Securities Finance Transaction Regulation (SFTR)

Issues & Challenges Identified by ISLA SFTR Working Group

October 2022

Contents

SFTR list of issues and challenges identified by ISLA SFTR Working Group:

Introduction

The **International Securities Lending Association** (ISLA) has hosted a member led SFTR Working Group since the initial proposal of the regulation. The working group consists of 300+ participants from our **membership**.

Throughout SFTR's evolution, ISLA has maintained a log of Working Group discussions and would like to share the current list of outstanding issues and challenges related to SFTR's reporting obligations. ISLA's approach to SFTR reporting is to consolidate opinion and facilitate industry standards. As it relates to this regulation, they can be found on the **ISLA Best Practice Handbook** page.

This document has been created for the regulatory and supervisory community as a representation of industry concerns and for discussion in future reviews or issuance of guidance regarding SFTR obligations.

For each issue/challenge raised, the document offers solutions and proposals and, where possible, data quantification to support that proposal.

ISLA welcomes your feedback. Should any clarification be required contact **regtech@islaemea.org**

1. Execution Timestamp Tolerance
Validation Field(s) in scope – 2.12

ISLA

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-452	Counterparts to a transaction may, for legitimate business reason, generate different timestamps when reporting SFTs. • Counterparties use booking times as a proxy for execution times may result in differences related to deal capture procedures. This leads to timestamp differences exceeding the current 1-hour tolerance. • Where booking of a transaction is not automated, or where confirmation of transaction is delayed for various reasons, firms will generate individual booking times which may result in mismatching data. • We note that actual booking times may provide extra insight to supervisory bodies reviewing SFTR data. • Market participants concluded that the current one-hour tolerance causes unnecessary reconciliation breaks.	ISLA members agree that increasing the currently mandated tolerance will reduce matching breaks and proportion of resource required to align those timestamps. Their proposal is therefore: • To increase the timestamp tolerance to at three (3) or more hours which would significantly reduce reconciliation breaks while still providing regulators with useful insight into trading party practices. • This proposal would not contradict the spirit of the regulation and would provide additional insight for supervisory bodies.	Impact analysis by a prominent SFTR reporting provider indicates that: • If the tolerance increases to 3 hours, it will reduce mismatches by approximately 52% on UK TR and 49% on EU TR. • If the tolerance increases to same day (that is to end of that event day) miss-matches will reduce by approximately 76% on UK TR and 64% on EU TR mismatches. Impact analysis by a large Trade Repository (TR) suggests: • For SLEB trades, if the tolerance increases to 3 hours it will reduce the miss-matches by approximately 43%.

Note: Information gathered from the minutes of the meetings of ISLA SFTR Reconciliation workshop held on 22nd and 24th of April 2021 and 15th of July2021

2. Returns Reporting

Validation Field(s) in scope – 3.00

ISLA Reference	Challenge(s)	Proposed Solution
SFTR-337	ISLA Best Practice was drafted to create a market aligned consensus on approach. It should be recognised that securities lending transactions differ in some respects to other financial markets. Specifically, economic exposure begins prior to settlement of the loan (collateralisation), and this exposure may continue after an agreed termination date. Exposure continues until both loan and collateral are terminated and returned to the respective parties. To adhere to the spirit of the regulation, ISLA member firm's preference is to report data that best reflects any relevant exposure(s). As it relates to this Field, ISLA members therefore agreed to report: • New Trades = Reported on contractual basis (i.e., by trade date +1) • Returns = Reported on an actual basis (i.e., actual settlement date +1) • Modifications = Reported on actual basis (i.e. effective date +1). However, the Level 3 guidance published on 6 January 2020 contradicted proposed best practice which has resulted in misrepresented exposure reporting and increased the number of breaks[1]: • Partial Returns = Reported on a contractual rather than actual basis, regardless of settlement failure. • Future dated Full Returns = Reported on a contractually on event date+1 by sending a MODI to add a 'Maturity date' and mark the trade as fixed term • Same day Full Returns = Reported on an actual basis (i.e., actual settlement date + 1) by sending an ETRM Marking an open trade as fixed term maturity may: • Contradict legal and regulatory requirements of some lending funds (e.g. UCITS) • Not be physically possible within agent lending programmes that represent multiple lenders in single external loans Agent lenders, representing >60% Securities Lending market activity, cannot meet this requirement without significant long-term development. [1]	ISLA members propose that: • All Securities Lending lifecycle events should be reported on an actual basis (rather than contractual) which will represent the most accurate reflection of activity and counterparty exposure, and closely underpin the spirit of the regulation. • Recognising the scope & limitations that exist outside the formal review process, ISLA propose that either a Q&A response or email be sent to clarify that it is acceptable industry practice to report loan closing events on the day settlement occurs, rather than a forward contractual date, which require complex systemic mappings. Similarly that partial returns be reportable on an actual rather than contractual basis. We believe this will provide supervisors with an accurate and the clearest possible view on exposures in our market, in keeping with the spirit of SFTR. ISLA members, in the Agent Lenders white paper[2], are seeking clarification that reporting returns on an actual settlement basis is acceptable, and that this will be considered as part of the SFTR review in 2022.

[1] *ISLA survey of Agent Lenders on Partial and Full return reporting Best Practices. Annex#1*
[2] *White papers sent to ESMA by Agency Lenders on Full and Partial return processing Challenges. Annex#2*
[3] *Cost-benefit analysis carried out by Europe Economics in 2017: https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-82_2017_sftr_final_report_and_cba.pdf*

3. Value Date of the Collateral

How does Value Date of Collateral identify which loans are included in a netting set?

