SFTR: NAVIGATING THE CHALLENGE

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INTRODUCTION

This is the second in a series of whitepapers where The Field Effect reviews the impacts of the Securities Finance Transaction Regulation (SFTR).

The European Commission has declared[1] to the European Parliament that SFTR is expected to be live as of 2019. If you trade repo or buy/sell-backs, if you lend or borrow equities, or as a prime broker lend margin to hedge funds, you must be ready to report. So, you must design, build and test your SFTR solution in 2018, ready for implementation and on-boarding in 2019.

This paper provides an overview of the regulation: who reports, what products are covered, which reports must be submitted by when, the 153 data attribute requirements, and what will be matched and reconciled. We examine the impact of SFTR requirements on the business operating model through 7 key dimensions: value, business process, controls, functionality, people, technology and data. We look at solution options and identify what work needs to be done in 2018 on the roadmap to compliance, and we suggest specific next steps that firms should consider.

SFTR is a sweeping, mandatory change for the securities financing industry that will consume significant 2018 budget. However, it doesn't have to be just about cost — there is value that can be extracted on the journey to regulatory compliance. Some firms will use SFTR budget to establish high quality data repositories of business intelligence to enhance decision making. Others will seize the opportunity to improve process efficiency and reduce manual touch points. Some will exploit the regulatory budget to enhance the business operating model to better support pledge structures, tri-party and clearing, reducing balance sheet costs.

In summary, the next few months are all about vision, solution design, roadmap, budget and business case (if you don't already have them). Given the regulatory timeline, firms really must mobilise their SFTR initiative early in 2018 if they are to have a decent chance of meeting the deadline. Time is short.

This paper is supported by EquiLend and Trax, leading trading and post-trade service providers for the securities finance and repo markets including support for matching, reconciliation and regulatory reporting. Whilst both firms have SFTR service offerings, the paper is vendor independent and solution-agnostic.

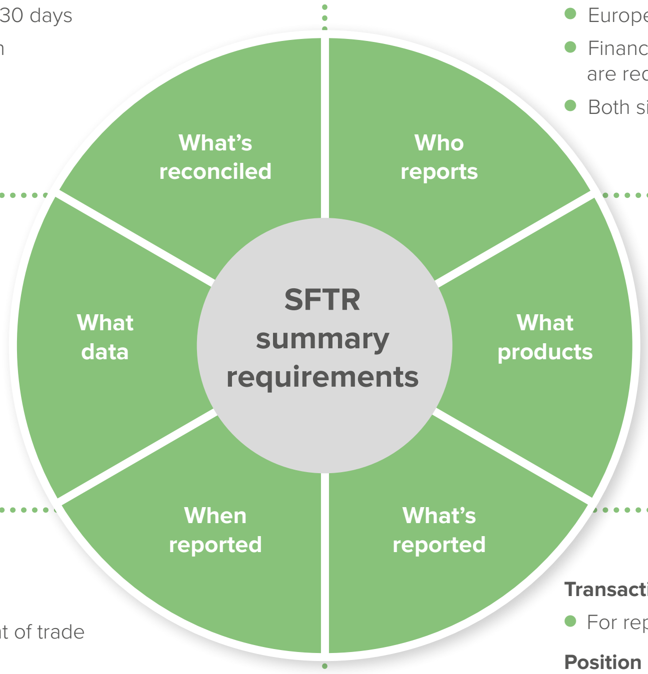
1 Brussels, 19 October 2017: REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL under Article 29(3) of Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 – 19.10.2017

REGULATORY OVERVIEW AND BUSINESS IMPACT

In this section we set out an overview of the regulation: who reports, what products are covered, which reports must be submitted by when, the 153 data attribute requirements, and what will be matched and reconciled. Full details are available in the Regulatory Technical Specification (RTS) published by ESMA[2] earlier in 2017, but we hope you will find this summary easier to assimilate.

Trade repository reconciliation:
- 96 Fields reconciled - phased in
- Closed positions reconcile for 30 days
- Inter and intra TR reconciliation

Principal parties to the trade reporting:
- 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)



Extensive data requirements:
- Up to 153 fields, depending on product and report type
- 40% of fields are not currently or readily available
- Unique Transaction Identifier (UTI) required for transactions
- ISO20022 Standards

Securities finance trades:
- Repo
- Securities lending & borrowing (Security & Commodity)
- Buy-sell back
- Margin lending (by prime brokers)

Timely and accurate reporting
- 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:
- For repo, securities lending, buy-sell back

Position level reporting:
- For margin lending

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

WHO REPORTS?

European entities of firms transacting in Securities Finance products are required to report. This includes:

- Firms with European entities and all the branches of those entities
- European Branches of non-European entities
- Financial and non-financial firms are required to report

2 31 March 2017; ESMA70-708036281-82; Final Report Technical standards under SFTR and certain amendments to EMIR

A scoping exercise to ascertain which entities / branches are required to report should be completed very soon. Scope in large firms may span numerous business lines or divisions such as principal and agent lender business lines, stock borrow/lend, repo trading, treasury and prime services for margin lending. An urgent review of the trading activities across those entities and clients should be carried out. Although entities / clients not in scope do not need to report, in-scope firms may need information from them such as beneficiary information and legal entity identifiers (LEIs). Where unique trade identifiers (UTIs) are concerned you would still need to generate a UTI even if your counterpart is out of scope. Furthermore, if firms are out of scope for reporting, they may be required to obtain and provide additional information on the in-scope firm.

Non-financial counterparts (NFCs) are caught by the reporting obligation 9 months after the initial go-live. Large NFCs are obliged to report, so companies with a large treasury function should be preparing for the reporting requirement. Small NFCs[3] are not required to report, so firms with small NFC customers must report both sides of the transaction on their behalf.

Reporting is two-sided: both parties (if in scope) are *accountable* for reporting, though responsibility for reporting may be delegated to a third party. For UCITS or AIF funds the management company is accountable for reporting. Firms should talk to their clients early, both to inform them of the impacts and communicate the approach. Some clients will look for additional services such as facilitated or delegated reporting.

Reporting requirements are phased in according to the type of firm:

Phase 1	Investment firms and credit institutions	Day 1
Phase 2	CCPs and CSDs	After 3 months
Phase 3	Insurance, UCITS, AIF, pension funds	After 6 months
Phase 4	Non-financial counterparts (NFCs)	After 9 months

Clearly reconciliation at the trade repository (TR) cannot happen until both parties to the trade are reporting. There may also be issues when a reporting party needs information from a non-reporting party in order to report fully. For example, CCPs – who are not caught until phase 2 – are expected to generate the Unique Trade Identifiers (UTIs) for cleared trades. Will CCPs be ready to provide novated trade UTIs to their members from day one, 3 months before their own compliance deadline? If not, parties to cleared trades will need tactical solutions for that 3-month period. Similarly, will UCITs and AIFs - caught 6 months after day 1 – be able to provide UTIs and beneficial ownership break downs on day 1 to the agent acting on their behalf? Will the agent lender be able to provide borrowers with this information to allow the borrower to report one-sided for that period?

