



ICMA EUROPEAN REPO COUNCIL

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel,
Switzerland

28 November 2013

Dear Sirs,

Addressing Shadow Banking Risks in Securities Lending and Repos

The ICMA ERCⁱ and the ISLAⁱⁱ (the “Associations”) are grateful for the opportunity to respond to the Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos (“Policy Document”). As the industry representative bodies for the professional repo and securities lending markets in Europe we have played an active part in the efforts of the FSB’s Workstream on Securities Lending and Repo (“WS5”) since its inception. We hope that our response is helpful to the FSB and other authorities as they consider further development and implementation of policy for these important markets.

In addition to providing responses to the consultation on the proposed regulatory framework for haircuts, we have taken the opportunity of also attaching some feedback on the policy recommendations detailed in Section 1 of the Policy Document. Whilst we appreciate that those recommendations are now final we hope that our feedback will be useful to the FSB and authorities when considering their implementation.

Executive Summary

As WS5 acknowledges, a large proportion of the repo and securities lending markets is already (and has for many years been) conducted under prudential regulation and is therefore not “shadow banking”. The workstream consequently focuses most attention on elements that fall outside of this. We agree this is important, to avoid confusion or conflict with prudential regulatory regimes. We hope that WS5’s policy recommendations will lead to a sound global regulatory framework, which will not unnecessarily restrict the valuable operation of these important markets, and which achieves a high level degree of harmonisation around the world. It is important that the FSB ensures that recommendations are implemented in a consistent way by national and regional authorities.

In terms of haircut policy we remain unconvinced that haircut practices in the repo and securities lending markets contributed materially to the crisis and believe that overly stringent regulation in this area might deter market participants from using these secured forms of transactions. Evidence from the crisis (gathered by bodies such as the CGFS) made it clear that the withdrawal of funding from some weakened institutions largely took the form of the withdrawal of credit lines and certain types of collateral becoming ineligible. A mandatory through-the-cycle haircut may therefore do little to prevent pro-cyclicality in another crisis. In support of this view we reference (i) the European Parliament's Economic and Monetary Affairs Committee's recently commissioned paper¹ on haircuts in these markets (which concludes that the case for mandatory minimum haircuts may be flawed); (ii) an article² published by the Federal Reserve Bank of New York which notes that there are systemic risks associated with the mandating of high haircuts in these markets (due to the perverse incentives they can create); and (iii) previous shadow banking research papers produced by the ERC³.

Nevertheless, we believe that the *intent* of the FSB's proposals for the regulation of haircuts appears broadly acceptable, although we have major concerns that the scope and application of the proposals as written could cause serious disruption to the repo and securities lending markets. We believe that the focus of these rules should be firmly on the financing of non-prudentially regulated entities, by banks and regulated broker dealers subject to prudential regulation and risk weighted capital charges. This approach has the advantage of focusing regulatory scrutiny on the regulated sector, making implementation and supervision more straightforward, but we believe that care is needed to ensure that the rules do not drive financing activity away from regulated firms. Whilst the numerical floor proposals are restricted in scope in this way, the recommendation for minimum standards for methodologies applies to all market participants and this may have some serious unintended consequences which we outline below. In our more detailed answers to Q5 and Q9 below we suggest some refinements to the proposals which we believe are consistent with the FSB's policy goals and which we believe, should avoid this disruption.

The question of margining on a portfolio basis is of far greater significance in the context of activities such as prime brokerage than it is for securities lending and repo activities. Accordingly, whilst we are aware that others are preparing appropriate comments, the Associations have decided not to express specific views on this point (in particular with respect to questions 6 and 12 in the consultation).

¹ http://www.europarl.europa.eu/RegData/etudes/note/join/2013/507462/IPOL-ECON_NT%282013%29507462_EN.pdf

² <http://libertystreeteconomics.newyorkfed.org/2013/08/are-higher-haircuts-better-a-paradox.html>

³ <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/icma-european-repo-market-reports-and-white-papers/shadow-banking-and-repo/>

We hope that our response to the consultation is helpful to you in finalising your work in this area. Our detailed responses to the consultation questions follow below and we follow this with some observations on the final policy recommendations which we hope will be helpful to you and authorities when considering their implementation. In addition we attach a copy of a white paper produced by the ERC entitled "Enhancing the transparency of the European repo market" which we reference elsewhere in our response.

As always we remain at your disposal should you require further information or assistance from us and our members.

