SFTR: forget the noise - its about reporting

A view of the forthcoming regulation by Dean Bruyns of Broadridge
First and foremost, the Securities Financing Transactions Regulation (SFTR) is a reporting obligation. The consequences for non-reporting are very real and should be ignored at your peril. Significant fines imposed under the second Markets in Financial Instruments Directive (MiFID II) and more recently with the European Markets Infrastructure Regulation, have brought this into razor-sharp focus. Be very sure that your SFTR reporting team has the experience and tools to deliver.

Now this is not about scaremongering. It’s about considering individual responsibilities, leveraging opportunities and adopting a sensible approach to balancing the books while achieving regulatory compliance.

The International Securities Lending Association, the International Capital Markets Association and other industry bodies are taking the lead by establishing working groups to deal with SFTR. Within this context, market players have assumed their collective responsibilities and contributed admirably in supporting these initiatives and helping flesh out the issues.

One of the strengths of the securities finance industry is the collegiate-style sense of camaraderie and the market has certainly rallied together to get to grips with the new regulation. The danger however lies when the will of the most vocal prevails and some players get side-tracked by factors which are actually unrelated to compliance with the regulation.

Focus on the fundamentals

The concept of business as usual when new regulations intrude can provide a real challenge. The default settings tend to lie at both ends of the spectrum depending on the nature of the personnel within the business.

Some parties adopt a "wait and see" approach. Others may even take on more than their mandated responsibility and end up duplicating other participants’ obligations at their own expense, only to find themselves over-committed and under-resourced.

The ongoing costs of meeting regulatory compliance are not insignificant and the balance between your mandated responsibilities within SFTR and establishing what is surplus to your requirements must be carefully considered.

Reap the associated benefits

There are, however, benefits which can be leveraged from a regulatory project and these must be realised to partially offset the costs of SFTR to businesses.

An example is concisely summarised in ‘The Cost Benefit Analysis’ conducted by Economics Europe, annexed to the European and Securities Markets Authority’s final regulatory technical standards on the trade repositories’s (TR) mandatory obligations.

One such TR obligation, which provides a powerful benefit to counterparties, is in respect of their mandated reconciliation feedback:

"TRs should provide to the reporting counterparties (or other authorised counterparties) feedback messages as to whether the securities financing transactions is reconciled or not. If it is not reconciled, then TRs should detail the relevant data elements where reconciliation breaks take place and provide both parties’ values reported."

This clearly represents an enormous benefit for counterparties. The TR essentially does the heavy lifting and reconciles loan and collateral data, comparing submissions in the first instance, pointing out discrepancies, providing both values and allowing counterparties the opportunity to reconcile the exceptions and then re-submit their reports.

Reconciling exceptions rather than the entire dataset provides obvious benefits from an operational resource perspective and essentially gets you a strong return on investment with respect to your unavoidable TR fees. Leverage this.

Oversight and data lineage

The UK’s Financial Conduct Authority recently highlighted the importance of oversight in its assessment of a regulatory reporting fine for another jurisdiction, flagging the lack of it, as a contributing factor to the severity of the fine.

This validates the emphasis that the regulator is placing on operational and compliance oversight in relation to reporting, so counterparties must take note if they want to stay on the right side of the regulator. Mitigating fragmentation risk by consolidating reporting into a single, centralised hub, will go a long way in simplifying oversight for more secure control.

In addition, the ability to reconcile reports from the TR back to source, justifying the reporting or non-reporting of trades, the reasons therefore and any amendments thereto throughout the lifecycle must be understood and evidenced to the regulators if called upon.

Operational visibility within a dashboard or graphical user interface should be easy to interpret and include powerful data lineage functionality, in order to be considered fully fit for purpose. Counterparties should consider this as a priority if building in-house, or demand it from their specialist reporting supplier.

Bear in mind, the ultimate responsibility for reporting lies with the counterparties involved in the trade. Understanding your data lineage internally holds the key to controlling this.
Data control

The Economist: “The world’s most valuable resource is no longer oil, but data.”

There are several variations of that headline so it’s clearly big news and with new regulations like the General Data Protection Regulation (GDPR) coming into play, all counterparties are well-advised to consider how they treat their data confidentiality.

Data sharing is obviously unavoidable when it comes to reporting but this access is strictly controlled at the TR. Beyond your mandatory obligations you should carefully consider whom you share your data with and also how you realise the benefits from your new SFTR data resource.

Clearly data control is retained when reporting in-house or via an installed on-premise reporting solution. Similarly, CSDs provide a trusted and natural data depository. Before relinquishing control to any hosted solution provider, ensure that you have complete confidence that your data will be properly respected and controlled within its environments. In short, data control must always be given thorough due diligence in the SFTR decision making process.

Business edge – reporting certainty

Responsible reporting businesses will be the winners post-SFTR go-live. There will be little patience extended to counterparties who are inefficient and slow to cooperate with timely reporting requirements.

Successful implementation demands a team performance from all market participants and any weak links will soon be relegated to the bench and leak market share. There will no doubt be challenges that will take time to iron out. However, beyond any initial grace period, should there be one, players will have to step up and perform.

Performance requires prudent decision making. Choosing your reporting team wisely. Are they experts in their field? Is your in-house knowledge base sufficient? Have you given due consideration to improving agency lending disclosure and bilateral legal negotiations if you decide to trigger step one?

Beyond go-live, performance requires booking trades quickly and accurately, sharing trade details efficiently, submitting reports on time, acting on TR rejections promptly and reconciling feedback for resubmission.

Everybody has their function, which must be fulfilled for the regulation to work. CCPs, trading venues, matching and confirmation platforms alike must follow their regulatory mandates in respect of factors like unique trade identifier code generation and the timely sharing thereof. Firms ignoring this should expect a robust response from the regulators and risk reputational damage from within the securities finance community. So report responsibly, fulfil your function, avoid duplication and gain an edge.

Commercial flexibility, agility and independence

Albert Einstein: “The measure of intelligence is the ability to change.”

Retaining agility in the face of future SFTR revisions and the addition of new jurisdictions is a massive consideration. The ability to change, whether out of necessity or to embrace opportunity, is a major factor for market players to consider.

Change becomes easier when solutions are abstraction layers within the businesses infrastructure, allowing for seamless integration and business continuity with minimal disruption and flexibility when it’s time to adapt. Reaching that status and embracing change requires bold decision making, stepping out of a comfort zone and opting for quality over familiarity.

Choosing best-of-breed solutions for their unique specialities is key to building a strong team around the core business, in whatever capacity they contribute. It also allows for easy extrication if the relationship sours, or if new and improved opportunities arise. Retaining that agility and independence keeps the power base where it belongs. SLT

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