Validation Field(s) in scope – 2.74

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-714	Current validation rules for net exposure collateral use "Value Date" (2.13) of the loan and "Value Date of the Collateral" (2.74) to identify which loans fall within the net exposure netting-set. However, this is too simplistic and does not take into account the different pre-pay collateralisation processes used in exposure management. Within the loan books linked to net exposure collateral, individual positions may be collateralised on a value date (VD) or a VD -1 basis. VD-1 is generally chosen where there is a disparity between the settlement market of the loan and that of the collateral (or indeed where the collateral is managed). For example, US Treasury collateral would need to be collected today in order for a Japanese loan to settle in APAC trading hours tomorrow. However, the challenge is that the loan book between "Reporting Counterparty" (1.3) and "Other Counterparty" (1.11) often comprises assets settling in multiple locations and time-zones and will be split between VD and VD-1 collateral requirements, while the "Value Date of the Collateral" is a fixed value which must state the "latest value date contained in the netting set of SFTs….". This means that if even a single loan attracts collateral on a SD-1 basis, every loan sharing that value date is captured in that netting set on SD-1. Example where Event Date = 03/10/22: Loan 1: 10,000 Siemens DE0007236101 €1,000,000 v/d 04/10/22 Collateral Date 04/10/22 Loan 2: 100,000 Vinci FR0000125486 € 8,200,000 v/d 04/10/22 Collateral Date 04/10/22 Loan 3: 1,000 Tokyo Electron JP3571400005 € 320,000 v/d 04/10/22 Collateral Date 03/10/22 In this example all three loans share the same value date (04/10/22), however only Loan 3 needs to be collateralised on 03/10/22 (VD-1). On Event Date 03/10/22, the COLU report for this netting set would therefore be required to quote "04/10/22" as this is the "latest value date, suggesting enough collateral be collected to cover all three loans (€9,520,000). However, in reality the counterparty / agent would only collect €320,000 on 03/10/22 with the remainder collected prior to release of the loans on 04/10/22. This can create a massive disparity in what the COLU shows compared to what is expected.	The current validation rules use a single "Value Date of the Collateral" (2.74) Field in the COLU report, to define which loans fall into scope of the netting set. ISLA would like to propose that "Value Date of the Collateral" is added to the NEWT report so that it is the loan itself that defines the date of its inclusion into the netting set. This would remove any ambiguity and inaccuracy caused by the current netting logic.	N/A

4. Trading Venue

Allocations booked under a non-disclosed Agent Lender model
Validation Field(s) in scope – 2.08

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-28 **REG-457**	In July 2020 ISLA consulted with ESMA regarding a set of questions intended to create further clarity on the subject of: "Whether allocations booked under a non-disclosed Agent Lender model should ever be reported as concluded on a Trading Venue in Field 2.08" [1&2] In response to the consultation letter ESMA requested further information and clarity on those questions. Please see [1&2] Annex#4 Correspondence regarding Trading Venue This issue relates to pooled transactions entered into by an agent lender on a trading platform and therefore the population of the Trading Venue Field. Using the example below, the trade of 100 shares on the Trading Venue is not reported under SFTR, but rather the allocations (50,20,30). When reporting those three trades, some of our members populate the Trade Venue with "XXXX" as those child trades could be considered as not traded but rather allocated after the trade initiation. This is particularly true when substitutions occur after the initial pool trade.	ISLA members propose[3] that: • ESMA can confirm that trades entered into by an agent lender, where the ultimate lender is not disclosed at point of initial trade, be reported as "XXXX" in place of a Trading Venue MIC code in Field 2.08.	Impact analysis by a Trade Repository suggests: • Of the total SLEB received, approximately 73% of the SLEB trades are associated with agent lender submissions.

Trading Venue Quantity	Lender
100	50
	20
	30

[1] Detailed Question and Answer email communication with ESMA. Annex#4
[2] Questions initially sent to ESMA with collective consideration from industry members. Annex#4
[3] In reference to the discussion and action points from the SFTR WG meetings held on 17/12/2021, 20/01/2022, 24/02/2022 & 28/03/2022

5. Insufficient Granularity within Primary Key for Net Exposure Collateral

Validation Field(s) in scope – 1.03, 1.11 & 2.09

ISLA®

SLA Reference	Challenge(s)	Proposed Solution
SFTR-451	The current Primary Key for Net Exposure Collateral is insufficient for Trade Repositories to distinguish between netting sets where the "Reporting Counterparty" (1.3), "Other Counterparty" (1.11) and "Master Agreement Type" (2.9) are the same. This regularly leads to the first netting set submissions being overwritten by subsequent submissions, due to "latest is greatest" treatment of Collateral Updates (COLU). Netting sets may be unique in a number of ways, all of which need to be considered when ingesting the COLU report: • "Triparty Agent" (1.14) - Lenders and Agent Lenders employ a number of Triparty Agents in the collateralisation of their loan books. If the Lender uses one Triparty Agent to manage their equity collateral (HPFHU0OQ28E4N0NFVK49) and a different one to manage Bond collateral (549300OZ46BRLZ8Y6F65), the use of both between the same Reporting Counterparty, Other Counterparty and Master Agreement will create two netting sets. When reported to the Trade Repository, the later of the two submissions will automatically overwrite the earlier one and the data for the initial netting set will be lost in the Trade State Report. • Agent Lender (1.18) - Some Lenders employ more than one Agent Lender to manage different assets within their portfolios. Those Agent Lenders are likely to transact with the same borrowers and under the same lending Master Agreement Type (GMSLA). Where both Agent Lenders report COLU reports, the Reporting Counterparty, Other Counterparty and Master Agreement Type will therefore be identical. Again, the Agent Lender that submits their COLU report last will be treated by the Trade Repository as the latest update, with the earlier report being overwritten. • "Branch of Reporting Counterparty" (1.7) and "Branch of Other Counterparty" (1.8) – Where entities operate out of different branches, this can also create separate COLU netting sets. Where those branches do not have their own LEI and only identify themselves with an ISO Country code for reporting purposes, the current primary key at the Trade Repository cannot differentiate between them. Again, the latest reported COLU will overwrite any earlier one, causing data to be lost from the Trade State Report.	ISLA members propose that: Key reporting Fields require additional and explicit Counterparty data Fields so that Trade Repositories might distinguish and identify the reports uniquely and accurately. Members have identified five (5) additional reporting Fields and have proposed three (3) options[2] to facilitate the above proposal: (see Proposal tables below)

