SFTR IMPACTS

TFE THE FIELD EFFECT

INTRODUCTION

As the first in a series of whitepapers, The Field Effect will review the impact of the Securities Finance Transaction Regulation (SFTR). In this paper we give an overview of SFTR and its high-level impacts, along with a review of market readiness for the implementation. In subsequent papers, we will discuss solution design and detailed planning in more detail.

Following the publication in March 2017 of the final draft technical standards by ESMA, the European Regulator, firms have had some time to digest and assess the impact of the regulatory requirements on their business, before SFTR reporting requirements come in to force in quarter 1 2019[1].

Firms now have around a year and a half to get ready. However, many firms advise that they have yet to assess the impact on their business and design their reporting solution. Part of the issue is the enormity of the regulation and its product scope, along with firms' continuing focus on MIFID II implementation.

TFE recently undertook a survey to assess how firms are preparing for the go-live date. In this paper we give an overview of the regulation and the impacts, along with a summary of the survey results.

1 Based on current market expectations at time of publication

SFTR – HOW DID WE GET HERE?

The regulation is driven by a policy framework adopted by the G20s Financial Stability Board (FSB) in 2013[2], with the European regulator, ESMA, establishing draft regulation and a consultation process with the European market in 2015[3]. Other regulators have yet to pursue their adoption of the FSB's policy and there has been industry talk on what shape this is likely to take.

Principles

The driver for the regulation is to increase transparency and shine light on the opaque world of securities finance trading. The FSB requires granular national level reporting on securities financing trades, along with collateral re-use. ESMA has taken an approach similar to the EMIR reporting requirements (European Market Infrastructure Regulation), both to complement OTC derivatives reporting, and to re-use as much EMIR reporting infrastructure to reduce the burden on reporting firms. Much has been made of the requirement to report at the transaction level within the market, and the effectiveness of this, but given the G20 driver for increased trade-level transparency, and an existing operating model with EMIR, it is more surprising that other regulators are not following suit.

2 Strengthening Oversight & Regulation of Shadow Banking, 19 August 2013

3 Regulation 2015/2365 of the European Parliament and of the Council, 25 November 2015

SFTR OVERVIEW

For anyone familiar with reporting of derivatives transactions under EMIR, SFTR takes the same concept and applies it to the securities finance market.

Extensive Data Requirements

The data payload for SFTR will take considerable effort to assemble, in summary:

- Reporting using a combination of 153 fields, depending on product and report type
- We believe that 40% of fields are not currently or readily available
- Each transaction requires a Unique Transaction Identifier (UTI)
- The data must conform to ISO20022 Standards

WHO

- European entities and their branches
- European branches of non-European entities
- Financial and non-financial firms are required to report
- Both sides to a transaction report (if in scope)

WHAT

- Repo
- Securities lending & borrowing (securities & commodity)
- Buy-sell backs
- Margin lending (by prime brokers)

WHEN

- T+1 for transactions
- T+1 for collateral known at point of trade
- S+1 for collateral at settlement
- 180 day rules for back-book trades at regulation go live

Transaction Level Reporting

Compliance is made harder by the need to report a low level of detail:

- Transaction level reporting
  — For repo, securities lending, buy-sell back

- Position level reporting
  — For margin lending

- Initial & modification reports
  — New trades and modification to open positions
  — Collateral and re-use of collateral
  — Certain CCP novation activity

Action Points

- Learn more about the regulation itself and the approach to regulation
- Visit the ESMA website here https://www.esma.europa.eu/press-news/esma-news/esma-provides-implementing-details-sftr
- Make a high level plan for your firm, including impact analysis, timing, budget, governance

