ADDRESSING SFTR'S INDUSTRY IMPACTS

THE VITAL ROLE OF TRADE REPOSITORIES

TFE THE FIELD EFFECT

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EXECUTIVE SUMMARY

The effective date of the European Union's (EU's) Securities Financing Transaction Regulation (SFTR) reporting requirements under article 4 of the regulation is drawing near, heightening the need for affected firms to start the necessary preparations to ensure readiness for compliance.

These preparations include the selection of a trade repository (TR) for reporting purposes. SFTR has designated TRs as essential elements of compliance by acting on behalf of firms to consume, validate, normalise and store the vast amounts of transaction data involved. By standardising data, validating the content of the data reported and collected and providing appropriate data analytics, TRs enable user firms to improve the quality of their reporting as well as reusing data for market intelligence and risk reduction analysis.

TRs are well-established solutions for trade reporting in the global over-the-counter (OTC) derivatives market, and their extension into securities financing transactions (SFT) will enable the SFT market to tackle the evolving operational and regulatory challenges posed by SFTR and similar regulations that will likely be implemented in jurisdictions beyond the EU.

According to current expectations, firms covered by SFTR will need to begin reporting securities financing transactions in Q1 2020. In developing their compliance strategies, firms need to understand and address the significant ways SFTR will impact the industry and their own business. These impacts include:

- Liquidity and collateral — SFTR's compliance costs and increased regulatory disclosures may affect firms' liquidity and sources of securities for repo and lending in the market. In addition, collateral will have to be reported in more detail.

- Reporting requirements — The regulation is expected to produce reporting volumes that are 400-500% more than the size of current levels of trade bookings in the market, which will in turn compel firms to revise existing and/or develop new processes and controls. Automation and workflow management tools can help firms' front and back offices address these challenges.

- Breaks — Based on the industry's experience with EMIR, SFTR is expected to generate a significant number of reconciliation breaks on day one. Reporting entities and their trade repositories will need to develop coherent and effective plans to resolve these breaks.

- Disclosures — The additional information firms will provide to regulators under SFTR may affect the disclosures firms make, particularly around agent lending and prime brokerage, regarding their securities financing businesses.

Firms will face a choice of TRs for SFTR reporting and should evaluate them carefully. Considerations should include:

- Does a particular TR have a strong track record — with clients, regulators and data security?

- Does a TR have the right functionality?

- Can a TR handle the required reporting volumes?

- Does a TR provide tools that help its clients effectively manage breaks?

- Can a TR help with automation and data management?

- Can the TR handle compliance beyond Europe if/when SFT regulation is enacted in additional jurisdictions?

Firms should also consider the impacts of Brexit and how their choice of TR can support the various potential scenarios post-March 2019.

This paper is sponsored by The Depository Trust & Clearing Corporation (DTCC), which operates the Global Trade Repository (GTR), a multi-jurisdictional trade reporting solution for global OTC derivatives and, pending regulatory approval, securities financing.

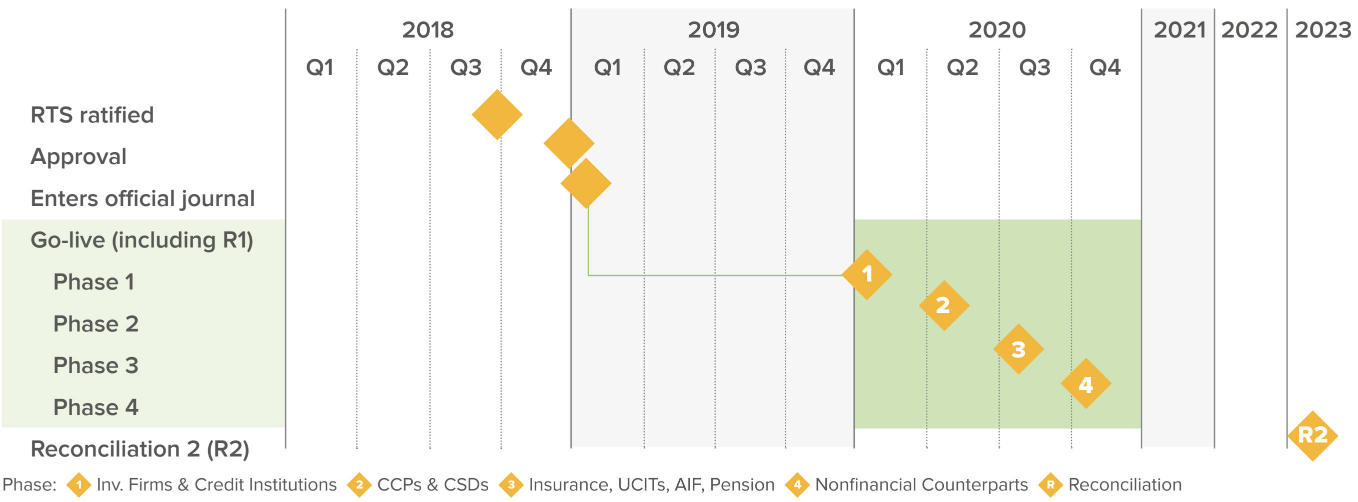
The paper is vendor independent and solution agnostic.

Regulatory update and timeline

Reporting is expected to start in Q1 2020

Following submission of the SFTR's regulatory and implementation standards (RTS/ITS) by the European Securities and Markets Authority, SFTR will need to be adopted by the EU Commission and European Parliament. Based on current estimates of the Parliament's review and ratification process, the first wave of firms covered by the regulation are expected to begin SFTR reporting in Q1 2020.

Figure 1—Indicative go-live dates



In devising SFTR, European regulators have taken the lead in interpreting and implementing the Financial Stability Board's (FSB)[1] post-financial crisis requirements for transparency around securities financing transactions (SFT). Other jurisdictions around the world subject to FSB rules are expected to draw up similar regulations in due course that respond to the FSB requirements. Currently, along with the EU, the Bank of Japan (BoJ) has started to implement its reporting requirements (with data reported directly to the BoJ).[2]

Given the multiple jurisdictions affected, different regulators may diverge in their approaches to SFT regulations—increasing the compliance costs and complexity for firms operating in more than one jurisdiction. Divergence between the EU's SFTR and the regulations eventually promulgated by the U.S., for example, would be particularly challenging for the industry.