3 As defined by criteria in Article 3(3) of Directive 2013/34/EU of the European Parliament and of the Council

WHAT PRODUCTS?

Products in scope are:

- Repo
- Securities and Commodities Borrowing and Lending (SBL)
- Buy Sell Backs (BSB)
- Margin Lending (ML)

In large firms the four product groups may be traded in various entities and business lines across the firm, both as principal and agent, and in central or shared treasury cash and collateral functions. It is important to establish scope early on, because there may be many individual units impacted, and decisions must be made early about whether to initiate a centralised all-encompassing SFTR programme with many disparate stakeholder groups, or fragment the programme at the risk of silo solutions and cost-duplication.

Within these product sets there are numerous issues lurking. Taxonomy and business practice discrepancies are common across the industry: one firm's repo is another's buysell back; some firms book repos in an SBL system (for historical reasons) where they are indistinguishable from SBL trades; some roll positions at maturity whilst others close and rebook; some firms do not book the repo off leg until near maturity. Plus, many of these processes rely on significant manual interaction. Unless these anomalies are resolved across the industry the matching and reconciliation challenge will be immense.

In the SBL world there are major issues to be resolved too, such as how Agent Lender Disclosure (ALD) will interact with SFTR. Today agent lenders typically disclose the identity of the beneficial owners on S+1. However, SFTR reports will force disclosure earlier to meet the T+1 reporting deadline. So will SFTR render ALD redundant in Europe? Will earlier disclosure encourage lender disintermediation, or will lenders disintermediate borrowers through peer-to-peer platforms? Some lenders already disclose the beneficial owner on trade date – will this competitive advantage become widespread, and will beneficial owners such as sovereign funds withdraw from the European lending market as a result? Will the traditional fair allocation process fall away as lenders favour fewer, larger beneficial owners?

Perhaps SFTR will be the catalyst for the securities finance industry to update its historical practices.

WHAT'S REPORTED?

SFTR requires six report types (mainly product-aligned), each triggered by up to 10 action types such as new, modification, termination etc. However not all action types are applicable to every report type. So instead of there being 60 report type / action type combinations (the maximum theoretically possible) there are in fact only 32 such combinations, indicated on the next page.

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Combinations of action types and report types

** From SFTR RTS March 2017*

	New	Modification	Error	Correction	Position component	Collateral update	Termination	Collateral reuse update	Margin update	Valuation update
Repurchase trade	x	x	x	x	x	x	x	-	-	-
Buy-sell back	x	x	x	x	-	-	-	-	-	-
Securities and commodities lending and borrowing	x	x	x	x	x	x	x	-	-	x
Margin lending	x	x	x	x	-	x	-	-	-	-
Margin	x	-	x	x	-	-	-	-	x	-
Collateral reuse	x	-	x	x	-	-	-	x	-	-

Repo, Stock Borrow/Loan and Buy/Sell Backs must be reported at transaction level. Importantly, all life-cycle events that affect any of the data fields also need to be reported, including re-rates, mark to market valuations and corporate actions. Cleared trades novated to a CCP must be reported using the UTI generated by the CCP (or as agreed between the counterparts). If a non-cleared trade has been reported with a UTI agreed with the counterpart and then is subsequently novated to a CCP, it must be re-reported using the CCP-generated UTI, and linked to the original non-cleared UTI in certain circumstances.

Margin Lending activity must be reported as at end of day position. Prime Brokers will be required to report where there is a net negative cash balance, or positive short position, at the relationship level. Firms should note that contractual settlement arrangements may give rise to margin loans which must be reported.

If margin can be identified at the trade level the collateral must be reported with the transaction. If collateral is calculated at the relationship level it is reported at portfolio level as is the case under EMIR. Margin posted for centrally cleared trades through a CCP is reported separately.

Collateral re-use is also reported separately. Whilst availability for re-use is reported in the transaction report, actual re-use is reported separately, including any reinvestment of cash collateral. Actual re-use should be calculated at a portfolio level using the ESMA calculation included in the RTS.

WHEN REPORTED?

All transaction reports must be made on a T+1 basis, including the collateral if it is known at the point of trade. Where collateral is not known at the point of trade, it is reported on S+1.

When the firms reporting obligation starts, any existing trade with a maturity greater than 180 days is reported, or where there is no maturity, a trade that remains open for 180 days after the initial reporting requirement will also need reporting to the TR.

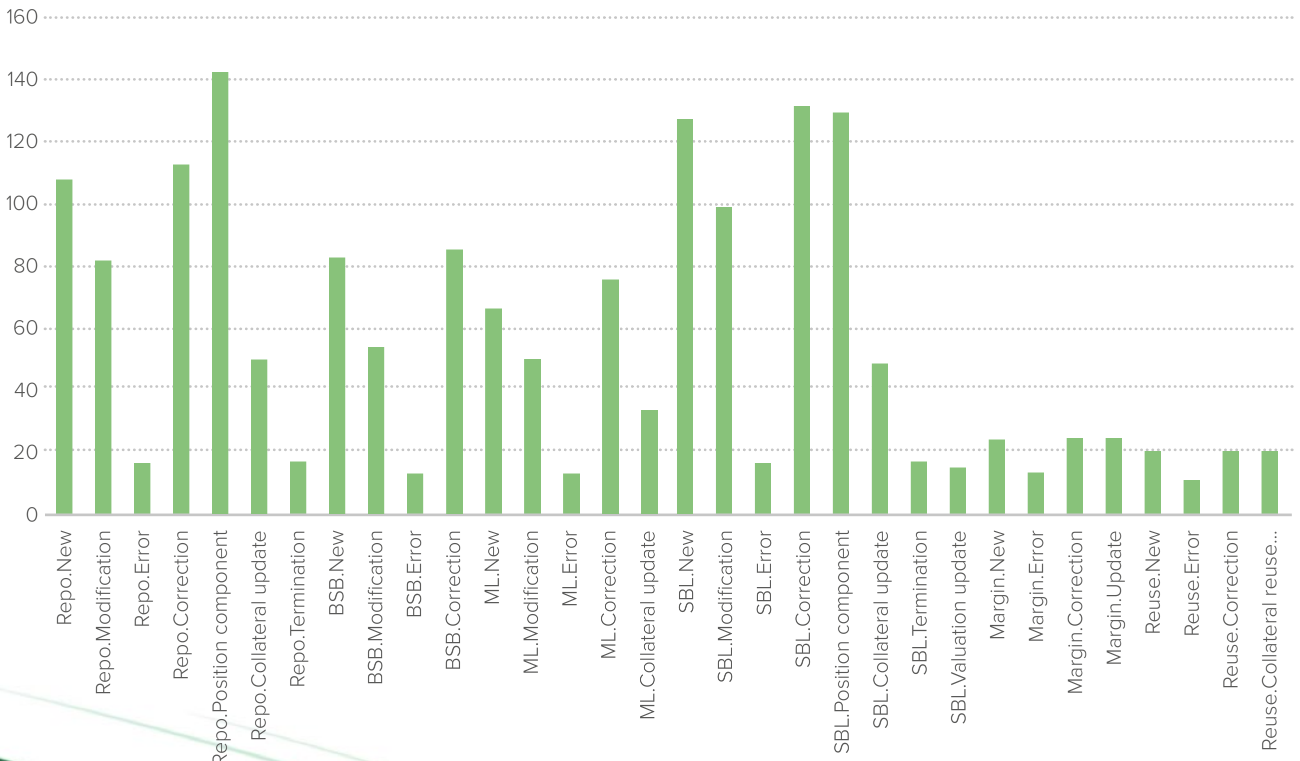
In our opinion many firms will face significant challenges in meeting these timescales due to the degree of manual processing that still exists across the industry – across all products, but especially repo. Any manual touchpoint within the workflow inevitably slows the process and has the potential to introduce errors. We believe firms have an opportunity catalysed by SFTR to transform the way the industry works, through more widespread adoption of automated platforms for trading, confirmation and life-cycle management, moving from end of day to intraday reconciliation and break management. This won't happen by accident – leadership teams must set a clear vision to steer the SFTR initiative if they want to move towards a lights-out, zero-touch operating model. We believe this has the potential to convert the SFTR programme from compliance-driven, cost-only to a business-led benefits-driven programme which will position the financing functions for the future.