SFTR IMPACTS

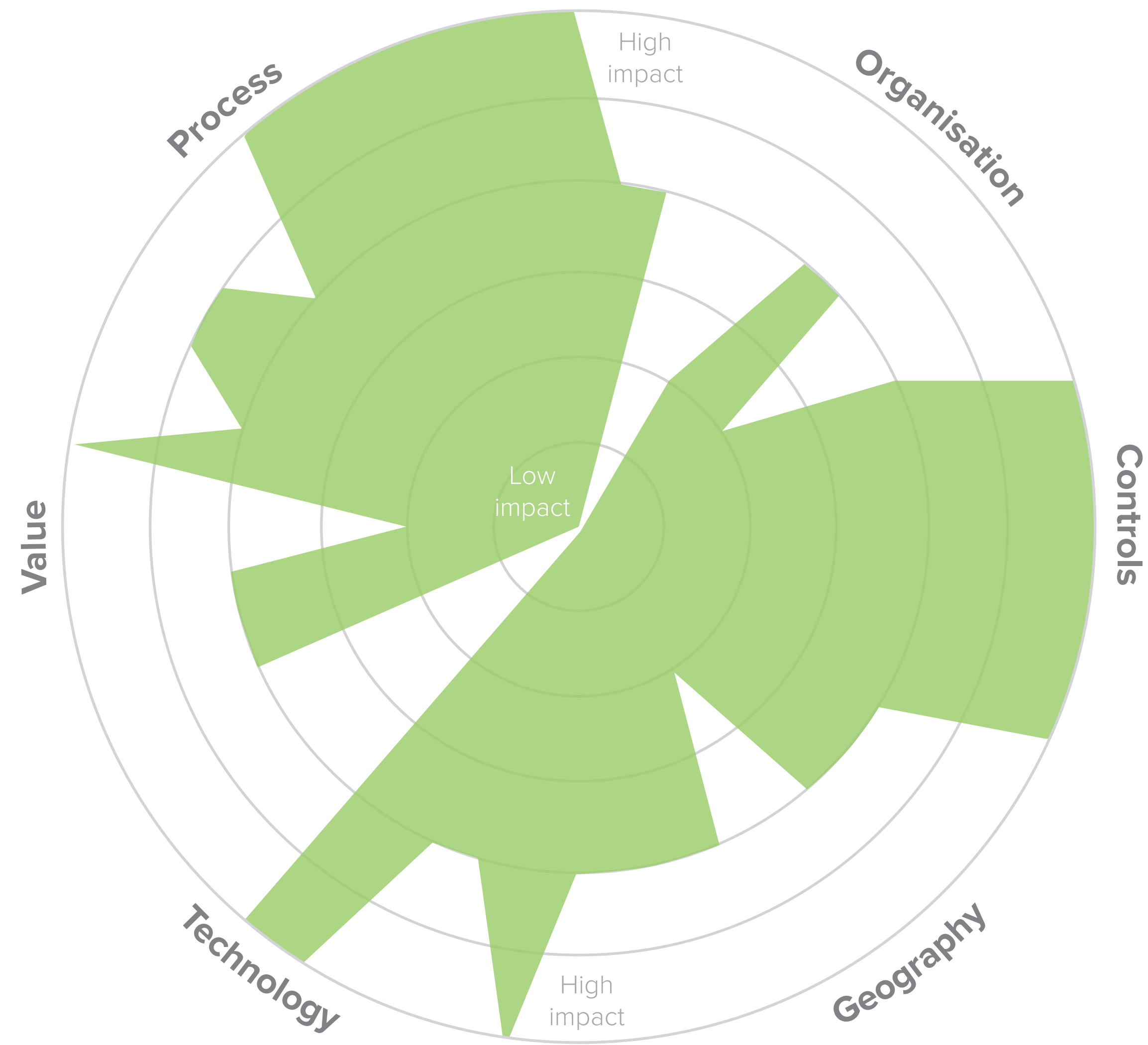
What isn't impacted (not much)

At TFE we've analysed the impacts of the regulation from looking at the principles, products, data, scope and reporting requirements. The main impacts centre around the business operating model, data and life-cycle event management. Out of the 18 functional areas we've identified in a typical Repo / SBL business, all 18 are impacted to some extent, with 12 highly impacted.

Businesses also have an opportunity to leverage the cost of SFTR implementation through enhancements to efficiency, and improving data quality and usage. However, concerns around the scale of impact and time available to build their SFTR capabilities means firms are often focusing attention on compliance to the regulation rather than the additional opportunities available.

