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SFTR: buyside go-live will either make or break

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Industry participants have told Practice Insight that phases one and two of the Securities Financing Transactions Regulation (SFTR) have gone smoothly, with no major client incidents reported. Things could, however, still be upended once phase three firms go live in October.

"By and large, the industry is generally pleased with the way SFTR reporting has gone since the go-live last month," said Sunil Daswani, senior securities lending and repo consultant at MarketAxess. "One must remember, though, that these are all new transactions, and that a lot of testing is yet to be done in certain areas of the regime."

Lifecycle events, Daswani continued, are one of the outstanding grey areas of the regime, insofar as they involve corporate actions. "Time will tell how the reporting of new transactions will pan out once corporate actions kick in," he said. "At this point we haven't really seen the full extent of how SFTR reporting will operate – it will happen over the course of the next six to 12 months."

Since July 13, banks and investment firms, as well as central securities depositories (CSDs) and central counterparty clearinghouses (CCPs) have had to report all their securities financing transactions (SFTs) and the related lifecycle events to one of four Esma-approved trade repositories. These include DTCC, Regis-TR, UnaVista and KDPW. Originally scheduled for April 13, phase one firms' (banks and investment firms) go-live date was pushed back to match that of phase two firms (CCPs and CSDs) in the aftermath of Covid-19.

"The delay that resulted from Covid-19 certainly helped market participants to complete their testing, and we were impressed with the level of focus and resources allocated by the sellside towards their preparations," said Val Wotton, managing director of product and development strategy at DTCC. "Testament to the success of SFTR implementation is the fact that firms can now focus their attention on the reconciliation of transactions. In the past, with other regulations such as Emir [European Market Infrastructure Regulation], firms waited weeks to address this due to the need to ensure successful data reporting first."

The prior establishment of best practices, combined with consistent testing, played a significant part in the smooth transition. “The go-live certainly exceeded expectations compared to previous similar experiences, with acceptance rates reported by trade repositories consistently around 95% since the beginning,” said Alexander Westphal, director of market practice and regulatory policy at the International Capital Market Association (Icma). “This shows that the vast majority of firms went into this well prepared, and is also testament to the extensive cross-industry work done over the past years, and coordinated by Icma on the repo side.”

See also: Buyside needs to step up SFTR efforts

Staying focused

Not everything, however, is sorted, and the next steps of the regime will be crucial to establish the stability of the reporting regime. “Notwithstanding the significant work and preparedness for the first two phases of implementation, some outstanding issues could only be resolved once SFTR took effect,” Wotton said. “There are also some specific elements on which you can’t get full clarity until the buyside starts reporting.”

Typical outstanding areas of uncertainty include complex product reporting, transaction pairing and matching, UTI [unique trade identifier] reconciliation, and legal entity identifier [LEI] generation.

“Pairing and matching remain more challenging, but this has been anticipated given the complexity of the reporting rules and their late finalisation,” said Westphal. “There are also inherent issues beyond the control of reporting firms, such as the inability for trade repositories to identify counterparties that haven’t yet started reporting. These issues still create significant noise in the reconciliation data, which makes it hard for us to understand where we are and challenging for firms to focus on the resolution of actual breaks.”

According to Icma, the first week of SFTR reporting saw firms report 1,435,727 SFTs [securities financing transactions] with a total value of €14.3 trillion and a collateral value of €17.8 trillion. Repo transactions accounted for 27.7% of the total number and 94.7% of the total value of transactions.

“I suspect that as the year progresses, Esma will shift its focus from monitoring the availability of the trade repositories’ systems to the shortcomings and interpretation of the data contained in the reports,” said Linda Coffman, executive vice-president at SmartStream. “Firms typically tend to focus on the mechanics of the reporting first, then take on the battle of ensuring a high standard of data quality, and Esma seems to follow the same approach. If we take Mifid II as an example, the quality of the data submitted now has improved compared to the first year.”

The overall market feeling remains positive. “The high acceptance rates are very promising and confirm that the testing has been successful,” said Daswani. “One month into the regime, we can say that it’s been a quiet transition overall, with few client issues. Although this was somewhat expected as we had been running tests with clients for many months, we were still pleasantly surprised by how smoothly things went.”

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All eyes on the buyside

In spite of the relative success encountered with phases one and two of SFTR so far, some market participants see the next phase as a potential cliff-edge. “We expect volumes to jump dramatically come October,” said Daswani. “From our perspective, hedge funds and asset managers have been the most engaged and seem to be further down the line with their projects. Pension funds and insurance companies have been less involved, so it’ll be interesting to see what they do over time.”

On October 13, phase three of the regime will see asset managers, hedge funds, UCITs [undertakings for the collective investment in transferable

securities], AIFs [alternative investment funds], pension funds and insurance companies come into scope. “What we saw in phases one and two is that best practices really came into play,” said Daswani. “Engaging with industry groups and adopting best practices early on helped to fade potential grey areas and drove better statistics. Phase three firms need to make sure they follow this example and adopt best practices as part of their ongoing testing.”

See also: SFTR delay: market relieved but stands ready

While the Covid-19-related delay has helped sellside firms to be better prepared, sources say it had the opposite effect for the buyside. “Based on what we’ve heard from our members, most firms with in-scope activities are looking to their brokers for delegated reporting solutions,” said Adam Jacobs-Dean, global head of markets, governance and innovation at the Alternative Investment Management Association (Aima). **“**The only snag is that the phase one reporting delay basically compressed the time available to the sellside to develop delegated solutions, which means clients haven’t always been able to get the answers they need to prepare themselves. Although there’s still time to work things out, there would have been some merit in delaying phase three as well to maintain the appropriate sequencing.”

While the onus is now on the buyside to get ready in time, the sellside still has a role to play. “Sellside firms have already gone live but they now have to engage with phase three firms,” said DTCC’s Wotton. “They are now turning their attention to finalising their operations to be able to support buyside clients and work through the issues they may face.”

One of the key decisions that buyside entities have to make is whether they will do their own reporting or employ a third party to do it for them.

“[The delay] has created an ambitious timeline for sellside firms to assist those buyside firms who have opted for delegated reporting models, as several outstanding issues – such as the reporting of collateral reuse – remain,” Wotton added. “Buyside firms need to engage either way as they’re still accountable for their reporting. This is why we urge them to act now, finalise their plans and commence testing to be ready for the October deadline.”

DTCC estimates that roughly 25% of phase three firms have made good progress on their preparations, but that another 25% have not yet begun.

“Whether choosing to delegate or not, there are portions of the reporting the buyside need to ensure they can handle,” said Coffman. “The data can generally be quite fragmented across internal and external systems, which is underestimated and can catch firms off guard when doing their analysis. Given the likelihood of delegation, appropriate frameworks need to be in place to validate the data and ensure that the reporting is accurate.”

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