1 http://www.fsb.org/2018/03/securities-financing-transactions-reporting-guidelines/

2 BOJ: FSB レポ･データ収集の進捗状況について 22nd March 2018

"SFTR is in response to a global regulatory requirement"

SFTR shares many similarities with the European Market Infrastructure Regulation (EMIR) and the second Markets in Financial Instruments Directive (MiFID II). Being a systemic risk reporting regime, SFTR, which covers securities finance transactions, is more closely aligned with EMIR, which covers OTC and exchange-traded derivatives, than with MiFID II, which regulates most derivatives and cash financial instruments and is centred on transparency and market abuse. Both EMIR and SFTR require reporting to a trade repository authorised by ESMA, whereas MiFIR requires reporting to a National Competent Authority (NCA), either directly or via an Authorised Reporting Mechanism (ARM).

The securities finance industry arguably has more work to do in comparison to the derivatives industry when it first faced trade reporting regulation, specifically in regard to data availability and the workflows that currently sit at the core of the securities finance industry.

Firms in the EU should recognise that, besides SFTR compliance, they will have to address implementation of the remaining articles of MIFID II and potentially additional SFT reporting under MIFID II.

Furthermore, firms should consider the impacts of Brexit. Because SFTR mandates operational separation within an EMIR-authorised TR, a TR will have to maintain separation not only between its EU27 EMIR and SFTR reporting operations but also between its EU27 and UK operations — effectively creating four separate TR work streams between which there must be operational separation. Post Brexit, firms must evaluate how their current or new reporting obligations will be managed, how their service providers will be affected and how their service providers are preparing to deliver these separate services.

Below are the requirements at-a-glance for the regulations

	EMIR	SFTR (proposed)	MiFIR
No. of fields:	129	153 (product and report dependent)	65
Product scope:	Derivatives (OTC & ETD)	Securities financing transactions	All "Financial Instruments" (broadly meaning most derivatives and cash products and including SFTs not covered by SFTR)
Reporting type:	Trade/Position	Trade/Position/ Collateral/Reuse	Transaction
Regulatory objective:	Systemic Risk Monitoring	Systemic Risk Monitoring	Market Abuse/Market Surveillance
Reporting to:	Trade Repository (TR) Obligation is met once a report has been accepted by a TR, which then reports to NCAs, ESMA and central banks	Trade Repository (TR) Obligation is met once a report has been accepted by a TR, which then reports to NCAs, ESMA and central banks	National Competent Authority (NCA) either directly or via an Authorised Reporting Mechanism (ARM)
TR/ARM supervisor	ESMA	ESMA	National Competent Authority (e.g., UK FCA)
Daily valuation reports	Yes	Yes	No
Daily collateral	Yes	Yes	No
Action type/ lifecycle maintenance	Yes Reporting of a UTI with up-dates to each position with Action Type choreography	Yes Reporting of a UTI with up-dates to each position with Action Type choreography	No Each execution event is distinct
Inter-TR reconciliation?	Yes	Yes	No
Message standards	Input — none specified	Input — ISO 20022	Input — none specified

A more detailed overview of the regulatory requirements is available in our first white paper on SFTR.[3] Here we show a summary of the reporting requirements.

Figure 2—Summary of the SFTR reporting requirements

Trade Repository Reconciliation:
- 96 fields reconciled—phased in
- Closed positions reconcile for 30 days
- Inter and intra TR reconciliation

Principal Parties to the Trade Report:
- European entities and their branches
- European branches of non-European entities
- Financial and nonfinancial 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 and 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 reuse of collateral
- Certain CCP novation activity

SFTR's impacts on the industry

SFTR will affect several important aspects of the securities financing business. To help firms mitigate or take advantage of these impacts, they are described below.

1 - LIQUIDITY AND COLLATERAL

Because SFTR will impose additional costs on and heighten the transparency of the SFT business, liquidity and the supply of SFT products may decline if some firms withdraw from or curtail their securities finance trading, switch to deal with non-European counterparts or shift into other products. However, the level of impact is difficult to predict, and firms should study what their providers and market counterparts

3 SFTR: Navigating the challenge, available at www.thefieldeffect.co.uk/white-papers/

will offer in the way of pricing and services to help them manage the increased complexity and costs before determining their strategy around trading of specific products.

SFTR includes a permission requirement for collateral reuse, already in force, and once reporting requirements take effect, firms will need to report any collateral reuse received from an SFT and used in an SFT. SFTR allows firms to report actual or estimated reuse of collateral. Reuse by parties such as tri-party agents, custodians and small non-financial counterparts also needs to be captured to meet reporting requirements.

SFTR permits firms to delegate reporting but not to delegate the reporting obligation, unless this is mandated by the regulation—such as for small non-financial counterparts, where the financial counterpart must report on their behalf. Reuse reporting when it is delegated needs to be carefully considered. If doing delegated reporting, providers need to assess if it includes collateral reuse, as firms will need to advise of any reuse to the firm providing delegated reporting for them, or reuse permission may need to be withheld.

Collateral needs to be reported using the Legal Entity Identifier (LEI) of the issuer of the security. If the issuer does not have an LEI, it is unclear whether firms can use that security as collateral. Resolution of this issue will continue to be monitored by the industry.

In preparation for SFTR, firms should:

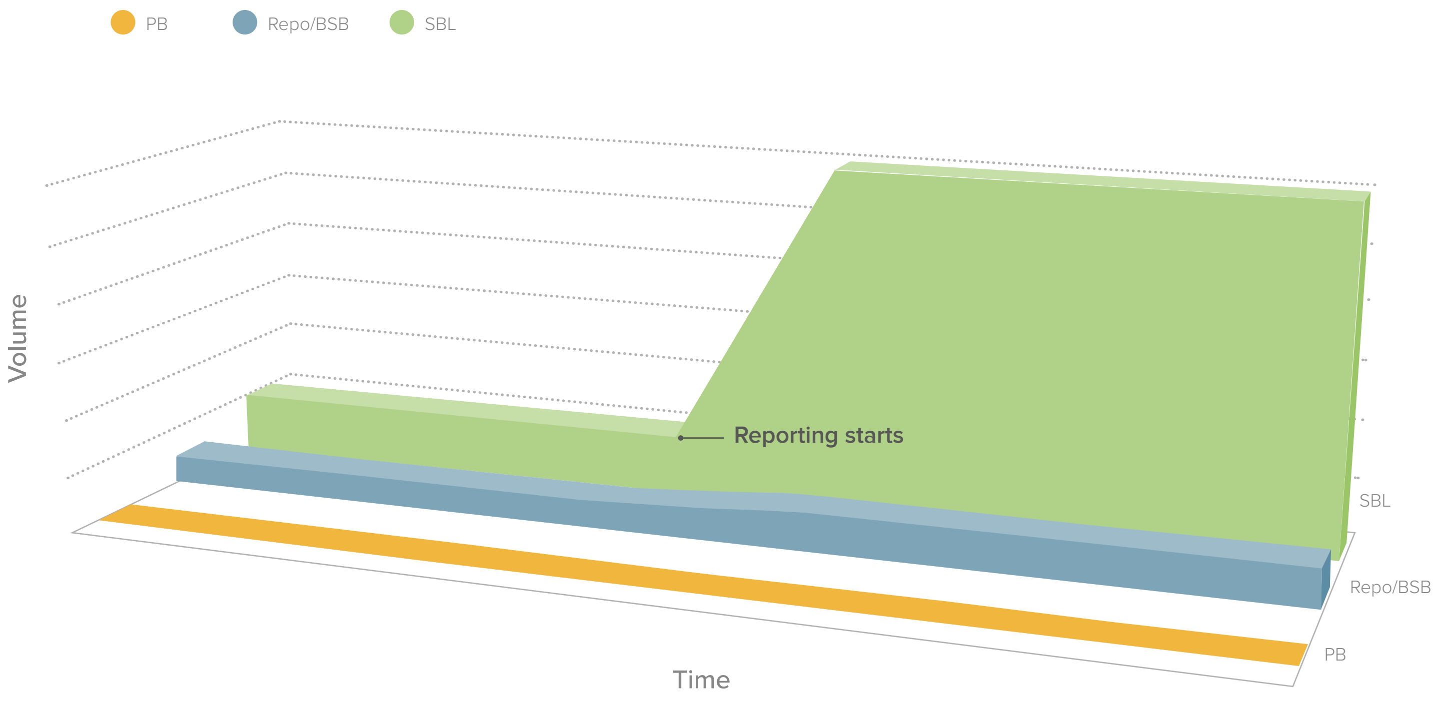
1. Establish a client outreach programme—with priority given to large or strategically important clients and those providing liquidity and supply—and assess how liquidity impacts supply and collateral availability and reuse
2. Consider their approach to reuse around actual or estimated reuse for each asset class
3. Review their LEI databases for issuer LEI availability
4. Review delegated reporting requirements

2 - REPORTING REQUIREMENTS

The amount of SFT data that firms will have to report under SFTR far exceeds what they have reported in the past. It is expected that firms will need to report their whole book every day (at the beneficiary level) at least once, in some cases twice. For example, in securities lending a mark will result in a modification report and a valuation report, and intraday bookings must be included—across the whole book.

To demonstrate how the scale of reporting required under SFTR is expected to dwarf the volumes of SFT bookings today, for this paper we developed—in the absence of publicly available transaction volumes—a model based on assumptions of daily trading and outstanding positions that are typical in the industry. Firms can use this model to scale up or down based on their own product volumes, scope of entities involved and product coverage.

Figure 3—Estimated reporting volume increase by product class



The regulatory reporting function that firms must complete under SFTR is highly complex, particularly because of the diversity of SFT products and the level of detail in the requirements. Consequently, firms face a significant risk of non-compliance both financially and from a reputational perspective.

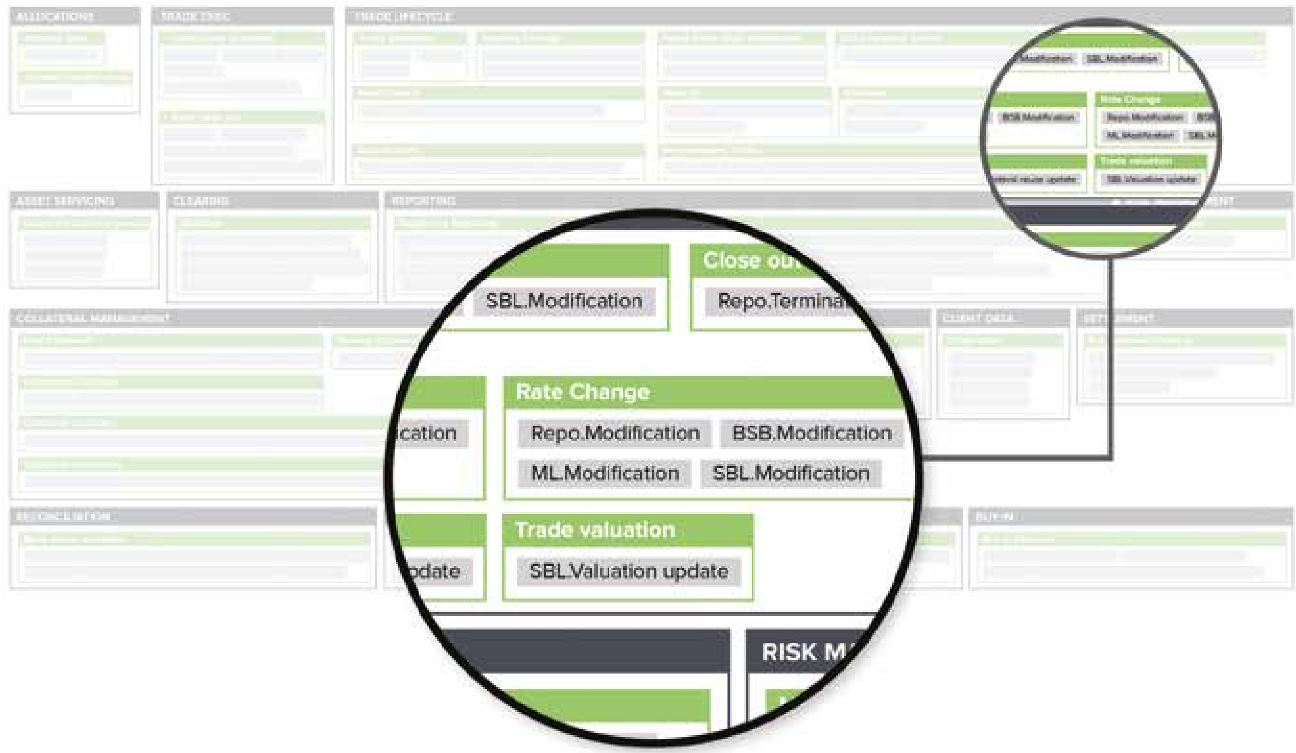
In establishing their internal reporting requirements, firms need to incorporate the processes that create reportable events and that deal with daily validation, exceptions and reconciliation. The best reporting functions are integrated with a firm's day-to-day business to provide the product knowledge and workflow to support interactions with the current SFT product functions.

Firms that do not have centralised reporting functions or are not planning to use them nevertheless will need to ensure they have a control framework in place and can leverage the regulatory expertise necessary to support it.

An indication of some event types and the reports that will be triggered is shown in Figure 4, with as many as 162 different combinations. The SFTR reports can be generated using several different approaches: event based, delta calculation (comparing trade attributes from one day to another) or a combination of both. The interpretation of the regulatory requirements is key to developing business requirements around reporting.