FIGURE 1

SFTR Impact Assessment



The main impacts are summarised here:

BUSINESS	LIFE-CYCLE	DATA
• Business strategy • Revenue & costs • People, processes & technology • Data	• Life-cycle event reporting • Position & collateral management • Collateral re-use & optimisation • Controls	• New & existing data reporting • Reporting standards and transformation • Client & delegated reporting • UTI generation and receipt • Matching / reconciliation • Timing and trade enrichment

Action Points

- Form a team to own SFTR – appoint an accountable executive and an expert working group to lead the firm
- Complete your impact analysis early – this will inform timing and budget for the implementation phase

Operating Model Impacts

Along with the high-level impact assessment, TFE has reviewed a typical securities finance transaction (SFT) process model - the processes, activities and steps that make up an end-to-end process. This model captures both the initial reporting activity that is required (new transactions), the life-cycle events that would trigger economic changes (modification) and close out (termination) reports, along with error, correction, position component, margin update, collateral re-use update, valuation update reports – all of which are required.

The model captures all of the processes a firm currently performs, from trade capture and agent lender disclosure to post trade amendments such as re-rates, partials, rolling maturity, netting, novation, reconciliation, corporate actions, collateral / exposure management and so on. Reviewing this helps build up a picture of the areas of the firm's operating model that are impacted by the regulation. Much is made within the market of the data issues around the regulation, but this is just the tip of the iceberg in terms of impact. The diagram below shows the areas impacted and any solution design should consider these.

As a result of the analysis, the reporting triggers and data required for each of the firm's activities can be ascertained along with any changes required to processes, data, technology, controls and people to achieve the target state. This target state is useful in helping design the overall solution a firm needs for SFTR compliance, vendor selection, developing the delivery roadmap and budgeting, along with building in potential benefits post regulation go-live.

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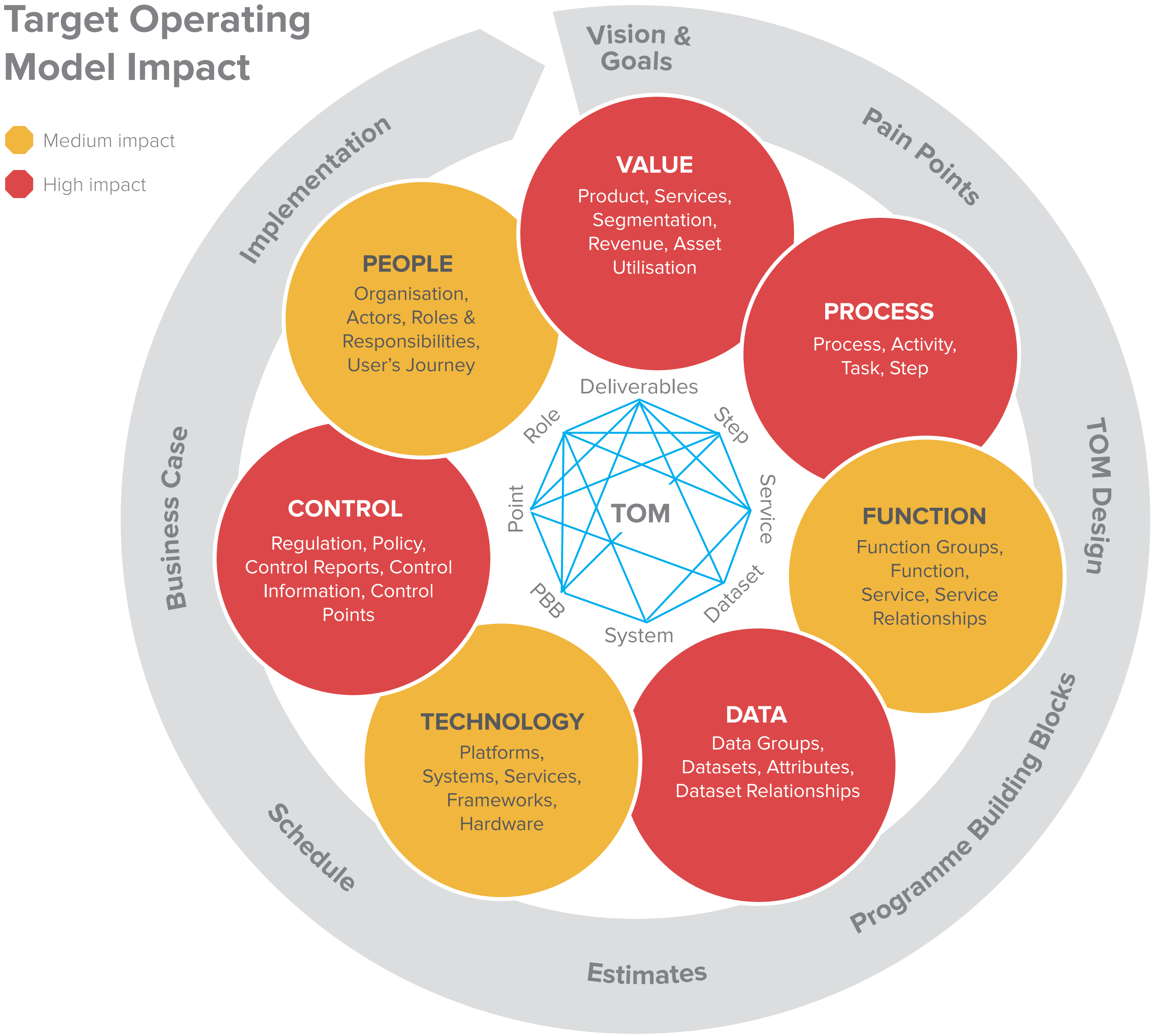
FIGURE 2

