SFTR: the red pill or the blue pill?

Martin Walker of Broadridge discusses how firms should open their eyes to the consequences of failing to adequately prepare for SFTR implementation

"You take the blue pill—the story ends, you wake up in your bed and believe whatever you want to believe. You take the red pill—you stay in Wonderland, and I show you how deep the rabbit hole goes."

The Matrix

In the film 'The Matrix' taking the blue pill would have returned the hero Neo to the state of blissful ignorance of reality that most humans lived in. Taking the red pill revealed the true reality of the world. When it comes to the Securities Finance Transaction Regulation (SFTR), it is very comforting to believe you can simply take the blue pill by trusting that a series of steering group meetings, the right infrastructure and drawing a collection of vaguely defined boxes with arrows between them is enough to comply. The trouble with simply taking the blue pill is that eventually you will face the consequences; spiralling costs, disrupted business focus and, potentially, fines for failing to meet the reporting requirements. Though the deadline for SFTR compliance is fast approaching, there is still time to take the red pill and face up to some uncomfortable truths now to avoid a great deal of pain in the future.

Market participants face huge challenges around SFTR compliance. Many firms are still in the nascent stages of defining how their target operating model will look. Some are simply making blue pill assumptions. Others have been so distracted by the second Markets in Financial Instruments Directive (MiFID II) and preparations for Brexit that they have not had time to make key decisions around data, process, technical and organisational models. Then there has been the on-going dialogue between the industry and regulators to drive out ambiguity in the regulations. While the temptation is simply to plunge in and do things because of the shrinking timeline for implementation and testing, it is critical that the big questions are properly aired in your organisation.

The big questions

Where is the data going to come from? Much of the data simply does not reside in existing core trade processing systems. Data point gap identification can highlight where required data is missing and a plan put in place for sourcing it. Firms must give further thought to how they will enrich data and what elements of data enrichment will take place through third party solutions. If your firm has been making assumptions about where data points would come from (whether from internal or external sources), now is the time to stop and work through each data point to get definitive answers.

What exception management flows (including counterparty interaction) need to be designed? Following go-live, ops teams will spend a lot of time and effort identifying and resolving breaks and mismatches. Setting out a clear process for exception management and how ops teams will interact with counterparties to resolve discrepancies in advance will lessen the operational strain immediately after go-live.

How should processes and teams supporting SFTR interact with existing securities finance processes? A great many of the breaks and exceptions that will be identified by trade repository reconciliations or 'pre-matching' prior to reporting will also appear as exceptions in existing processes related to contract compare or trade/settlement instruction matching. There is also a clear overlap between SFTR and the European Market Infrastructure Regulation (EMIR) related business processes for the management of unidentified transaction identifiers (UTIs) and legal entity identifiers (LEIs). These types of problems do not just create costs in the reference data or regulatory reporting teams. When there is a break due to LEI or UTI issues, the query can bounce around the organisation, including the front and middle office until a conclusion is reached about what are simple questions. Who have we traded with and which trade are we all talking about? These breaks, which can persist for days in some scenarios are a major source of operational risk and potentially, regulatory fines in future.