Yours faithfully,



Kevin McNulty
Chief Executive
ISLA



Godfried De Vidts
Chairman
ICMA ERC

cc :

David Rule, Chair of FSB W55, regarding Shadow Banking Risks in Securities Lending and Repos, Prudential Regulatory Authority, Bank of England;

Andrew Hauser, Head of Sterling Markets Division, Markets, Bank of England;

Ulrich Bindseil, Director General, DG Market Operations, European Central Bank;

Daniela Russo, Director General, DG Payments & Market Infrastructure, European Central Bank;

Francesco Mazzaferro, Head of the ESRB Secretariat, European Systemic Risk Board;

Nadia Calviño, Deputy Director-General, DG Internal Market and Services, European Commission;

Patrick Pearson, Head of Directorate G (acting), Financial Markets, DG Internal Market and Services, European Commission;

Mario Nava, Head of Directorate H, Financial Institutions, DG Internal Market and Services, European Commission;

David Wright, Secretary General, International Organization of Securities Commissions.

Detailed Responses to the “Proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions”

Q1. Do the proposed policy recommendations in Annex 2 adequately limit the build-up of excessive leverage and reduce procyclicality? Are there alternative approaches to risk mitigation that the FSB should consider to address such risks in the securities financing markets? If so, please describe such approaches and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?

In our opinion, both the role that many deem haircuts to have played in amplifying the last crisis and the effectiveness of minimum haircuts in reducing procyclicality are debatable. A number of existing regulatory developments (such as Basel III and AIFMD in Europe) include provisions designed to directly limit the build-up of excessive leverage and thereby to reduce procyclicality. As a principle we believe that appropriately calibrated regulation that tackles leverage directly, rather than indirectly through imposing minimum haircuts on financing transactions, is a better way to address concerns.

Q2. What issues do you see affecting the effective implementation of the policy recommendations?

In general we believe that regulators should focus on developing transparency measures before looking to finalise and implement rules on haircuts. Whilst the second QIS should be more comprehensive, we are concerned about finalising policy in this area before regulators have had the benefit of reviewing more comprehensive data on the secured finance markets. At the point where policy is decided, sufficient time will be necessary for firms to adapt systems and develop methodologies, which may be different to those in use today or required by other regulation (such as Basel III), and to assess all counterparties in terms of the precise scope of the finalised proposals. Consideration will also need to be given to the ability of some counterparties to themselves adapt to transacting on a compliant basis.

Q3. Please address any costs and benefits, as well as potential material unintended consequences arising from implementation of the policy recommendations? Please provide quantitative answers, to the extent possible that would assist the FSB in carrying out a quantitative impact assessment. [Note: respondents may also consider participating in QIS2]

We believe that the FSB does not intend for the proposals to result in mandatory haircuts for either government bond or inter-bank repos, nor for “vanilla” securities lending transactions to be treated as financing transactions (and therefore subject to a haircut in favour of the securities borrower). Nevertheless, we believe that there is scope to interpret the proposals in ways that would have these effects (see Q5 and Q9). If this were to be the case the financing costs for governments and banks would increase and the size of the securities lending markets would be significantly reduced resulting in severe impacts on market liquidity.

Other regulatory developments⁴ (such as the CSDR in Europe and proposals under Basel III) are generally increasing the costs associated with the provision of liquidity and market making through repo and securities lending. If regulatory implementation of the FSB's recommendations on haircuts adds significantly to these costs a likely consequence would be that secured financing and lending activity would migrate away from the prudentially regulated sector. Notwithstanding policymakers' objectives to regulate the non-prudentially regulated sector we believe that the task of developing transparency and a harmonised framework for the regulation of these markets will be made significantly more difficult if banks are effectively prevented from acting as intermediaries.

Q4. What is the appropriate phase-in period to implement the policy recommendations? Please explain for (i) minimum standards for methodologies and (ii) the proposed framework for numerical haircut floors separately.

Please see our answer to Q2 above. As noted we believe that regulators should develop transparency measures and then, with the benefit of data and information, consider the implementation of policy measures for haircuts. In addition we believe that policy in this area should not be implemented earlier than corresponding measures for non-centrally cleared OTC derivatives and Basel III.

Q5. Are the minimum standards described in Section 2 appropriate to capture all important factors that should be taken into account in setting risk-based haircuts? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?

We believe that counterparty creditworthiness is an incremental factor that should be taken into account but otherwise think that the list looks comprehensive. Furthermore, we agree that price correlation between loaned securities and collateral should be taken into account as this can clearly serve to mitigate risk.

