

SFTR: Countdown to the first reporting go-live date

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Introduction

The 22 March 2019 saw the publication in the Official Journal of the full package of Commission Delegated Regulations under the Securities Financing Transactions Regulation 2015/2365/EU (**SFTR**), including the long awaited regulatory and implementing technical standards on the reporting of securities financing transactions (**SFTs**) to trade repositories. The technical standards entered into force on 11 April 2019, which means that

for banks and investment firms, reporting go-live will be 11 April 2020 – other counterparty types will be captured from subsequent dates as detailed below.

With less than a year to go until that first deadline, we take this opportunity to consider the scope and requirements of the SFTR reporting obligations as well as highlighting the key interactions with Regulation 648/2012/EU (**EMIR**).

Background

The SFTR is part of the EU initiative on “shadow banking” and aims to improve the transparency of SFTs by introducing rules in three key areas:

- reporting of SFTs to trade repositories in order to allow supervisors to better identify the links between banks and shadow banking entities and understand some of their funding operations;
- disclosure by collective undertakings of their use of SFTs and total return swaps in their prospectuses and periodic reports with the aim of enabling better-informed investment decisions by investors; and
- prior risk disclosure and written consent before counterparties are permitted to reuse or rehypothecate assets – thereby ensuring clients or counterparties take their decision based on clear information regarding the risks that it might entail.

Whilst the SFTR came into force on 12 January 2016, the publication of the detailed implementing rules was delayed as the industry waited for them to be endorsed by the European Commission. Following the end of the scrutiny period on 13 March 2019, the full package of SFTR Regulatory Technical Standards (**RTS**) and Implementing Technical Standards (**ITS**) was published on 22 March in the EU’s Official Journal.

On 27 May 2019, the European Securities and Markets Authority (**ESMA**) opened a public consultation on

draft guidelines on how to report SFTs (the **draft Guidelines**). ESMA expects to publish a final report on the draft Guidelines in Q4 2019. The draft Guidelines include general principles that apply to SFT reporting, including how the reports should be constructed and where the reports should be sent. The draft Guidelines seek to provide clarity and a harmonised implementation on the following aspects:

- the number of reportable SFTs;
- the population of reporting fields for different types of SFTs;
- the approach to certain exclusions from the meaning of SFTs;
- the implications for third country firms concluding SFTs via their EU branches;
- the approach used to link SFT collateral with SFT loans;
- the population of reporting fields for margin data;
- the population of reporting fields for reuse, reinvestment and funding sources data;
- the management by counterparties of feedback from trade repositories, namely in the case of:
 - rejection of reported data; and
 - reconciliation breaks; and
- the provision of access to data to authorities by trade repositories.

What is the SFTR reporting obligation?

Under Article 4 of the SFTR, counterparties to SFTs must report the details of any SFT they have concluded, modified or terminated to a trade repository registered in accordance with Article 5 of the SFTR or recognised in accordance with Article 19 of the SFTR no later than the

working day following the conclusion, modification or termination of the SFT. If a trade repository is not available to record the details of the SFTs, counterparties are required to ensure that those details are reported to ESMA.

What is the scope of the SFTR reporting requirements?

Counterparty Scope

The SFTR reporting requirement applies to all counterparties subject to a few specific exclusions set out in Article 2(2) – which may be amended by the European Commission and may also be extended to third country equivalents – for example, the Bank for International Settlements. Counterparties of such entities will still be required to report under Article 4 unless that transaction involves a member of the ESCB, in which case the reporting obligation does not apply to the transaction at all.

Counterparty is defined broadly and includes financial counterparties and non-financial counterparties. These terms mirror but are not identical to the EMIR definitions and include the concept of an equivalent

third country entity. Territorial scope and the limits set out in Article 2(1)(a) of the SFTR are considered further below.

The obligations under Article 4 SFTR do distinguish, to a limited extent, between financial counterparties and non-financial counterparties but only in the context of where a financial counterparty may be responsible for reporting on behalf of itself and its non-financial counterparty – this is discussed further below. It is unclear at this stage whether there will be amendments to the SFTR to reflect the amendments to the definition of EU financial counterparty which will be introduced by EMIR Refit 2.1.

