



ESMA PROVIDES SFTR REPORTING CLARIFICATION: ARE WE LOOKING AT THE FINAL PUZZLE PIECES?

On 6 January 2020, ESMA published Guidelines on reporting under Articles 4 and 12 of the Securities Financing Transactions Regulation (SFTR) (the Guidelines), together with a Final Report (resulting from the consultation on the Guidelines), amended SFTR validation rules and a statement on Legal Entity Identifiers (LEIs). The Guidelines complement existing SFTR technical standards and ensure the consistent implementation of the SFTR across EU member states.

What is the SFTR?

The SFTR aims to ensure transparency in the securities financing markets by requiring that securities financing transactions (SFTs), where one counterparty has a legal presence in the EU (including third-country entities of EU-domiciled firms), are reported to an ESMA-approved trade repository (TR) shortly after their conclusion.

In practice, details of the principal leg are reported by the close of business the day after the transaction is executed, and collateral positions are disclosed by the end of the day following settlement. Up to 155 fields will need to be reported across all SFTs, which include not only new trades, but also any lifecycle events such as re-rates, change of principal, and collateral updates, which might occur during the term of the transaction.



What are SFTs?

SFTs allow investors and firms to use assets, such as the shares or bonds they own, to secure funding for their activities. An SFT can be:

- A repurchase transaction: selling a security and agreeing to repurchase it in the future for the original sum of money plus a return for the use of that money.
- The lending of a security for a fee in return for a guarantee in the form of financial instruments or cash given by the borrower.
- A buy-sell back transaction or sell-buy back transaction (that isn't a repurchase transaction).
- A margin lending transaction.

What are the SFTR reporting requirements?

Modelled on the European Market Infrastructure Regulation (EMIR) on derivatives, central counterparties and trade repositories reporting obligation, SFTR requirements oblige counterparties to SFTs to report the details of any SFT they've concluded and any modification or termination thereof to a registered TR on a T+1 basis.

Are you impacted?

SFTR defines counterparties as:

- Financial Counterparties (FCs).¹
- Or Non-Financial Counterparties (NFCs).²

Although SFTR broadly follows EMIR counterparty classifications, it does also have some distinctions.³

SFTR Overview

The purpose of the regulation on transparency of securities financing transactions (SFTs) and of reuse (known as SFTR) is to improve the transparency of the securities financing markets and help regulators and investors better understand the risks.

The financial crisis highlighted the need to improve regulation and monitoring outside the regulated banking sector, because the volume of transactions carried on outside the core banking sector had increased tremendously and the risks created could be systemic.

SFTR enhances transparency in 3 ways:

1

Introduces the reporting of all SFTs, except those concluded with central banks, to trade repositories. Depending on their category, firms should start reporting at different stages from 12 to 21 months after the entry into force of the relevant regulatory technical standards. See reporting timeline below.



2

Since 13 January 2017 investment funds (AIFs and UCITS) have been required to disclose information on the use of SFTs and Total Return Swaps to investors in their regular reports and also, from 13 July 2017, in their pre-contractual documents (prospectus).



3

SFTR introduced on 13 July 2016 minimum transparency conditions that should be met on the reuse of collateral, such as disclosure of the risks and also for the need of the providing counterparty to grant its prior express consent.



What is an SFT?



A repurchase transaction



Securities or commodities lending and securities or commodities borrowing



A margin lending transaction



A buy-sell back transaction or sell-buy back transaction (that is not a repurchase transaction)

Reporting Timeline



22 March 2019
RTS/ITS published in the Official Journal of the European Union.

11 April 2019
Entry into force.



11 April 2020
Start of reporting for credit institutions and investment firms.

11 July 2020
Start of reporting for CSD's and CCP's.



11 October 2020
Start of reporting for other financial counterparties, including AIFs and UCITS.

11 January 2021
Start of reporting for non-financial counterparties.



Which trades need to be reported and by when?

SFTs are determined by their go-live dates. For each counterparty type, this can be further broken down into:

- All SFTs entered into on or *after* the relevant reporting date.
- And SFTs entered into *before* the relevant date, that remain outstanding on such date and whose remaining maturity exceeds 180 days or that have an open maturity and remain outstanding 180 days after the relevant go-live date (reports for these pre-existing SFTs must be made within 190 days of the relevant reporting date).

Where the reporting deadline falls on a non-working day (such as a weekend or a national holiday) counterparties should comply with their reporting obligation no later than after the working day following the conclusion, modification or termination of the transaction. For

example, the 11 April 2020 reporting deadline falls on a Saturday, the following Monday (13 April) is Easter Monday, so entities in EU member states where 13 April is not a public holiday (i.e. it's a working day) should start reporting by that date, whereas the remaining member states will report by Tuesday 14 April.

The Guidelines

The Guidelines aim to clarify a number of provisions of SFTR and to provide practical guidance on the implementation of some of these provisions. The Guidelines should contribute to the reduction of costs along the entire reporting chain – the counterparties that report the data, the TRs that put in place the procedures to verify the completeness and correctness of data, and the authorities, defined in article 12(2) SFTR, that use the data to supervise risks to financial stability.

