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Data Management
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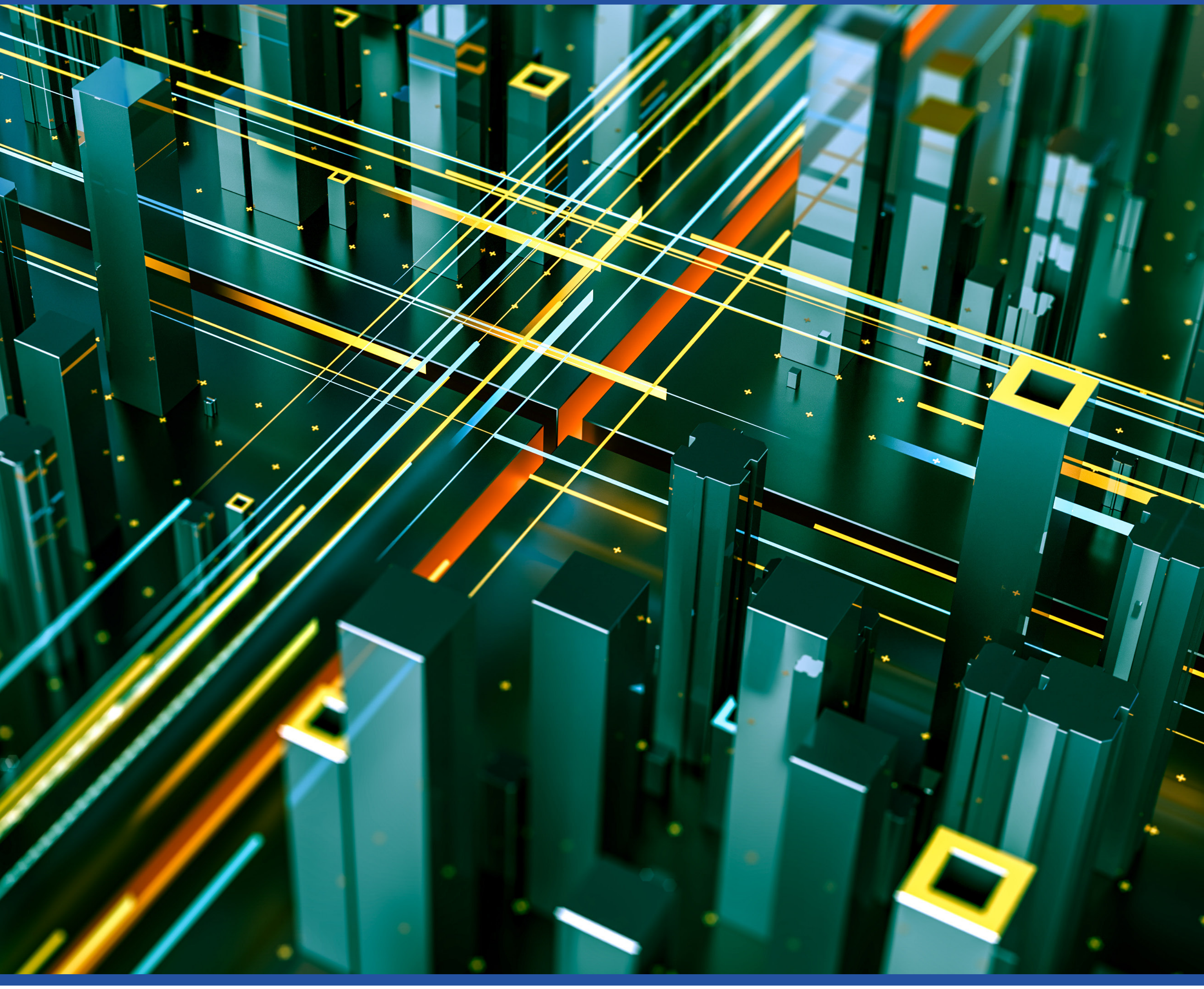
Addressing the Reference Data Challenges of SFTR



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INTRODUCTION

The EU's Securities Financing Transactions Regulation (SFTR) - designed to increase transparency around activities that are broadly categorised as shadow banking - comes into force in April 2020. As the name implies, the regulation focuses mainly around securities financing and by extension securities lending and rules around the use of collateral.