Territorial Scope

The SFTR reporting obligations apply to counterparties to an SFT which are:

- established in the EU, including all their branches wherever located (ie including in third countries); or
- established in a third country, if the SFT is *concluded* in the course of the operations of a branch in the EU of that third country entity – making the territorial scope of the SFTR reporting obligation significantly wider than under EMIR (which only extends to counterparties established in the EEA). This limb does not only apply to EU branches of third country entities – it is capable of applying to other offices of the third country entity as long as the SFT can be said to be concluded in the course of operations of an EU branch. This could occur, for example, where a non-EU branch is the counterparty to the SFT but the EU branch facilitates it. Section 5.5 of the draft Guidelines

considers the application of the SFTR reporting obligations to SFTs concluded by branches.

Section 5.5.1 looks to article 14 of the MiFIR RTS on transaction reporting when considering the concept of “concluded” and sets out the minimum conditions under which an SFT becomes reportable under the SFTR.

The reporting obligations do not distinguish between the obligations on EU entities and third country branches, except that a branch outside the EU (of an entity established in a third country) is not covered by the obligations unless caught by the second limb set out above.

The SFTR contains provision for the EU Commission to determine that a third-country regime is equivalent such that, where a report is made in that third country, no report is required in the EU. It is worth bearing in mind that currently, no SFTR equivalence decisions have been made.

Transaction Scope

The SFTR applies to SFTs, which are defined as transactions falling within the categories of repurchase transactions, securities or commodities lending or borrowing, buy-sell back transactions or sell-buy back

transactions or margin lending transactions. These in turn have relatively high level definitions.

Recital 2 of the Commission Delegated Regulation (EU) 2019/356 (the **SFTR Reporting RTS**) states that while margin lending “includes transactions subject to margin agreements between financial institutions and their

clients where financial institutions provide prime brokerage services to their clients, it does not include other loans such as loans for corporate restructuring purposes which, despite the possibility of involving securities, do not contribute to the systemic risks addressed by the SFTR”.

Recital 7 of the SFTR indicates that the definition of SFT is intended to exclude derivatives subject to EMIR (and therefore that there should not be any dual

reporting of the same transaction). It is also worth noting that SFTs are not required to be reported under MiFIR transaction reporting requirements.

Who is required to report under the SFTR?

Generally, both counterparties are responsible for reporting under the SFTR although there is an exception where an SFTR financial counterparty transacts with an SFTR non-financial counterparty which on its balance sheet does not exceed the limits of at least two of the following three criteria:

- a balance sheet total of EUR 20,000,000;
- net turnover of EUR 40,000,000; or
- an average number of employees during the financial year of 250.

In this case the SFTR financial counterparty is responsible for reporting on behalf of both counterparties. While this is a similar concept to that introduced by EMIR Refit, the test for which non-financial counterparties it applies to is different for the SFTR, based on the size of entity rather than, as with EMIR, the notional value of its transactions.

Following previous industry requests for clarification, the draft Guidelines consider several types of loans, facilities and transactions that, in ESMA’s opinion, do not fall under the definition of an SFT – for example, overdraft facilities of custodians and CCP daylight lending facilities, CSD fails-curing overdrafts and intermediate give-ups and take-ups in the execution and clearing chain.

In addition, UCITS management companies and AIFMs are responsible for reporting on behalf of the UCITS and AIFs they manage (again, a similar concept to that introduced by EMIR Refit), although unlike EMIR Refit, the SFTR does not mention managers of institutions for occupational retirements provision (IORPs).

Article 4(2) of the SFTR provides that a counterparty may delegate the reporting of the details of SFTs (in a similar manner to the delegation under EMIR). Whilst the action of reporting can be delegated, the responsibility cannot, meaning any entity engaging a third party to report on its behalf will remain responsible for ensuring its SFTR reporting obligation is met. The SFTR does not include detailed provisions on the form or manner of delegation but, given the entity retains responsibility for reporting, the entity should ensure the third party reports properly on its behalf (and will typically have a detailed delegated reporting agreement).

When do the reporting obligations commence?