The figure below demonstrates the complex nature of the reporting events using an example of rate changes.

Figure 4—Summary of reporting events by function



In our previous white paper we analysed how SFTR is expected to impact about 60% of existing front-to-back processes related to the SFT lifecycle—from trade execution/capture through to matching and settlement—and prompt the addition of new ones, such as the reporting function, enhanced disclosure processes, delegated reporting and break fixing for SFT products.

Firms should:

1. Assess how their proposed operating model will handle expected volumes
2. Review non-standard processes or client requirements
3. Decide on an event-driven, delta-calculated or combined reporting solution

3 - BREAKS MANAGEMENT

While SFTR does not mandate the pre-matching of trades before reporting to the TR, the regulation's extensive reporting requirements give firms strong incentives to reduce the incidence of breaks by pre-matching some data to facilitate generation and sharing of universal transaction identifiers (UTIs). However, given the volume levels anticipated, the number of fields to be reconciled and the tight tolerances, firms will find it difficult to completely resolve the number of breaks produced daily, and firms should look to develop a break-prevention strategy, which includes seeking out a TR that can effectively help firms reconcile breaks.

Inter TR reconciliation is a two-stage process, whereby a trade is first paired with the other side of the trade and then the rest of the fields are reconciled (matched). Therefore, firms should prioritise the four fields used to pair the trade - UTI, reporting counterparty, other counterparty and master agreement type (where applicable), because if these fields are not reported consistently by both parties, then no matching can take place.

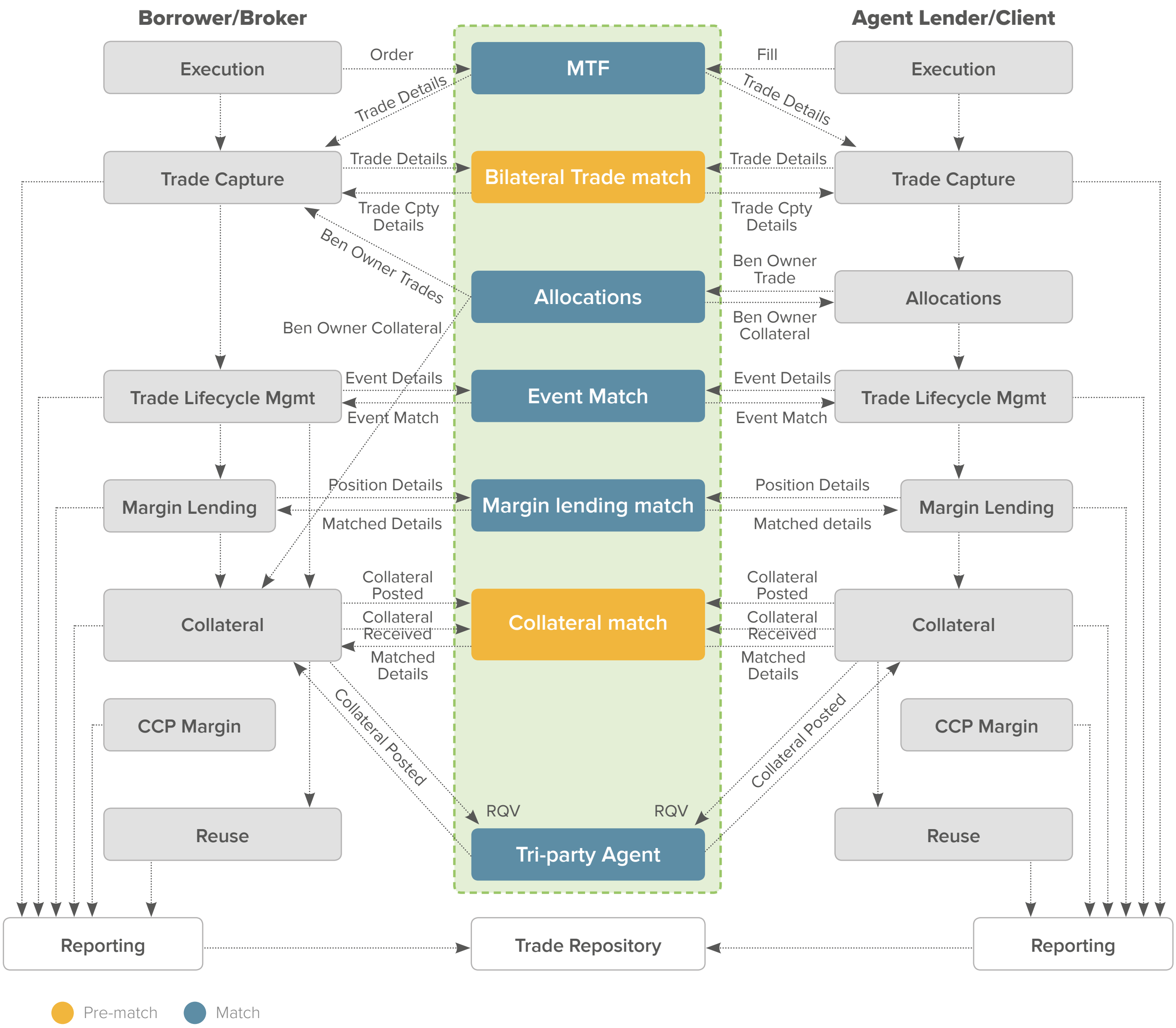
Ahead of SFTR go-live firms should identify the root causes of their breaks, remediate those related to processes and sources of data where possible and start to reconcile data bilaterally with their counterparts at what will be the UTI level within the new reporting regime.

Firms can also use multilateral trading facilities (MTFs) to automate trade booking and UTI generation as early as possible within the trade lifecycle. MTFs can also help automate booking of already matched data from one party of the trade—such as accepting and booking agent lender disclosure information by the borrower, automated marks and returns functionality and common or central price sources.

Firms will need to deal with the additional TR reconciliation feedback and build it into reporting and BAU processes. The ability to leverage an interoperable process across a firm and its counterparts' TRs can help manage complexity and costs.

Figure 5 — Data sources and pre-matching flow for securities finance

Shown below are some of the sources of matched data and where pre-matching should be considered



Above all, firms need to accurately report their books and records, even if it results in a break at the TR. In its March 2017 final report, ESMA states[4] "There is a learning curve and entities improve their reporting both in terms of reduction of number of rejected reports and in terms of reconciled reports." In EMIR reporting, reconciliation breaks were significant at go-live and have materially reduced over time as firms and the TRs worked closely with ESMA to identify and eliminate issues and increase data quality and consistency of reporting.

