Consultation response

DACSI 16-1224

From : DACSI

Subject : **Reply to the ESMA Consultation on SFTR Reporting –**
Draft RTS and ITS under SFTR and amendments to related EMIR RTS
version 2.0 (as submitted)

30 Nov 2016

What follows is a proposed text for DACSI's response to ESMA's Consultation Paper "SFTR Reporting" (DACSI 16-2277).

General remarks
Existing obligations to report transactions to the ECB under the MMSR (Money Market Statistical Reporting) regime largely coincide with the new (broader) obligations under SFTR. As the resulting double reporting burden is significantly cumbersome for reporting parties, we strongly suggest that ESMA and the ECB reconsider the possibilities for making the SFTR data available to the ECB. Considering the broadness and granularity of the SFTR data, this would not hamper the quality of the data made available to the ECB.

We were disappointed to hear that the proposal to require collateral data reporting on value date + 1 (VD + 1) was a clerical error and not an intended amendment.
If reporting would need to take place on value date (VD + 0) this may have a detrimental impact on the efficiencies established in the securities lending market, as collateral positions would need to be finalised at an earlier point in time compared to current practice, only in order to meet the reporting deadline.
We maintain that reporting of collateral transactions should occur on VD + 1 which is still a challenging deadline for the securities lending market, but will still enable the regulator to receive accurate matched information in a sufficient timeframe for any analysis required.

DACSI responds to selected Questions only.

Chapter 4 - Reporting

Q 4 Do you consider that the currently used classification of counterparties is granular enough to provide information on the classification of the relevant counterparties? Alternatively, would the SNA be a proper way to classify them? Please elaborate.

Par. 87 (reporting logic) states that "where a financial counterparty concludes an SFT with a small non-financial counterparty, the financial counterparty is responsible to report". In this regard, it is highly important that this reporting responsibility can be established unequivocally. To that end:

1. DACSI requests ESMA to confirm that the criteria for "small non-financial counterparty" are those mentioned in Article 3(3) of Directive 2013/34/EU:
   Medium-sized undertakings shall be undertakings which are not micro-undertakings or small undertakings and which on their balance sheet dates do not exceed the limits of at least two of the three following criteria:
   a. balance sheet total: EUR 20 000 000;
   b. net turnover: EUR 40 000 000;
   c. average number of employees during the financial year: 250.
2. It would be helpful if ESMA can provide guidance, as they did for EMIR, stating that non-financial counterparties are responsible for advising financial counterparties whether they are defined as a small non-financial counterparty under the EU Accounts Directive. If the non-financial counterparty does not provide this to the financial counterparty, then the financial counterparty can assume that they are not a small non-financial counterparty and will therefore not be responsible for reporting on their behalf.

Q7 Based on your experience, do you consider that the conditions detailed in paragraph 105 hold for CCP-cleared SFTs? Please elaborate.

In general, DACSI expects that the conditions as outlined in the consultation document hold for CCP-cleared SFTs. However, please consider that CCPs can provide different netting models for SFTs. Netting of front and term leg may be processed separately and a new UTI may not be created in every case. Hence, this would limit the possibility of position-level reporting.

Q8 In the case of CCP-cleared SFT trades, is it always possible to assign and report collateral valuation and margin to separately concluded SFTs? If not, would this impair the possibility for the counterparties to comply with the reporting obligation under Article 4 SFTR? Please provide concrete examples.

There is currently only one CCP model to be considered in the securities lending market; it should be noted that other CCPs may develop alternative models in the future.
Currently, it will not always be possible to report collateral valuation and margin to separately concluded SFTs.
Valuation margin may be held separately and may be held as a collateral "pool" (as defined in paragraph 248.a.).
Equally, collateral margin may be held against the net exposure of SFT's and other exposures to the CCP (created by other transaction types outside the scope of SFTR.

Q 9 Would the suggested data elements allow for accurate reporting at individual SFT level and CCP-cleared position level? In line with approach described above?

Unlike under EMIR, where events can affect an entire position (as a set of transactions), position reporting doesn't seem to add value under SFTR. The (additional) position reporting option is not useful.
A unified regime between EMIR, MiFID, DFA etc. would be recommended.

Q 14 Do you agree with the revised proposal to use the terms "collateral taker" and "collateral giver" for all types of SFTs?

Yes, but this terminology does not always bring relief (see Q 15).

Q 15 Are the proposed rules for determination of the collateral taker and collateral giver clear and comprehensive?

No, at least not under all circumstances.
In symmetrical contracts, e.g. collateral swaps or (other) securities lending where parties trade a security for a security, it seems arbitrary who has to be considered as the collateral giver and who as the collateral taker.
In order to avoid that parties report the trade differently and hence to avoid mismatches, DACSI would welcome ESMA providing a tool for an unambiguous allocation of roles.