The regulation is extensive, with some 150 data fields in its mandatory regulatory reports. But alongside the kind of transaction reporting practitioners are familiar with, much of it along the lines of MiFIR and EMIR, SFTR has a strong reference data requirement.

Around a dozen of its data points require regulated firms to ensure they have access to high-quality reference and descriptive data, and the sourcing and management may prove a bridge too far for firms that otherwise have a firm grip on the rest of SFTR's requirements.

This paper looks at SFTR's requirements with specific focus on its reference data aspects. It discusses the challenges involved in populating key SFTR report fields that require robust reference data, and discusses how these should be dealt with.

WHAT IS SFTR?

SFTR is designed to highlight transactions that could pose a significant level of systemic risk and specifically sets out requirements to improve market transparency of securities financing transactions (SFTs). SFTs are typically transactions that use securities to borrow cash, or vice versa. They include securities and commodities lending, margin lending and repurchase agreements. Total return swaps are also covered by some of the regulation's disclosure requirements.

SFTR permits collateral reuse, but only when the collateral provider has given explicit consent in writing. It also mandates fund managers to disclose policies on the use of SFTs and total return swaps to their investors in both pre-investment documents and ongoing periodical reports.

The regulation's scope is broad, covering SFTs made by firms established in the EU, and SFTs made by EU branches of non-EU firms. The regulation explicitly identifies Undertakings for Collective Investment in Transferable Securities (UCITS) funds and Alternative Investment Fund Management (AIFM) funds as being within its scope.

To achieve improved transparency, SFTR requires all SFTs and associated collateral to be reported to recognized trade repositories, using the ISO 20022 standard, building on the MiFIR requirements. But the regulation's reach means that any firm engaging in SFTs will have to review their workflows and upgrade data management systems to fulfil the transaction reporting obligation. This presents an onerous additional burden to firms already scrambling to meet their reporting obligations ahead of the April 14, 2020, implementation date.

The European Securities and Markets Authority (ESMA) issued its Regulatory Technical Standards (RTS) on implementing SFTR in March 2017, detailing the rules for reporting SFTs to approved trade repositories, and more recently a Consultation Paper in May 2019. It is now considering the extensive feedback it received from the industry in response to the CP, and is expected to issue its final recommendations in the fourth quarter.

While ESMA is expected to issue some modifications before the end of the year (see timelines box, below), many believe the standards covering key elements of the regulation are now close to final. These include rules around the generation of Unique Trade Identifiers (UTIs), factors used for assessing security and collateral quality, collateral reporting timing, margin lending, the use of the Legal Entity Identifier (LEI) and reference data requirements for specific reportable fields.

While it's clear that the industry needs - and expects - some form of UTI-sharing utility, responsibility for populating the reference data fields will fall to individual regulated financial institutions. Whatever ESMA's modifications to the reporting requirements as they now stand, reporting for banks and investment banks is set to begin on Tuesday, April 14 next year. As such, firms need to embark on their plans for SFTR compliance, while keeping a keen eye on developments.

Key Dates for SFTR Specification and Implementation

August 2013	Financial Stability Board (FSB) publishes its 'Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos'
January 2016	EU Regulations (2015/2365) on SFTR come in to force
March 2017	ESMA's final report on technical standards for implementing SFTR published
May 2019	ESMA consulted on 'Future Reporting Guidelines under SFTR'
Q3 2019	ESMA reviews industry consultation feedback
Q4 2019	ESMA expected to publish final report on Guidelines on Reporting under SFTR
April 14, 2020	Reporting go-live date for banks and investment firms
July 13, 2020	Reporting go-live date for CCPs and CSDs
October 12, 2020	Reporting go-live date for insurance firms, UCITs, AIFs and pension funds
January 11, 2021	Reporting go-live date for non-financial entities

SFTR'S REFERENCE DATA REQUIREMENTS

SFTR requires all securities finance trades where one counterparty has a legal presence in the EU (including third-country entities of EU-domiciled firms) to be reported to an ESMA-approved trade repository on a T+1 basis after their conclusion. Regulated trades include those in repos, securities loans/ borrows, buy-sellbacks / sell-buybacks and commodities finance trades in all asset classes. With 143 fields needing to be reported across all transactions – and for all lifecycle events, not just new trades – this is a significant task.