4 Final Report, technical standards under SFTR and certain amendments to EMIR, 31st March 2017, s393 pg 125

Firms should:

1. Develop a pre-matching and break prevention strategy prioritising the four key fields used to pair a trade
2. Leverage the TR reconciliation in their solution design and processes
3. Develop a UTI creation and sharing process

4 - DISCLOSURES

Given the goal of SFTR is to increase transparency around securities finance transactions, the reporting requirements will prompt additional disclosures to regulators, including around Agent Lender and Prime Broker activity.

Agent lender

The use of agent lenders in securities lending and repos will affect SFTR reporting. Generally, when a firm acts as an agent lender in an agency capacity, SFTR does not require the agent to make a transaction report. Rather, the beneficial owners to the trade by an agent lender will have the reporting obligation, and the broker must report the SFT at the beneficiary level. However, if the agent lender uses the current agent lending disclosure (ALD) process to disclose the beneficiary to the trades post settlement, the borrower will not be able to meet its SFTR reporting obligation on time. In addition, beneficiaries will need transaction-level (including intraday trades) and collateral information from their agents in order to meet their SFTR reporting obligations.

The industry has not reached a consensus on how this process should be conducted, and different agents will likely have different solutions. Agents also utilise different booking models and algorithms to allocate positions to beneficiaries to ensure a fair allocation across their lending portfolio, and agents may reallocate intraday and throughout the lifecycle of a trade. The use of algorithms for allocation decisions needs to be reviewed according to the regulators' "completion" test to see what constitutes a new or modification to a trade and whether the lender modifies UTIs, generates new ones each day or does a combination of both. These operational details add significant complexity, volumes and costs to the beneficiary and the borrower, particularly if no single model prevails across the industry.

Borrowers also need to decide whether to reflect the beneficiary allocations, including intraday allocation and reallocations, in their books and records for regulatory reporting. Currently, most feed this information to their credit departments for credit/capital allocation purposes but don't capture the data in a way that would be sufficient for the regulatory reporting requirement. The data needs to be captured to ensure that firms are reporting their books and records and the firm's reporting function itself is not necessarily the sole place for this data to be stored; firms should conduct a legal review to ascertain what is required. Retaining the data will have benefits for borrowers, for example, around capital calculations and returns processes, but could result in inadvertent disclosure of undisclosed beneficiaries, so firms should consider anonymising the data for internal use.

Disclosure at the point of trade, even if anonymised for desk purposes, would allow booking to be made at the UTI level and help with trading decisions. However, in this case, firms should review and amend where necessary the use of algorithms and automation to deal with the additional volumes that would ensue.

Prime brokerage

Although the industry is less focused on the impacts of disclosure around margin lending (ML), it should be a key area for prime brokers (PBs) and their hedge fund clients. For an ML position between a PB and its hedge fund client, the position held by the hedge fund will be deemed as collateral covering that loan, however large or small. But it's unclear whether this is just what will be deemed as margin in the PB's margin calculation or everything held in all accounts covered by a European PB agreement at the LEI level of the hedge fund. As a result, the hedge fund's positions may need to be reported to the TR regardless of the size of the ML and, as the PB would be in scope, regardless of the jurisdiction of the HF manager. Another unanswered question is whether the additional disclosure will lead to changes in asset segregation by the funds, restrictions of securities for margin and rehypothecation or a move to alternative non-European PBs.

Whilst ALD and PB issues have not been fully resolved, firms across the value chain should carefully assess the impacts of these issues on their business.

Firms should:

1. Discuss counterparty requirement for disclosure models
2. Assess impact on liquidity
3. Review booking models for capturing beneficiary allocations

SFTR's Impacts on the Industry

1. Liquidity and collateral
2. Reporting requirements
3. Breaks management
4. Disclosures
   - Agent lender
   - Prime brokerage
5. Automation and MTF use

5 - AUTOMATION AND MTF USE

The use of MTFs in the securities financing market for repo/buy-sell backs and securities lending has been growing over the last decade. As with many products, SFT volumes have increased whilst margins have reduced, so there has been a general push for automation. Yet bilateral trading persists, and the general level of automation and manual processing has not kept pace with other products across the industry, mainly driven by lack of investment and behaviour and incentivisation within the front office.

As a result, many processes are still manual, ad hoc or not standardised, such as re-rates, maturity rolls, returns, corporate actions and CCP novation. The use of existing services could greatly increase the level of automation and, whilst implementing the reporting function, automation and workflow management will play an integral part in facilitating compliance as well as reducing manual touch points and costs.

SFTR, along with other regulations such as MIFID 2 best execution, could be an opportunity to release head count for value-add activity like business generation, through a refocus on automating the order management and trade processes. For transaction reporting, firms should leverage MTFs for UTI generation/sharing and increasing the level of matched data included in the reporting function. Firms should look at their bilateral business activity and assess where they can move it to MTFs and increase straight-through or zero-touch processes across trade flow and client segments. Emerging new technologies like distributed ledgers and artificial intelligence may also enhance regulatory reporting for the industry.

Firms should:

1. Review the order management function
2. Review the trade flow and booking structures (front to back)
3. Review front-office incentives and behaviours

If the industry cannot demonstrate a strict regulatory compliance culture and manage the break levels between counterparts, regulators are likely to take further action to increase automation and mandate clearing, as they have done in other product classes.

"The choice of trade repository is pivotal"

Trade repository checklist: a roadmap for SFTR readiness

TRs' origins and their extension to SFT reporting

Trade repositories are electronic platforms that centrally receive, validate and maintain the transaction records for certain types of trading instruments. TRs were originally established to monitor trading activity in and heighten transparency around OTC derivatives contracts in the aftermath of the 2008 global financial crisis. Perceiving that trading in OTC derivatives had elevated systemic risk and contributed to the financial instability that brought on the crisis, the G20 nations, meeting in September 2009 in Pittsburgh, directed that OTC derivatives contracts be reported to central trade repositories.

This mandate led to the establishment of TRs in the U.S., EU and elsewhere around the world, and, as of mid-2018, 22 TRs are operating in jurisdictions subject to Financial Stability Board (FSB) recommendations and standard setting.

In extending trade reporting requirements to the SFT market, ESMA recognised the ability of TRs to serve the same trade reporting, validation and transparency functions for SFT as for OTC derivatives under EMIR. Therefore, SFTR, like EMIR, is written to mandate reporting to a TR that provides prescribed services for compliance with the regulation. SFTR also serves to further the goal of standardising the reporting solutions utilised in the EU in line with recommendations to deal with the complexity of post-trade reporting structures (Barrier 6) in the European Post Trade Forum (EPTF) report of 2017.[5]

5 https://ec.europa.eu/info/sites/info/files/170515-eptf-report_en.pdf

TRs that operate in the EU are regulated by ESMA, and that oversight guides ESMA's interactions with the industry and its understanding of the data collected by the TRs.

