The global financial crisis that emerged in 2007-2008 has revealed excessive speculative activities, important regulatory gaps, ineffective supervision, opaque markets and overly complex products in the financial system. So, the Union has adopted a range of measures in order to render the banking system more solid and more stable. The crisis has also highlighted the need to improve transparency and monitoring not only in the traditional banking sector but also in areas where there are bank-like credit intermediation known as ‘shadow banking’.
Therefore, the European Commission introduced the **European Market Infrastructure Regulation**, focused on derivative instruments, and the **Securities Financing Transactions Regulation (SFTR)** to increase the transparency of securities financing markets, focusing on mitigating the risks of collateralized financial transactions. In particular, this regulation pays great attention to collateral reuse because it may pose risks to the financial system. For example, it may:

- Increase the interconnectedness of market participants due to chains of transactions involving the re-use of collateral;
- Increase the sensitivity of market participants to counterparty credit risk, especially in stressed conditions, and hence, reduce their willingness to rollover secured transactions;
- Induce fire sales in stressed market conditions if entities liquidate assets to raise cash in order to repurchase recalled collateral;
- Amplify stress in the market, resulting from a distressed entity recalling its collateral.

This paper focus on the following topics:

1. An overview of the Securities Financing Transactions Regulation;
2. The main information to report to Trade Repository;
3. The reporting process;
4. The functions of Financial Institution involved in the process;
5. Comparison between SFTR, EMIR and MIFID II;
6. Conclusion;
7. Reply values proposition.
OVERVIEW


This regulation applies to:

- Any EU counterparty, including branches in third countries;
- Funds, investment companies and asset management companies;
- Management company of Alternative Investment Funds;
- Third- country counterparty if SFT is concluded with an EU branch of that counterparty.

These counterparties must prepare and transmit reports to a Trade Repository regarding the conclusion, modification or termination of a transactions that includes one of the following products:

- REPO;
- Securities Lending or Securities Borrowing;
- Buy-Sell back or Sell-Buy back;
- Commodities Lending or Commodities Borrowing;
- Margin Lending.

An intragroup transaction is a transaction between two undertakings that are included in the same consolidation on a full basis and are subject to appropriate centralized risk evaluation, measurement and control procedures. Therefore, when an intragroup SFT is concluded, the counterparties should report it to the Trade Repository.

This information is transmitted at the latest on the working day following the conclusion, modification or termination of the transaction. The timing may be different for guarantee information, in fact if the collateral is unknown at point of trade, the counterparty must transmit to Trade Repository the related information at the latest on the working day following the settlement date.

The reporting obligations will be effective for different recipient typologies according to the following dates shown in Figure 1.

![Figure 1: Timeline](image)

SECURITIES FINANCING TRANSACTIONS REGULATIONS| PAGE 3
SFTR provides that the reporting obligation applies to SFTs concluded before the date of application (which is determined by the type of reporting counterparty) which remain outstanding on that date if their remaining maturity exceeded 180 days, or the SFT had an open maturity and remained outstanding 180 days after the date of application. With this in mind, some historical SFTs must be back-loaded by reporting counterparties within 190 days of the relevant date of application.

The following figure shows, for example, the different timing of reporting of SFTs to the Trade Repository by a credit institution.

**INFORMATION TO REPORT**

Information, relating to an SFT subject to reporting, are transmitted to a Trade Repository in electronic form and in a uniform XML model according to the ISO 20022 method.

Information to report are divided into four main categories: counterparties, loan and collateral, margins, collateral reuse (Figure 3)
As summarized in Figure 4, SFTR requires six report types (mainly product-aligned), each triggered by up to 10 action types such as new, modification, termination etc. Instead of there being 60 report type / action type combinations (the maximum theoretically possible) there are in fact only 32 such combinations:

**Figure 4: Report Types**

Therefore, the counterparties must report 155 data fields but not all data attributes are needed for all reports, in fact some attributes are mandatory, some conditional and some optional. The Figure 5 indicates which attributes are required for each of the 32 report type / action type combinations:

**Figure 5: Mandatory Fields**

**COUNTERPARTIES.** In this category are reported information on counterparties like beneficiary, broker, clearing member, triparty agent and the branch of the reporting counterparties. For each counterparty the following must be indicated:

- LEI Code according to ISO17442 of 20 alphanumeric characters;
- Nature (if it is a financial counterparty or not);
- Country;
• Sector (like credit institution, investment firm, insurance company, etc.).

**LOAN AND COLLATERAL.** Information about the economic terms of the loan and the collateral of a Securities Financing Transaction are reported in Figure 3 – Table 2. If the collateral of a SFT is linked to a single loan, but the information on the guarantee is unknown to the counterparty by the term of the report, the specific counterparty gives the complete and precise information relating to all the individual components of the guarantee of this SFT as soon as known and, in any case, within the working day following the value date.

The purpose of collateral information is to:

• Indicate if the securities lending operation isn’t assisted by a real collateral;
• Specify if the collateral is:
  o Security;
  o Cash;
  o Commodity;
• Indicate price, currency, market value, possibility of reuse of real collateral;
• Specify ISIN of a basket of collateral if it is known, otherwise compile with the code “NTAV”;
• Identify as action type “Collateral Update” any changes to the collateral.