We are however very concerned that the proposals for minimum qualitative standards for haircut calculation methodologies, to be used by all market participants, could have serious unintended consequences. The proposal states that "Haircuts should be set to cover..." and then describes the factors that are to be used in the methodology. This raises two significant concerns in respect of alignment with current market practices, one for the government bond repo market and the other for the securities lending market:-

- i. The non-centrally cleared inter-bank government bond repo market has historically operated on a zero haircut basis. The Policy Document notes that transactions backed by government securities are excluded from the scope of numerical floors because price movement in these securities tend not to be pro-cyclical, and that imposing numerical floors on these transactions could have a large negative impact on the liquidity and functioning of core funding markets. We are concerned that the different and all-inclusive scope of the haircut calculation methodology proposals and the requirement that haircuts must be "set" in accordance with the methodology will result in an effective minimum floor for haircuts on government bond repo. Imposing a de-facto mandatory haircut on this business would raise costs for banks providing liquidity in government bond

⁴ <http://www.icmagroup.org/assets/documents/Regulatory/Other-projects/Avoiding-Counterproductive-Regulation.pdf>

markets and would ultimately increase financing costs of both governments and banks. We highlight that if firms which are subject to prudential regulation choose to conduct business with a haircut lower than suggested by risk based models, they must then allocate appropriate risk based capital to the transactions and this acts as an alternative brake to the build-up of leverage. We also reiterate that imposing haircuts in an inter-bank context has no net benefit for the system as a whole, since the effect of a haircut is to transfer risk between the parties.

- ii. The second concern relates to an adverse impact on the securities lending markets. As the FSB will be aware, the institutional investors that engage in the securities lending markets generally receive the benefit of a haircut on the collateral they receive (i.e. transactions are generally over-collateralised). Much investor protection legislation around the world (for example ERISA in the US and UCITS in the EU) does not permit the lending of securities unless the lender receives collateral to at least the same value as the securities being lent and the vast majority of investors require additional collateral as a condition of participating in securities lending programs. The proposals for numerical floors provide some exemptions for traditional securities lending arrangements to avoid disrupting the market. However, the scope of the proposals for minimum haircut calculation methodologies and the requirement that all participants “set” haircuts in accordance with the models, throws doubt on whether a bank can borrow securities from an investor and over-collateralise that investor. For example, if a UCITS fund lends equities to a bank and receives government bonds as collateral, the bank’s methodology is likely to suggest that the government bonds should be subject to a haircut which would result in the UCITS fund being “under-collateralised”. Institutional investors, such as UCITS would not lend securities on this basis (as they would not have the risk appetite and in any case would be barred from doing so by regulation).

The simplest way to avoid these negative effects would be to change the scope of covered transactions for the minimum standards for methodologies to be consistent with the proposed scope for numerical haircuts (i.e., exclude, among other things, certain securities loan transactions, transactions with banks, broker-dealers, other prudentially regulated entities and central banks, transactions involving government securities and centrally cleared transactions).

Q7. In your view, is there a practical need for further clarification with regard to the definition of proposed scope of application for numerical haircut floors?

We believe that there may be a case for entities other than banks and broker dealers to be considered “entities subject to regulation of capital and liquidity/ maturity transformation” and it will be important for the FSB and authorities to carefully consider which other entities might be included within this definition. For example, insurers will be subject to capital and liquidity rules in Europe under Solvency II, and certain funds are already, or are increasingly being, tightly restricted in terms of their liquidity and leverage risks. We would therefore ask that the FSB and national/ regional authorities provide more guidance as to which entities might be considered as falling within the definition of “subject to regulation of capital and liquidity/ maturity transformation”.

In addition, the scope of covered transactions as drafted in the current proposals is ambiguous because without further guidance it would be unclear whether a transaction is a covered securities financing transaction. While margin loans, repo and reverse repo are financing transactions and should therefore be in scope unless one of the exemptions applies (*i.e.*, borrower is a bank, broker-dealer or central bank, securities are government securities or the transaction is centrally cleared), securities loans require more nuanced rules because only a small portion of them are financing transactions.

To address this, in addition to the general exceptions described above, we propose that a cash-collateralised securities loan should be outside of scope of the framework if either (1) the lender of the securities reinvests the cash collateral meeting the minimum standards of Section 3.1 of the FSB framework or (2) the borrower uses the received securities to meet a current or anticipated demand (delivery obligation, customer demand, satisfaction of segregation requirement, etc.). On this point, please also see our response to Q13. Similarly, in case of a securities loan collateralised by other securities rather than cash (“borrow-pledge”, “collateral upgrade”), the transaction would be outside of scope of the framework if either the borrower or the lender uses the respective received securities to meet a current or anticipated demand (please see our response to Q15/16).