As far as there could have been room for other interpretation based on other parts of the proposed RTS, these proposed rules clearly imply that securities lending transactions without collateral are outside the scope of the reporting obligation.

Q20 Would it be possible to link the 8 trade reports to constitute the "principal clearing model" picture? If yes, would the method for linking proposed in section 4.3.4 be suitable?

It will be very difficult to link the 8 reports to constitute the "principal clearing model" with the CCP design for securities lending transactions as this would require a single UTI across the 8 reports.
From the CCP perspective linking would also be very difficult. The CCP would only be able to report against the clearing member who is disclosed to the CCP (ref paragraph 212).

Q 24 Do you agree with the proposal with regard to reporting of SFTs involving commodities? Please elaborate.

In point 169 it is stated that where a counterparty has the right, but not the obligation to repurchase the transaction would be regarded out of scope. Nevertheless, in case party A has purchased a commodity from party B on the first leg of the transaction and Party A has a put option to sell equivalent commodities back to party B, could ESMA confirm that this is not considered as an SFT and therefore out of scope for reporting purposes?
A put option would mean that Party A has a right to sell the commodities back, but this would be considered an obligation (albeit a contingent obligation) on the side of Party B. DACSI's view is that it is not an SFT, because at the moment the commodities are sold the commitment to buy back does not exist. Only if the put option would be exercised would an obligation be created. Another practical issue would be if this would be considered as an SFT that on value date the transaction should be reported, while it is not clear if the put option will be exercised at all.

Q 27 What types of loans or activities, other than prime brokerage margin lending, would be captured in the scope of margin lending under the SFTR definition? Please provide details on their nature, their objective(s), the execution and settlement, the parties involved, the existing reporting regimes that these may already be subject to, as well as any other information that you deem relevant for the purpose of reporting.

It is DACSI's position that margin lending transactions with clients served through retail channels, i.e. non-wholesale clients (hereinafter "***retail margin lending***", known on the Dutch market as *Effectenkrediet* and similar to the MiFID ancillary service, i.e. granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction), and types of ***acquisition finance*** do not comprise a "shadow-banking" activity within the meaning the FSB has attributed to the term and were therefore not intended to fall in scope of the SFTR.

SFTR, Article 4 requires counterparties to "*..report the details of any SFT they have concluded*..". SFTs are defined in Article 3(10), SFTR to include "margin lending transactions". Those are transactions "*in which a counterparty extends credit in connection with the purchase, sale, carrying or trading of securities, but not including other loans that are secured by collateral in the form of securities*;"
The definition contained in Article 3(10) appears to bring in scope retail margin lending transactions, which is why the Level 1 definition is not subject to our argumentation. However, it is our interpretation that the intended scope as articulated in the Consultation Paper, extends to prime brokerage (FM) margin lending transactions only and not to retail margin lending transactions.

a) Section 4.2.4.5, Paragraphs 173-180 of the Consultation Paper focus on margin lending. In this part of the consultation, ESMA has on more than one occasion indicated its awareness that the scope of margin lending, as defined in the Level 1 text, could be overly broad:

   Paragraph 174: The "*…scope of this definition is potentially very broad*..", "*potentially capture transactions of very different natures*.."

Paragraph 180: "*A broader scope of the definition, for example not excluding retail clients, would potentially encompass many other types of loans*."

b) ESMA have also admitted that they are not abundantly familiar with all possible businesses that might be brought in scope as a result of the broad definition.

Paragraph 173: "Limited information is available on margin finance in Europe"

c) Most importantly, ESMA has directly requested the market participants to supply more information and feedback on other loans or activities, other than prime brokerage margin lending, which would be captured in the scope of margin lending under the SFTR definition:

Q27 "What types of loans or activities, other than prime brokerage margin lending, would be captured in the scope of margin lending under the SFTR definition"

d) ESMA clearly reiterates FSB's intention to capture "*margin lending provided to non-retail clients in its description of the standards for SFT data collection*" (paragraph 175).

e) In paragraph 177 of the same section, it is implied that ESMA's understanding of what margin lending is, pertains really to prime brokerage financial market transactions: "*Based on the feedback received, margin lending takes place when a prime broker's cash balance with its clients falls below zero by (re)using assets in the margin account as collateral*. "

Also in a higher level perspective capturing types of acquisition finance and ***retail margin lending*** cannot reasonably be intended, given the objectives of the SFTR and the FSB Policy Framework Shadow Banking, which are to mitigate the systemic risks of shadow banking. Such risks do not exist in case of acquisition finance and ***retail margin lending*** (as explained below).

Acquisition finance often concerns a transaction in which a bank extends credit in connection with the purchase of securities. The securities are typically the shares in the target company's equity capital. Such shares in principle qualify as securities, even if they are not publicly traded. The purchaser of the target company could be any type of company. Securities credit for retail clients by its very nature concerns a transaction in which credit is extended in connection with the purchase of securities.

