CAPCO

SFTR:

CONSIDERATIONS FOR BUYSIDE FIRMS

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With phase one and two firms fast approaching the July go-live milestone for Securities Financing Transaction Regulation (SFTR) reporting, buy-side are in the midst of their preparations for their own implementation date of 11th October 2020. Although the regulation has put pressure on the whole industry, it has been felt most acutely on the buy-side, with many firms making less than ideal progress on their individual journies. This has been attributed to resource challenges and extenuating circumstances in the form of COVID-19 and late level 3 guidelines.

At this point in time, most – if not all – buy-side firms will have chosen their reporting model to ensure SFTR compliance, and should be tackling the challenges associated with that model. In this paper we examine the three types of reporting models adopted by firms and offer some observations and advice based on practical experience gained from our in-flight SFTR programmes and our wider market insights.

REPORTING MODEL	ASSISTED REPORTING
OVERVIEW	The assisted reporting model is where an in-scope firm sends its data to a third-party vendor who will report on a firm's behalf. The third-party vendor may carry out several additional services such as data enrichment, Unique Transaction Identifier (UTI) generation and validation checks. Reasons a firm may adopt this model include: • Reduces the amount of development work required internally to comply with the regulation. • Third-party vendors may offer a whole host of additional services that are value adding such as UTI generation. • Shifts the onus of UTI generation/dissemination to a third-party vendor allowing management bandwidth relief and a defined SLA for on-going compliance. • Third-party vendors may provide in-scope firms with an additional layer of controls should there be a lack of confidence in a firm's internal build.
KEY CONSIDERATION	**Data Consumption** – firms choosing the assisted reporting model must consider the different ways in which a third-party vendor consumes the data to be reported to the trade repository. Different vendors will offer varying levels of service, with some consuming the data from a range of sources; while others consume it from a centralized source once a firm has had time to carry out some enrichment and controls of its own. Third-party vendors consuming data from different sources could mean a firm will retain less oversight of its data internally, and this may make post submission remediation more burdensome. Furthermore, for firms with a large reporting volumes and numerous systems in scope this approach could lead to greater difficulties when connecting all their systems with the third-party vendor. Capco recommends that assisted reporting models - whereby the vendor will consume from various sources - are better suited to smaller firms with very low trade volumes and fewer source systems in scope. Conversely, firms with high trade volumes and complex system flows would be better off pushing all the data to a centralized source, enabling the firm to retain a better level of oversight and ensuring an easier transfer of data to the third-party vendor.

REPORTING MODEL	ASSISTED REPORTING
KEY CONSIDERATION	**Additional Offering (UTI Generation & Dissemination)** – many vendors offering assisted reporting will bundle in additional functionality, such as UTI generation and dissemination. Such functionality will be of appeal to firms as it enables them to use one vendor to solve multiple SFTR-related challenges. For many firms, the biggest UTI related issue is deciding whether to use a vendor that generates UTI at point of execution or post-trade. An ill considered decision here will require manual processes to be embedded to overcome shortcomings in the UTI solution; and this is what we observed in several sell-side firms. For example, if you are the receiver of a UTI and rely on having it supplied at point of execution, yet the majority of your counterparties are generating it post-trade, then this is going to negatively impact your SFTR solution. Capco's advice to firms is to understand fully how all counterparties intend to generate and/or consume a UTI before making a final decision on solutioning. **Post Submission Remediation** – when using an assisted reporting model, it is important to remember that the responsibility of submitting timely, accurate and complete data continues to reside with the in-scope firm. Any remediation required will likewise need to be carried out by the in-scope firm. The challenge posed here is maintaining a clear process to relinquish control of your data and trade repository responses so you can remediate and resubmit any NACKs. Most third-party vendors offer firms a choice. Some can transfer final submissions and trade responses back to the in-scope firm so that a process for remediation might be defined and centralized internally. There are vendors who are willing to offer a user interface where firms can login to view their exceptions. Firms with high trade volumes and hence potentially more exceptions would be better advised to consume final messages and trade responses internally so they can clearly define a remediation and resubmission process. Additionally, this approach will ensure a clearer audit trail if held internally. Firms with very small trade volumes and few rejections should, on the other hand, be well placed to simply review rejections in an external dashboard and coordinate resubmissions accordingly.