WHAT DATA?

Up to 153 data fields must be reported, but not all data attributes are needed for all reports. Some attributes are mandatory, some conditional and some optional. The table below indicates which attributes are required for each of the 32 report type / action type combinations we identified earlier. We estimate that a typical firm will have difficulty sourcing up to 40% of the data, so firms will need to decide how to source and enrich what's missing and consider the use of centralised data sources and vendor solutions.

Report type and data

RTS required datafields



Unique Transaction Identifiers (UTIs) must be reported consistently by both sides to the trade; adopting the IOSCO UTI protocol[4] should be considered. Firms will need to be able to generate & publish UTIs where they are the responsible counterparty, as well as ingest UTIs from counterparts. Who does this is based on bilateral agreement with their counterpart, or the ESMA SFTR waterfall. In many cases a third party such as an MTF or CCP will generate the UTI which both parties must adopt.

Firms must report the agreement governing each trade (GMRA, GMSLA, OSLA…) and the agreement version. Updating the version year of a client's contract will need to be captured for new trades from the effective date, but must not impact existing or old trade positions. Some firms have implemented central golden sources of legal agreement information which may make this easier – others still rely on SharePoint and pdf. These are merely examples of the numerous other data challenges that must be overcome.

What's more, reports must be delivered to the trade repositories using ISO 20022 data dictionary and message standards. ESMA's Business Justification[5] to the International Standards Organisation for adopting the standard was accepted by ISO in October 2016, but there is no definition yet of the standards themselves. The equivalent standards for MiFID were published in May 2017, a mere 8 months before go-live. Until the standards are published market participants and TRs will be unable to create, let alone test, the data translations and mappings required.

WHAT'S RECONCILED?

Once reported to the TR, a trade level reconciliation takes place if both parties to the trade are in scope for reporting. The reconciliation fields are phased in, with 65% from day one, and the rest introduced after 2 years and 9 months. The TR will report back any breaks for firms to rectify. There are very few tolerances on reconcilable fields. Current contract compare and affirmation processes normally reconcile trade economics covering only a sub-set of what will be reconciled in the future — applying tolerances and reconciling some elements at an aggregated portfolio position rather than at trade level. In addition, many firms only prioritise large breaks that impact collateral exposure calculations.

We might reasonably assume that regulators will initially focus on whether reporting is being done at all, but it won't be long before attention is turned to matching rates. Many are expecting everything to break on Day One, so market participants should seriously consider mechanisms to improve data quality and match rates, such as MTFs, electronic confirmation, clearing, event driven automated processes, counterparty taxonomy alignment and data sources. SFTR will make it increasingly difficult for firms to manage any flow that isn't electronically traded or confirmed. Getting this right early will give a strong indication to authorities that the industry is functioning effectively, and could lessen any further regulatory burden (as seen with other products) such as mandatory exchange trading and clearing – otherwise expect these to follow in SFTR 2!

4 February 2017, IOSCO BIS Technical guidance on the harmonisation of the unique transaction identifier

5 2 Sep 2016, ISO20022BJ_ESMA_v2, Business Justification for the development of new ISO 20022 financial repository items

SFTR — CHANGING THE OPERATING MODEL

It is vital that reporting firms ensure their transaction reporting systems are tested as fit for purpose, adequately resourced and perform properly.

— FCA

WHAT'S A TARGET OPERATING MODEL (TOM) ANYWAY?

It should be clear from the myriad of business impacts identified so far that SFTR requires significant change to the way firms operate. In our opinion the most effective way to tackle change of this magnitude is to design and agree with key stakeholders the future state and roadmap before you begin. Without agreement in advance, impacted functions such as trading, operations, product management and technology can easily head off in different directions with inadequate shared understanding of customer impact, programme dependencies, resource profile and cost / benefit. We have seen the negative consequences in other recent regulatory initiatives.