Q8. Would the proposed scope of application for numerical haircut floors be effective in limiting the build-up of excessive leverage outside the banking system and reducing procyclicality of that leverage, while preserving liquid and well-functioning markets? Should the scope of application be expanded (for example, to include securities financing transactions backed by government securities), and if so why?

The numerical floors for non-government securities should provide a conservative back-stop and provide some assurance against the build-up of excessive leverage outside of the banking sector. We also believe that it is appropriate that government bond securities financing transactions should be exempt from the numerical floor proposals.

We do however believe that the language used to exempt certain cash collateralised securities loans and collateral upgrade transactions needs further work to be fully effective (see answers to Qs 13, 14 and 15).

Q9. In your view, what would be the impact of introducing the numerical haircut floors only on securities financing transaction where regulated intermediaries extend credit to other entities? Does this create regulatory arbitrage opportunities? If so, please explain the possible regulatory arbitrage that may be created and their impact on market practices and activity.

We believe there is a risk that the policy recommendations may lead to greater secured financing activity directly between non-prudentially regulated entities. Notwithstanding the fact that policymakers are endeavouring to regulate the non-prudentially regulated shadow banking sector it would seem counter-productive to encourage these markets to move in this direction through regulation. We believe this risk can be mitigated through modification and clarification of the proposals as outlined in this response.

Q10. In your view, would the proposed levels of numerical haircut floors as set out in table 1 be effective in reducing procyclicality and in limiting the build-up of excessive leverage, while preserving liquid and well-functioning markets? If not, please explain the levels of numerical haircut floors that you think are more appropriate and the underlying reasons.

We believe that both the scope and proposed levels for numerical floors are appropriate.

As the vast majority of secured financing market activity is currently undertaken or facilitated by banks and broker dealers, the activity is potentially more straightforward for authorities to monitor and regulate. Nevertheless, should the numerical floors be set at higher levels, this might drive secured financing activity to occur directly between non-prudentially regulated entities.

Q11. Are there additional factors that should be considered in setting numerical haircut floors as set out in table 1? For example, should “investment grade” or other credit quality features be factored in?

As the floors are set at back-stop levels (which we believe are appropriate) we do not believe that there is any reason to complicate the table. If the floors were at higher levels there would be a need for the table to include more specifically defined asset types and quality (such as credit ratings and instrument types). Authorities should make emphatically clear that these are minimum floors, in order to mitigate the risk that they become regarded as the accepted market levels.

Q13. What are your views on the merits and impacts of exempting cash-collateralised securities lending transactions from the proposed framework of numerical haircut floors if the lender of the securities reinvests the cash collateral into a separate reinvestment fund and/or account subject to regulations (or regulatory guidance) meeting the minimum standards? Do you see any practical difficulties in implementing this exemption? If so, what alternative approach to implementing the proposed exemption would you suggest?

As the vast majority of cash collateralised securities lending is not financing (the cash received by the lender is treated as collateral for the loan of securities), it is important that this type of transaction is not in scope. Cash is a very effective form of collateral and it is estimated that approaching 50% of all transactions in the global securities lending segment are collateralised with cash. In some parts of the world lenders are actively encouraged to accept cash by regulation. In securities lending transactions lenders expect to receive the benefit of a haircut on the collateral they receive (for reasons noted earlier). If the securities lent against cash were to be subject to a haircut, lenders would not lend securities and market liquidity and efficiency would suffer.

In terms of requiring cash collateral to be reinvested in accordance with the FSBs minimum standards (to avoid being treated as a financing transaction) we believe that this may have some merit, however the implementation of this will create considerable practical difficulties and the FSB should consider whether its policy objectives could be achieved in a more proportionate way. (We include some thoughts below on how this might be achieved).

To illustrate the concern, the proposed policy would require the collateral giver to know how the cash will be reinvested by the lender in order to determine whether the transaction is within scope or not. Whilst the collateral giver might be given a representation from the lender about the treatment of cash, he has no way of actually monitoring what has happened, to ensure the lender is complying with the policy recommendations for cash collateral reinvestment. In addition, if the collateral receiver invests cash outside of the policy recommendations, he will need to identify to which specific securities lending transaction that portion of the cash applies. As cash is fungible this will be problematic. For example, if the lender after receiving the cash collateral were to make a payment, the lender may not be able to practically determine which cash it used for the payment – the cash posted to the lender as collateral or any other cash. Furthermore, even if we assume that the lender is accurately able to identify the cash with a specific securities loan, the use of the collateral may switch during the lifetime of that loan.