At a high-level, the Guidelines aim to provide clarity in relation to the following aspects:



Reporting start date when it falls on a non-working day.



Number of reportable SFTs.



Population of reporting fields for different types of SFTs.



Approach used to link SFT collateral with SFT loans.



Population of reporting fields for margin data, reuse data, cash reinvestment and funding sources.



The Guidelines also provide clarity to the generation of feedback by TRs and its subsequent management by counterparties – namely in the case of 1) rejection of reported data and 2) reconciliation breaks – and to the provision of access to data to authorities by TRs.

In more detail, the Guidelines cover the following areas:

- Reporting start date.
- Determining the number of reportable SFTs.
- Reporting of CCP-cleared SFTs.
- Allocation of responsibility under Article 4(3) SFTR.
- Voluntary delegation of reporting.
- Application of SFTR reporting obligations to SFTs concluded by branches.
- Reporting by an NFC.
- Action types.
- Timely reporting of conclusion, modification and termination of an SFT.
- Mapping business events to action types and levels.
- Identification of a CSD participant.
- Determining counterparty side.
- Price and value fields.
- Reporting of CFI for a security used as collateral.
- Back-loading.
- UTI generation and structure.
- Identifying and reporting on beneficiaries.
- Identification of issuer securities and securities.
- Procedure when a counterparty undergoes a corporate action.
- Reporting in the phased-in period.

- SFTR fields (counterparty data, loan and collateral data, margin data, reuse data, cash reinvestment and funding sources).
- Rejection and reconciliation feedback.
- How to provide information to authorities.

Final Report, SFTR validation rules and LEI statement

Alongside the Guidelines, ESMA published a Final Report on Guidelines on reporting under SFTR, updated SFTR validation rules and a statement on LEIs.

The Final Report contains the assessment of the feedback received from stakeholders on key elements of the Guidelines and is split into different sections, each containing a brief explanation of the proposals in the consultation paper and the assessment of feedback taken on board or not with reasons why.

ESMA has also updated the SFTR validation rules. The amended SFTR validation rules are fully aligned with the updated XML schemas published in December 2019, as is the LEI statement.

The LEI statement clarifies the expectations with regards to reporting of LEIs for issuers of securities used in SFTs, as well as the relevant supervisory actions to be carried out by authorities.

ESMA disclosed in the statement that on average, 88% of instruments issued by EU issuers have a LEI code, compared to an average of 30% from non-EU jurisdictions.

As a result, ESMA reached a decision to allow a 12-month grace period for the LEI requirement for third-country issuers, originally set to come in as part of phase 1 reporting requirements in 2020. This will give the industry time to lobby issuers of securities to ensure that they can obtain LEIs by April 2021.



Industry views – clarification or not!

Despite these new clarifications, do the Guidelines resolve all industry concerns?

There were concerns surrounding the reporting of cash-driven securities-lending transactions. The industry had argued that these trades had more repo-like characteristics than traditional stock loans and fit better within the repo reporting template. ESMA has now agreed with the industry on this point, and has confirmed that these transactions should be reported as repos.

Other industry commentary suggests that grey areas still exist, for example, around front-loading and back-loading, time-stamp validations, settlement (contractual vs actual), lifecycle events, haircuts, collateral quality, securities reuse and corporate actions.

Firms must now complete their preparations in time for the key reporting start dates, and if they haven't already done so, should be considering the following:

¹ Financial Counterparty or FC means 1) an investment firm authorised in accordance with Directive 2014/65/EU; 2) a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council or with Regulation (EU) 1024/2013; 3) an insurance undertaking or a reinsurance undertaking authorised in accordance with Directive 2009/65/EC; 4) a UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/138/EC of the European Parliament and of the Council; 5) an AIF managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU; 6) an institution for occupational retirement provision authorised or registered in accordance with Directive 2011/61/EU; 7) a central counterparty authorised in accordance with Regulation (EU) No 648/2012; 8) a central securities repository authorised in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council; 9) a third-country entity that would require authorisation or registration in accordance with the legislative acts referred to in the points above if it were established in the Union.

² Non-Financial Counterparty or NFC means an undertaking established in the Union or in a third country other than the entities referred to in the definition of FC above.

³ ManCos and AIFMs are responsible for reporting of their respective UCITS' and AIFs' SFTs, and, in certain limited cases, FCs are responsible for reporting SFTs with certain small NFCs that satisfy prescribed criteria.



Identifying your SFT activity.



Considering whether you're a relevant entity type.



If you have SFTs, how will you comply and when must you comply by?



Have you identified a trade repository?



If you plan to report directly, do you have appropriate IT capabilities in place?



Determine the option you wish to pursue, given, similarly to EMIR, SFTR reporting obligations can be delegated.



If you're a buy-side firm, you need to ensure you can supply your counterparties with sufficient information to enable reporting, for example active LEI codes for the contracting entity.



If you're acting on behalf of multiple underlying entities (e.g. UCITS managers, insurance companies, funds with their own lending programmes), information on the end counterparty to the transaction must be made available to the bank on the other side of the trade.

Should you have any questions, or wish to discuss this topic in more detail, please don't hesitate to contact us on the details listed below:

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