Checklist for choosing the right TR
Firms will have a choice of TRs, which are highly regulated, for their SFTR compliance. There is extensive oversight of both their initial application for approval and day-to-day operations. In addition, TRs cannot apply to cover SFTR reporting until the RTS ratification process has been concluded; therefore, they can currently only disclose their intent to offer reporting, and any services and pricing are indicative. Because SFTR services and pricing offered by a TR forms part of the registration process, they cannot be confirmed until that TR has gained approval from ESMA. Pricing offered by TRs must be non-discriminatory, cost based and separately disclosed from other services.

Nevertheless, ahead of a TR's final approval to support SFTR oversight, firms can evaluate particular TRs using the following checklist to help determine if they will meet their needs.

1 - What is the TR's track record?
The risk of SFTR non-compliance, financially and from a reputation perspective, is high because the regulatory reporting function firms must fulfil under SFTR is extremely complex, given the diversity of SFT products and the level of detail in the rules.

An important risk mitigation strategy is to consider using an experienced TR that has demonstrated its ability to launch into new products and jurisdictions. Such a track record provides a good indicator that the TR will continue to adapt successfully as SFTR reporting requirements are refined over time.

In reviewing TRs, firms should also look at customer service and client relations, data security, strength of relationships with national and regional regulators and governance policies.

Figure 6 — Overview of the TR's role

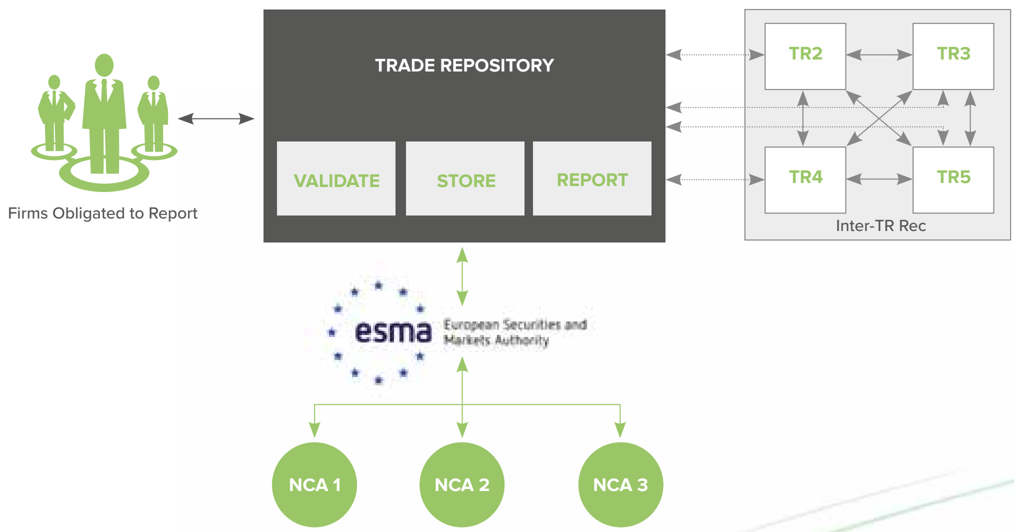
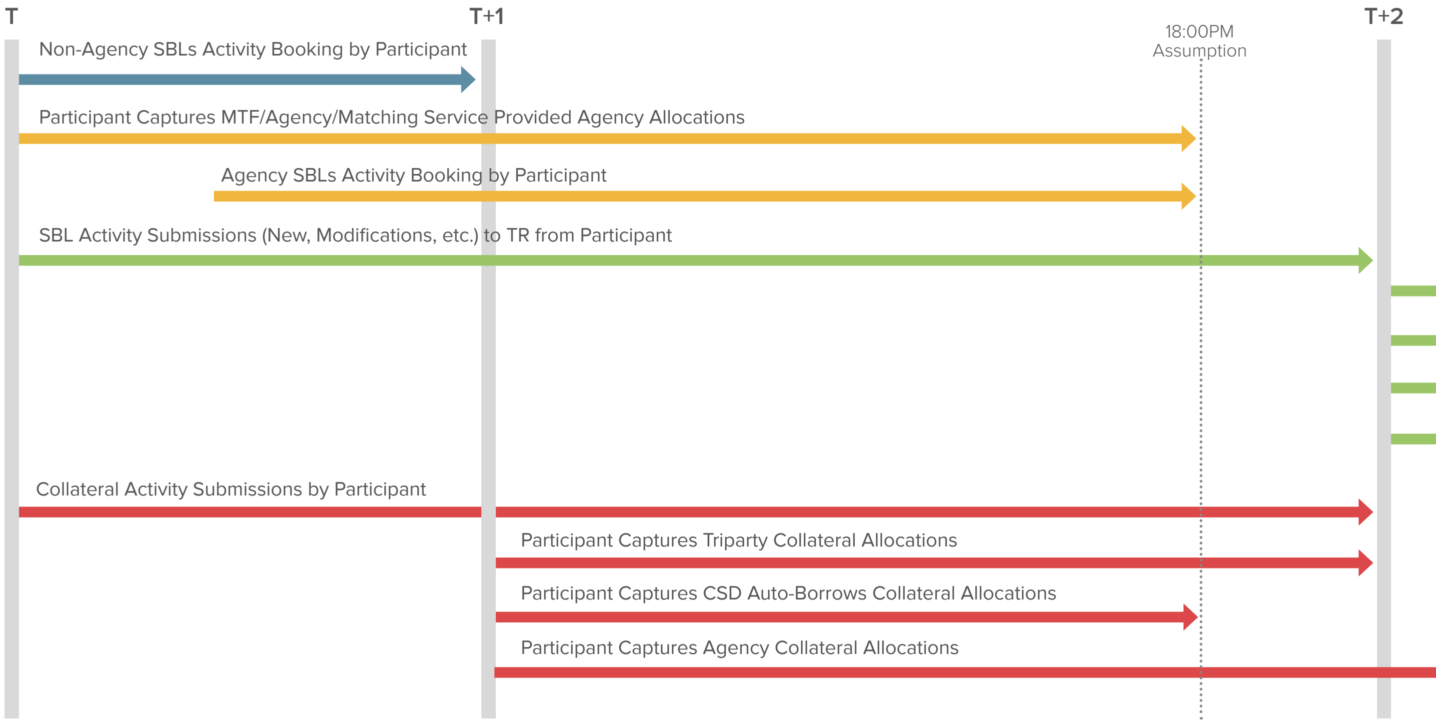


Figure 7—Reporting timelines: Simplified new stock loan trade and TR reporting
(Assumption: Agency lending, netted exposure based collateral; trade and collateral settlement is on T+1, and collateral reporting is on S+1, (which is T+2)



