UTIs– Navigating the Waterfall

"You don't drown by falling into water. You only drown if you stay there." – Zig Ziglar

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Introduction

It appears that many market participants are still in the process of defining their target operating models for SFTR. This is particularly the case for complex areas such as who will generate Unique Trade Identifiers (UTIs) and how they will be reconciled between counterparts.

UTIs are one of the most troublesome components of SFTR compliance, with significant potential for time consuming breaks and perhaps even regulatory fines at some point in the future.

To help clients and other market participants simplify the complexity around SFTR operating model definition, including key aspects such as UTI sourcing and matching, Broadridge has launched an SFTR consulting service. In addition, Broadridge offers Data Control, a UTI reconciliation and matching product and an end to end transaction reporting solution.

This article discusses the difficulties of assigning and reconciling Unique Trade Identifiers (UTIs) for securities finance transactions. It covers some of the key challenges, practical steps to consider and ways to avoid costly and operationally intensive breaks.

The EMIR Experience of UTI Generation in the Derivatives Business

EMIR introduced the use of UTIs. The UTI is a trade reference that is shared by both sides of a transaction. The idea is that both sides would present the same UTI when they report the transaction to the regulator.

In 2015, ESMA introduced compulsory reporting of derivatives trades under EMIR. After a long period of consultation, a "waterfall" system was agreed. This methodology aimed to ensure a UTI was generated and shared for every trade.

Three years later, a major trade repository reported that UTI matching rates for derivatives for many banks were still in single figures (<10%). Even for exchange traded derivatives, matching rates varied between 30-60%.

The result is that firms employ large numbers of operations staff for "UTI Exchange processes" and face the risk of punitive fines for poor quality reporting.

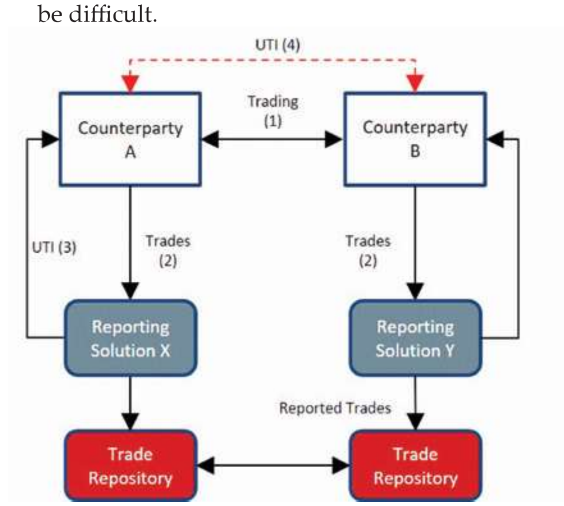
SFTR and UTI Generation

The SFTR (Securities Financing Transaction Regulation) comes into force in April 2020. Once again, a complex "Waterfall" has been discussed and agreed. As with EMIR, the "Waterfall" looks unlikely to guarantee that parties agree on UTIs and alternative solutions are being considered. Multiple solutions have been proposed and some firms have stated that they will create their own "bilateral" UTIs (which the waterfall allows). However, there is still the prospect of high costs and risks resulting from UTI related problems.

We will now discuss some potential scenarios where issues may arise.

Cross Vendor Trades

- In this scenario "Counterparty A" uses "Solution X" for SFTR reporting and "Counterparty B" uses "Solution Y" for SFTR reporting. At the moment, there is no mechanism for Counterparty A to advise Counterparty B of what the UTI is (and vice versa).
- There has been discussion among SFTR vendors about "interoperability" but achieving this may be difficult.



Potential Points of Failure
- Confusion over who should generate UTI
- UTI may already be generated by Counterparty B even though Counterparty A is the agreed reporting party
- Parties need an agreed mechanism to communicate UTIs and resolve differences
- Counterparties need to agree on who generates UTI
- How does the party receiving UTIs know which trades it should be applied to?

