SFTR UTI Creation: ISLA Guidance/Recommendation

Overview

On 31st March 2017 ESMA published final Technical Standards for the implementation of EU Securities Financing Transactions Regulation (SFTR).

Article 4 (1) of the legislation requires that counterparties to all Securities Financing Transactions (SFT's) report details of any SFT they may have been concluded, as well as any modifications or terminations thereof, to a trade repository (TR) on a daily basis. ESMA has provided a number of relevant reporting templates for loan and collateral data that will require collection and aggregation of relevant data

The creation of transaction UTI's is a critical data enrichment process of the SFTR reporting requirement.

ESMA have produced a decision tree[1] to define who should be responsible for UTI creation following market feedback. However, the proposal is sub-optimal for securities lending purposes. The industry has sought a market consistent approach to be agreed via ISLA that enables participants to adhere to the ESMA decision tree, but that fits with the expected data flows of the industry.

Feedback from EMIR reporting issues, suggests that a robust approach to creating, and counterparties matching UTI's, will significantly improve matching rates at the Trade Repositories.

In general, it is expected that data will flow from lender to borrower; given that, in many cases, lender has to be the 'golden source' for loan allocations, as well as other data field requirements. Therefore, it would seem logical if in most instances the lender created the UTI.

Considerations

If counterparties apply the ESMA decision tree, scenario 7 defines the UTI creator for securities lending transactions: hence the Collateral provider, or borrower would take ultimate responsibility.

This is contrary to the majority preference in the market, and the likely data flows.

The lender has knowledge of the beneficial owner and will be required to transfer this information to the borrower in order that the borrower can complete reporting requirements, (except where beneficial owners are disclosed at the point of transaction execution). Equally, collateral allocations are made by the lender in most cases and again this data will need to be transferred to the borrower. This means that most agent lenders will need to provide data to the borrower for every trade (And collateral allocation)

The ESMA decision tree also potentially causes confusion when transactions are Financing trades where the collateral provider/taker is less easily defined.

Moreover, this may lead to the majority of transactions between firms having UTI's created by one entity and potentially a sub-set where the UTI creation sits with the other. This will mean both parties must have the capability to create UTI's and receive them from an alternative source, and may also lead to the need to confirm responsibilities on a transaction by transaction basis

It is therefore proposed that in the majority of cases, UTI creator is decided at ESMA's scenario 2 *"is the agreement between the counterparties – the entity responsible for the generation of the UTI is the one agreed by the counterparties".*

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Recommendations

Having sought agreement from member firms, ISLA makes the following recommendations:

1.   UTI Creation should be in adherence with the IOSCO recommendations [2]

2.   Borrower and lender should agree at a **RELATIONSHIP** level, who will be responsible for UTI creation of all transaction under the GMSLA[3].

3.   It is expected that in most circumstances the lender will assume the responsibility of UTI creation unless the lender is unable to

4.   As data is likely to flow from lender to borrower but less likely to flow the other way, it is expected that in most cases it will be the entity that is mostly a lender in the relationship (or its agent) who creates the UTI. This can be achieved using Scenario 2 of the ESMA decision tree.

5.   The entity responsible for UTI's will create the UTI for all transactions, including where the underlying beneficial owner is a Non-Financial Counterparty or an entity that does not have a reporting obligation.

6.   Agreement under ESMA's Scenario 2 may be driven by a number of considerations and the ISLA decision tree (Appendix 2) may assist in the agreement process.

Please note that this proposal is for transactions executed under a GMSLA as ISLA is unable to comment on transactions executed under alternative documentation including, but not restricted to the GMRA. However, counterparties may decide to take a single approach to all transactions reportable under the SFT Regulation.

The ISLA decision tree is designed so that the lender is the UTI Creator at every opportunity.

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[2] CPMI-IOSCO Technical Guidance – Harmonisation of the Unique Transaction Identifier – February 2017

[3] ISLA is only able to comment on the GMSLA. For repo transactions under GMRA, counterparties should follow ICMA recommendations

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Compliance with ESMA's decision tree

ISLA believes that applying the ISLA decision tree is completely compliant with the ESMA decision tree. The following logic has been applied:

ESMA scenario's
Scenario 1: Is the a global UTI endorsed by ESMA- if yes- Global UTI should be used
ESMA state "there is no global UTI for the SFT transactions"[4], therefore scenario 1 is invalid.

Scenario 2: Is there agreement between the counterparties – if yes- The entity responsible for the generation if the UTI shall be the one agreed by the counterparties.

This is the scenario that ISLA recommends member firms use. In order to assist in the agreement of the UTI creator, ISLA has produced the "ISLA decision tree" as seen in appendix 1.

Scenario 3 – 7 become invalid if the decision is made off scenario 2. However it is recognized that utilization of CCP UTI's (ESMA scenario 3) trading venues (ESMA scenario 6) and trades between FC and NFC (scenario 6) are relevant and so have been incorporated into the ISLA decision tree for consideration.

Compliance with IOSCO Technical Guidance

IOSCO produced technical guidance for the market relating to the creation of UTI's[5]. and member firms are keen to ensure any process for UTI creation by the securities finance industry is compliant with the guidance.
The guidance covers five aspects which ISLA has considered in respect of these UTI recommendations.

I.   **The circumstances in which a UTI should be used**

  b   A UTI should be created for every reportable transaction.

II.   **The impact of life cycle events on the UTI, through the setting of principles that provide guidance on when a life cycle event should or should not cause a new UTI to be used**

  a. Any individual transaction should have the same UTI even if such transaction is reported more than once.
  b. A transaction should keep the same UTI through-out its lifetime.
  c. If one transaction is replaced by another with a different UTI, then there should be a means of relating the transactions before and after such a change UTI. This is covered by ESMA in their Final Report section 4.3.4 Linking SFTs and may need further consideration.