Proposal#1: Make all below fields Primary Keys:	
SFTR Field No.	Field name
1.07	Branch of the reporting counterparty.
1.08	Branch of the other counterparty.
1.14	Tri-party agent.
1.18	Agent lender.
2.96	Collateral Basket Identifier

Proposal#2: Make all below fields repeatable Keys on Security level:	
SFTR Field No.	Field name
1.07	Branch of the reporting counterparty
1.08	Branch of the other counterparty
1.14	Tri-party agent
1.18	Agent lender
2.96	Collateral Basket Identifier

Proposal#3: Make a few fields Primary and a few repeatable to mix and match.		
SFTR Field No.	Field name	Primary or Repeatable
1.07	Branch of the reporting counterparty	Key
1.08	Branch of the other counterparty	Key
1.14	Tri-party agent	Repeatable on Security Level
1.18	Agent lender	Repeatable on Security Level
2.96	Collateral Basket Identifier	Repeatable on Security Level

6. Pricing Mismatches due to Tolerance

How will market participants manage pricing discrepancies which cause breaks on matching Fields?

Validation Field(s) in scope – 2.49, 2.56 & 2.57

ISLA Reference

SFTR-188

Challenge(s)

There is no tolerance[1] on Fields 2.49 (Security and Commodity price) and 2.56 (Loan Value) and Field 2.57 (Market Value) has a extremely strict tolerance of 0.000005. Matching dates for these Fields commence on 1st of January 2023.

ISLA members note two major concerns regarding these matching Fields:

- The Level 3 guidance will cause large amounts of breaks when reconciliation on these Fields begins on 1st January 2023 where ‘Loan value’ (2.56) and Loan ‘Market Value’ (2.57) are reconciled by the TRs.[2]
- The Level 3 guidance to use ECB FX rates for SFTR reporting was unexpected by the industry and still challenging for firms to implement even after SFTR went live.[2]
- A concern is raised that forcing price convergence in regulatory reporting may by incorrectly representing the books and records of a reporting party. It is noted that centralised pricing was proposed and rejected during initial SFTR discussions.

Proposed Solution

ISLA members proposed to have wider tolerances for the Fields 2.49, 2.56 and 2.57 and suggested to bring up the tolerance levels at either of the four:

- 0.025%
- 0.050%
- 0.075%

Or

- 0.100%

Supporting Information

Impact analysis by a Trade Repository indicated the following beneficial improvements in % matches for each validation Field:

Proposed limits	Estimated % increase in number of matches for each validation field		
	Security or Commodity Price (2.49)	Loan Value (2.56)	Market Value (2.57)
0.025	0.79%	1.13%	0.79%
0.05	1.09%	1.42%	1.41%
0.075	1.34%	1.67%	2.02%
0.1	1.57%	1.90%	2.53%

[1] https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.esma.europa.eu%2Fsites%2Fdefault%2Ffiles%2Fesma74-362-1008_sftr_validation_rules.xlsx&wdOrigin=BROWSELINK

[2] ISLA / FCA SFTR meeting and presentation on 05/03/2020. Annex#5

7. Reporting of Loan &Collateral Data in CORRs (Validation Rules Errors)

Validation Field(s) in scope – 2.75

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-438	As per the Validation Rule[1], it was understood that the ESMA's aim was to implement support for reporting CORR messages containing only loan data, collateral data, or both. The industry supported the Regulator's objective of reporting loans and collateral separately in CORR messages. However, the current validation rules (counterparty transaction) did not align with the ESMA's objective. It does align with the separate reporting of loan and collateral in NEWTs (when the collateral is not known until S+1) and separate COLUS. However, to support the inclusion of collateral in CORRs, firms are required to store previously reported collateral and loan data and look this up to include in the CORR messages when a correction to loan or collateral data occurs. The above is a complicated logic to implement, and incurs a high cost from a data storage perspective. Therefore, market participants have adopted a mixture of approaches to overcome the issue however: • Few member firms have managed to implement the logic. • Other firms have opted to report MODIs and COLUs when corrections occur as an alternative (so loan and collateral data can be reported separately).	ISLA members propose that: • The validation rules be revisited to facilitate separate loan and collateral data reporting in CORR messages.	N/A

[1] *"Report with action type "CORR" can contain only loan data (1.11-1.18, 2.1-2.73, 2.97-2.99) or only collateral data (1.1-1.3, 1.7, 1.8, 1.10, 1.11, 1.14, 1.18, 2.1, 2.3, 2.4, 2.9-2.11, 2.73-2.96, 2.98) or both, and should not be rejected as long as all requirements, as specified in the validation rules for the applicable Fields, are fulfilled"*

8. Type of Collateral Component & Collateral Basket Identifier issues with NEWT template reporting (Validation Rules Errors)

Validation Field(s) in scope – 2.75 & 2.96

ISLA Reference	Challenge(s)	Proposed Solution
SFTR-438	Due to the re-introduction of the validation rules on 2.75[1] and 2.96[2], securities lending participants have implemented a practical solution for the reporting of NEWTs related to Net Exposure SLEB transactions. As these SFTs are collateralised by a pool of collateral, 2.75 and the associated Fields for collateral are not applicable, therefore 2.96 must be populated for the 'NEWT' to pass the validation. The industry is now obliged to report Net Exposure (NE) SLEBs with 2.96 = 'NTAV', which creates misleading data in both Fields. However, this is not a true reflection of the submitter's books and records. Members also draw attention to: • Article 3 para 4 of the Commission Delegated Regulation 2019/356 starting "A counterparty collateralising several SFTs on a net exposure basis.." which highlights a misalignment with current validations.	ISLA members propose that: • The current validation rules be revisited and corrected to allow securities lending participants to report Fields 2.75 and 2.96 accurately when the true conditions are met and thereby reflect activity correctly. Pending any review, the proposed best practice[3] is presented in below logical approach:

Business Use Case	Pre-Condition(s)	2.75 (Type of Collateral Component and related fields)
Uncollateralised SLEB	2.04 = SLEB and 2.72 = true	Do not populate
Individually Collateralised SLEB (Cash Rebates)	2.04 = SLEB and 2.72 = false and 2.73 (NE) = False and type of collateral is cash	Populate 2.75 with 'CASH', also populate the related cash collateral fields
SLEB against Net Exposure Collateral	2.04 = SLEB and 2.72 = false and 2.73 (NE) = true	Do not populate (not possible to)

Business Use Case	Pre-Condition(s)	2.96 Collateral Basket Identifier
Uncollateralised SLEB	2.04 = SLEB and 2.72 = true	Do not populate
Individually Collateralised SLEB (Cash Rebates)	2.04 = SLEB and 2.72 = false and 2.73 (NE) = False and type of collateral is cash	Do not populate
SLEB against Net Exposure Collateral	2.04 = SLEB and 2.72 = false and 2.73 (NE) = true	Populate with 'NTAV' ***(populate NTAV for all NE SLEBS*** **as its not possible to report 2.75)**

[1]2.75: For action type is NEWT:

-For SL: If Field 2.72 is populated with 'true', this Field shall be left blank. Otherwise at least one of the Fields 2.75 "Type of collateral component" or 2.96 "Collateral basket identifier should be populated".

[2]2.96: For action type is NEWT:

- For SL: If Field 2.72 is populated with 'true', this Field shall be left blank. Otherwise at least one of the Fields 2.75 "Type of collateral component" or 2.96" Collateral basket identifier should be populated".

[3] ISLA'S SFTR Best Practices https://www.islaemea.org/isla-best-practice-handbook/subsection/SFTR-95/

9. T vs T+1 Reconciliations Issues

Validation Field(s) in scope – 1.01

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-448	Securities Lending participants rely on a variety of underlying platforms to maintain their SFTR activities. These many platforms present a significant diversity in processing abilities and mechanisms and, as it relates to SFTR reporting obligations, the timing of necessary output. As a result, TR submissions may arrive either on T+0 or T+1. This creates a challenge regarding reconciliation of SFTR data within Trade Repository network. From a practical perspective, changes to an entire operating model represent a significant development and therefore an ongoing challenge.	ISLA members propose that: • A cost-benefit analysis be undertaken to mandate the reporting of the trade activity to either T+0 or T+1. This guidance, to either of the two options will trigger the necessary development in technical reporting architecture. However, either option will undoubtably incur high development costs. • A second more pragmatic approach would be the inclusion of Event-Date of SFTs in the reconciliation output so that the reporting firms and TRs can easily prioritise the breaks to be investigated. This second option provides both the practical and pragmatic resolution to reconciliation breaks.	Approximately 45% of the Trades received by TR on a T+0 basis, compared to 55% of the trades received on a T+1 basis.

[1] *ISLA FAQ https://www.islaemea.org/isla-best-practice-handbook/subsection/SFTR-448/*

10. Post Maturity Date Reconciliations Issue

Validation Field(s) in scope – 2.14

ISLA Reference	Challenge(s)	Proposed Solution
SFTR-210	The RTS for Trade Repositories mandates that unreconciled SFTR reports should be visible on the daily Trade State Report for 30 days following the maturity or termination of that report. ISLA members raised concerns that: • The current validation rules do not allow participants to submit a modification to a report, where the Event Date of the report is greater than the maturity or termination date. • The result of this, is that participants are unable to fix unreconciled reports during this 30-day period. • In addition, in scenarios where a settled return becomes unsettled again, participants are unable to 'resurrect' the corresponding report. This is an acute issue for most of ISLA members, including Agent Lenders, where firms are unable to fulfil the regulatory obligation to match and reconcile reporting with respective counterparties. Where it relates to Agent lenders, the reporting process[4] is complex due to: • The unreconciled reports, following maturity or termination, severely impact the Agency lender's reporting (shell vs allocations) to the borrowers due to the mandatory pre-matching conditions for key pairing Fields and, therefore, further impacts the timeliness and accuracy of reporting allocations under SFTR. • The reconciliation on the matching platform can only occur with the latest event records received from the agent lenders, which cannot be reconciled on the historical event if not reported or incorrectly reported.	ISLA members propose several approaches as potential solutions to this challenge: Long-term solution: The solution to several reconciliation and pairing issues should be addressed through an amendment to SFTR reporting rules[1&2] which would require changes in Level 1 (primary) legislation. Such as: 1. Change in the logic for updating the Trade State Report by TRs, that is: • TRs to update the Trade State Report relying on the logical order derived from the “Event Date” without applying any restriction based on the “reporting timestamp”.[3] Or 2. Remove the existing limit of 30 day period and reconcile only Live SFT trades. Or 3. Further widening the limit of 30 days period.

