DACSI

Position paper DACSI 14-1122

Proposed Regulation on reporting and transparency of Securities Financing Transactions: the NL market's view

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On 29 January 2014 the European Commission published a proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of Securities Financing Transactions (2014/0017 (COD)). This paper explains the NL market's position with regard to this proposal.

Summary

The proposed Regulation has more or less surprised the industry, not because of its objectives, but because of some choices made in it.
Since no explicit consultation was held in advance of the publication, we use this paper to make clear to decision makers how and why we anticipate some problems. We are sure that similar signals are given by other parties and we trust that the decision makers in the trilogue process will take these concerns in consideration.
Our main concerns are that:

- the use of the term re-hypothecation is ambiguous, the requirement of additional written agreement for title transfer in repo's and similar SFTs would be redundant and unproportionate;
- the scope of parties who have to report is left open;
- the scope of contracts under the reporting obligation is open to such a large extent that contracts may be included for which it is obviously not intended.

General Remarks

We appreciate and fully support the objectives of the proposed Regulation: "ensuring that the benefits achieved by strengthening the resilience of certain actors and markets are not diminished by financial risks moving to less regulated sectors" and "data availability in terms of shadow banking activities".
The securities financing transaction (SFT) markets provide important tools for the temporary transformation of certain characteristics of financial assets and for ensuring liquidity. As such, SFTs are a welcome instrument enabling financial parties to perform their risk management and – thereby – to comply with regulatory (e.g. EMIR) and other requirements.
When analysing the proposal and its components, we take the above objectives in consideration, while also answering the questions whether the functioning of the SFT markets as such, and their function in the real economy, are not hampered by onerous or over-structured regulation.
With the EMIR implementation we have experienced that ambiguities with regard to definitions and/or scope can easily distract attention from the essentials; all parties will benefit when clarity is provided at an early stage.

At this stage and to our knowledge, the EU is the only – or most advanced - jurisdiction preparing reporting and transparency obligations for SFTs. Where EMIR was and remains backed by a push by G20, the SFT Regulation is mainly pushed by the FSB, which is essentially different. With this different context we fear that the EU initiative would not be followed by other jurisdictions, leading to severe competitive disadvantages for EU parties. In order to avoid these disadvantages and to avoid regulatory arbitrage, we recommend that both the timing and the detailing of the implementing measures are strictly coordinated with other major jurisdictions (like e.g. the US and Japan).

* The Dutch Advisory Committee Securities Industry is the principal trade association in The Netherlands for firms active in the securities industry. The Association represents the interests of its members on all aspects of their securities and securities related business - both domestic and international - and positions the Dutch view to the market infrastructures service providers and regulatory authorities in The Netherlands and the European Union.

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Reporting and disclosure

Scope and reporting obligation

Definition of SFTs
SFTs are defined as securities lending and borrowing transactions, repos, reverse repos, buy/sell backs and sell/buy backs and *any transaction having an equivalent economic effect*. This open-ended addition could easily refer to transactions that are already in scope of other regulations (EMIR) or to transaction types that should obviously not be within the Regulation's scope because they are not relevant in terms of "shadow banking". Examples of such unintended transaction types are total return swaps, equity financing ("effectenkrediet") or the substitution of collateral under existing portfolio collateral arrangements.
More legal certainty should be created by narrowing the definition of SFTs in article 3(6) of the Regulation, limiting them to the category of financial instruments of MiFID II Annex 1 Section C.

Intra-day repos
Reporting on intra-day repos would – while requiring substantial efforts – lead to actual reporting by end-of-day, when the transaction already terminates. As an effect, the combined reporting effort (with regard to both the entering into and the closing of the transaction) would not provide useful information.
Hence, intra-day repos should be excluded from the reporting obligation.

T2S auto-collateral
Transactions executed through the Target2-Securities (T2S) auto-collateralisation system remain within the regulated financial system by definition; hence, reporting these transactions in the context of the Regulation cannot add value in the light of the objectives of the Regulation.
In order to avoid unnecessary reporting obligations, we would welcome clarification/confirmation that the intended scope of the proposed Regulation does not extend to these transactions.

Transactions with an exempt party
Particular entities (e.g. central banks) are exempt from the reporting obligation by the rationale that their transactions are not relevant in the context of shadow banking. By the same rationale, their (financial sector) counterparties should not be obliged to report their transactions with these exempt parties.
We recommend including an explicit provision in the proposed Regulation, in order to provide clarity at an early stage.

