Emily: **Hello and welcome to this DerivSource podcast. I am Emily Fraser Voigt, acting editor of DerivSource.com.**

Although the Securities Financing Transactions Regulation (SFTR) has many of the same aims as EMIR in terms of transparency, it covers a far wider scope of instruments and the challenges are therefore greater. In this podcast, Alexander Westphal, Director, Market Practice & Regulatory Policy at International Capital Market Association (ICMA) and Secretary to ICMA's European Repo and Collateral Council (ERCC), outlines the main obstacles and explains why overcoming them requires industry and vendor collaboration.

Here is DerivSource reporter Lynn Strongin Dodds.

Lynn: **I'd like to thank you very much, Alexander, for taking the time to speak to us about the developments in SFTR.**

The first question I would like to ask is what is ICMA's view on the final standards, and will they change anything?

Alex: Hi Lynn. Very good to be here. On that question, I think on balance we saw the final ESMA standards as a rather positive development, certainly compared to the initial proposals at the start of the process.

ESMA took on board quite a number of relevant points that we as the ERCC and of course other industry stakeholders have raised in the two consultations on those standards - of course as usual, fewer than we had hoped for, but clearly a few helpful and significant improvements were made.

Just maybe to give you a couple of examples; one significant point is certainly on the timing of the reporting, which has been now at least partly relaxed, in particular for collateral related information where ESMA has now acknowledged that in many cases, the collateral allocation is actually only available upon settlement. So that can now be reported one day after settlement, instead of trade date plus one.

Similarly, for the reporting of collateral reuse, this is still required on a daily basis, but ESMA has now clarified that it can be reported after settlement only, which would make it much less cumbersome for firms and would also ensure that the regulators actually get more accurate data.

Then the second element that we think is very positive is that ESMA has introduced an element of phasing-in of the requirements, specifically in relation to the reconciliation requirements. So that is also something that is certainly appreciated.

Clearly, despite these positive developments, that doesn't change the fact that the SFTR reporting regime as a whole still remains hugely challenging for both the industry and actually also regulators. The reporting requirements remain extremely onerous, and it will take certainly a lot of effort from all sides to get this regime working.

Lynn: What lessons have been learnt from EMIR in terms of implementation with SFTR?

Alex: That's a very relevant question. I think there is quite broad agreement across the industry and also shared by regulators that the EMIR implementation process for derivatives reporting was not exactly a smooth ride, and the data quality that comes out of that now two years into the regime is still quite problematic, which can certainly not be in the interests of either firms or regulators.

So indeed, it would be very important to draw the right conclusions and to learn the lessons for SFTR, and clearly what we have seen is that some of the lessons have been learned. There are a number of improvements that will hopefully avoid some of the problems that we've experienced with EMIR.

Probably most importantly for us, the guidance provided by ESMA in the technical standards is now much more granular. So that relates to the actual reporting fields, which are now broadly aligned with ISO 20022 Messaging Standards. But also many other elements of the regime, including the procedures for the central trade repositories (TRs), which will collect the data. So that's an important element, because inconsistent practices and processes across TRs was really one of the key issues experienced under EMIR, so that will be hopefully better now.

Also, there's more detailed guidance now on the issue of unique trade identifiers (UTIs), which are a very critical element of the regime, and the lack of guidance on that issue was also a big problem under EMIR.

Finally, there are a number of other, smaller points that may prove actually quite important to improve the overall workability of the regime. For example, ESMA has suggested now a cut-off for trades (for the reconciliation of trades in particular), one month after their termination, which is something that doesn't exist under EMIR, where reports are still being reconciled even if they're terminated now already for months. So that's also an important element.

That said, some of the underlying fundamental problems remain the same, which is very much a result of the double-sided nature of the regime under SFTR as well as under EMIR, which is heavily reliant on matching of the two sides of the reports, where all the fields have to be essentially identical, and also importantly on the excessive number of data fields, and that is actually something that has even increased in SFTR compared to EMIR.

So, in our view, one of the key lessons from EMIR, which hasn't really been learned, is that there should have been a much more gradual approach, so we think it would have been easier and also much more efficient, to start from a small basis, which could then be gradually expanded, maybe first relying on some of the central infrastructures that already exist in the market, in particular CCPs and tri-party agents, which I think could provide a very reasonable basis of very accurate data, and then gradually expand that over time. That would have been much easier, in our view, and would also have helped regulators to receive more consistent data.

In that sense, I'm a bit less optimistic and we will probably have to go through some of the same learning process again.