[1] *ESMA Q&A 6 states that “In line with the paragraph 83 of the Guidelines, the reports with the Event date earlier than the reporting date -1 should not be considered by the TRs for the purpose of constructing the trade state report, therefore the reporting counterparty should submit the reports pertaining to the relevant modifications with the respective “past” event dates. To confirm the current state of the loan data, the reporting counterparty should subsequently send a report with action type “MODI” populating the Field “Event date” with the date when report is made (i.e., the same date as the date provided in the Field “reporting timestamp”). This last modification report should contain the most up-to-date state of the SFT.”*

[2] *ESMA Guidelines 2021 paragraph 444. “Furthermore, no SFT can be revived, hence an SFT should be excluded from reconciliation 30 days following the maturity date or early termination of it, i.e., reporting with action type “Termination/Early termination”, or “Position component” in accordance with the conditions under Article 2(2)(h) of the RTS on verification. Furthermore, in the case of the reconciliation of the details of collateral, these messages differ from loan messages in that there are no maturity dates. For net exposure-based collateral this means that the date of it is related to the date of the loan side of the SFT. Hence a TR should seek to reconcile this information until thirty days after the termination or maturity of the last loan that is included in the net exposure collateralisation. Moreover, the collateral reconciliation status for net exposure collateral will be repeated for all SFTs included in the net-exposure collateralisation.”*

[3] *Please note that the above approach was also proposed by ESMA, in the Consultation paper on EMIR REFIT reporting (July 2021), for derivatives template.*

[4] *A case study prepared by a member firm on Agency lending allocations reporting from Borrower’s prospective. Annnex#6*

11. Reporting of the SFTs with EU Central Banks

Validation Field(s) in scope – 2.00

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-166	SFTs to which the counterparty is a member of the European System of Central Banks (ESCB)[1], are only reportable under EU MiFIR and excluded from reporting under EU SFTR[2].	ISLA members, and members of other associations, propose that there should be a complete exemption of reporting SFTs to ESCBs under EU MiFIR based on the following facts: • SFTs with Central banks are not a source of systemic risk, nor are they directly price-forming or a source of market abuse and therefore are not relevant to MiFID/MiFIR transparency aims. • The regulators can directly source data for SFTs with ESCB(s) from the respective central bank(s), thereby reducing the cost of reporting for market participants and also the cost of collection, processing and analysis. • Our members note that the UK (FCA[3]) excluded all central bank SFTs from being reported under UK MiFIR.	N/A

[1] *European System of Central Banks: The ESCB comprises the ECB and the national central banks (NCBs) of all EU Member States whether they have adopted the Euro or not.*
https://www.ecb.europa.eu/ecb/orga/escb/html/index.en.html?msclkid=227db877a97b11eca6c155f10f6c7596
[2] *https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2365&from=EN*
[3] *https://www.fca.org.uk/publication/fca/handbook-notice-96.pdf*

12. Method used to Provide Collateral

Validation Field(s) in scope – 2.20

ISLA Reference	Challenge(s)	Proposed solution	Supporting Information
SFTR-40	In comparison to Field 2.18, it is mentioned in Validation rules that if the conditions do not meet, the Field can be left blank. The absence of similar wordings for Field 2.20 causes ambiguity where a trade is not collateralised. **Validation rules description[1] of the Field 2.20 states:** “Indication whether the collateral is subject to a title transfer collateral arrangement, a securities finance collateral arrangement, or a securities finance with the right of use.” “Where more than one method was used to provide collateral, the primary collateral arrangement should be specified in this Field.” **Validation rules description[1] of the Field 2.18 states:** “If, for SL, Field 2.73 is populated with 'true', or if Field 2.72 is populated with 'false' and Field 2.75 is populated with 'SECU', this Field shall be populated. **Otherwise it shall be left blank….”**	ISLA members propose that: • The existing validation rules be revisited to clarify if the wording “Otherwise, it shall be left blank” was purposefully not added under Conditional Validation for 2.20. Clarification on this point will feed into industry practice, aligning firms reporting practices and reducing related reconciliation breaks.	N/A

[1]*https://www.esma.europa.eu/sites/default/files/esma74-362-1008_sftr_validation_rules.xlsx*
[2]*https://www.islaemea.org/isla-best-practice-handbook/subsection/SFTR-40/*

13. General Collateral Indicator

Validation Field(s) in scope – 2.18

ISLA Reference	Challenge(s)	Proposed Solution	Supporting Information
SFTR-38	In current ESMA guidelines[1], Field 2.18 only applies to the securities provided as collateral with the validation rules requiring mandatory population of Field (2.18) when the Net Exposure (Field 2.73) is "True" for SLEBs. The validation rule causes a reporting issue where Cash is used as collateral. ISLA members concluded[2] that Field 2.18 can be populated with GENE[3] or TTCA[4] for securities used as collateral. However, for Cash collateral, the Field should be populated with GENE to avoid data rejections. Although this is not precisely a challenge, ISLA members concluded[2] that as best practice[5] and short term solution, Field 2.18 should be populated with 'GENE' where Cash collateral is used. This should be done to avoid data rejections. The ISLA SFTR Best Practice on this point is currently "Validation rules (31 Jan 2022) require mandatory population, therefore regarding cash pool collateral a default value of 'GENE' should be used to avoid data rejection".	ISLA members propose the following short term solution : • Clarification on whether Field 2.18 "General Collateral Indicator" apply only to SECU[6] collateral? and • Since the current Validation rules do not consider Net Exposure SLEBs against a cash pool, would there be a consideration for agreeing with current ISLA Best Practices[5] that GENE can be populated where collateral type is Cash? <u>Long term solution:</u> • The current validation rules be revisited to have provisions for a "Blank" value or any other alternative value that could be populated in Field 2.18 for the cash pool's Net Exposure collateral.	N/A

[1] *https://www.esma.europa.eu/sites/default/files/library/esma70-151-2838_guidelines_on_reporting_under_sftr.pdf under RTS = 248-249*
[2] *From the minutes of SFTR WG Meeting held on 03/11/2021*
[3] *GENE – General Collateral arrangement.*
[4] *TTCA – Title Transfer Collateral Arrangement.*
[5] *Extract from ISLA's SFTR Best Practices for Field 2.18: https://www.islaemea.org/isla-best-practice-handbook/subsection/SFTR-38/*
[6] *SECU – Security Collateral*