Under the SFTR, there are different reporting start dates for different counterparty types meaning that the reporting obligations will apply on a phased-in basis from the date which is 12, 15, 18 or 21 months after the date of entry into force of the SFTR Reporting RTS. The intention behind the phase-in is that more sophisticated market participants will be required to report first. As a result the obligations will apply as follows:

- **11 April 2020:** reporting go-live for banks and investment firms, which is 12 months after entry into force

- **11 July 2020:** reporting go-live for CCPs & CSDs, which is 15 months after entry into force
- **11 October 2020:** reporting go-live for all other financial counterparties (including UCITS and AIFS) and third country entities, which is 18 months after entry into force
- **11 January 2021:** reporting go-live for non-financial counterparties, which 21 months after entry into force.

Some of these dates fall on weekends, which means in practice that effective go-live dates will be one or more days later than the legal date.

In addition to those SFTs entered into after the relevant reporting start date, certain SFTs must be reported with retrospective effect (so-called “back-loading”).

Counterparties must, within 190 days of the relevant reporting start date, report SFTs which remain outstanding on that date if the remaining maturity of those SFTs on that date exceeds 180 days or those SFTs have an open maturity and remain outstanding 180 days after that date.

Reporting to trade repositories under the SFTR

The SFTR creates a registration and supervision regime for trade repositories to whom reports may be made under the SFTR. Although a trade repository which is registered to accept reports under EMIR may apply to extend its registration to cover reports under the SFTR, a separate application is required. The regulatory technical standards relating to the authorisation and recognition of trade repositories came into effect on 11 April 2019, and as such ESMA may now process the relevant applications for authorisation or extension of registration. Trade repositories authorised under EMIR have indicated their intentions to apply for the SFTR extension.

ESMA publishes a list of trade repositories which have been authorised under EMIR and it is expected that will be a similar list to be published for those authorised under SFTR.

What and how to report

The data fields required to be reported to a trade repository under the SFTR are set out in the SFTR Reporting RTS and the formats for how each piece of data should be submitted are set out in Commission Implementing Regulation (EU) 2019/363 (the **SFTR Reporting ITS**). While there is overlap with the data fields required for reporting under EMIR (especially following the changes introduced by the SFTR Reporting ITS which replaces the Annex to Implementing Regulation (EU) 1247/2012), the SFTR requirements are more detailed and divided between four tables rather than two.

Table 1 (Counterparty Data) includes details of the parties to the SFT. Table 2 (Loan and Collateral Data) contains the key terms of the SFT and any collateral. Table 3 (Margin Data) contains the details of any margin required to be provided under the SFT. Table 4 (Re-Use, Cash Reinvestment and Funding Sources Data) contains

Once the regime is in effect for relevant counterparties to SFTs, those counterparties will be required to report the details of any SFT they have concluded, modified or terminated no later than the working day following the conclusion, modification or termination of the SFT.

Under Article 5(2) of the SFTR, trade repositories are required to verify the completeness and correctness of data reported to them. Commission Delegated Regulation 2019/358/EU (the **Trade Repository RTS**) specifies the details of the procedures to be applied by trade repositories in order to verify the details of SFTs reported to them. Article 1 of the Trade Repository RTS sets out the elements that need to be verified including the identity of the report submitting entities and the logical integrity of the sequence in which the SFT details are reported. Article 1(3) of the Trade Repository RTS requires a trade repository to reject an SFT report if it does not comply with one of the requirements set out in Article 1(1) and assign it to one of the rejection categories set out in Table 2 of Annex I to RTS.

details of any collateral which has been re-used. Not all of the fields are required for each type of SFT and the tables set out which fields apply to each of repurchase transactions, securities lending transactions, buy-sell back transactions and margin lending transactions.

The SFTR Reporting ITS provides that entities should be identified by their LEI; however, Recital 2 notes that an extension of the global LEI system to identify branches of legal entities is currently being developed and has not been finalised and considered suitable for the purposes of reporting SFTs. As such, Article 2(3) of the SFTR Reporting ITS requires branches to be identified by the ISO 3166-1 alpha-2 code of the country where the branch is located. Recital 2 indicates that the SFTR Reporting Format ITS will be amended as and when the extension of the global LEI system to branches is finalised and considered suitable.

What is the frequency of reporting under the SFTR?