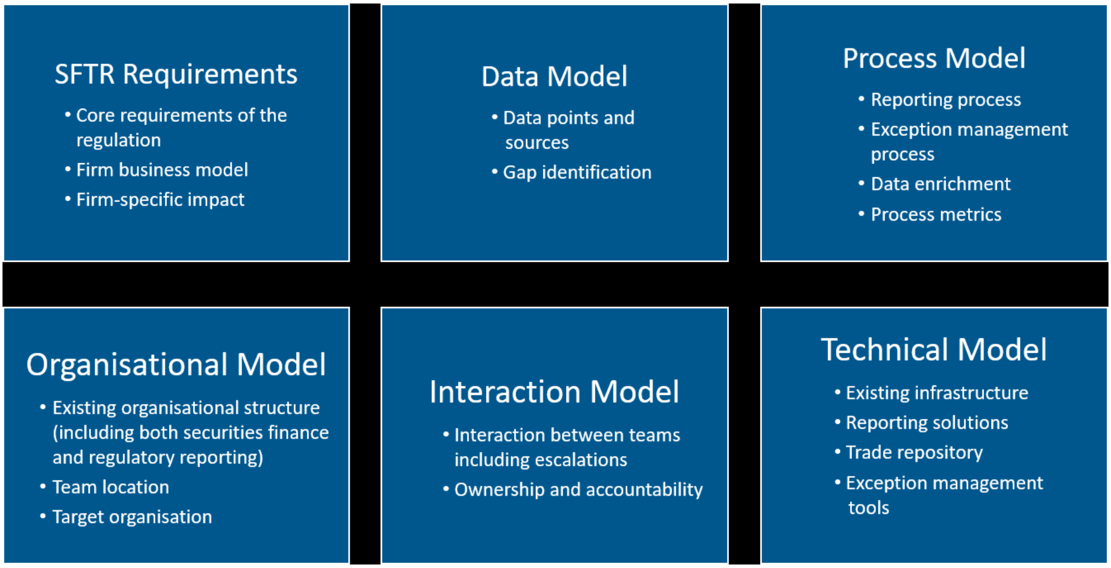
What should the roles and responsibilities look like for relevant functions? Roles and responsibilities need to be clearly defined to avoid confusion where some work is duplicated, and other work may have been completely missed. No firm, particularly those in the securities finance business, can afford the costs that would occur from lack of ownership of problems or unclear escalation paths.

How are you going to use data to manage and change the processes? Everyone in capital markets seems to be talking about data these days. However, the data in many firms and functions is incredibly poor quality.

An effective data-driven process for management, control and change requires up-front thinking as part of operating model design. Do you really want to repeat the mistakes of so many other major changes? Many people will be familiar with the experience; operational and regulatory teams are initially overwhelmed and management demand data and metrics about the extent of the problem. Data that comes from the very same teams that are sinking under work. It is hardly the basis for generating high quality data and making good decisions.

Designing clear and accurate reporting of process metrics will enable managers to measure the volume of work and efficiency of processes. It can also identify where to focus efforts to deal with the root causes of problems and where to invest in process improvement in the future.

Is your current plan genuinely joined up? Finally, there is a fundamental need for all firms to look at their model, in terms of both infrastructure and business process and ask if it is genuinely joined up. Many of the obvious gaps at both the firm and the industry levels involve the exchange of UTIs. Do you hope pre-matching will ensure you always have the same UTI as your counterparty? Well what if your counterparty is using a different reporting service? What would happen if, despite the best intentions of the 'waterfall', counterparties generate (or do not generate) UTIs as agreed. Do you have smaller counterparties you trade with less frequently? Then there will inevitably be some need for manual exchange of UTIs. Do you know who will do this and how?



More than just boxes

Based on our experience, the high-level view of an SFTR operating model should look like the diagram above:

However, effective targeting operating model design is more than just a collection of boxes on a PowerPoint. It needs to capture a picture of current reality, clearly articulate the needs the operating model has to fulfil and provide real solutions. To turn the target state into a practical reality requires significant effort. Generally, implementation is harder work than creating the blueprint, but without the initial design it is unlikely the new model will work effectively. Ideally those designing the operating model are people who have had practical (and successful) experience of implementing change and are available to help as you move from design to implementation.

Broadridge can help

Broadridge is helping existing clients and other market participants to cut through the complexity of SFTR and create a long-term vision for their SFTR operating model. This provides a practical blueprint for front-to-back changes to overall architecture, organisational structure, business processes and where appropriate, location strategy.

Broadridge's SFTR consulting service offers:

- Consultancy to define target operating models for SFTR that reduce the cost of compliance and operational risk
- Project management, business analysis and testing support to augment firms' internal project teams to help firms get over the line with SFTR and hit reporting deadlines
- A long-term strategic approach to operating model definition that will position your firm for future phases of the reporting mandate and facilitate further automation of the securities finance process

Broadridge's SFTR consulting service leverages our deep knowledge of the securities finance business, lessons learned from EMIR and MIFID trade reporting and the expertise of staff who have managed large-scale transformation projects in banks.

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