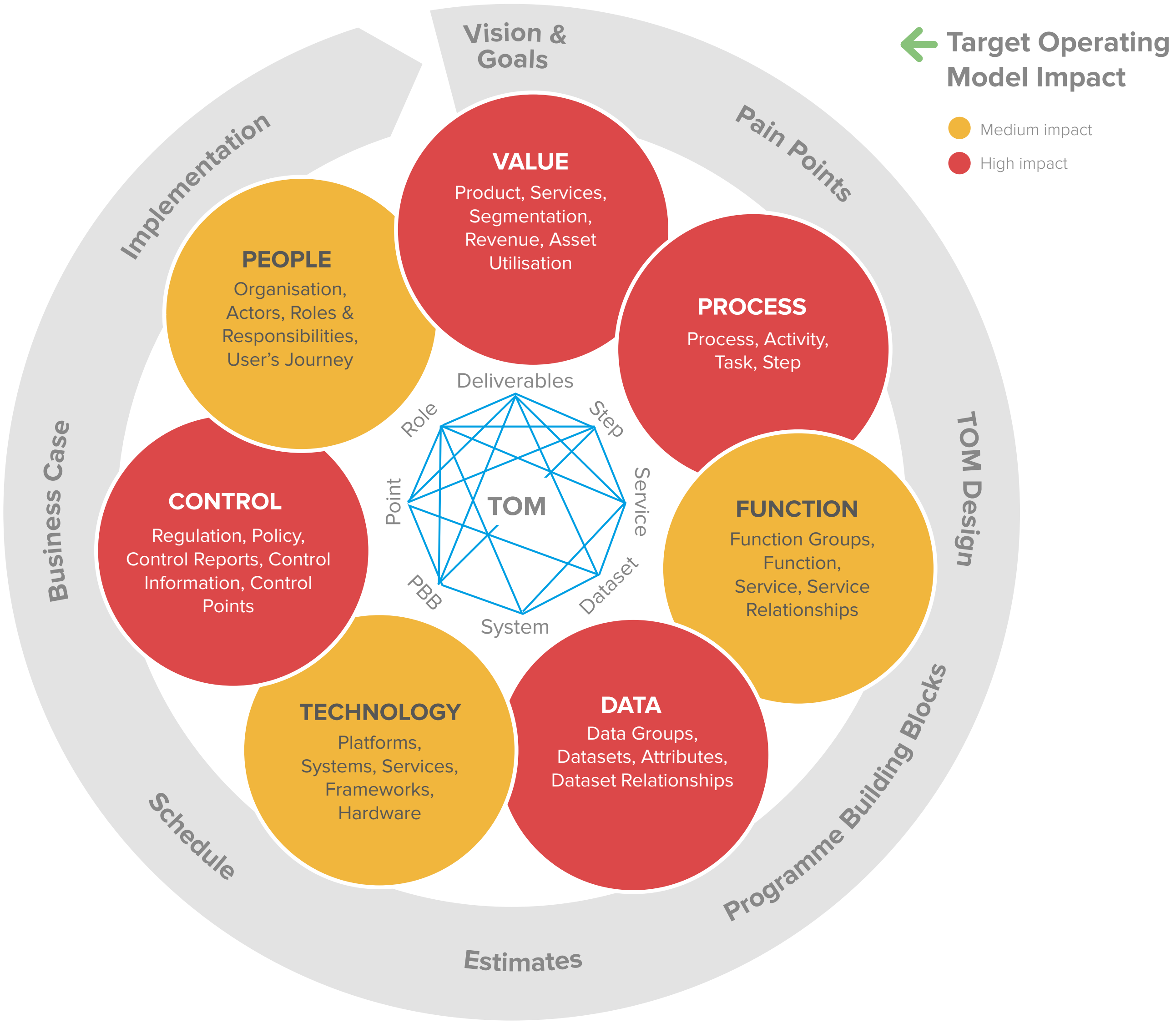
However, it is not easy to design a target operating model. The term is widely used but not widely understood, so firms should establish a clear view on what constitutes a "TOM".

The Field Effect describes target operating model through seven interlinked dimensions:

- **Value:** the benefit of strategic products & services delivered by business processes
- **Process:** the activities, tasks and steps that describe the end-to-end workflow
- **Controls:** tests embedded in the process that prevent or detect errors
- **Function:** the services, manual or automated, that execute the process steps
- **People:** the actors (internal or external) responsible for manual or semi-automated services
- **Technology:** the applications that automate services
- **Data:** the entities and attributes consumed and delivered by process steps

The key point is that these dimensions are inter-related – a change programme that fails to describe an integrated TOM up front is heading for cost over-run, benefit under-delivery, or worse. Managing and delivering the change from your current to a target operating model will be more successful if the business, IT, vendors and partners have a clear, agreed understanding of the target state everyone should be aiming for.

We used the TFE operating model framework to evaluate the impact of SFTR on the way firms will operate and applied a "RAG status" to highlight the most affected dimensions, shown in the diagram above. We couldn't identify any non-impacted dimensions: everything is "amber" or "red" in our assessment. We'll look at each in turn.



VALUE

SFTR is a sweeping mandatory change for the securities financing industry that will consume significant 2018 budget. However, it doesn't have to be just about cost - there is value that can be extracted on the journey to regulatory compliance. We see some of the key drivers of value (both positive and negative) as:

- **Cost:** there is a minimum cost for achieving mere compliance than can only be estimated once your solution is decided and your roadmap set out. Early estimates for larger firms are in the region of $3-6m for change-the-firm costs, plus operational costs for vendor and TR licenses and transaction fees, but of course this will be lower for smaller firms with simpler operational footprint. We recommend allowing approximately 10% of the total programme cost for change preparation covering solution design, TOM and roadmap and business case.

- **Revenue:** some firms may be in a position to offer delegated reporting as a customer service, or may indeed have no choice based on customer expectation. Whilst delegated reporting will be more expensive to implement, the potential revenue streams may offset more than their fair share of cost.

- **Loss of business:** unfortunately, there may also be a threat of loss of business, particularly if certain counterpart types withdraw from the market on grounds of cost and complexity. For some this may render certain business lines unviable.

- **Cost reduction:** there is a significant opportunity to reduce operational costs by automating to improve process efficiency and reduce manual touch points, perhaps establishing cross-silo shared services for reg reporting, and through use of automated processes such as MTFs and for post-trade electronic trade confirmation platforms.

- **Better decision making:** some firms will use SFTR compliance budget to establish high quality data repositories of business intelligence to enhance decision making in the front office. Hard to quantify, but could be a game changer.

- **Balance sheet benefits:** we believe there is an opportunity to exploit the regulatory budget to enhance the business operating model to better support pledge structures, tri-party and clearing, reducing future balance sheet costs.

The key to extracting value is to establish an early position on each of these questions and to set out a vision and objectives for the SFTR initiative. Without a business vision, the initiative will by default deliver mere compliance. Maybe that would represent your firm's best return on investment… but how will you know?

Importantly, don't leave anything too late. Service providers and clients will need time to prepare –with MiFID II we've seen vendors turn firms away because there isn't enough capacity to deal with late on-boarding requests.