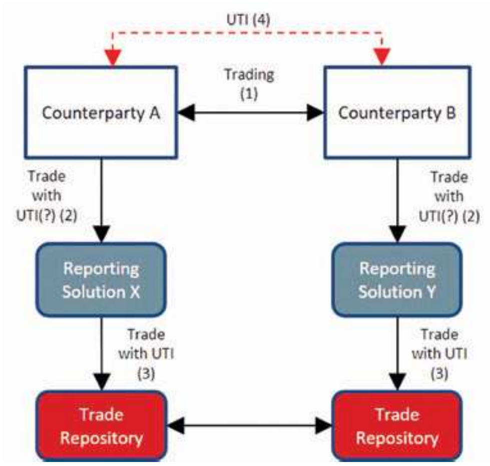
Relevant Products
- SBL (principle or disclosed agent lending)
- Repo (bilateral and not traded on a platform)

Example
One party
Broadridge, Pirum, Equilend as the external reporting vendor

Probability of Pairing trades and Common UTI = Low

Bilateral Repo Trading

- This is an area where there appears to be lower levels of coverage by vendor solutions than in the securities lending markets.
- Trades are generally agreed bilaterally and UTIs would therefore need to be manually transmitted and agreed.



Potential Points of Failure

- Both parties may generate UTI, neither party generates UTI
- UTI Exchange process
- One party may model each "interlife" as a new trade generating a new trade and the other party as lifecycle events that do not generate a UTI

Relevant Products

- Bi-lateral non-electronic Repo

Probability of Pairing trades and Common UTI = Low/Medium

Problem Scenarios

There are three main areas where the generation & agreement of UTIs is problematic.

- Cross Vendor Trades
- Bilateral Repo Trading
- Allocations for Non Disclosed Funds (ex-"ALD")

Scenario Outcome

In the above scenarios, counterparties face the prospect of having to transfer files containing UTIs directly between each other.

The industry may end up with a situation where hundreds of counterparties all need to send files back and forth to each other, all in different formats. All of these files then need to be parsed and loaded into the requisite systems.

Industry Solutions

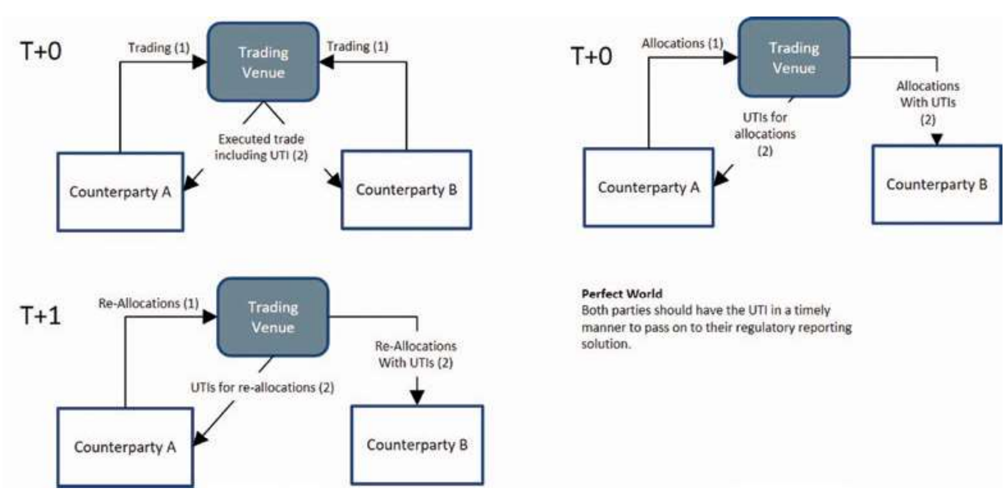
Some vendors have come up with the concept of "portals". However, there is a good deal of debate about how these portals will work, whether you need to be a customer of the vendor and who will pay for the service.