Target Operating Model Impact



Action Points

- When conducting your impact analysis, an integrated view of your securities financing business is important – ensure all stakeholders are engaged
- The owner(s) of your business need to understand the outcome of achieving compliance not just from an operational perspective but from an opportunity point of view – are there any new business possibilities created by SFTR?

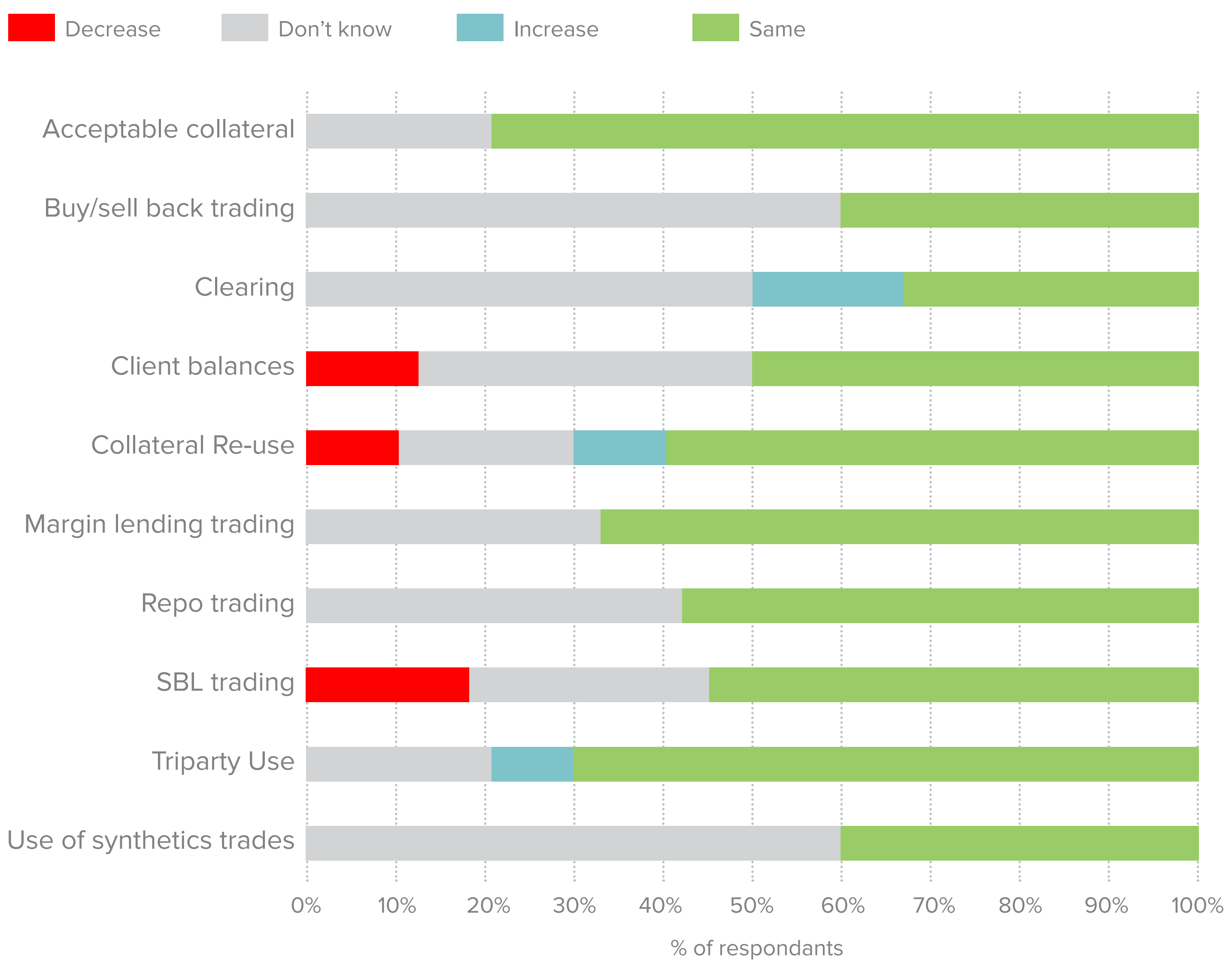
OUR SFTR SURVEY

The Field Effect surveyed the market to understand how prepared firms are. 77% of the respondents are at the early stages of preparing their businesses for the new regulations (about 46% in the early stage of impact analysis). Survey respondents identified the highest impacts were around the data requirements, controls and processes – regardless of the product, and they expect relatively low impacts on their product and service offerings.

Generally, firms are either positive that the market impacts will be minimal, or are unsure – particularly around trading activity. However, some firms saw potential increases in clearing activity and triparty use, whilst a small amount, evenly split, thought there would be either an increase or decrease in collateral re-use.

FIGURE 3

Market Assessment of the Activity Impact of SFTR



Action Points

- What effect will SFTR have on your business processes and client facing activity?