PROCESS

The Field Effect has developed a securities finance model comprising 112 processes of which we believe 68 are impacted by SFTR. Some examples include:

- **UTI management:** firms will need automated processes to generate, publish and receive UTIs, potentially from multiple sources

- **Returns and maturity process:** automation will help ensure allocations are done at the correct trade level to prevent breaks

- **Agent lender disclosure:** timings must be brought forward to meet SBL reporting requirements

- **Data management:** pricing data and reference data management processes must be enhanced to source new reporting fields and improve quality to reduce reconciliation issues

- **Reporting:** the existing reporting process must be enhanced for these new product types, and will need to be highly automated to meet the tight deadlines for assembling, enriching, formatting and reporting data

- **Delegated reporting:** new processes will be needed if using or offering a delegated reporting service

- **Collateral management:** new processes will be needed to re-purpose tri-party collateral allocation reports to enrich the SFTR collateral reports

- **Breaks management:** anticipating a day 1 environment where everything is likely to break, firms should look to leverage existing infrastructure to support the automation of event-driven/lifecycle processes to help mitigate the potential volume of breaks they may encounter. To the extent that manual intervention persists, break management operational processes should be reviewed in advance to ensure adequate controls are in place, and break fixing should be prioritised, including route cause analysis and remediation

Our model generates a process heat map (next page), illustrating the breadth of the process impact. As many of these processes have historically been manual, more people or more automation will be needed to ensure the reporting requirement can be met and to minimise reconciliation issues at the Trade Repository. Where possible bespoke counterparty processes should be eliminated. The trade bodies (ISLA and ICMA / ERCC) have developed industry best practice guidelines, currently being amending to account for SFTR, which may be helpful.

Standardisation event-driven automation is needed to meet the requirement and to minimise reconciliation issues. How automated are your processes?

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SFT process impact

An illustrative impact analysis, not all review points are shown

High impact · Medium impact · Low impact

PRE TRADE PROCESS

- **Review order management system**: Client order | Internal order
- **Select trading counterpart**: Trade review | Trade fill | Return | Complex trade review
- **Check credit & risk limits**: Credit review | Risk review
- **Agree commercial terms**: Indicate terms | Agree terms

POST TRADE PROCESS

- **Book trade**: Execute and book | Authorisation
- **Create confirmation**: Confirmation Gen | Confirmation Send | Confirmation resolution
- **Pre-match trade**: Instruct trade | Pre-match | Pre-match reconciliation
- **Agree collateral requirements**: Collateral demand | Agree collateral
- **Trade settlement**: Post collateral | Fails mgmt | Fails Resolution | Settlement Confirmation

LIFECYCLE MANAGEMENT

- **Review corporate action announcements**: CA capture fields
- **Agree corporate actions with c/p**: CA capture (mandatory) | CA capture (voluntary)
- **Book required corporate action events**: CA booking (mandatory) | CA booking (voluntary)
- **Review billing statement**: Create billing statement | Chase outstanding billing
- **Reconcile billing discrepancies**: Reconcile billing | Amend billing
- **Agree and book billing payment**: Agree billing | Pay/receive billing
- **Review internal nostro accounts**: Reconcile accounts / records | Age breaks
- **Reconcile and adjust required positions**: Investigate breaks | Break rebooking
- **Resets & rate changes**: Maturity review | Maturity evaluation | Maturity agreement | Maturity booking
- **Agent lender disclosure (ALD)**: Send / receive ALD | Credit ALD evaluation | Credit ALD approval | Credit ALD decline
- **Cashpool agreement**: Cashpool reconciliation (balance) | Cashpool reconciliation (rates)
- **Contract compare (open positions)**: Contract / Position compare | Contract / Position reconciliation | Contract / Position booking

MARGIN & COLLATERAL

- **Value portfolio**: Trade M2M | Collateral M2M
- **Agree portfolio value with c/p**: Agree M2M | Settlement agreement
- **Select collateral for mark to market**: Collateral review | Collateral optimisation
- **Agree collateral for mark to market with c/p**: Collateral call | Collateral agreement
- **Book collateral movement**: Collateral booking | Triparty posting
- **Settle collateral movement**: Trade settlement | Fails management | Fails resolution

CLIENT ONBOARDING & MAINTENANCE

- **Qualify business opportunity**: Trade activity review | Trade demands | Pricing
- **Begin KYC process**: KYC contacts | KYC data collection | KYC review
- **Negotiate contractual terms**: Legal documentation | Exchange contracts
- **Agree contractual terms**: Agree terms | Review terms
- **Set up client accounts**: Trading review | On-boarding | Account set up
- **Establish risk & trading limits**: Credit submission | Credit approval
- **Grant connectivity access**: Client connectivity | Connectivity testing
- **Execute test trade**: Client testing | Trade testing | Trade pre-matching | Trade settlement | Trade reconciliation
- **Periodic review of KYC information**: KYC review triggered | KYC review update

> *60% of securities finance processes are affected by SFTR*
>
> — TFE

CONTROLS

As SFTR reporting is mandatory and fines for non-compliance are happening with other regulations, it is clear that a robust control framework will be necessary.

Multiple product lines, entities and businesses may be involved in generating any of the 32 report type / action type combinations. Firms will have multiple service providers, custodians and triparty agents, data providers and technology platforms (both in-house and vendors). The scope for error or omission is significant. For example a missing data feed, late file delivery, stale data or amendments to upstream systems may result in a missed or incorrect report. Consideration should also be given to fixes to problems, so that once fixed any re-reporting required is done correctly. Manual intervention to processes may also trigger reporting requirements that unless controlled could be missed, for example fixing a trade booking error or a settlement break. In addition, the cause of either late or inaccurate reporting and reconciliation breaks should be monitored for resolution and built in to a remediation plan to be reviewed with regulators if needed. Leveraging SFTR will give you the opportunity to ensure controls are adequate to protect the firm, built into the target process model, and sufficiently automated to minimise manual touch points.

FUNCTION

The Field Effect securities finance functional model comprises 18 functional areas. Each has been reviewed for SFTR impact, and all are impacted.

Trading, funding and inventory management	Countrparty exposure management
Client relationship management	Collateral management
Trade capture, enrichment, booking & allocation	Ops. reconciliation and control
Valuation and risk	Sub-ledger books records proc.
Settlement	Position servicing
Clearing	Exclusives
Confirmation	Client account servicing
Reporting	Reference data & permissions
P&L, balance sheet and management reporting	Connectivity