Tri-party collateral management
Transactions under tri-party collateral arrangements, will be reported most cost-effectively by the tri-party agents because these agents have all relevant details. The quality of reported data will also benefit significantly, and less reconciliation will be necessary.
We propose an explicit recognition on Level 1 (like in EMIR) of the possibility that others (in this case the tri-party agents) report on behalf of their customers.

Overlap with other reporting requirements
The proposal clearly stipulates that if a transaction is already reported under EMIR with the same details it will not have to be reported again under the SFT Regulation. However, it does not take into consideration the mandatory reporting under CRR, MiFID2/MiFIR (art. 26) or from/by settlement internalisers, which will come into force under the CSD Regulation (CSDR).
We strongly recommend that overlap with other regulatory reporting obligations is addressed as well.

Transactions between Financial Counterparties (FCs) and Non-financial counterparties (NFCs)
Where an FC trades with an NFC, the reporting of such a transaction should clearly be mandated by the Regulation. However, it is not necessary that both parties report. Implementing EMIR has taught us that enforcing NFCs to report

to a trading repository is often problematic (and many of them are outsourcing their reporting to their counterparties). In contrast to EMIR, having the same transaction reported by both parties to the transaction does not add value in the context of the Regulation's objective.
We recommend that for a transaction between an FC and an NFC only the first one will be obliged to report.

Modalities

Lending and repo fees – Fees charged or earned in transactions are commercial data that do not contribute to the Regulation's objectives; hence, they should not have to be reported.

Shared/pooled collateral
The pooled/aggregated collateral is common practice in Europe and is contractually agreed between parties (GMSLA/GMRA provisions). In the event that each SFT should be linked with precise collateral, the IT impact, contractual impact and business model impact would be high. It is understandable that transparency should be available as to what instruments have been received and transferred between parties. In addition, substitution of collateral is common practice; after a substitution no direct link is possible with a precise transaction. The same transparency results as a transaction-by-transaction reporting principle can be reached by obliging parties to report on a counterparty-by-counterparty basis their total cash positions received and transferred and securities (per ISIN) received and transferred in connection with SFTs. This would allow the regulators to have all relevant data and easily interpretable.

Counterparties outside the EEA
Imposing obligations on counterparties outside the EEA (extra-territoriality) would be detrimental in EU parties' relation with these "outsiders", and hence damage the competitive position.
In our opinion, the Regulation's objectives are sufficiently met when the EU parties have to report their side of transactions.

Back-loading
The proposal does not address back-loading. It should be made explicit that back-loading will not be obliged.

Rehypothecation

Scope and definition
Chapter V (article 15) holds provisions for the transparency of rehypothecation of instruments received as collateral.

We note that the proposal does not include a definition of "rehypothecation", while no reference is made to external definitions either. This absence creates uncertainty about the scope of the requirements made in this chapter: should they apply to collateral as security interest only or to situations of transfer of title as well?
These requirements are far-reaching: the condition of prior express consent by signing a written agreement is not easily met operationally, and is very distant from current market practices; the condition of informing in writing is even more onerous because no "equivalent alternative mechanism" could be used.
In our opinion, both conditions are mainly based on considerations of protecting (non-professional?) counterparties, rather than on the objectives of the proposed Regulation (the shadow banking context, see General Remarks).

We do not disagree that re-use of collateral has to be based on explicit consent of the collateral giver, but we are of the opinion that the proposed SFT Regulation is not the right place to create these provisions. MiFID would provide a much better investor protection context; while the risk dimension is already being addressed by the Risk Mitigation Techniques under EMIR.

In case conditions as proposed are maintained in the Regulation, it should be made clear that they solely apply to collateral consisting of security interest.
The provision of collateral in the form of transfer of title is completely straightforward in SFT transactions: the simultaneous exchange of two types of assets against a second future (reverse) exchange obviously involves a counterparty and settlement exposure. It is in the nature of these contracts that a default of the counterparty may endanger the future delivery; SFTs are designed especially to address/mitigate that risk. Hence: entering into an SFT implies the transfer of title (and hence the right of re-use of the collateral); the conditions under 1 of article 15 would not add any value, but would create substantial costs because of the written procedures.

For the exact definitions of both types of re-use of collateral we recommend that reference is made to / equivalence is construed with the EU Collateral Directive (2002/47/EC):

> (b) '*title transfer financial collateral arrangement*' means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations;
>
> (c) '*security financial collateral arrangement*' means an arrangement under which a collateral provider provides financial collateral by way of security in favour of, or to, a collateral taker, and where the full ownership of the financial collateral remains with the collateral provider when the security right is established;