An acquisition finance transaction is usually executed by means of a credit facility agreement and settled by the lending bank or, in case of a syndicate or club of banks, the facility agent transferring the borrowed money to the vendor upon utilisation of the relevant credit facility by the borrower-purchaser. ***Retail margin lending*** is usually executed in the form of a credit agreement and settled by payment to borrower provided the borrower provides sufficient collateral in the form of securities. The credit enables to retail investor to leverage the investment portfolio.

The risk profile of acquisition finance and ***retail margin lending*** is also not comparable to typical shadow banking transactions such as prime brokerage transactions. This can be demonstrated by focussing on the following risks identified by the FSB (page i of the 29 August 2013 report):

i. 'the spill-over effect between the regular banking system and the shadow banking system' – not applicable: the counterparties of banks in case of acquisition finance and ***retail margin lending*** are typically not shadow banking system participants but corporates engaged in the 'real' economy or retail investors respectively;
ii. 'the susceptibility of money market funds (MMFs) to "runs"' – not applicable: MMFs are typically not involved in acquisition finance or retail securities credit because they should not purchase 'companies' (undiversified and generally (because of the large size) illiquid portions funded by acquisition finance – they are acquired for strategic corporate purposes) and because MMFs are not classified as retail;
iii. 'incentives associated with securitisation' – not applicable: neither acquisition finance nor ***retail margin lending*** typically involves securitisation;

iv. 'risks and pro-cyclical incentives associated with SFTs such as repos and securities lending that may exacerbate funding strains in times of market stress' – not applicable: see under (v);
v. to assess and mitigate systemic risks posed by other shadow banking entities and activities – not applicable: acquisition finance and ***retail margin lending*** are typically uncorrelated transactions which do not form part of a chain of transactions which could have materially adverse domino effects on default or market stress situations.

We believe it would be good for legal certainty that ESMA clarifies that the definition of 'margin lending' is not to be construed so broad that it would capture acquisition finance and ***retail margin lending***.

Q 39 Do you agree with the proposal to identify the country of the branches with ISO country codes?

We agree partially.

Conceptually DACSI would prefer to use LEI codes for branches, ensuring consistent and non-redundant data. However, we recognise that LEI branch codes may not be available before the SFTR reporting has to start. Therefore, we agree that using ISO country codes is an acceptable alternative in line with current EMIR requirements. However, DACSI would strongly suggest ESMA to consider also accepting LEI branch codes when these become available.

The actual country codes used should be aligned between the various regimes (EMIR, MIFID, MMSR, DFA, HKMA, ASIC etc.) for ease of use. The clarity should be on the information field level (there should be no optionality between 2 alphanumeric, 3 alphanumeric and/or numeric).

Q 44 Do you agree with the above rules for determining the entity responsible for the generation and transmission of the UTI? If not what other aspects should be taken into account? Please elaborate.

DACSI welcomes ESMA's intention to provide clarity for determining the responsible entity.
We also note that in practice UTI agreements and ISDA best practice are not stable across banks in the EU. It will be very helpful when standardised UTI generation is made mandatory, not only for SFTR purposes, but unified between regimes (DFA, EMIR).

We regard the flowchart(s) in the Consultation Paper very helpful, but we note that the application of Figure 1 – UTI generation flow chart means that the creation of UTI0 in paragraph 226 is not applicable.
According to the flowchart, the CCP will be responsible for creating a single UTI which will be used throughout the lifecycle of the transaction. This is how the market believes the process should work.
It should be noted that where a CCP provides a backload functionality to novate existing transactions to a centrally cleared regime, the CCP will provide new UTIs which will replace the prior UTI and this will generate a modification amendment report from the bilateral counterparties.

In addition, an issue arises on which counterparty is to be considered as the 'collateral taker' in occasions where this is not clear (for example 'collateral swaps' and (other) transactions where securities are lent against other securities). "Scenario 7" of the flow chart on page 80 would not be feasible in cases where it is not clear who is considered to be the collateral taker.

Q80 Do you agree with the fields proposed for reconciliation? Which other should be included, or which ones should be excluded? Please elaborate.

DACSI has significant concerns about the number of fields required to be matched, their appropriateness, and the proposed tolerances applied, all of which we believe will have a significant detrimental effect on the markets' ability to meet the reporting requirements.

For a number of fields, it is difficult to see how a reconciliation will occur as the information will be one-sided – such as the first field listed in paragraph 365: Reporting counterparty. It is unclear what data this will be reconciled to. The same concerns apply to a number of the reconciliation fields.

DACSI is equally concerned about the number of required matching fields and believe this will have a detrimental impact on the number of transactions successfully matched by the TRs. We believe matching requirements should be restricted to only the fields that have an economic impact on the transaction. For an illustration of the latter, we refer to a separate file (Annex 1: New Consultation Reporting Fields SN) prepared by ISLA.