Industry practitioners acknowledge SFTR as a data-heavy regulation. Beyond the transaction data, roughly half the fields to be reported relate to collateral or counterparties. Furthermore, since this is a dual-sided reporting requirement, most of the data fields need to be reconciled with the counterparty. As such, the quality of data - and reference data, in particular - is a key consideration.

Indeed, one of the biggest issues facing regulated firms is reference data. Within the requirement are 12 fields covering the details of the financial instrument traded, including an SFTR specific classification and a security quality indicator. Collecting this data, identifying and closing any gaps in coverage, and finally enriching it so it meets the quality criteria of the regulation, together represent an onerous distraction from the true objective of the regulation, which is to report regulated transactions to trade repositories.

The reference data requirement for SFTR is as follows:

- **Security/collateral Identifier**. ISINs (International Securities Identification Number) of both the security and the collateral used in the securities finance transaction.
- **Classification of security/collateral**. The CFI (Classification of Financial Instruments) code of the security/collateral used in the SFT.
- **Currency of nominal amount**. Currency of nominal amount of the security, where necessary.
- **Security/collateral quality**. Code for classifying the credit risk of the security/collateral.
- **Maturity of the security/collateral**. Date of maturity of the security/collateral involved in the SFT.
- **Jurisdiction of the issuer**. Jurisdiction in which the issuer of the security/ collateral is located.
- **LEI (Legal Entity Identifier) of the issuer**. The LEI, if available, of the issuer of the security/collateral.
- **Security/collateral type**. Classification code that describes the type of security/ collateral used in the SFT.

KEY REFERENCE DATA CHALLENGES

While the above list of reference data points isn't extensive, a handful of the elements pose thorny problems for data managers.

First among these is security/collateral quality. The marketplace has been debating on how best to address this requirement since the specification was first published. Perceived wisdom suggests the only way to assign a quality value to a security is by using a rating from a recognized ratings agency. However, in its consultation paper, ESMA suggested that other measures could be acceptable, without specifying what those other measures might be. As such, the reality is that there is no recognized source other than ratings for measuring security or collateral quality.

Another data issue concerns the LEI of the issuer. The SFTR regulation demands that the LEI of the issuer is required, which is fine for securities issued in the EU, since there is likely to be an LEI, given the demands of other regulations like MIFIR. But if someone wanted to use a US company's security as collateral, an LEI may not exist, since there is no mandate for LEI issuance in the US or in many other regulatory jurisdictions globally.

Again, there is significant debate in the industry around this topic, with the default position that the LEI won't be available for some securities. ESMA may have to accept a null or 'X-off' reading for this data field, but so far it's been ambiguous about how to deal with the situation, having both stated it expects the field to be populated and hinting it would accept that there may not be an available LEI. Clarity may emerge from its consultation process.

Practitioners are grappling with other related issues here. For example, identification of the jurisdiction of the issuer may not be straightforward where securities are issued by a non-EU entity or subsidiary. Here, the jurisdiction of the ultimate parent applies, but this may require firms to establish beneficial ownership, which can pose problems without access to a robust entity database and hierarchy.

The other significant issue relates to security/collateral type. This attribute requires a mix of codes inherited from different regulations, such as those required by the Financial Stability Board (FSB) or EMIR/MiFIR. SFTR brings this set of classifications together to create a combined attribute that is very unique to SFTR. For Equities this includes a still partially defined requirement to differentiate between Main Index Equities and Other Equities, where the list of indices meeting the 'main' criteria has yet to be finalised by ESMA and FSB. Hopefully, ESMA and the FSB will clarify the indices to be used as part of ESMA's final guidelines expected in Q4 this year.

Elsewhere, and given the close proximity of the implementation date, there is likely to be a last-minute rush to on-board trade repositories. Firms will need to get their reference data in order before they will pass validations for acceptance by the trade repository.

Backloading is also an issue. SFTR requires regulated entities to report still-ongoing SFTs within 180 days of their applicable go-live date; banks, CCPs, funds and non-financial firms each have their own implementation date for the regulation. For these current SFTs, regulated entities will require a snapshot of the reference data set from the implementation day, which can be used as the reference data set for the back-loaded SFTs.