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<tr><th>REPORTING MODEL</th><th>VOLUNTARY DELEGATED REPORTING</th></tr>
<tr><td>OVERVIEW</td><td>
Voluntary delegated reporting allows an in-scope firm to choose to delegate the reporting of their transactions to the other counterparty, where that counterparty is willing to offer a delegated reporting service.
Reasons a firm may adopt this model include:

Shifting the onus of UTI generation to the other counterparty and removing the need for UTI dissemination.
Firms delegating their reporting should not need to worry about pairing and matching breaks, as the reporting counterparty will be reporting for both sides.
Minimum development effort required by the firms delegating their reporting to the other counterparty.

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<tr><td>KEY CONSIDERATION</td><td>
Data Consumption – in delegated reporting both firms are parties to the same transaction, which means that sourcing the data related to Table 1 (Counterparty Data) and Table 2 (Loan and Collateral) should not be a problem. The main challenge we see here is the sourcing and reporting of Table 4 (Collateral Re-use). Firms offering delegated services may find it difficult to source reuse-related information from the counterparty, as they may not be willing to share this information as that will lead to disclosure issues.
Firms opting for delegated services offered by other reporting counterparties should make their preferences known to them i.e. what tables of SFTR transaction reporting they would be willing to delegate. A point to note here is the firms that fall under the Mandatory Delegated model - i.e. firms that are classed as Medium Sized Undertakings - will have to delegate all the tables of SFTR reporting, including Collateral Reuse. Therefore they must ensure they have the relevant information available for the reporting counterparty.
Post Submission Remediation – firms delegating reporting must not forget that the reporting obligation and ownership of the report still resides with them. The main challenge this poses is when a trade repository rejects a report submitted by a firm on behalf of its counterparty, as the rejection will only be sent to the report-submitting entity. However, any remediation required will need to be carried out by the firm that has delegated reporting. Therefore, firms opting for this model must have a clear process in place to relinquish control of their data and trade repository responses, ensuring that they can strategically remediate and resubmit the data.
Reconciling Reported Data with Books & Records – despite there being no explicit reconciliation requirements, as we saw in MiFID II, firms should still ensure that the data reported is accurate and reconciles with their books and records. To do this, the right access must be setup by the firm at the trade repository so they can access the data that gets reported on their behalf. Failure to do this will leave a firm unable to download the reports that are generated on their behalf.
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REPORTING MODEL	SELF REPORTING
OVERVIEW	Firms who have in-house capability to generate ISO XML messages may choose to self-report to the Trade Repository (TR) and consume the messages directly from the TR. Reasons a firm may adopt this model include: • Less dependency on external vendors or other counterparties to fulfill their obligations. • Better visibility of the data that is reported. • Less effort will be required to reconcile reported data with the firm's books and records. • Remediation will become easier, as firms will have visibility of internal validation exceptions and rejections received from the TR.
KEY CONSIDERATION	**Data Consumption** – firms opting for this model will face fewer challenges, as most of the data attributes can be sourced from their internal systems. However, they may encounter issues when consuming collateral data where they are using triparty agents (TPAs) to post collateral. Firms must ensure that in such a scenario TPAs are able to provide the collateral allocation file by S+1, the deadline for firms to submit their collateral information to the regulator. Capco recommends that: • Firms must conduct outreach with TPAs or any other external vendor to confirm whether they will be able to provide the necessary data attributes the firms require to meet their reporting obligation. • Firms must ensure they perform proper testing involving TPAs / external vendors to avoid last-minute surprises. • Firms must ensure they have robust reconciliation processes in place to identify any gaps that could lead to under-reporting. **Internal Controls:** firms choosing to self-report have the ability to retain stronger control over their data compared to the other two models. Capco recommends firms build sufficient in-house controls at every point of the reporting process. • Firms should have trade eligibility checks to ensure they are correctly identifying reportable trades. • Firms should have controls to ensure all mandatory and conditional fields are being reported in full as required by the regulatory requirements. • Firms must ensure they have accuracy controls to ensure fields adhere to ESMA's reportable field formats. • Firms must employ robust reconciliation controls in order to maintain the accuracy of data by reconciling reported data with their books and records.