Similar to EMIR, all reporting elements are required to be reported “as they occur” and taking into account that the details must be reported no later than the working day following the conclusion, modification or termination of the contract. The SFTR Reporting ITS

also sets out additional requirements which go beyond the overarching requirement to report events in chronological order as they occur. Article 5 of the SFTR Reporting ITS adds additional specific rules in various contexts, such as margin loans and cleared SFTs.

Data privacy and confidentiality requirements

Article 4(7) of the SFTR expressly provides that a counterparty that reports the details of an SFT to a trade repository or to ESMA, or an entity that reports such details on behalf of a counterparty shall not be considered to infringe any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision. Article 4(8) provides that no liability resulting from that disclosure shall lie with the reporting entity or its directors or employees. Where data is being disclosed outside of the EU, it may be necessary to consider whether Article 4(7)

and 8 provide sufficient comfort or whether an additional confidentiality waiver is required, similar to the position under EMIR.

The SFTR does not permit the masking of data in relation to the reporting requirements. However, it is not intended to affect general data protection law, meaning that confidential data, and in particular, personal data, should still be masked to the extent possible prior to the report being made.

Record keeping requirements under the SFTR

Article 4(4) of the SFTR applied from 12 January 2016 and requires all counterparties to keep a record of any SFT that they have concluded, modified or terminated

for at least five years following the termination of the SFT.

Infringement Policy requirements

Article 24(3) of the SFTR requires counterparties to have in place appropriate internal procedures for their employees to report infringements of the reporting

obligation – whilst this requirement has applied since 12 January 2016, it will clearly be of more relevance from April 2020 when Article 4 begins to apply.

Practical comment

The industry has been actively engaged on delving into the detail of the technical standards through working groups run by trade associations such as ISLA and ICMA. Member surveys have looked at questions such as which data fields are likely to need market standard requirements, suitable approaches for meeting the back-loading requirement and which fields (and transaction types) are most likely to cause problems in terms of reconciliation.

It is clear that data quality will be key as ESMA has already stated that because the data will be used to build intelligence and supervise risks, any incorrect data will be rejected from day one. ESMA will be publishing results on failed data which will be shared with the competent authority.

For those entities that currently offer delegated reporting under EMIR and propose to operate an SFTR delegated reporting service alongside their EMIR service, they will need to review their delegated reporting agreements carefully and have policies and procedures in place that ensure clarity over which regime a particular transaction falls under (given the differences in counterparty scope and data to be reported). There will also be additional clients who are EEA branches of third country entities who may wish to use the delegated reporting service for the SFTR reporting obligation where they would not need to use it for EMIR. The EMIR and SFTR regimes will be increasingly aligned over time, and firms will need to consider how to provide an integrated reporting offering to their clients and counterparties.

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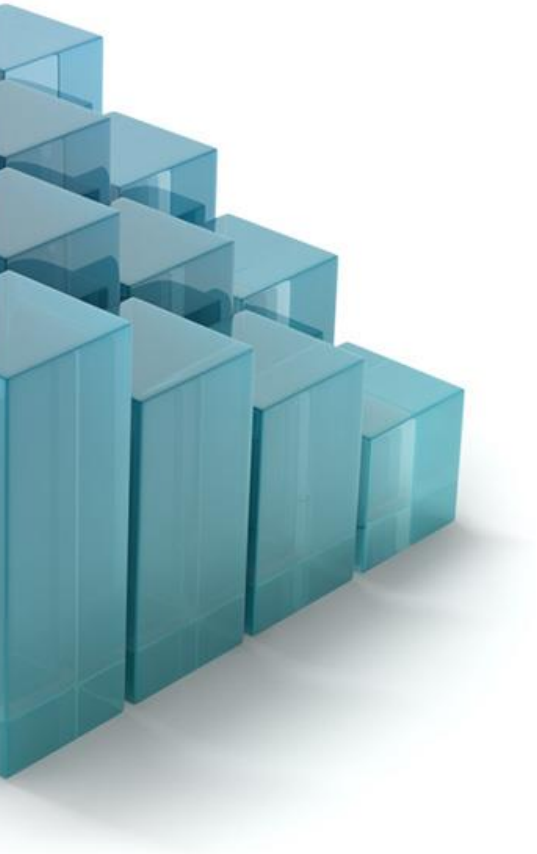
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