Whilst we understand the FSB's policy objectives in this area we believe that further consideration should be given as to how best to achieve this. Implementing the policy as written is practically difficult and risks significant disruption to the cash collateralised securities lending market.

Accordingly, the cash collateral giver should be entitled to rely on representations from the securities lender as to whether the cash will be reinvested in accordance with the FSB's criteria. In addition, and to more effectively alleviate the implementation challenges outlined above, we believe that solely considering how the cash collateral is used by the lender is not sufficient. The use of the securities by the borrower is also a significant factor. If the transaction is driven by the demand of the borrower for the specific securities (to meet a delivery obligation, customer demand, or segregation requirement, etc.), the transaction is not a financing transaction – regardless of how the lender uses the cash collateral.

Accordingly, we propose that a cash-collateralised securities loan should be outside of scope of the framework if one of the following applies:

- i. the lender of the securities reinvests the cash collateral meeting the minimum standards of Section 3.1 of the FSB framework; or
- ii. the borrower uses the received securities to meet a current or anticipated demand.

This suggested approach would be consistent with the regulatory approach in the U.S., which focuses on the permitted use by the borrower of the securities (as opposed to the use of the cash by the securities lender) as the means to prevent the parties from circumventing U.S. broker-dealer regulatory minimum margin requirements under Regulation T. The general exception should continue to apply (*i.e.*, borrower is a bank, broker-dealer, other prudentially regulated entity or central bank, securities are government securities or the transaction is centrally cleared).

Q14. Do you think cash-collateralised securities borrowing transactions where the cash is used by the securities lender to meet margin requirements at a CCP should also be exempted from the proposed framework of numerical haircut floors?

We believe this use of cash collateral should be exempted as we do not believe that it contributes to overall system leverage and will enhance buy side firms' ability to use CCPs. We are mindful however of the FSB's concerns about liquidity risk and would suggest that this use of cash collateral should be referenced within the standards for cash collateral reinvestment, with a requirement that the cash investor is mindful of the liquidity risks inherent in depositing cash with a CCP.

Q15. What are your views on the proposed treatment of collateral upgrade transactions described above? Please explain an alternative approach you think is more effective if any.

Our main concern with the proposal relates to the scope of the exemption for certain securities lending transactions (see answer to Q16).

Q16. What are your views on exempting collateral upgrade transactions from the proposed framework of numerical haircut floors if securities lenders are unable to re-use collateral securities received against securities lending and therefore do not obtain financing against that collateral?

In the same way that cash collateral securities lending transactions should be exempted so should securities lending transactions where the lender receives "higher quality" collateral against the loans. The proposed wording of the exemption for securities lending transactions however needs modification in order to be effective. This states that to be exempt from application of the numerical floors the collateral receiver must be "unable" to use the "higher quality" securities transferred as collateral. In many jurisdictions securities lenders receive full title to the collateral (for example under the GMSLA) which affords them a high degree of protection and legal certainty. In this case the lender has the legal right to re-use the collateral but in most cases does not. Placing restrictions on a lender's right to re-use collateral creates a high degree of legal risk (e.g. that the transaction could be recharacterised and the non-defaulting party's rights weakened). We accept that our proposed change creates some complexity in the implementation of the policy but the issues will be broadly the same as for the exemption from scope for certain cash collateralised transactions. A failure to make this change would have a very significant effect on the securities lending market in Europe.

To help with this problem, as a minimum we believe that the wording of the exemption should be changed from "is unable to re-use" to "has agreed not to" (use the collateral) and the borrower should be permitted to rely on representations from the lender to this effect. Furthermore, analogous to cash-collateralised securities loans, implementation for the market and authorities would be more straightforward if non-cash collateralised securities loans were outside of scope of the framework if the borrower uses the securities to meet a current or anticipated demand.

In addition, for the same reasons expressed in our answer to Q14 we believe that re-use of collateral for margining CCP transactions should also be specifically exempted from the scope of numerical floors.

Q17. What do you view as the main potential benefits, the likely impact on market activities, and possible material unintended consequences on the liquidity and functioning of markets of introducing the proposed framework of numerical haircut floors on securities financing transactions as described above?

