SFTR and Brexit threaten to expose regulatory reporting weakness

Mounting costs threaten to overburden firms as reporting obligations grow writes **David Farmery,** Head of Business Development, Message Automation, Broadridge Financial Solutions

Faced with additional stress on regulatory reporting functions, firms with a patchwork of reporting technology will risk coming undone. The Securities Financing Transaction Regulation (SFTR) and Brexit each pose different challenges for those banks and asset managers whose report delivery is siloed by asset class and function.

Since 2012, when we tackled the initial Dodd Frank reporting required by the CFTC, we have seen a maturing in the way that firms approach regulatory technology (regtech). Historically, banks and asset managers would tackle multiple regulations, individually. Senior management, when building their initial solutions to comply with Dodd Frank in 2012, had an expectation that those same solutions would function globally, given the common agreement on market reform set out by the G20 in 2010. Regulators did not see it that way when it came to enacting the reforms locally.

David Farmery, Head of Business Development, Message Automation, Broadridge Financial Solutions

When the European Markets Infrastructure Regulation (EMIR) came into effect, it was very different, in terms of its structure, to Dodd Frank. Therefore the systems that people had built in-house for Dodd Frank were not fit for purpose for EMIR.

All of a sudden, a second big budget and development were needed in Europe. That was repeated as the G20 agreement was rolled out across Asia and other jurisdictions. Tactical solutions were built on tactical solutions, in order to hit compliance deadlines.

POSITIVE CHANGE

We believe that the industry has reached a tipping point. It is apparent that the in-house, tactical approach is costing many firms a fortune both to maintain and to expand, whenever new requirements are imposed.

As it offers no competitive advantage and has many standard elements between businesses, there is a willingness amongst senior management to explore alternative vendor-based, mutualised approaches to reporting. The trigger for many was MiFID II. Its complexity led many businesses to take the first step in implementing a strategic trade-reporting solution.

Broadridge took on six new clients during that process, almost all of which had an in-house solution, or had previously delegated reporting and decided in the face of the requirements they were going to handle MiFID II differently. Once MiFID II was out of the way many chose to migrate everything over to their new multi-jurisdictional strategic platform. That momentum has been sustained. Post-MiFID we are signing and implementing new clients who are going through the same process.

DRIVERS FOR CHANGE

The first common driver occurs when an institution needs to change or upgrade one or more core systems. Often reporting logic has been embedded within the legacy system and implementing a new system gives them the opportunity to address their reporting needs in a more system-agnostic manner.

Existing arrangements are often siloed, with firms using different reporting stacks across different jurisdictions and for different asset classes. Such an approach is multiplying maintenance costs and operational costs, removing any synergies or cross-training for the operational team, and often reporting to different trade repositories (TRs), creating additional external costs.

The decision that firms must make is either to build a new platform on top of the existing technology, to build from scratch or to look for a system externally.

The second driver we have seen is a shift from delegated reporting to in-house reporting. Often this is driven by concern about the loss of control in reporting, while responsibility to the regulator is retained. In some cases delegation responsibility shifts based upon different trading scenarios, creating operational complexity and risk.

The third driver stems from institutions wanting to move into new areas of business which changes their regulatory status. For example, some sell-side businesses building up US business may need to register as a swaps dealer in the United States. That carries a reporting obligation, in real time, based upon Commodity Futures Trading Commission (CFTC) regulations to a US Trade Repository. Equally, dealing with Swiss counterparts in Europe can require brokers to support delegated reporting under FinFrag if they are to win business.

IMPROVING TOTAL COST OF OWNERSHIP

To implement a strategic platform, banks and asset managers need technology that is truly capable of working cross-asset. It must extract trade event information from disparate source systems, capturing data once, enriching it, harmonising it within a common data model and then using that data to populate trade reports across markets and jurisdictions. Having the ability to ingest a trade event once, determine which rules it is in scope for, and in cases where it might be caught by several – for example EMIR and for MiFID – is where a holistic platform can deliver intraday at an operational level. It enables the firm to support a single Regulatory Operations team, which tracks cross-jurisdictional exception handling.

Over the medium-term, having trades represented in a harmonised data standard allows new regulations to be onboarded rapidly. Specific information that a new jurisdiction or regulation might need can be mapped into the data standard. Formatting the output for the relevant trade repository is managed simply, through dropping in new business rules.

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THE IMMINENT RISK

Looking ahead there are new challenges, which a strategic approach can futureproof against. The first is Brexit, which will potentially lead firms to create separate entities in mainland Europe and in London. That potentially means a new operational team, although reporting could still continue to be centralised. However there will likely be a bifurcation of where those reports go to. We are having Brexit conversations with existing customers now, setting up the infrastructure to support their European entity.

The second is ongoing regulation. Stock lending and repurchase agreements will come into scope for reporting under the SFTR for the first time in 2019.

From a pure regulatory reporting perspective we see few challenges for our platform in supporting SFTR. There will be new data sources, new asset classes, and quite a few new moving parts. There are certainly new market infrastructures that need to be in place to support it. There is nothing unique about SFTR from a reporting point of view but there will be challenges within firms organisationally, for example, SFTs have never been reported before. These organisational challenges impact both the buy side and sell side. With the provision for delegating reporting, buy-side firms may be looking for their brokers to report on their behalf, but equally it is part of the continuum, and if they have their MiFID II reporting in-house, they may be tempted to continue to build on that for SFTR.

The big risk is where a business has a disconnect internally. Regulatory reporting teams are often fully supportive of leveraging a strategic solution to do all of their reporting, but a desk or business with no exposure to other regulatory reporting may see their systems and reporting as proprietary to their function, creating a silo which stops the business from driving down costs.

Looking ahead there are two imminent situations, one political, one regulatory, which present major challenges for a tactical approach to reporting. To keep ahead of the risks, senior management should develop an assertive strategic approach now. ■