14. ESMA Q&A Update on Reporting of Settlement Fails Under SFTR

Validation Field(s) in scope – 2.00

ISLA Reference	Challenge(s)	Proposed Solution
REG-803	Further to Question 2 of ESMA's SFTR Q&As[1] update (25/Jan/2022) on the reporting of settlements fails, which states: "Counterparties should report the remaining or outstanding SFT with a new UTI and specify accordingly the complete and accurate details of that SFT and its maturity date." ISLA members raised several strong concerns such as: • The unsettled trade(s) remain reflected on books and records as an active exposure, the act of generating a new UTI for regulatory reporting would impact up-stream processes. For example, new trade generation is based on trading desk authorities which create new exposures, draws down trading limits and requires new collateral. • The unique nature of the proposed new trade would create double counting of the existing trade, that is not settled and remains active for purpose of exposure and risk measures in Securities Lending platforms until settlement occurs. • The proposed fictional trade could create entries in lending ledgers that break concentration limits (e.g., UCITS Efficient Portfolio Management). • Further concerns include the different abilities of the diverse market practitioners. Specifically, that counterparts to a trade would react at different times and ways that will increase reconciliation challenges. E.g., where one party changes and the other has not at the same time. • A further concern is the accounting within agent lenders books and records where the lender's loan(s) exist within a shell/omni structure. Creating a 'new' trade would fall outside that structure and be unrecognizable to the borrower. ISLA members agree that reporting should reflect the realities of settlement state and resulting exposures, however the nuances of different SFT markets create a challenge that this recent amendment compounds.	ISLA members propose several pragmatic approaches that might be consider as potential alternative solutions to this challenge: 1. Relaxing Validation rules for the maturity dates of the trades regarding reporting failed settlements. 2. Introducing REVIVE functionality to re-open the historic closed transaction in SFTR reporting in alignment with EMIR reporting[2]. 3. Adding the requirement to report failed settlement on a maturing SFT in the Level 2 legislation. Benefits: • This will provide an explicit reporting obligation for firms to comply with and ensure that all in-scope firms would report a "MODI". • This will also ensure a 'consistent' reporting approach by counterparties to a transaction. 4. Allowing reporting flexibility: • Removing the block on back-dated reporting and report corrections after the reporting window for maturity or termination is closed. or • Increase the settlement date to SD+2. The extra day would ensure accurate and consistent reporting of settlement fails by both counterparties to the trade.

[1] *https://www.esma.europa.eu/sites/default/files/library/esma74-362-893_qas_on_sftr_data_reporting.pdf*

[2] *https://www.esma.europa.eu/sites/default/files/library/esma74-362-1893_consultation_paper_guidelines_emir_refit_.pdf Point 552-553 Page 207*

Annex.1

Extract of ISLA survey of Agent Lenders on Partial & Full return reporting Best Practices

	Member Firm	For SLEB, when reporting full returns under SFTR, which version of best practice are you most aligned to?	Are you planning to begin reporting full returns using ESMA's best practice?	Comments	For SLEB, when reporting partial returns under SFTR, which version of best practice are you most aligned to?
1					
2	Agent Lender	ISLA Best Practice	No	•Recharacterizing open SFTs as term trades just to report settlements does not seem to be the correct thing to do, particularly given that some clients are prohibited from participating in term trades. •The rolling of term dates to cater for failed settlements does not reconcile with the ESMA guidance that states that firms should report contractually agreed term dates. •Maturity/Term dates apply to omni-trades and all the underlying allocations, it is therefore difficult for agent lenders to apply a	ISLA Best Practice
3	Borrower	ISLA Best Practice	No	IT systems unable to be able report correctly for Returns, resulting in incorrect reporting. System limitations and infrastructure cos	ISLA Best Practice
4	Borrower	ESMA Best Practice	Yes		ESMA Best Practice
5	Agent Lender	ISLA Best Practice	No	As per ISLA steerco conversations	ISLA Best Practice
6	Borrower	ESMA Best Practice	Yes		ESMA Best Practice
7	Borrower	ESMA Best Practice	Yes		ESMA Best Practice
8	ICSD	ISLA Best Practice	Yes		ISLA Best Practice
9	Agent Lender	ISLA Best Practice	Yes		ISLA Best Practice
10	Agent Lender	ISLA Best Practice	No	We would not look to change reporting on full returns until the regulation is sufficiently clear about the handling of returns. While	ISLA Best Practice
11	Borrower	ESMA Best Practice	Yes		ESMA Best Practice
12	Agent Lender	ISLA Best Practice	No	Await further ESMA feedback to ISLA on this topic. No change from the previous reasons given by Agent Lenders (e.g. not always known which allocation a return will be on until it settles / certain beneficial owners cannot be place into termed trades).	ISLA Best Practice
13	Borrower	ESMA Best Practice	Yes		ESMA Best Practice
14	Borrower	ESMA Best Practice	Yes		ESMA Best Practice
15	Borrower	ESMA Best Practice	Yes		ESMA Best Practice

Annex.2 Extract from White Paper

Sent to ESMA by Agency Lenders on Full & Partial return processing Challenges

AGENCY LENDING RETURNS REPORTING

Securities lending activity through agent lenders currently represents around 60% of the overall securities lending market. Under the Securities Financing Transaction Regulation (SFTR), the majority of agent lenders are providing both SFTR reporting services to beneficial owners, and also sharing crucial allocation data with borrowers to support their SFTR obligations across loans and collateral. This has involved highly complex proprietary system implementations whilst also making use of one or multiple vendor solutions available in the market. As a result, any significant changes made by agent lenders individually or collectively can have a large impact on the respective systems of beneficial owners and borrowers. It is also important to reiterate that while many agent lenders also participate in Repurchase (REPO) activity as part of their service to underlying beneficial owners, this document is solely looking to address those transactions reported as "SLEB" under SFTR. We are fully aware of the significant legal and operational differences between each of the reportable transaction types and it is absolutely not our intention to comment on anything other than Securities Loans.