SFT functional impact

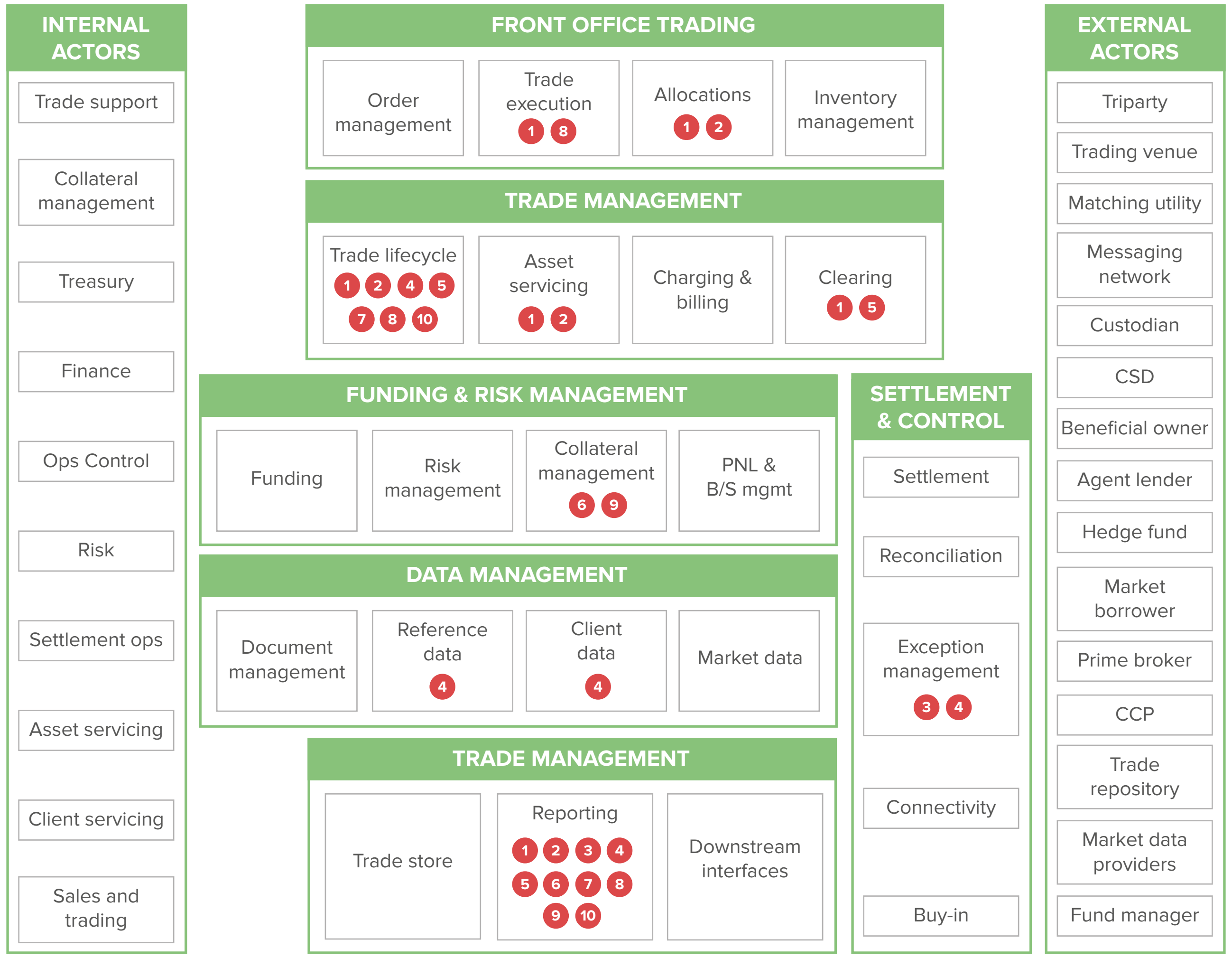
Medium impact · High impact

© The Field Effect 2017

We recommend developing a future state model that describes the new and amended functionality needed to create an SFTR reporting capability, to support newly automated processes, the new control framework and new services such as delegated reporting. It goes without saying that the functional model must be aligned with the target business process and control frameworks.

We have mapped each of the 10 SFTR Action Types we noted earlier to a high level functional framework (below) to help identify where new reporting-related functionality will be needed. These areas should be a focus for further analysis and review in order to develop the functionality required.

Reporting "action type" functional sources



Action types

1 New
2 Modification
3 Error
4 Correction
5 Position component
6 Collateral update
7 Termination
8 Collateral reuse update
9 Margin update
10 Valuation update

SFTR: NAVIGATING THE CHALLENGE

PEOPLE

SFTR will affect people's roles, responsibilities and day to day activity, particularly regarding automation of processes and controls. How client reporting, delegated reporting and transaction reporting are performed and resourced will be critical to the success of the project.

This may result in requirement for additional headcount, new or changed job descriptions, skills and personal objectives, and of course people will need to be trained in the detailed operation of new process and technology.

TECHNOLOGY

Once the functional model outline earlier has been aligned with people, process, controls and data, it is usually straightforward to design a logical target SFTR technology applications architecture. Current applications and technology can be mapped to the target state to identify gaps which must be filled, via build, buy or outsource. This supports creation of RFPs to the securities finance application vendors, all of whom are busy designing SFTR modules, and to the SFTR data enrichment and reporting service providers who may already have a significant proportion of the high quality data you need.

There is no one "right answer" to which technology or service should be chosen. For some, there will be an obvious outsource option to a service provider who may be able to handle much of your SFTR challenge, at least as far as data enrichment, formatting, reporting, matching and TR connectivity is concerned – though you will still need to source any missing data and change your operating procedures and controls as discussed earlier.

For others, especially those with an existing multi-regulation, multi-jurisdiction reporting platform, the obvious choice may be to enhance that platform to handle SFTR. There will still be significant amounts of data mapping and translation to be done, especially given the adoption of the yet to be defined ISO 20022 standard.

For most, the answer may lie in a combination of in-house and outsourced approaches, potentially organised by asset class, balancing the opposing objectives of best-of-breed vs minimising architectural complexity. The target architecture enables identification of the data flows and therefore interfaces that will be needed across the firm's existing infrastructure, and externally to counterparts and clients, MTFs, service providers, CCPs, custodians, triparty agents etc.

In our opinion the key is to drive the technology choices from the business operating model, not the other way round.

SFTR: NAVIGATING THE CHALLENGE

DATA

With 153 data fields, 96 reconcilable (65% from day one) with practically no tolerances, with 32 Report Type / Action Type combinations and the adoption of ISO20022 standard, there has been a great deal of focus within the industry around data! The availability of data and its enrichment within the reporting cycle needs to be carefully considered and reviewed. The Field Effect has created a heatmap of the SFTR data attributes to illustrate where the main problems may occur, which we estimate to be approximately 40% of the data attributes. Each firm will need its own specific data analysis across its in-scope entities.

For each reporting event, data will be sourced from a combination of the trade, the reporting event, static / reference data or the previous report, and mapping this to each process adds additional complexity. The trade repositories' reporting requirements also needs to be considered, along with validation and data transformation and mapping requirements.

Whether data is sourced internally or externally, whether enriched and validated in-house from centralised sources, or outsourced to third party providers, firms will need a target data model that is aligned to the target business process, controls framework and functional model.