- How are your clients responding? Do they need your help?

IMPLEMENTATION ROADMAP

Before planning the 2018 book of work, firms must first design their SFTR solution. A number of vendors have launched SFTR solutions allowing firms to outsource functions such as UTI generation, data enrichment, report generation and connectivity to trade repositories. Some firms may select a single outsourced solution, whereas others with more complex or wider business scope may select a patchwork of providers, others may opt to build on in-house reg reporting platforms. Key determinants in the decision will be price, service, architectural complexity and alignment with strategic vision.

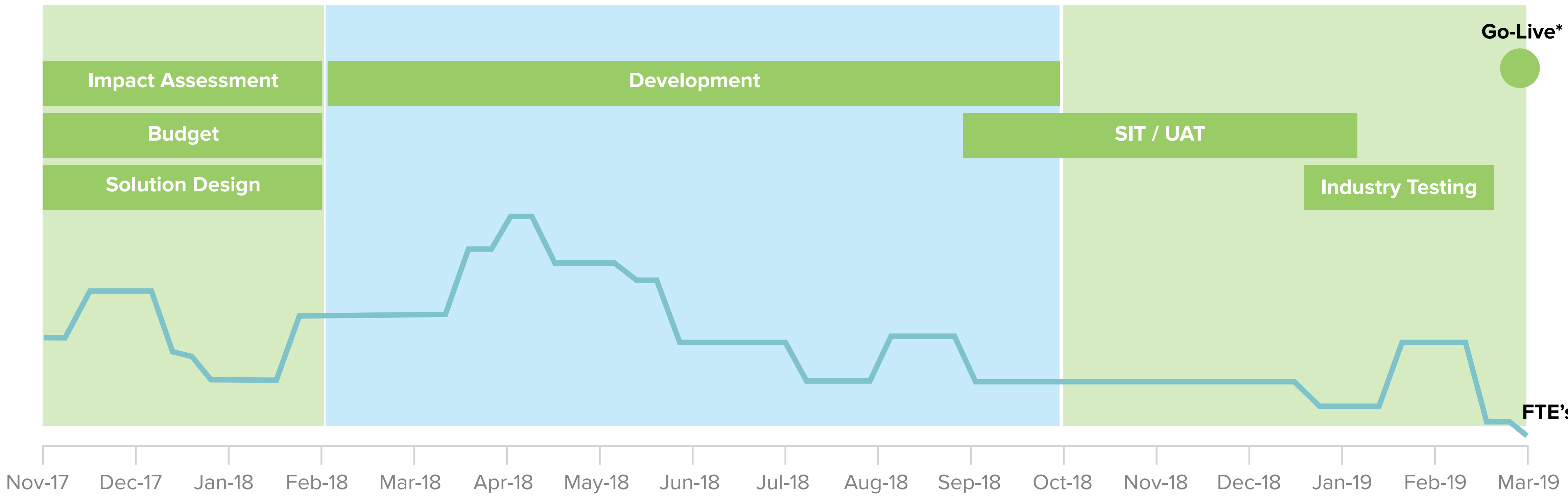
Once the solution is agreed, firms are then in a position to identify, estimate and sequence the units of work need for implementation. TFE has identified 38 such “programme building blocks”, which our bottom-up estimates indicate will need approximately 68-74 weeks to complete. Clearly this will vary according to business line scope: some firms may have a single business line and may be able to delegate reporting, others may act as agent lender, borrower and prime broker and may also decide to offer delegated reporting to beneficial owner and hedge fund clients. The TFE roadmap template provides a baseline for planning and estimating.