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[4] Final Report:Technical Standards under SFTR and certain amendments to EMIR, 31st March 2017, ESMA70-708036281-82, page 75
[5] IOSCO Technical Guidance on the Harmonisation of the Unique Transaction Identifier, February 2017

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III.   Which entity or entities should be responsible for generating UTI's

a. IOSCO provides guidance to authorities for determining who is responsible for generating UTI's and states " market participants should follow any rules for UTI generation responsibility of the applicable reporting regime.

b. ESMA note in their Final report [6] that the ESMA flowchart (and therefore the ISLA flowchart which complies) is broadly aligned with the IOSCO flowchart with the exception of the placement of counterparty agreement at the top of the flowchart.

IV.   When UTI's should be generated, considering the reporting timescales

a. The UTI should be generated and made available to all relevant parties in time for them to make use of it as required. In particular to make a report to a TR
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V.   UTI structure and format

a. IOSCO provides guidance to authorities to seek a harmonized approach and ESMA has adopted an identical approach.

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[6] [6] Final Report: Technical Standards under SFTR and certain amendments to EMIR, 31st March 2017, ESMA70-708036281-82, page 76

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Appendix 1: ISLA decision tree (to be used as a sub-set of ESMA's scenario 2
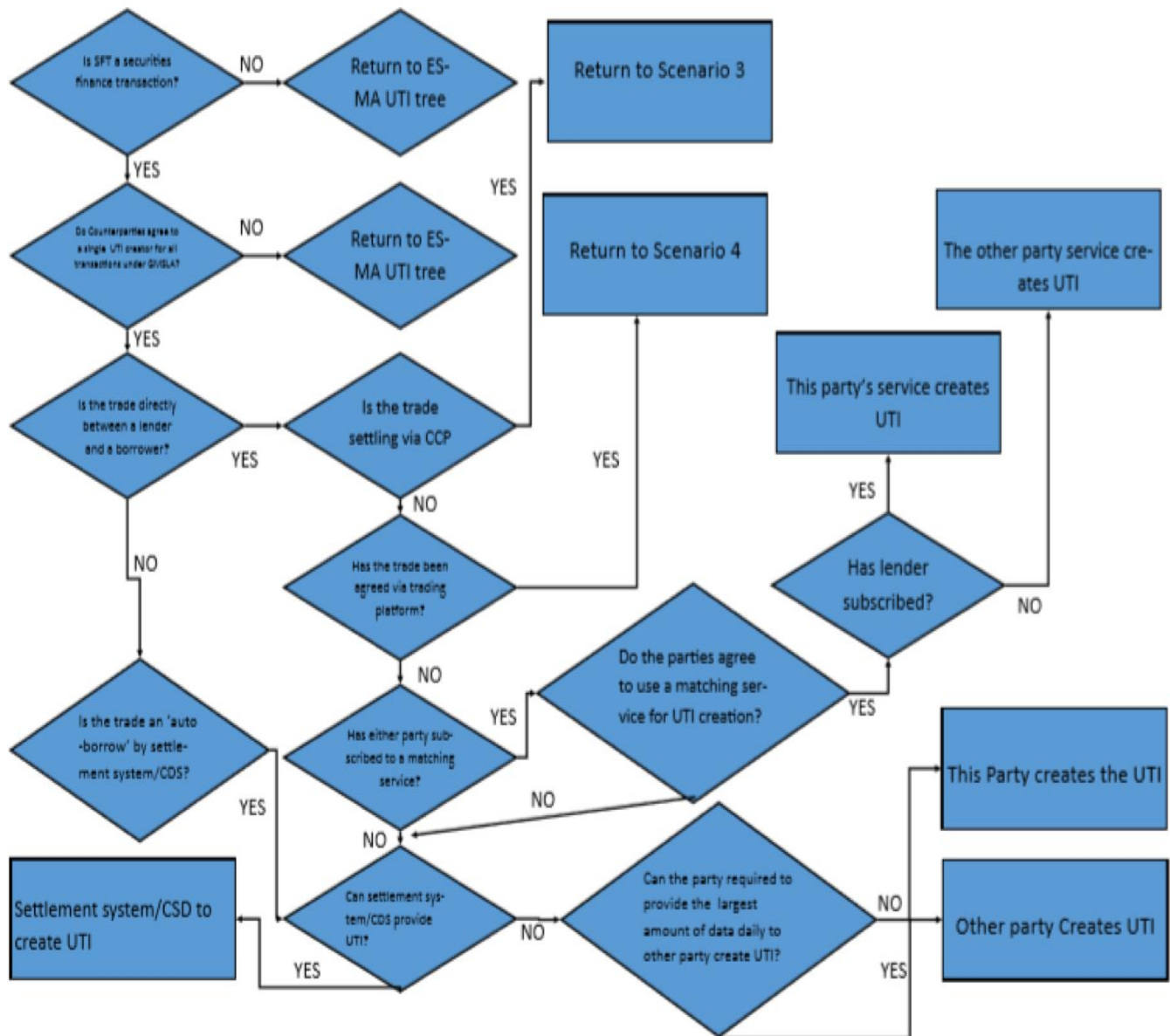
Matching service: This term is intended to incorporate any third party engaged by either lender of borrower to undertake data management for the purposes of SFTR reporting. Data management may include enrichment, cleansing or pre-matching services. A matching service may be responsible for providing data directly to a TR or preparing data for lender and/or borrower