SFTR reporting data analysis

- Sourceable
- Needs enrichment
- Difficult to source

COUNTERPARTY DATA

Reporting timestamp	Report submitting entity	Reporting counterparty
Nature of the reporting counterparty	Sector of the reporting counterparty	Additional sector classification
Branch of the reporting counterparty	Branch of the other counterparty	Counterparty side
Entity responsible for the report	Other counterparty	Country of the other counterparty
Beneficiary	Tri-party agent	Broker
Clearing member	CSD participant or indirect participant	Agent lender

MARGIN DATA

Reporting timestamp	Event date	Report submitting entity
Reporting counterparty	Entity responsible for the report	Other counterparty
Portfolio code	Initial margin posted	Currency of the initial margin posted
Variation margin posted	Currency of the variation margins posted	Initial margin received
Currency of the initial margin received	Variation margin received	Currency of the variation margins received
Excess collateral posted	Currency of the excess collateral posted	Excess collateral received
Currency of the excess collateral received	Action type	

COLLATERAL DATA

Uncollateralised SL flag	Collateralisation of net exposure	Value date of the collateral
Type of collateral component	Cash collateral amount	Cash collateral currency
Identification of a security used as collateral	Classification of a security used as collateral	Base product
Sub-product	Further sub-product	Collateral quantity or nominal amount
Collateral unit of measure	Currency of collateral nominal amount	Price currency
Price per unit	Collateral market value	Haircut or margin
Collateral quality	Maturity of the security	Jurisdiction of the issuer
LEI of the issuer	Collateral type	Availability for collateral reuse
Collateral basket identifier	Portfolio code	Action type
Level		

RE-USE DATA

Reporting timestamp	Event date	Report submitting entity	Reinvestment rate	Re-invested cash	Re-invested cash amount
Reporting counterparty	Entity responsible for the report	Type of collateral component	Re-invested cash currency	Funding sources	Market value of the funding sources
Collateral component	Value of reused collateral	Estimated reuse of collateral	Action type		

LOAN DATA

Unique Transaction Identifier (UTI)	Report tracking number	Event date	Principal amount of value data	Principal amount of maturity data	Principal amount currency
Type of SFT	Cleared	Clearing timestamp	Type of asset	Security identifier	Classification of a security
CCP	Trading venue	Master agreement type	Base product	Sub product	Further sub product
Other master agreement type	Master agreement version	Execution timestamp	Quality or nominal account	Unit of measure	Currency of nominal amount
Value date (start date)	Maturity date (end date)	Termination date	Security or commodity price	Price currency	Security quality
Minimum notice period	Earliest call-back date	General collateral indicator	Maturity of the security	Jurisdiction of the issuer	LEI of the issuer
DBV indicator	Method used to provide collateral	Open term	Security type	Loan value	Market value
Reporting timestamp	Report submitting entity	Reporting counterparty	Reporting timestamp	Report submitting entity	Reporting counterparty
Termination optionality	Fixed rate	Day count convention	Fixed rebate rate	Floating rebate rate	Floating rate rebate ref. period: time period
Floating rate	Floating rate reference period: time period	Floating rate reference period: multiplier	Floating rebate rate reset frequency: time period	Floating rebate rate reset frequency: multiplier	Spread of the rebate rate
Floating rate reset frequency: multiplier	Spread	Margin lending currency amount	Lending fee	Exclusive arrangements	Outstanding margin loan
Margin lending currency	Adjusted rate	Rate date	Base currency of outstanding margin loan	Short market value	

Indicative: Scope, Product, Counterparty Dependent

NEXT STEPS

SFTR STRATEGY

The immediate priority is to identify:

- **Scope:** which parts of the business are covered, including products, legal entities and business lines, principal and agent roles, lender and borrower, treasury and prime services
- **Impact:** identify where SFTR will impact your operating model - people, process and technology
- **Vision:** clarify your drivers, your vision and objectives – what pain points do you want to fix along the way? What do your clients need from you? What business value do you want to gain from your SFTR spend?

SOLUTION DESIGN

Steered by your vision, the immediate next steps are to design:

- **TOM:** design a target operating model that will deliver your vision by designing and aligning target process, controls, people, functionality, data sourcing & enrichment, technology – how do you want the business to operate in a post-SFTR world?
- **Partnerships:** who can help you reduce risk and cost? What RFPs should you issue for what functionality and services? Which partners can help with data extraction and enrichment, data mapping and translation, TR connectivity, break management? Who can help you deliver the programme?
- **Gap analysis:** what are the gaps between your current and desired target state?

MOBILISATION

Once you have identified your solution and gap analysis, you are ready for:

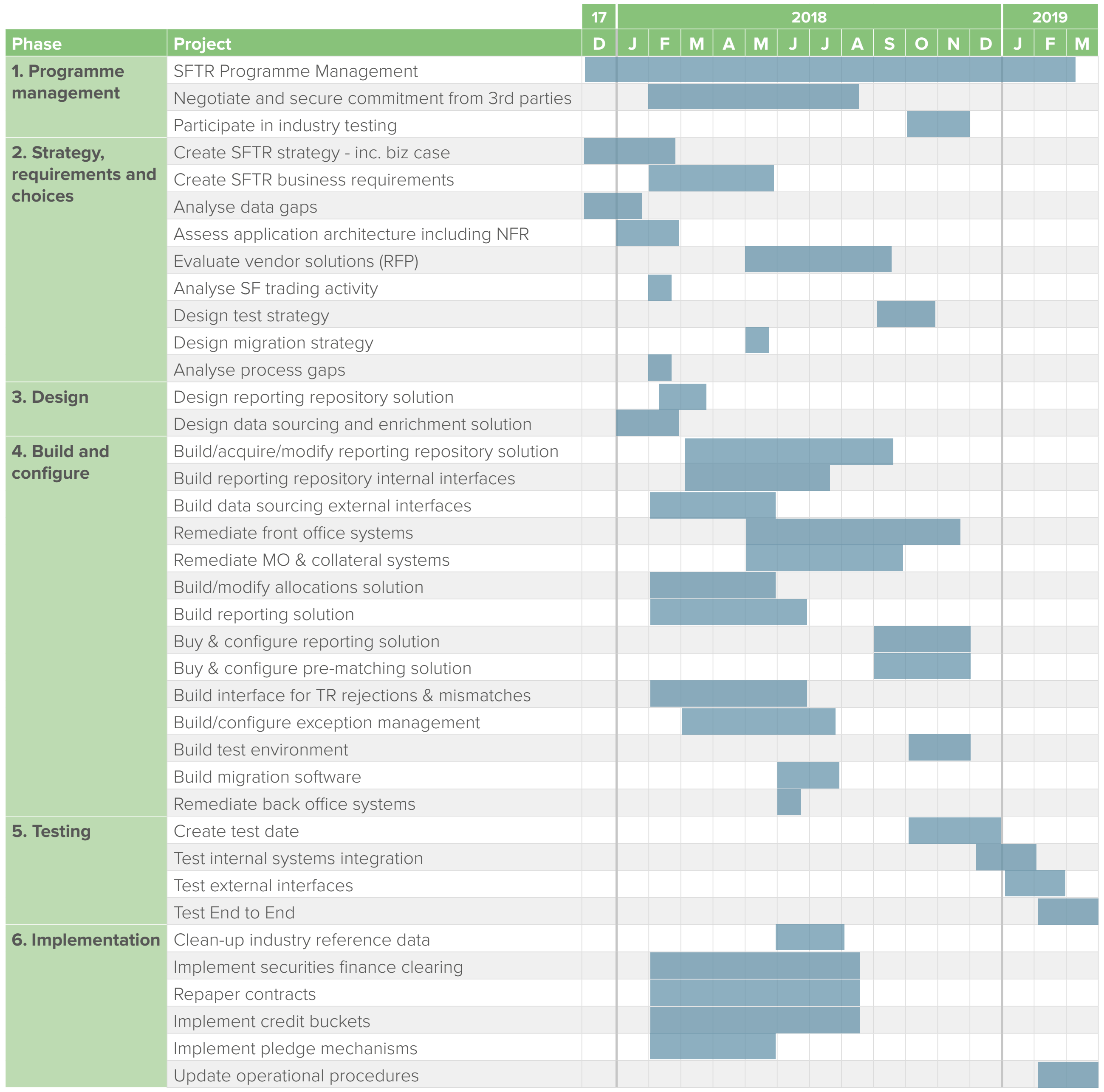
- **Roadmap:** identify the units of work ("programme building blocks") needed to address the gaps – including partner and TR on-boarding, data remediation, process change, interface and application development, system testing, industry testing, training and migration
- **Business case:** estimate at high level the activities, skills and effort needed to deliver the programme; quantify the business value your SFTR initiative will deliver; secure the resource allocation and budget
- **Mobilisation:** establish programme governance and a design authority; secure your resource supply – some firms expected MiFID II resources to come free in 2018 but now realise there will be a long tail of competing resource demand leading to a resource squeeze and lack of SMEs