The illustrative roadmap (see next page) shows the overall timeline is consistent with the assumed go-live date of Q1 2019[4], thereby giving firms enough time to implement a solution…just!

4 The actual compliance deadline date will be derived from the date on which ESMA submits the final RTS to the European Commission, which assuming approval then publishes the regulation in the official journal of the EU. This has yet to take place.

FIGURE 4

Indicative roadmap and resource requirements



*Assumed go-live date

Action Points

- Make a high level plan soon, and include SFTR in your business planning for budget and people immediately
- Put high level estimates on your implementation stages based on an internal quick analysis of extending your existing EMIR derivatives reporting platform
- Start vendor and service provider analysis

NEXT STEPS

With around one and a half years to implement a robust, compliant SFTR solution, firms need to get started now, if they haven't already, and accelerate the impact assessment and solution design phase. Part of that design will be to answer several questions – such as building or buying a solution, using an in-house data repository, assessing the ability to enrich and source missing data fields, the choice of trade repository and additional services to be offered to clients – such as delegated or enhanced reporting.

The survey indicates 54% don't know if their solution will be partly or wholly built internally or sourced externally, with 23% looking to build and 23% buy at least part of their solution. Additionally, 25% of firms have a preferred Trade Repository, with the others un-decided, not surprising given the early stage most respondents are with their implementation and the lack of publicly available information on the TRs progress themselves.

If firms are considering external solution providers, time needs to be given to assess the solution against the firms defined requirements, along with any RFP and selection processes to be run. In addition, as many of the potential vendor solutions involve working groups, resources will need to be allocated accordingly.

Draft budgets already submitted must be firmed up before any build in 2018, along with assessing any on-going costs from vendors and the trade repositories. Depending on scope and the impact assessement, budgets for such a significant regulation will be several millions of dollars, so the budgeting process needs to be be robust and credible, giving confidence that the firm will have both funds and resources for a smooth implementation.

Finally, firms need to have a view of what their future business requirements may be (CCP, pledge, collateral buckets etc), and prepare for these or build in flexibility around their future operating model. This will also allow them to build in strategic initiatives to help increase efficiencies from their business model, and take advantage of the opportunites that SFTR brings.

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Simon Davies joined The Field Effect after nearly 20 years working in Investment and Corporate Banking, with experience in securities finance and collateral management, prime brokerage and depositary banking, including process change, outsourcing, client and relationship management, and business development roles. Simon has particular expertise in securities finance, OTC derivatives, collateral management and regulatory change. Prior to joining TFE Simon worked for Morgan Stanley, Deutsche Bank and Fortis.

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SECURITIES FINANCE PRACTICE LEAD