The Figure 6 shows the UTI Code process definition (the unique identifier of the transaction). It is a code of up to 52 alphanumeric characters: alphabetic characters from A to Z (including these two letters) and numbers to 0 to 9 (including these two numbers). The UTI has to be the same for both counterparties of the transactions and the stakeholders have some problems to generate this code. So, the graph below shows how this code should be generated and the related responsible parties.

***Figure 6: UTI Generation (Source: “Consultation Paper” by ESMA)***
It is important to specify that, in the case of open term SFTs (for example open maturity repo), the counterparties should retain the initially generated UTI for that SFT and should not re-generate a new one on each renewal. The non-generating counterparty should be able to ingest in its systems or in the systems of the entity responsible for reporting or the report submitting entity the UTI communicated by the counterparty that generated it.

**MARGINS.** Information about margins provided to a CCP or bilateral margins of a Securities Financing Transaction are reported in Figure 3 – Table 3.

The purpose of margin information is to:

- Indicate the value and the currency of the initial margin constituted;
- Indicate the value and the currency of the variation margin. If the variation margin is established on the basis of a portfolio, include in the field the global value of the variation margin established for the portfolio;
- Indicate the value of the initial margin received;
- Indicate the value of the variation margin received;
- Define the value and the currency of the collateral in excess of that required;
- Identify as action type “Margin Update” any changes to initial and variation margin.

**COLLATERAL REUSE.** Collateral is “re-used” when a market participant, such as a bank, receives collateral in one transaction and subsequently sells, pledges or transfers this collateral in a second transaction. This category is strongly linked to the collateral information provided in the Figure 3-Table 2.

Any right of counterparties to reuse financial instruments received as collateral shall be subject to at least both of the following conditions:

- The providing counterparty has been duly informed in writing by the receiving counterparty of the risks and consequences that may be involved in one of the following:
  - granting consent to a right of use of collateral provided under a security collateral arrangement;
  - concluding a title transfer collateral arrangement;
- The providing counterparty has granted its prior express consent, as evidenced by a signature, in writing or in a legally equivalent manner.

The purpose of collateral reuse information is to:

- Indicate the type of real collateral: security or cash;
- Indicate price, currency, estimated reuse and the re-investment rate of the collateral reused;
- Identify any modification of the value of reused collateral with the action type “Reuse Update”.
REPORTING PROCESS

The Figure 7 shows the reporting process of counterparties in scope of SFTR versus the Trade Repository.

![Figure 7: Reporting Process](image)

Both of counterparties, after completing the securities financing transactions, send the report to the Trade Repository at the latest on the working day following the conclusion of the operation. SFT report is subject to 2 different feedback’s TR defined by the following sequential checks:

- **Data quality control** using technical standards validation rules about format, XML 20022, logical action (i.e. a "Modified" action), collateral fields, correctness and completeness;
- **Reconciliation process** between the two reports with restrict tolerance. The reconciliation is carried out through the following information which must be the same:
  - LEI code;
  - UTI code;
  - Master’s agreement.

The “Data quality control” feedback is sent to the counterparties within 60 minutes after the Trade Repository has received the SFT report, while the “Reconciliation process feedback” is sent to them within 60 minutes after the conclusion of the reconciliation process with deadline conclusion of process fixed 6 p.m. working day, time according to Coordinated Universal Time (UTC).

As shown in the overview, the reporting obligations will be effective for different recipient typologies in different dates. Therefore, in this interim period, the securities financing transactions that are concluded between two counterparties, one for which the reporting obligation has kicked in and one for which it has not, cannot be reconciled, as they are reported only by one of the counterparties. On the other hand, the counterparties for which the reporting obligation has not yet started should provide to the counterparty for which the reporting obligation has commenced with all the relevant information.
FUNCTIONS OF FINANCIAL INSTITUTION INVOLVED IN THE PROCESS

The securities financing transactions regulation affects many offices and functions of Financial Institutions, Figure 8 shows the main Area involved by SFTR.

The most important aspect of the regulation is the collateral and its possibility of reuse. In fact, the Collateral Management must do an actual and estimated reuse of collateral and define the agreement with the legal office. In regards to collateral reuse, for example, the Legal Office must administrate the reuse requirement and the counterparty’s consent. Also the IT department is an office to keep in mind because it must perform several actions, such as:

- Create a new automated reporting process;
- Define how to handle the exceptions;
- Store the data for a period of 5 years;
- Define where to source the data required for reporting and define the timing.

The Accounting department has to manage the collateral reuse linking with securities account, whereas the Financial Engineering has to define the estimated value of the collateral reuse and its market value.

The Back Office & Operation plays a key role in the SFTs reporting process; in fact, this office deals with:

- Reconciliation breaks management (pre-matching practice, cause of breaks, remedy action etc.);
- Regulatory reporting;
- SFT and event management;
- Exception management.

Due to the complexity of regulation some firms can decide to reduce their SFT trading activity or to shift SFT trading to Countries out of EU or, in addition, to provide the task of reporting operations to another subject. So the Business Desk has to consider all these aspects, in particular the margin on delegated reporting.