The aim of this document, then, is to outline the complexity and impact associated with reporting partial and full returns in a pooled agency lending model. Currently there is no consensus across the securities lending market on how partial and full returns should be reflected in the SFTR report. Initially the best practice from the International Securities Lending Association (ISLA) stated that all lifecycle events should be reported on an actual basis (rather than contractual) as this was acknowledged to provide the most accurate representation of activity and exposure, and best reflect the intention of the regulation.

Within the ESMA Guidelines, some market participants have interpreted the need to report a mix of contractual and actual depending on the type of lifecycle event. ISLA have since removed their best practice and simply state the two options for reporting. As outlined below, it is not seen as practical, appropriate or an accurate reflection of market risk if any reporting on lifecycle events is carried out on a contractual basis.

Making reference to the cost-benefit analysis carried out by Europe Economics in 2017[1], the potential need to change systems to cater for multiple reporting triggers dependent on partial/full returns processing and settlement would see the ongoing costs be much higher than the estimates of €0.3m – €0.6m for a Tier 1 firm. Cost to implement such a change would be much higher and closer to the original one-off costs per Tier 1 firm of €2.1m – €3.1m. Furthermore, there would be a need to coordinate across the market to ensure that all participants are able to report in such a way, given the current bifurcated approach, this is not viewed as achievable.

Outlined below are various scenarios and detailed impacts which we ask ESMA to take into consideration and provide a response to. We request that in the response, ESMA clarify that reporting on an actual basis is acceptable and that the specific challenges around returns will be considered as part of the SFTR review in 2022. We are committed to providing any further information as required and making ourselves available for discussion to ensure this explanation is clear and understood, and to demonstrate our commitment to work together to reach a conclusion.

[1] https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-82_2017_sftr_final_report_and_cba.pdf

Annex.3 LEI Data Table

Jurisdictions	# of ISINs Missing LEIs	# of Active ISINs missing LEIs (on Loan)	Average Loan market value ($)	# of Active ISINs missing LEIs (on Collateral)	Average Collateral market Value ($)	Sum of Unique Active ISINs	% of Active ISINs Missing LEIs (on Loans)	% of Active ISINs Missing LEIs (on Collateral)	% of Active ISINs Missing LEIs (Overall)
Africa	188	23	6,152,843.1	67	83,447,783,794	74	12%	36%	39%
Asia	13,775	1,071	732,074,684.2	4,609	1,369,614,092,398	4,803	8%	33%	35%
Europe	3,452	209	323,438,962.3	1,228	125,623,684,958	1,245	6%	36%	36%
North America	33,398	2,026	856,393,582.4	8,486	707,195,608,095	9,017	6%	25%	27%
Oceania	2,251	186	248,932,485.9	630	57,628,984,334	637	8%	28%	28%
South America	566	-	-	53	30,277,178	53	0%	9%	9%
International CSD	1,340	98	141,590,639.8	745	1,039,524,240,661	745	7%	56%	56%
Grand Total	54,970	3,613	2,308,583,197.6	15,818	3,383,064,671,417	16,574	7%	29%	30%

Annex.4 Correspondence Regarding Trading Venue

How the scenario described by you relates to the instances described in table 6 of the Guidelines on Reporting under SFTR, under items 2 , 7-11?

- The Omnibus level trade agreed on the Trading Venue is not reportable under SFTR, hence is not listed in the Table 6.
- Initial allocations to any omnibus loan, (whether the initial omnibus was agreed on a trading venue or not) would fall under Event 7, in Table 6. Reported as NEWTs.
- A change in allocation to a **new** beneficial owner / UTI, (whether the initial omnibus was agreed on a trading venue or not) would always fall under Event 8 (full reallocation) ETRM & NEWT or Event 10 (partial reallocation) MODI & NEWT, in Table 6
- A change in allocation to an **existing** beneficial owner (whether the initial omnibus was agreed on a trading venue or not) could be handled in one of two ways, depending on the firm's process:
  - Some firms treat the quantity of the increase as a new position with a new UTI and Execution Timestamp, so would again utilise Event 8 (full reallocation) ETRM & NEWT or Event 10 (partial reallocation) MODI & NEWT, in Table 6.
  - Some firms treat the quantity of the increase as an increase to the existing UTI, so would utilise Event 9 (full reallocation) ETRM & MODI & Event 11 (partial reallocation) MODI & MODI, in Table 6.

Can you please point out which is the Trading venue where such SFTs are concluded?

- EquiLend, operating under 2 MIC codes;
  - EquiLend Limited (MIC Code: EQIE) is authorised and regulated as an MTF under MiFID by the Central Bank of Ireland, reference C187728.
  - EquiLend Europe Limited (MIC Code: EQLD) is authorised and regulated by the UK's Financial Conduct Authority (FRN: 225141).
  - No other MIC codes are used in SLEB.

Is the Agent lender a member of the Trading venue?

- Yes. The Borrower also. The Beneficial Owner lending entity would typically not be.

Is there any impact if one of the end counterparties are also members of this Trading venue?

- If an underlying beneficial owner lending counterparty (to whom an Agent Lender has allocated a trade to) is also a member of the Trading Venue, it makes no change to the examples previously supplied. It makes no difference to the trade flow, booking process, nor ongoing maintenance of the open loan. It would merely be a coincidence that the beneficial owner lending counterparty happened to also be a member of the Trading Venue which the Agent Lender has used.
- The Trading Venue still has no sight of the allocations internal to the Agent Lender. The Trading Venue only sees the omnibus level trade.

Are there any allocations when they are not known at all by the Trading venue? If case they are known, what is the timeline by which the Trading venue receives the relevant details?