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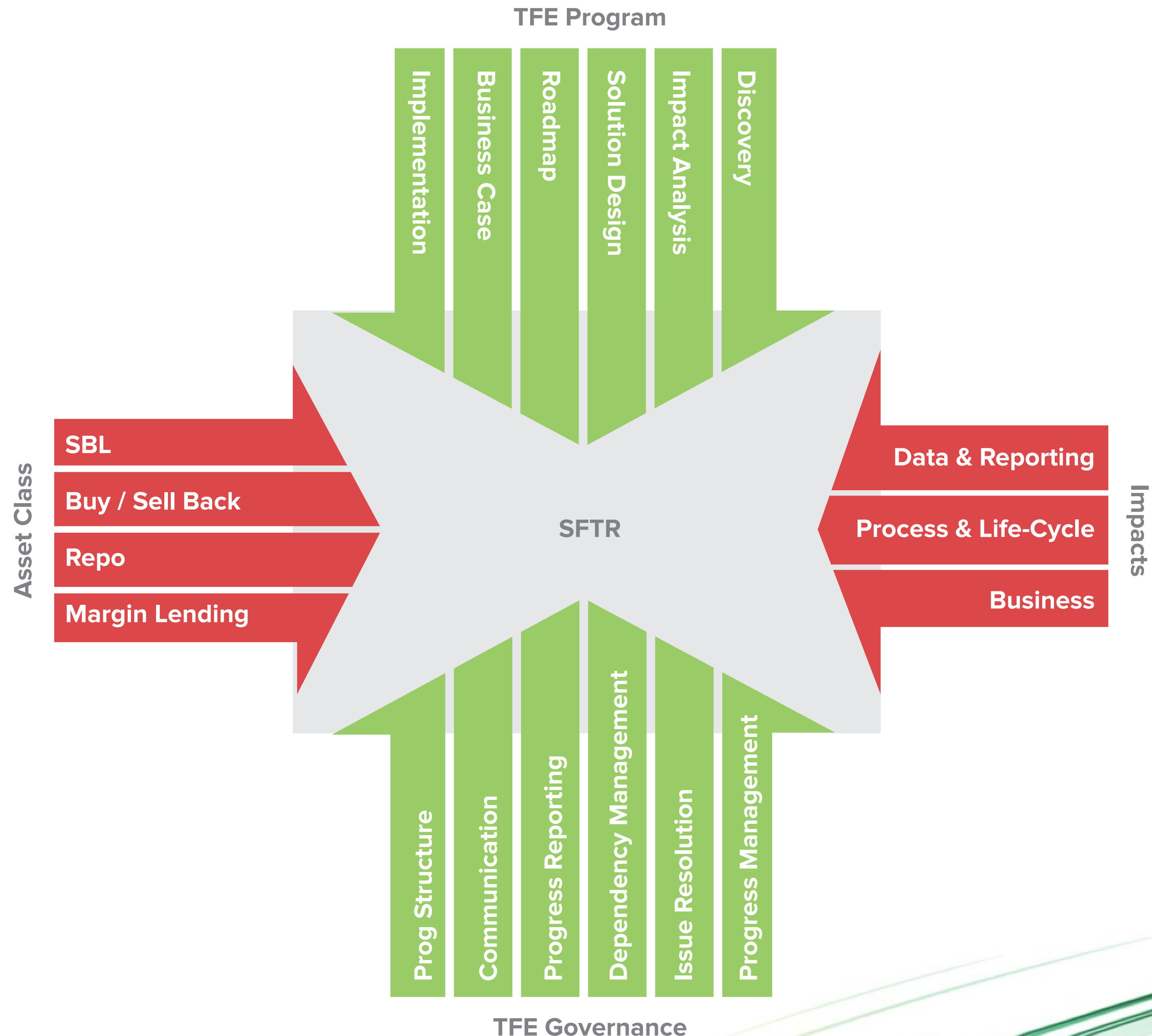
THE FIELD EFFECT SFTR PROGRAMME

The Field Effect can help design and deliver change through advice and expertise supported by powerful methods, tools and unique business insight.

We create a tailored SFTR programme covering: Discovery, Impact Analysis, Solution Design, Roadmap, Business Case and Implementation. Coupled with TFE programme governance we can help you meet the regulatory deadline whilst enabling the business opportunities that are available.



To discuss how The Field Effect can help, please contact us at **Info@thefieldeffect.co.uk** or call The Field Effect on **+44 20 3906 7369** or visit our website at **thefieldeffect.co.uk**

ABOUT THE FIELD EFFECT

Vision

Target Operating Model

Roadmap and Business Case

Implementation

The Field Effect is an independent consultancy specialising in accelerating change in financial markets, providing advisory services to every participant in the industry value chain.

Our services include helping clients to enhance trading and customer service strategies; improve operating efficiency; and simplify technology infrastructure to reduce run costs.

Finance, Capital & Collateral Specialists.