Lynn: **You spoke about a few of the challenges; the reporting, the dual-side nature of the reporting, the number of fields. Is there anything else that will be challenging to the industry?**

Alex: No. Indeed, I think those are really the key points. From our perspective, I think the biggest challenge is probably the sheer amount of data, as I mentioned, that needs to be reported, and subsequently matched. So there are actually now in the latest proposals 98 reporting fields for each repo trade, and many of these fields are currently not even captured by firms, so that related market practice will have to be developed first.

And probably even more importantly, the vast majority of these fields need to be reconciled across the two reports, with only very limited tolerance. Again, this needs to be done within each trade repository but also across trade repositories, which will probably be one of the key challenges.

Lynn: **In the past you have talked about collaboration between the industry and vendors. Which initiatives do you think will help and where do you believe there needs to be more work done?**

Alex: We think that this will probably be one of the key elements of the implementation. There's quite a wide range of ways in which vendors can help, and we're seeing more of these solutions already emerging now. That ranges really from more targeted tools related to trade matching, or enriching of reports, to full front-to-back reporting tools that do all of these things and where basically the whole reporting process is outsourced.

It is important to keep in mind that the ultimate responsibility remains with the counterparty that has the reporting obligation, so we assume that while many smaller firms will rely very much on vendors, some of the bigger firms will be much more reluctant to rely fully on vendors and will prefer to build those solutions for themselves, maybe combined with some vendor capabilities.

But there's also a bit of a repo-specific concern here in relation to vendors, because many of these solutions are already existent in the securities lending space, but much less so in the repo space. So there is clearly a risk that some of the vendors might rely on their existing tools and then not take into account sufficiently repo specifics. And of course also that relates to the other side, so some firms might excessively rely on vendor products that are then not coming up to the task.

So, indeed, I think all of those issues just highlight the need that we as an industry now have to work very closely together, also with the vendors, to avoid that these risks actually materialise.

Lynn: Can you please explain what the main objectives of the ICMA ERCC Operations Group are with SFTR and in general?

Alex: Of course. Maybe first on the ERCC Operations Group in general, this group convenes operations experts from the ERCC member firms, where our overriding theme is really to improve the efficiency and consistency of the repo post-trade process. So that involves following closely regulatory initiatives such as the SFTR and also other market developments such as T2S, but also to develop and maintain very detailed operational best practices, and there are very good examples in our ERCC Repo Guide, which we continuously review. So that's at the core of the ERCC Ops Group.

Now, the SFTR of course fits very well into this agenda. We've created a dedicated SFTR taskforce to follow this proposal more in detail, which has gained a lot of traction, and also in relation to SFTR it's important to mention that we as the ERCC are certainly very supportive of the overriding goal to increase transparency in repo and SFT markets. In fact, this has been on our agenda already for quite some time. Since 2001, the ERCC has been publishing a semi-annual European Repo Survey, which includes detailed data on repo markets.

Our key objective with SFTR, while we really support the overall objective, is very much to ensure the effectiveness and workability of the regime, and of course to avoid excessive and avoidable costs. Our focus now is very much on the actual implementation, and the objective is to help firms as much as possible to reduce implementation efforts, to share information, where it's useful, and to co-ordinate our efforts, and also to develop and agree additional guidance and best practices where needed.

Lynn: Finally, in general, what impact do you think the SFTR will have on the industry?

Alex: From a repo ops perspective, I think it's fair to say that SFTR is certainly the key challenge over the next months and years. This will require firms to invest a lot of time and resources in an already challenged environment, and we have to also keep in mind that there are other major implementation projects ongoing, such as MiFID II, so that's in the short term.

In the longer term, I think there's certainly a risk that this will add significant costs and could make SFTs in general less attractive.

I think there's also a risk that some counterparties might even decide to leave the market, because simply of prohibitive costs. More specifically of course the European market, because we shouldn't forget that this also has a global dimension.

The push for transparency in SFT markets was agreed at a global level, but so far Europe is really very much front-running the agenda, and we don't see any comparable regimes being put in place in other jurisdictions. So this of course also raises a question in terms of global competitiveness, and that's certainly something that we need to be mindful of.

However, to finish on a more positive note, we also do see some important opportunities in the SFTR, certainly for vendors, but also for the industry more widely. Firstly, transparency as such is certainly a fair request, which we very much support, as I mentioned. And there's also some hope in the industry that SFTR will actually provide a necessary focus on the repo back office and could create some momentum to improve back-office processes, and to achieve a more efficient and cleaner repo lifecycle in the long term.

Almost certainly, this will involve much more automation and straight through processing, which we'll see, and probably also a push towards more electronic trading on platforms.

Lynn: **Thank you very much for your time and your thoughts. It's been very interesting and helpful.**

Alex: Thank you, Lynn, it was very good to speak to you.

Emily: **Thanks Lynn and thank you Alex for sharing your insights.**

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