- The allocations are not known by the Trading Venue. It is the omnibus trade that is being agreed via the Trading Venue.
- Allocations are created solely within the Agent Lenders systems.
- These allocations are shared with the counterparties (borrowers) along with any future unilateral changes made by the Agent Lender.

Is there any impediment (e.g. Technical/Legal) for Trading venue to obtain information on the allocation?

- The Trading Venues role is for initial omnibus level trade negotiation and execution, rather than the allocation of that omnibus trade to underlying Beneficial Owners nor the ongoing monitoring of subsequent allocations made at a later date into that omnibus trade. It is the role of the Agent Lender to allocate trades to its underlying clients and amend those allocations over time to maintain the omnibus level trade with the Borrower.

Annex.5 Extract from ISLA & FCA SFTR
Meeting on 05 March 2020

ISLA®

SFTR Issues of Concern

3) FX Rates and Pricing (Tolerances on Loan Market & Collateral Market Values set to .0005)

In the final report and guidelines ESMA has stated that it is not possible to increase the tolerance levels which will come into force 12 months after 11 April 2020.

a. ESMA has stated the industry should align to ECB closing FX rates.

b. Tolerances are so low for loan and collateral market value (.0005) that counterparties may also need to align prices. Note this is an absolute figure not a %.

ISLA has stated to ESMA in the July 2019 consultation that firms do not expect to change applicable FX rates or market prices in their systems just to fix a tolerance created reconciliation break.

4) Price/Currency/Value (Fields 2.49, 2.50, 2.51) are to be denominated in security currency

Paragraphs 274 & 275: ESMA want fields 2.49 (Security of Commodity Price), 2.50 (Price Currency) and 2.56 (Loan Value) reported in the currency that the security is denominated in. These may not be the values that are actually agreed when then the trade is executed.

This is a known issue to ESMA and would require an amendment to the RTS under any Phase II work which may result in further industry costs.

Annex.6 Agency Lending Allocations Reporting From Borrower's Prospective
Extract from a case study presentation by AMAFI

Agency lending allocations reporting – Borrower prospective

This note highlights some specifics related to agency lending allocations reporting from borrowers' perspective.

In practice, within the agency lending model, borrowers will send the trades executed with the agent (shell block trades) to a third-party platform to get in return the allocations from agent lenders and report those allocations under SFTR. This is especially critical for undisclosed agency lending model[i].

Borrower accurate and timely reporting is depending on the following

- Agent lenders timely reporting and data quality impact borrowers reporting
- Agent lenders decide quantities allocations to end beneficial owners, subsequent life cycle events (partial and full returns). This results in limited control from borrowers to respect T+1 reporting deadline with more stringent criteria for data quality
- triparty agents' collateral data [ii],
- **key reconciliation fields block shell vs multiple allocations is critical for the reporting of borrowers' allocations, same goes for collateral data: this impacts reporting [1]**
- synchronization of life cycle events between the borrower and the agent with specific critical impact post terminations / maturity date
- limitations to perform past corrections of errors (sometimes from the agent), due to limitations on backdated corrections [iii] coupled with technical operating model of vendor platforms where reconciliation is based on last record version, not past events. So it is not feasible to remediate missed events.

I- Agency Lending reporting dependency on key fields reconciliation shell/ allocations

For the borrower to report accurately and on a timely basis, **some key fields** [iv] on loan and collateral have to pre-match between the borrower shell and the agent allocations within the reporting deadline T+1 while borrower have no control over the data on agents who do not have any reporting obligation under SFTR. This reconciliation shell versus allocations will indirectly impact the accuracy and timeliness of borrower reporting.

Asynchronous life cycle events also impact this critical pre-TR matching, however this synchronization on both sides could prove challenging:

- there could be several dozen intraday allocations from the agent or on triparty agents with corrections, errors, useless events. There is usually no filtering of allocations on agent lender side, and a single file is often difficult as it would imply some retention for events reporting from the agent lender side, hence it is often up to the borrower to filter out all events despite the lead of multiple events being on the agent lender side

- there is uncertainty on industry approach on partials and full returns with a market rather split on this case [v]

II- SFTR Limitations on past corrections

Past errors corrections for allocations reporting require resending the shell and re-entering the pre-TR reconciliation process via the vendor platform. The difficulty lies in the fact that pre matching platform reconciliation does not base itself on the past event date, but only considers the last version of the events. (This seems to be the same for TR process). There is then a multiplier effect due to allocations and re-allocations along with related collaterals.

Hence, in practice, back reporting of allocations beyond one or two working days is usually not feasible: allocations characteristics would have already moved very fast since that past event date.

Below are some examples where there are issues on back-reporting. Usually, the previous pairing cannot be undone due to limitations on backdated corrections for dead trades.
The above issues will occur for the reporting of bilateral trades, but the impact is much worse for agency lending allocations reporting. Examples as follows: initial mispairing to be undone/ corrected while trades are now closed, one side has no open trade anymore, but the other side trades are still open due to errors on closure on one side or the other, or mismatches between termination events, issues related to roll overs with several UTIs hence mispairing shell/ allocations, reallocation / Partial allocation (master agreement not yet technically updated).

http://amafi.fr/download/pages/Ib0Eo7GaTDY6jRWLdqOrEkh9BmmjTDThzxClw4UB.pdf

Disclaimer

While we have made every attempt to ensure that the information contained in this Report has been obtained from reliable sources, International Securities Lending Association (ISLA) is not responsible for any errors or omissions, or for the results obtained from the use of this information. All information in this Report is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability, and fitness for a particular purpose. Nothing herein shall to any extent substitute for the independent investigations and the sound technical and business judgment of the reader. In no event will ISLA, or its Board Members, employees, or agents, be liable to you or anyone else for any decision made or action taken in reliance on the information in this Report or for any consequential, special or similar damages, even if advised of the possibility of such damages.