UniCredit

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UniCredit comments to the FSB report on "Securities Lending and Repos: Market Overview and Financial Stability Issues"

UniCredit Group is a major international financial institution with strong roots in 22 European countries, active in approximately 50 markets, with about 9.500 branches and more than 160.000 employees. UniCredit Group is among the top market players in Italy, Austria, Poland and Germany. In the CEE region, UniCredit operates the largest international banking network with around 4.000 branches and outlets. UniCredit Group is a market leader in the CEE region. Furthermore UniCredit was recently recognized as Global Systemically Important Bank.

General considerations

We fully appreciate the FSB effort to rationalise the wide spectrum of repo and securities lending activities by identifying four market segments and describe how they work. Such an identification is of crucial importance to **tailor made the regulatory reform proposals to better capture the sources of systemic risk, without penalising market segments that are used in a way that is beneficial to the economy**. It is of crucial importance in fact not to stigmatise certain financial instruments *tout court*. Specifically, with reference to repo financing, the regulatory framework should be defined in order to properly address the related "embedded" risk, but at the same time should aim to preserve (and not penalise) a crucial and resilient financing source for the banking sector.

This is the case for instance of repo activity in the interbank market, which is a well-tested and standardised technique that follows relatively homogenous and transparent worldwide market standards. The collateral used is usually quite liquid and characterised by an underlying deep market. In view of these characteristics, repo activities per se - *ceteris paribus* - are a far less risky financing source. Also, repo activities, where the underlying collateral has been purchased by the party providing the collateral – as usually happens in the interbank market - is not a source of leverage compared to unsecured lending and securities lending.

For information purposes, although precise statistics are not available, in the Euro area most of the repo transactions take place in the interbank markets. In addition, in Europe, government bonds account for around 80% of the EU-originated collateral used in the repo transactions [1] and the

[1] "Shadow Banking in the Euro Area – an overview", Occasional Paper Series, N.133 April 2011

volatility of the related haircut has been historically lower[2].

Based on its experience as a major player in the European market, in the next Section UniCredit is pleased to share with the Financial Stability Board few suggestions with specific reference to the repo market segment.

Suggestions

1. To focus the attention of the regulator on CCPs, which might be a channel of systemic risk propagation.

In our view, **CCPs' risk control framework should satisfy specific guidelines imposed and monitored by the authorities,** with the aim to avoid pro-cyclical effects. In particular, the conservative computation of risk control measures, especially the fixed component of initial margins and haircuts, should be adequately calibrated considering a sufficiently ample dataset, including both normal and distressed times dataset. As a consequence, **CCPs would be in charge of implementing the authorities' requirements and maintain a degree of discretion with reference to execution only activities,** for instance **by competing on the efficiency of the services provided** (e.g. on the straight through processing of transactions).

General guidelines to promote global efforts to strengthen financial market infrastructures have recently been published by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO)[3]. We appreciate that CPSS and IOSCO recognise the need to regulate and properly supervise CCPs. On the other hand, we have still major concerns on the liquidity risk management principles outlined in these documents[4] where the responsibilities for changing risk control measures and eligibility criteria are exclusively allocated to the CCPs.

Most notably, the upward revision in the risk mitigation tools (haircuts and margins) to be held against government bonds used as repo collateral during the sovereign crisis proved to be extremely pro-cyclical. Such sudden change under already distressed conditions was dangerous from a systemic risk perspective and suddenly discouraged banks to use the CCPs, by reverting them to the ECB or to the bilateral repo market. Instead, a conservative, but stable level of the ECB risk control framework (valuation methods, margins and haircuts) proved to be an effective practice during the crisis.

Besides, we also recall the important attempt of legislators to contrast the fragmentation of market infrastructures (see for instance the proposed EU Regulation on CSD). This objective, including the harmonisation of the settlement procedures, is definitely welcome, though some aspects (such as

[2] Haircuts and initial margins in the repo market, ICMA, European Repo Council February 2012
[3] Principles of Financial Market Infrastructure, IOSCO and CPPS, April 2012
[4] Principle 5 on collateral, 6 on margin and 7 on liquidity

mandatory buy-in) have to be carefully assessed in terms of unintended consequences.

2. Enhanced transparency. It should be investigated how an efficient form of a **central repo trade repository** could be implemented. In this context it is very much welcome the feasibility study, which has just been announced by the ECB, on a central database to provide information on the European Repo Market as well as the intention by ICMA European Repo Council to work together towards this objective. In the European Union for instance, there are several market data sources with inconsistent / non homogeneous data. In addition, it should be properly considered how each financial institution (therefore, not only banks) should be required to set-up **a trades' repository of all non standardised collateralised transactions**. It should include all detailed information, in an electronic common standard template, to increase effectiveness of internal controls as well as to speed-up resolution if and when needed.

3. The promotion of standardised contracts, such as EU GRMA and EMA, should be strongly encouraged among financial players, both in Europe and outside Europe. It is also worth exploring the opportunity to publish and regularly review a list of those jurisdictions where international standard contracts are not applicable.

4. Introduce adequate methodologies and measures to deal with liquidity mismatch, concentration and roll over risk in the collateralised funding markets.

> **4.a.** Although contributing to addressing liquidity mismatch, concentration and roll over risk in the collateralised funding markets, Basel III does not specifically cover them. Hence, we deem worth assessing the opportunity to introduce an international methodology and framework allowing competent authorities to monitor an **asset encumbrance ratio.** The definition of the methodology for calculating such ratio should be carefully assessed over time by the authorities (possibly sharing views with the industry), considering that different initial assumptions may lead to significantly different results (for example: the assumption regarding the roll over of outstanding "long" positions – i.e.: bonds purchased and financed via repo). In its initial phase of introduction, the ratio for a broad range of financial institutions (banks and shadow banking entities pursuing similar activities) would be monitored by the authorities. Over time, it could be considered whether – under certain proper conditions - it may be useful and advisable to disclose such an information to the market or even to define a maximum threshold at group level.
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> **4.b.** Only in those circumstances where the competent authority detects that the repo technique is used to build up a significant leveraged position, then it could be investigated **within Pillar II the possibility for the relevant competent authorities to apply supervisory (risk control) measures** to constrain such behaviour or increase the costs of those transactions. Of course, such supervisory direct measure would in principle equally apply to any "abused" product, not only to repo.

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