Plus is that customers can define which attributes are important for them, such as those related to SFTR, among large and constantly updated asset class subscriptions. Datascope Select provides an agile request-response solution, where customers define their own list of cross-asset instruments alongside the attributes that interest them and retrieve the resulting data.

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Challenges and opportunities

While all participants are eager to encourage a better-functioning market, most firms would probably see the challenges of reporting under SFTR as outweighing the opportunities.

"The regulatory reporting framework specified by ESMA is ambiguous and complex, hence the interpretation is not an easy task," says Ironside.

All the data required by SFTR must be gathered in one report for each transaction, no later than the following business day after the transaction. This can be troublesome, according to Dale at ISLA, not least because any data replicated may need to be reconciled, which ties up resources and also creates dependencies that have to be observed in future developments and regression testing.

Although this reporting process can be delegated to third parties such as brokers or securities lending agents, the regulatory responsibility for ensuring accurate and timely reporting remains with counterparties.

Also, the basic framework of SFTR reporting is not entirely new. Many banks and investment firms are familiar with such requirements through their experience of reporting trades under the European Market Infrastructure Regulation (EMIR), which introduced rules for over-the-counter derivatives, central counterparties and trade repositories in 2012.

For example, EMIR necessitates dual-sided reporting the following day, applies to a similar class of counterparties, requires reporting at the level of an individual contract with the full set of data in a single report and mandates that records must be kept for five years — all of which are also required under SFTR.

While SFTR reporting creates additional challenges for firms, there may be some operational upside in the long run. When the industry was discussing settlement disciplines under the Central Securities Depositories Regulation, firms recognized that SFTR could create some positive side effects. For example, increased reconciliations could improve settlement failure from mismatches of price, value or quantity.

Another potential upside from SFTR reporting is the additional performance analytics that become possible through the new data sets that are being created. Data providers can help firms comply with their SFTR reporting obligations and perform insightful performance attribution reporting, and such diagnostics can highlight important information about types of collateral or margining practices, for example.

Standardization

Participants in the securities lending industry have a history of working together to achieve a unified operating framework in areas such as legal opinions and taxation through industry associations such as ISLA, triggered in part by the need to comply with regulatory changes.

SFTR is no different. The regulation is driving industry standardization across market participants and accelerating the digitization of the securities financing sector, especially in areas such as standardizing terms and booking practices.

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"There are few things that force change in the finance industry as quickly as regulation," says Dale. "To deliver the required data, aspects of our market that perhaps hadn't been looked at in a while were reviewed and, in some cases, refined. One example, perhaps overused now, is of loan reduction or partial close, where some systems close the full loan and then restart a new smaller loan, others create a tidier delta movement which fits better with SFTR reporting."

Other examples such as corporate actions, time stamps and the use of legal entity identifiers are also useful additions. This momentum towards standardization continues in the work ISLA is doing regarding a common domain model and standard clause library.

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What's next?

The effect of COVID-19 was not only to delay the implementation of SFTR, but also to significantly reduce the amount of transaction data — because the removal of the backloading requirement means that only transactions entered into since go-live are being reported.

One result of this is that it will take time for loan and collateral levels to equalize as older transactions mature, due to the fact that collateral has a shorter life cycle.

In October, the next phase of go-live will extend SFTR reporting requirements to insurance companies, funds, pension schemes and relevant third-country entities, many of which will rely on outsourcing.

"In practice, where these entities lend securities through an agent lender, they are likely to delegate the reporting to the agent," says Ashall.

However, as buy-side firms start to submit their data, it is expected that there will be an increase in dual-sided reporting and reconciliation breaks. This should provide a clearer picture of what the industry needs to prioritize to improve the process and reduce such breaks.

ISLA's Dale says that he expects the association's SFTR working group should be in a position to start that work by December. "Though I would note that, as pairing is high, firms are already discussing remediation work with trade repositories and, where used, their vendors," he says.

After that, in January, the next phase of go-live will see all nonfinancial counterparties reporting SFTs.

RE1294404/10-20