The Field Effect has developed a bottom up SFTR roadmap based on the gaps we have identified across the industry, comprising around 40 high level programme building blocks. Clearly this must be tuned for the specific vision and solution of individual firms, but it may help to accelerate your budgeting and resource allocation decisions.

SFTR: NAVIGATING THE CHALLENGE

Our indicative plan is based on a combined build / buy reporting solution. We estimate SFTR will take approximately 56 - 62 weeks elapsed time to complete (dependent on scope). With a period of further TR integration and testing, you could be ready for an assumed go live date of 1st or 2nd quarter 2019 if you start soon. Given the probably compliance timeframe, we recommend firms should confirm their SFTR strategy, solution design and roadmap by the end of Q1 2018.

SFTR Roadmap



Indicative, product and scope dependent

Involvement in working groups – it is also important to consider the firm's involvement in the industry working groups now being established by industry trade associations, service providers and vendors, and specifically how this should be resourced and managed across the firm.

SUMMARY

What you do next depends where you're starting from. A small number of leading firms are deep into SFTR analysis, realise the scale of the "lift", and are well prepared for the work to come. A few more firms have issued vendor RFPs, evaluated and selected solutions, so they're ready to start. Most firms however have been pre-occupied with MiFID so have guessed a 2018 cost number for their annual budgeting process based on the misperception that it's "just see more reporting". Some have done no analysis and have no budget for SFTR in 2018.

Critical to the analysis is your vision and objectives. Do you want to merely achieve minimum compliance, or will you take the opportunity to reduce operating cost by automating business process while you're digging up the road? Can you generate revenues by offering delegated reporting services? Can you streamline or replace no-longer-fit-for-purpose ALD processes? Will you leverage mandatory SFTR funding to move towards the securities finance platform of the future, capable of supporting trading decisions with high quality analysable data, able to support more clearing, or balance-sheet reducing pledge structures using tri-party?

Clear vision combined with detailed regulatory understanding is needed in the very near future, to flush out impact on the operating model, to evaluate solution choices and decide your target business and technology architecture. With a defined gap analysis firms can plan, estimate and cost the roadmap to compliance. A robust roadmap provides firms with a resource requirement profile so key subject matter experts, business analysis, project managers and testers can be allocated and mobilised. A costed roadmap will also provide the basis for a robust business case to support (and sustain) the budget request.

In summary, the next few months are all about solution design, roadmap, budget and business case if you don't already have them. Working back from the expected 2019 deadline, firms really must have mobilised their SFTR initiatives by the end of the next quarter if they are to have a decent chance of delivering on time. Time is short.

SFTR: NAVIGATING THE CHALLENGE

ABOUT THE AUTHORS

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SFTR SME, SENIOR CONSULTANT

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.

Co-author: David Field

FOUNDER, THE FIELD EFFECT

David Field founded The Field Effect (TFE) in 2015 with 25 years' experience consulting in financial services spanning sell-side, asset management, custody and hedge funds. As well as leading the firm, David has led numerous strategy and transformational change engagements for clients. Prior to founding TFE David was Managing Director of Rule Financial and led the wholesale banking practice at TCA Consulting.

ABOUT THE FIELD EFFECT

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.

ABOUT THE SPONSORS

THE INTEROPERABLE EQUILEND AND TRAX SFTR SOLUTION

EquiLend and Trax are collaborating on a full front-to-back Securities Financing Transactions Regulation (SFTR) solution to support mutual clients in their SFTR reporting requirements. EquiLend's expertise in the securities finance industry, combined with Trax's regulatory reporting and repo trade confirmation heritage, will result in a comprehensive service covering all SFTR-eligible asset classes

ABOUT EQUILEND

EquiLend is a leading provider of trading, post-trade, market data and clearing services for the securities finance industry with offices in New York, London, Hong Kong and Toronto. EquiLend is owned by BlackRock, Credit Suisse, Goldman Sachs, JP Morgan, JP Morgan Chase, Bank of America Merrill Lynch, Morgan Stanley, Northern Trust, State Street and UBS.

Used by securities borrowers and lenders globally, the EquiLend platform (for equities) and BondLend platform (for fixed income) automate formerly manual trading and post-trade processes in the securities finance industry. DataLend provides performance reporting and aggregated, anonymized, cleansed and standardized securities finance data covering all asset classes, regions and markets globally. EquiLend Clearing Services operates the ECS Middle Office and the ECS Gateway, which offer CCP services and connectivity. **www.equilend.com**

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Trax is a leading provider of capital market data, trade matching and regulatory reporting services to the global securities market. In 2016, Trax processed 1.2 billion transactions on behalf of its user community, including 13 million fixed income transactions. Trax estimates that it processes approximately 65% of all fixed income transactions in Europe as part of its post-trade service offering.

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