REPORTING MODEL	SELF REPORTING
KEY CONSIDERATION	**Reporting Architecture:** solution architecture is of the utmost importance for firms self-reporting. Sell-side implementations have taught us a lot about the architectural pitfalls to which firms' can fall victim. Several vendors were offering trade enrichment services at point of execution, for example, allowing firms to source all the collateral-related static data (LEI of Issuer, Collateral Quality, Collateral Type etc.) from point of execution. This is helpful should the collateral remain constant for the entire lifecycle of a trade. However, we know that lifecycle events, such as substitutions, will result in the collateral changing - and this is typically entered into a trade booking system by updating the ISIN. The problem that then arises is the collateral-related static data will not match the new ISIN. Capco strongly advises that all static-related data is stored in strategic systems, enabling firms to consistently look up ISINs to ensure they have the correct related static data. **Post Submission Remediation** – post submission remediation will be less of a challenge for the firms who are submitting the report on their own behalf, as they will have better control over their data. However, firms must ensure they establish proper connectivity to receive the responses back from the TR so they can then be made available to Operations for remediation. Capco recommends that MiFIR to remediate these exceptions firms should utilize the existing infrastructure/interface used to meet the requirements of other regulations, such as EMIR or MiFIR. This will help firms to maintain all exceptions in one centralized location, hence making it easier to manage them. **Pairing & Matching** – SFTR involves dual-sided reporting. Therefore, it is important for both sides of a transaction to pair and match on reports submitted to the TR. The regulation requires that firms pair the transaction based on a unique key, which is a combination of UTI, the LEIs of both counterparties and the Master Agreement type. Firms failure to do that will result in a pairing break. However, it is around the matching that we see a specific problem. As illustrated in our last SFTR paper*, there are a considerable number of fields that must match, and tolerances are very low. Here, we strongly recommend that: • Firms undertake counterparty outreach to understand the solutions adopted by other counterparties. • Firms must also focus on vendor engagements to understand the solutions offered by those vendors in terms of UTI and Pre-paring and Matching. * https://www.capco.com/Intelligence/Capco-Intelligence/SFTR-Unprecedented-Times

CONCLUSION

As we have highlighted, the key considerations for a firm when it comes to SFTR can vary significantly depending on the type of reporting model that has been selected.

The voluntary delegated reporting model is relatively light touch when the focus is on setting up a streamlined process for sharing data. This is very different to the self-reporting model which requires a lot more effort. Virtually all firms using this reporting model have needed to invest in new infrastructure, whether it be for UTI generation or pairing and matching, and this warrants strong engagement from architects and development teams. This will ensure the solution architecture works and does not result in firms succumbing to the various pitfall outlined in this paper.

Finally, the assisted reporting model is not too dissimilar from the self-reporting model, in that many of the same considerations exist. However, there is a key nuance around retaining oversight of your data. Under the assisted reporting model, it is important firms do not lose complete oversight of their data, as this will make post submission remediation much more challenging.

We trust this article has provided some valuable insights that you can take forward to ensure you navigate your go-live milestone successfully.

CONTACTS

Tej Patel, Partner
tej.patel@capco.com

George Phillips, Principal Consultant
george.phillips@capco.com

Rahul Trivedi, Senior Consultant
rahul.trivedi@capco.com

ABOUT CAPCO

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