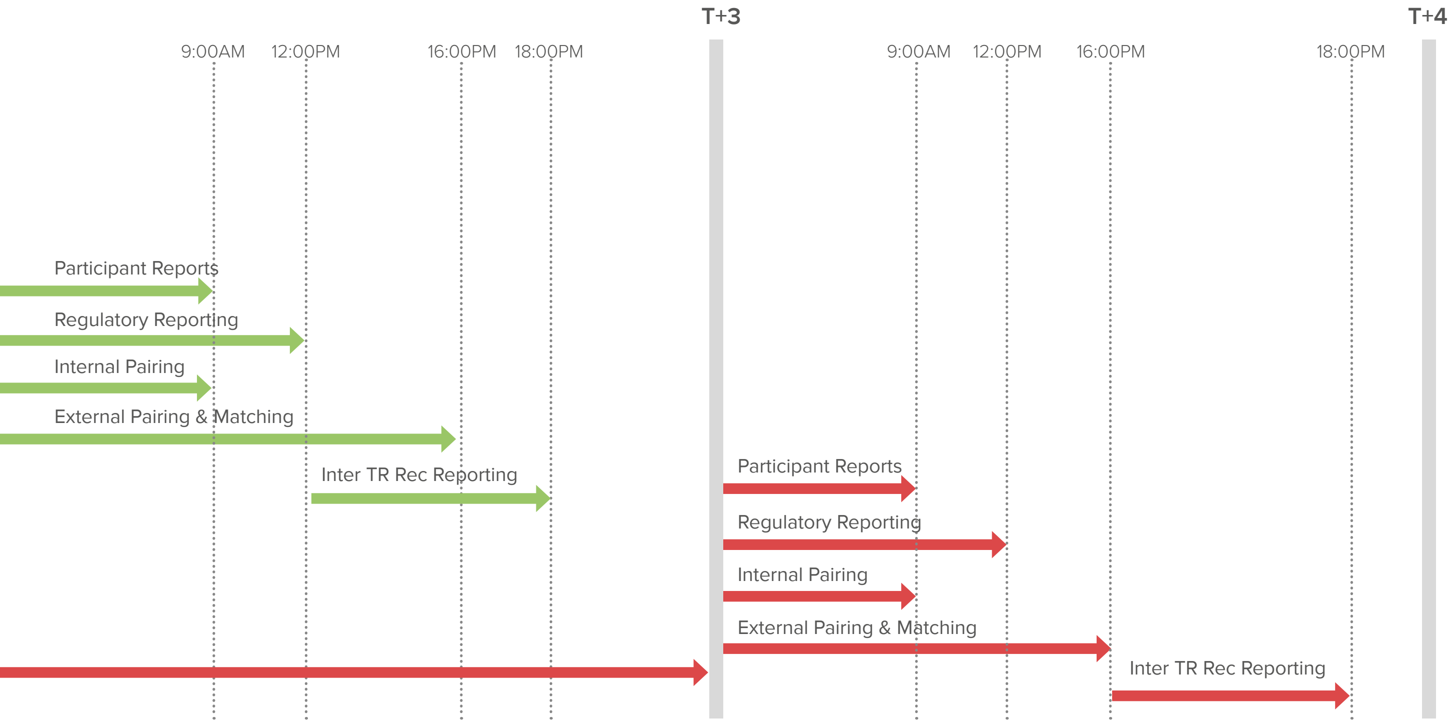
2 - What functionality does the TR offer?
Transaction reports will need to be submitted on a daily basis to a TR. A TR needs to be able to accept transaction reports from parties to a trade as well as electronic execution platforms, CCPs, confirmation providers, intermediaries like interdealer brokers, custodian and other middleware providers.

Once the TR accepts a report, it should be able to efficiently pair and match LEIs and UTIs for both sides of the transaction (if both are in scope), then report back to the submitting parties results of the pairing and matching as well as any unpaired trades and unmatched data attributes for correction.

A TR also needs to act as a portal for the relevant NCAs of member states by collating reported data into standard reports, making transaction-level information available and providing ad hoc reporting that the NCAs can use for regulatory oversight and analysis.

TRs must also be able to make some aggregated data publicly available and be responsible for collating, aggregating, anonymising and publishing the data.

The timing of the report to the TR and the reconciliation processes depends on several factors, including the product, report type and timing of the collateral report due to the



trade level or netting portfolio requirements. The high-level timeline shown above gives a typical reporting flow for a new trade.

Reports must be submitted to the TR in ISO20022 format. TRs will have options for the report submission processes and timing, and firms should review them as part of their requirements and determine whether they want a batch or real-time reporting function.

The high reporting volumes required by SFTR will pressure firms that employ bilateral trading and manual processes to automate more internal processes. For example, by requiring up to 153 data fields—compared to 129 required under EMIR for OTC derivatives—SFTR gives firms strong incentives to eliminate manual touch points where they can.

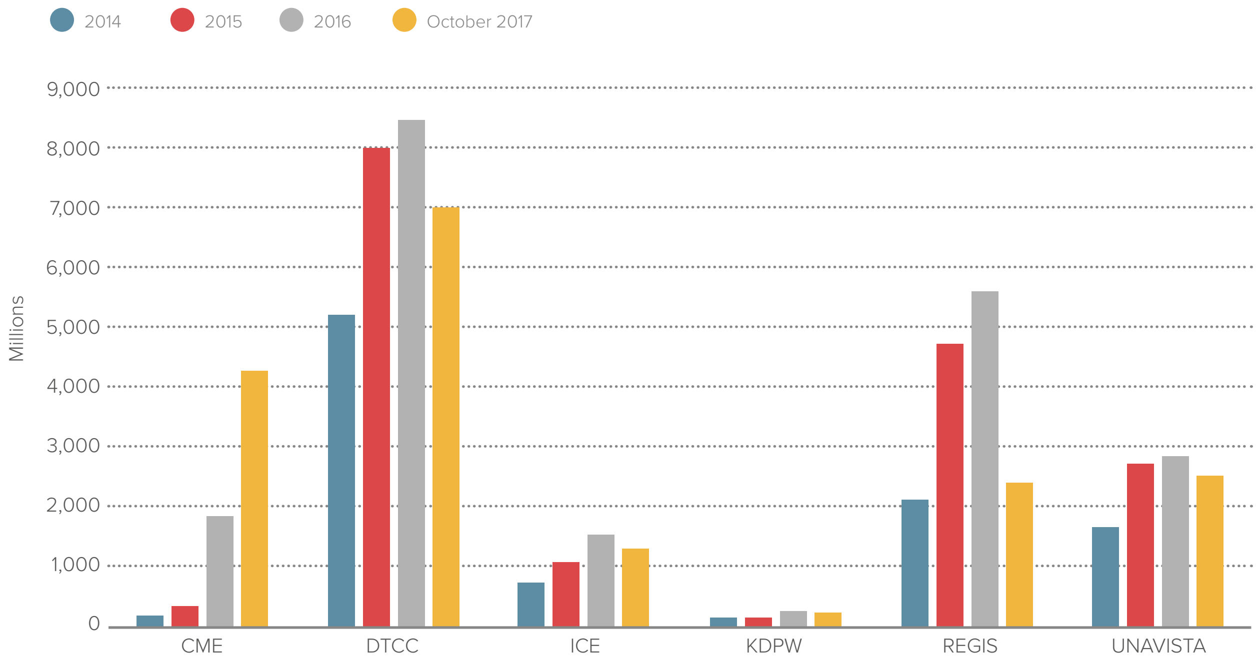
Firms should seek out TRs that can help firms automate and, therefore, better integrate their processes with those of the TR. Some TR features to look for are user-friendly dashboards, simple file feed capacity, ad hoc reporting options, data extraction for exception management, schedulers that create and manage bespoke recurrent reports and Management Information Systems that record and track accepted and rejected trade details.