ISLA Initiatives

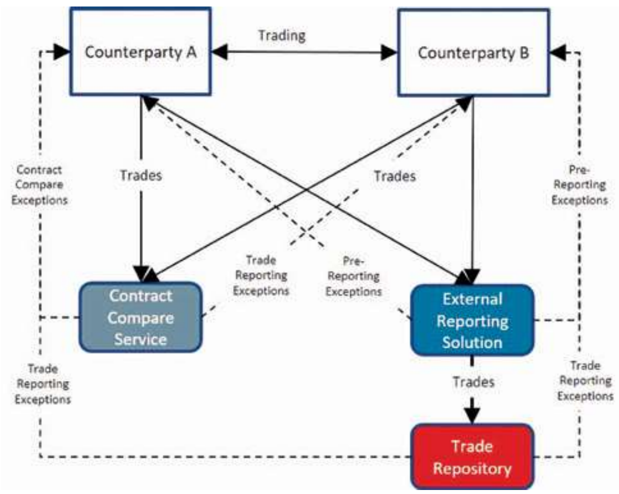
The ISLA SFTR vendor group is working on a file format that would at least standardise the format of the allocation file that would be swapped between counterparties. While this standardisation may alleviate the issue, it does not solve the problem. Firms that cannot generate and consume these files systemically will have to do so via another manual process.

Allocations for Non Disclosed Funds (ex-"ALD")

- Allocations must be transmitted to the borrowers as quickly as possible to enable them to report in the allowed timeframes. No mechanism exists to allow Lenders to report allocations (and the related UTIs) to the borrower unless the Lender and the Borrower share the same SFTR provider.



The Reconciliation Problem – Combined Picture



Potential Points of Failure

The market is heading towards a situation where many firms will be reconciling/matching the same set of trades with their counterparties three times, as shown in the diagram above. However, each will be based on slightly different sets of data and with different tolerances.

This means that each reconciliation/contract compare process would potentially produce different exceptions. Even worse, it could identify the same exception three times in different ways for different teams.

If regulatory reporting exceptions are dealt with by different teams from the contract compare exceptions, this may mean front office and other functions within a firm are queried multiple times (in different ways) about the same fundamental issue.

Some scenarios are more complex. For instance, where two parties are using different regulatory reporting solutions, using different trade repositories or are signed up to use multiple trade reporting solutions.

Key Considerations

Most importantly, if you have not yet defined your operating model for SFTR already, you need to start working on one now. This can be a complex exercise. Leveraging the knowledge of Broadridge's SFTR consulting service can provide the depth of securities finance expertise required to define a workable target state. This allows you to define an operating model that will greatly reduce the complexity around the more cumbersome areas of SFTR, such as the UTI process.

Secondly, engage with your counterparties on who will generate the UTI. ICMA suggests that it is best practice for the agreement to be captured in writing. This means that both counterparties can demonstrate to the regulator that appropriate arrangements have been made if required.

Firms also need to understand whether they or their counterparty is going to provide the UTI:

- Per relationship
- Per type of business (e.g. Securities Lending/Repo etc)
- Per platform (e.g. Equilend/MTS/Eurex/Bilateral etc)

Furthermore, it should be clearly understood how each UTI is going to be communicated:

- How will they send the UTI? Will the platform do it? Will the firm have to do it?
- How will they receive the UTI? Via a platform or bilaterally?
- Can the UTI be consumed systemically or will it be a manual process?
- Do I have to make system changes to cope?
- Do I have to hire and train staff to do the processing?

Finally, think carefully about how you will handle the reconciliation/s. For example:

- Do I execute 3 reconciliations? (1. Post trade 2. Pre Submission 3. Post Submission)?
- For each reconciliation, which team will handle it?
- If I have multiple reconciliations, how do I handle the break management so as not to overwhelm the SME's who could resolve the breaks? (e.g. A trader being asked about a Rate Difference by 2 or 3 different teams).
- Do I have to make system changes to cope with the new reconciliations?
- Do I have to hire and train staff to process reconciliations?

Conclusion

The considerations above demonstrate the complexity involved in the UTI process. Defining an operating model for this and other key areas of SFTR as quickly as possible will save a great deal of time, money and operational workload further down the line. Make sure you have a clear plan in place to navigate the UTI waterfall effectively - this could be difference between sinking and swimming once the regulation is live. ■

Mike Lambert is the Product Director for Securities Lending within Broadridge SFCM ("Securities Finance & Collateral Management"). Mike has over 20 years' experience in the design, build and implementation of Securities Finance systems such as "4sight" and other vendor systems. He has wide industry experience having previously worked for Santander (Abbey/Cater Allen), BNP, Barclays Capital, Merrill Lynch and Lehman Brothers.