In addition, given the complexity around getting a transaction report correct and the potential for discrepancies when matching with the counterparty's transaction report, it is inevitable that regulated firms will need to correct historic reports. This will require them to put in place a robust audit and control framework that allows them to justify what they have reported. As a result, it will be important to secure point-in-time access to the reference data set for a specific date so that corrections can be re-reported and audit controls can reliably re-create the conditions at the time a transactions report was sent to the trade repository.

Unlike MiFID II, where practitioners had already been collecting and reporting information long before implementation date, SFTR requires firms to build from scratch in many instances. According to a practitioner at a major sell-side institution, "The information was there [under MiFID I], they had the systems and it was just a question of adding a few additional fields for reference data. SFTR doesn't have that, so it's almost like starting from scratch and trying to upgrade systems and reference data at the same time."

ENSURING REFERENCE DATA READINESS

More broadly, the number of fields required for reporting will present a substantial challenge for regulated firms. Since there is a need to report transactions, collateral, margin and collateral reuse, the amount of reference data needed to manage this process is substantial and complex.

SmartStream RDU has developed a database for SFTR that provides the entire reference data dataset for firms impacted by the new rules. The RDU has been designed to allow clients to focus on the core aspects of the regulation as they apply to their business, in essence building an efficient SFT work flow, by alleviating the need to address the complexity of sourcing the security reference data required by the regulation.

The SmartStream RDU SFTR reference data service removes the complexity. You simply identify the security that is the subject of the SFT and the RDU returns the fields that you need to complete the SFTR transaction report before submission to the trade repository.

The RDU makes the data available through simple-to-use cloud-based APIs, updated daily with five years of history accessible through the APIs to support back-loading, to enable necessary reporting corrections and to underpin an auditable control framework.

Specifically the RDU provides the following:

Attribute Name	Attribute Definition
Security/collateral identifier	Identifier of the security/collateral (ISIN) subject of the SFT.
Classification of a security/collateral	CFI code of the security/collateral subject of the SFT.
Currency of nominal amount	In the case where nominal amount is provided, the currency of the nominal amount shall be populated in this field.
Security/collateral quality	Code that classifies the credit risk of the security/ collateral: 'INVG' – Investment grade 'NIVG' – Non-investment grade 'NOTR' – Non-rated

Maturity of the security/ collateral	Maturity of the security/collateral.
Jurisdiction of the issuer	Jurisdiction of the issuer of the security/collateral. In case of securities issued by a foreign subsidiary, the jurisdiction of the ultimate parent company shall be reported or, if not known, jurisdiction of the subsidiary.
LEI of the issuer	LEI of the issuer of the security/collateral.
Security/collateral type	Code that classifies the type of the security/collateral: ‘GOVS’ - Government securities ‘SUNS’ - Supra-nationals and agencies securities ‘FIDE’ - Debt securities (including covered bonds) issued by banks and other financial institutions ‘NFID’ - Corporate debt securities (including covered bonds) issued by non-financial institutions ‘SEPR’ - Securitized products (including CDO, CMBS, ABCP) ‘MEQU’ - Main index equities (including convertible bonds) ‘OEQU’ - Other equities (including convertible bonds) ‘OTHR’- Other assets (including shares in mutual funds)

SFTR is a data-heavy regulation with a strong emphasis on reference data quality and rapidly approaching implementation date. Many firms are behind on their implementation plans, and sourcing and managing the non-trivial reference data set required for compliance represents an additional burden that could create delays.

ABOUT SMARTSTREAM RDU

The SmartStream Reference Data Utility (RDU) is a managed service that delivers complete, accurate and timely reference data for use in critical regulatory reporting, trade processing and risk management operations, dramatically simplifying and reducing unnecessary costs for financial institutions.

The RDU acts as a processing agent for its participants selected data sources; sourcing, validating and cross-referencing data using market best practises so that these processes do not need to be duplicated in every financial institution. An experienced global team, who operate under the compliance frameworks of their customers, deliver data that is fit-for-purpose, consistent and in a format that is specific to the financial institutions' needs.

www.smartstreamrdu.com

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