3 - Can the TR handle heavy reporting volumes?

The massive amounts of transaction detail that SFTR requires firms to provide could quadruple reporting volumes compared to the size of current levels of trade bookings in the market. The expectation that firms will have to report their entire book each day coupled with the diversity of SFT products in the market make it critical that a TR has a solid track record in dealing with substantial daily volumes.

Data published in January 2018 by ESMA[6] on TR activity for OTC derivatives shows relevant EMIR reporting volumes, a useful benchmark for TR volume capacity. The graph below shows market volumes for the six active EMIR TRs as of October 2017.

Figure 8—Comparative EMIR TR reporting volumes



Source: ESMA

In the evaluation process, firms should review a TR's client base, the number of new transactions reported to it weekly and the quantity of messages it transmits each month.

A TR's volume capacity also needs to account for backloading of open trades where required. SFTR requires SFTs that meet the 180-day rule, as stipulated in the regulation's RTS, to be reported in addition to any new trades.

While backloaded volumes will in most cases be relatively low, choosing a TR with experience in backloading for other regulations is nevertheless important in mitigating the risks of improper reporting.

6 https://www.esma.europa.eu/sites/default/files/library/esma80-196-954_thematic_report_on_fees_charged_by_cras_and_trs.pdf

4 - How can the TR improve your breaks management?
The expected high reporting volumes of SFTR and large number of fields that must be reconciled will inevitably result in initial reconciliation breaks. TRs can play a key role in reducing the incidence of breaks by identifying their causes, validating data quality and making reporting more consistent.

In selecting a TR, firms should evaluate its experience with breaks management around EMIR reporting for OTC derivatives. TRs that enforce strong data quality standards and work with users to enhance trade reconciliation should be able to help with breaks management.

Firms should also look for TRs that offer robust customer service functions and an extensive User Acceptance Testing (UAT) period—no less than three months—ahead of SFTR go-live, to ensure sufficient time to address potential reconciliation problems in advance.

5 - Can the TR accommodate future expansion of SFTR implementation across other jurisdictions?
The FSB's transparency requirements around SFT are expected to result in regulatory mandates similar to SFTR in other jurisdictions around the world, including the U.S. and Japan, over the next few years. For firms with global trading activity, it is important to choose a TR with operations in multiple jurisdictions. These TRs will have the operating experience and relationships with regulators that can facilitate rules compliance of firms across multiple jurisdictions.

Besides the expected proliferation of SFT mandates, SFTR itself may continue to evolve with amended requirements over time. TRs that have weathered the regulatory evolution of EMIR will be best positioned to adapt their functionality and help users build a more flexible compliance framework in response to any future changes in the mandate.

Brexit and the various potential scenarios under which it will unfold create further uncertainties around SFTR implementation and compliance, but at a minimum there will be an SFTR reporting requirement in both the UK and the EU27 post Brexit.

Checklist for Choosing the Right Trade Repository

- ☑ What is the TR's track record?
- ☑ What functionality does the TR offer?
- ☑ Can the TR handle heavy reporting volumes?
- ☑ How can the TR improve your breaks management?
- ☑ Can the TR accommodate future expansion of SFTR implementation across other jurisdictions?

Again, TRs that operate in multiple jurisdictions and have experience working with a myriad of regulators will be best positioned to help firms cope with future uncertainties.

Conclusion

The complexities of SFTR demand advance planning and preparation, which should already be well underway for firms subject to the regulation. If not started, this is the time to get mobilised and ensure the budget, roadmap and resources are in place to start your SFTR implementation. Key decisions firms will have to make include whether to invest in building in-house reporting functionality or outsourcing that work and which vendors to partner with on these efforts.

Firms should consider the future state of the market and the impact around liquidity, volumes, breaks management, disclosure, automation and collateral reuse when developing the vision for their business. These considerations will lead to business requirements that should be incorporated into the solution design at an early stage.

Finally, the choice of TR is a critical piece of compliance preparation, and firms should carefully review the capabilities, track record and coverage scope of the TRs they are considering. The sooner firms can select their TRs plus other required services, the less risk firms will encounter in being fully prepared for SFTR when it takes effect

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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 expertise in securities finance and SFTR impact analysis and solution design, OTC derivatives, collateral management and regulatory change. Prior to joining TFE, Simon worked for Morgan Stanley, Deutsche Bank and Fortis.

ABOUT THE FIELD EFFECT

The Field Effect is a boutique consultancy specialising in clearing and collateral management spanning cleared and non-cleared OTC Derivatives, Exchange Traded Derivatives and Securities Finance. We provide advisory and implementation services to every participant in the industry value chain: buy-side and sell-side firms, clearing houses, custodians and CSDs. Our in-depth understanding of cleared and non-cleared OTC business processes, collateral segregation, transformation and optimisation, along with extensive experience of change management, allows us to add value to your organisation and a structured approach to your needs.

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DTCC's Global Trade Repository is the industry's preferred solution for global OTC derivatives reporting. GTR holds detailed data on OTC derivatives transactions globally and has grown to become the largest trade repository in the world, providing new insight and perspectives to better monitor and respond to the regulatory reporting requirements of our clients. It maintains approximately 40 million open OTC positions per week and processes over 1 billion messages per month.

GTR will be extending its regulatory reporting capabilities within the securities financing market, helping clients meet new reporting requirements under the Securities Financing Transactions Regulation (SFTR), subject to regulatory approval.

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