Finally, the Treasury and Liquidity Department has to consider the impact of this new EU regulation on the LCR and NSFR calculation.
REGULATION COMPARISON

It is important to define the differences and similarities between SFTR, EMIR and MIFID II, highlighting the operations fall within the various reports:

<table>
<thead>
<tr>
<th>Instruments</th>
<th>EMIR</th>
<th>SFTR</th>
<th>MIFID II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivatives (OTC and ETC)</td>
<td>Securities financing transactions</td>
<td>All financial instruments</td>
<td></td>
</tr>
<tr>
<td>Number of fields</td>
<td>129</td>
<td>155</td>
<td>65</td>
</tr>
<tr>
<td>Recipients</td>
<td>FC and NFC in EU</td>
<td>FC and NFC in EU including branches not in EU and their country counterparty with an EU branch of that counterparty</td>
<td>EU investment firm for financial instruments traded on a trading venue</td>
</tr>
<tr>
<td>Report format</td>
<td>Not specified</td>
<td>ISO 20022</td>
<td>Not specified</td>
</tr>
<tr>
<td>Reporting type</td>
<td>Trade and position</td>
<td>Trade, position, collateral and collateral (100%)</td>
<td>Transaction</td>
</tr>
<tr>
<td>Reporting to</td>
<td>Trade Repository</td>
<td>Trade Repository</td>
<td>NCA either directly or via an ARM</td>
</tr>
<tr>
<td>Regulatory objective</td>
<td>Systemic risk monitoring</td>
<td>Systemic risk monitoring</td>
<td>Market abuse/ Market Surveillance</td>
</tr>
<tr>
<td>Time to report</td>
<td>T+1</td>
<td>T+1</td>
<td>As real time as possible</td>
</tr>
<tr>
<td>Action type/life-cycle</td>
<td>Yes, reporting of a UTI with updates to each position</td>
<td>Yes, reporting of a UTI with updates to each position</td>
<td>No, each execution event is distinct</td>
</tr>
<tr>
<td>Supervisor</td>
<td>ESMA</td>
<td>ESMA</td>
<td>NCA</td>
</tr>
</tbody>
</table>

*Figure 9: EMIR, SFTR and MIFID II*

CONCLUSION

The new EU regulation about securities financing transactions involves challenge and opportunities for all interested parties.

- **Challenge**
  - *Reporting Timing* – The counterparts must prepare and send the report to Trade Repositories at the conclusion, change or termination of a SFT within the later than the business day;
  - *Record Keeping* - The counterparties must keep the data relating to the SFT for a period of 5 years starting from the date of termination;
  - *Data Management* – The counterparties must, for example, deal with data fragmentation, data availability, data source management, UTI and LEI generation;
  - *Organizational Cost* - Integration of collateral reporting, workflow, IT infrastructure required effort in term of cost and resources;

- **Opportunity**
  - *Process Optimization* - There is a significant opportunity to reduce operational costs by automating to improve process efficiency, also making synergies establishing cross-silos shared services for regulatory reporting;
  - *Data Quality* - Data Reconciliation (pre and post reporting) ensure a better data management;
  - *Better Decision Making* - SFTR Compliance budget to establish high quality data repositories of business intelligence to enhance decision making in the front office;
ABOUT REPLY AND ITS VALUES PROPOSITION

With operations in Amsterdam, Brussels, Frankfurt, Lisbon, London, Luxembourg, Milan, Munich, Paris, Rome and Turin, Avantage Reply is the Reply Group financial services consulting practice employing more than 300 specialized consultants and drawing on the wider capabilities of Reply’s 7,500+ people. Avantage Reply delivers advisory and management consulting services to financial services institutions with respect to Risk and Compliance, Finance (including Capital Management and Regulatory Reporting), and Treasury. Since its establishment in 2004, Avantage Reply has been committed to industry specialization (financial services) offering insights and in-depth experience. Avantage Reply works with board members, CROs, CCOs, COOs and CFOs, senior and mid-management finance and risk executives of leading financial services institutions across the Eurozone and the United Kingdom. We provide advisory and management consulting services to help financial institutions address the risk, finance and compliance challenges arising from changes in regulation and strategic and organizational change, including technology.

Regarding the SFTR, Reply aims to help interested parties to start the reporting process through four high level phases:

1. **PLAN** - In this initial phase Reply identifies:
   - The business desk in scope;
   - The source systems and data model;
   - After that, planning the assessment and builds the project plan.

2. **ASSESSMENT AND ANALYSIS** – This phase develops in the following way:

Figure 10: SFTR between challenge and opportunity
3. **EXECUTION AND CHECK** – This phase concerns of:
   - Insert the mandatory fields of SFTR in the AS-IS data model;
   - Build XML file required from SFTR for each asset class;
   - Test the connection versus TR, XML submission and TR feedback.

4. **DEVELOPMENT AND FOLLOW-UP** – In this last phase Reply proposes to:
   - Deployment of the solution and test before deadline;
   - Submission of transactions already booked;
   - Management and resubmission of warning and error messages.