We have made a number of suggestions in this response which we believe are important in order to avoid adverse impacts on market activities and possible unintended consequences.

Q18. Would implementing the proposed numerical haircut floors through regulatory capital or minimum margin regimes for regulated intermediaries be effective in reducing procyclicality and in limiting the build-up of excessive leverage by entities not subject to capital or liquidity regulation?

Focusing on the “indirect” regulation of other entities by implementing rules aimed at regulated entities should make implementation of the proposals more straightforward. We also agree that final proposals in this area should not be created until a more comprehensive QIS is completed which considers the costs and benefits of introducing floors, and after the implementation of transparency measures which will allow for the monitoring of market activity.

Should authorities retain powers for raising numerical floors as a macro-prudential tool, the circumstances in which such powers may be used should be clearly articulated and appropriately constrained; and a full evaluation of the impacts (including the potential for unintended consequences, such as increasing procyclicality or driving activity further from the prudentially regulated sector) should be made. We believe there is considerable risk of promoting procyclicality through the use of such measures.

Q19. Are there specific transactions or instruments for which the application of the proposed framework of numerical haircut floors may cause practical difficulties? If so, please explain such transactions and suggest possible ways to overcome such difficulties.

As mentioned previously requiring banks acting as borrowers in collateral upgrade transactions or cash collateral securities lending transactions to effect numerical floors based upon the actions of their counterparties does raise significant practical difficulties.

Q20. What would be an appropriate phase-in period for implementing the proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions? Please explain for (i) minimum qualitative standards for methodologies and for (ii) numerical haircut floors separately.

We believe that the phase in of any regulatory framework governing haircuts for secured financing transactions should follow some time after the implementation of the transparency proposals as suggested in this response. This will enable regulators to better consider the implications of any proposals, with the prior benefit of a period of data observation. In addition policy recommendations should not be implemented ahead of analogous measures for the regulation of non-centrally cleared derivatives transactions or Basel III.

Comments by the Associations on the Policy Recommendations

Recommendation 1: Authorities should collect more granular data on securities lending and repo exposures amongst large international financial institutions with high urgency. Such efforts should to the maximum possible extent leverage existing international initiatives such as the FSB Data Gaps Initiative, taking into account the enhancements suggested in this document.

We remain supportive of authorities obtaining the data needed to understand exposures amongst large international financial institutions, and note the FSB's acknowledgement of existing sources of data for these markets (such as the ICMA European repo market survey and data collected by commercial data companies). The Associations have been involved in discussions with the ECB, ESRB and BoE and will be happy to engage in further dialogue to assist with the provision of data.

We agree that the collection of more granular data on large exposures should be a higher priority than the development of detailed trade data reporting (which will be both complex and costly to implement) and suggest that authorities explore what data would be useful by initially conducting market surveys. This approach has the benefit of a shorter lead-time to implementation (as opposed to a data repository) and will ensure that future developments are focused on obtaining useful information. In this regard we would draw the FSB's attention to a white paper recently published by the ERC, "Enhancing the transparency of the European repo market"⁵ which expands on this point and which is also relevant to our thoughts on Recommendations 2, 3 and 4.

Recommendation 2: Trade-level (flow) data and regular snapshots of outstanding balances (position/stock data) for repo markets should be collected. Regular snapshots of outstanding balances should also be collected for securities lending markets and further work should be carried out on the practicality and meaningfulness of collecting trade-level data. Such data should be collected frequently and with a high level of granularity, and should also capitalise on opportunities to leverage existing data collection infrastructure that resides in clearing agents, central securities depositories (CSDs) and/or central counterparties (CCPs). National/regional authorities should decide the most appropriate way to collect such data, depending on their market structure, and building on existing data collection processes and market infrastructure where appropriate. Trade repositories are likely to be an effective way to collect comprehensive repo and securities lending market data. Regulatory reporting may also be a viable alternative approach.

Whilst a recommendation for trade-level data or position data for repos and securities lending is consistent with existing initiatives for derivatives markets, it is not yet clear to us that the benefits of these outweigh the substantial costs involved. We therefore believe that authorities should consider carefully the costs and benefits of such reporting arrangements and in particular should look to learn from the apparent challenges of implementing such trade repositories for OTC derivatives before creating new requirements for repos and securities lending.

⁵ A copy of the ERC white paper "Enhancing the transparency of the European repo market" is appended in full to this response.

In light of the above and as suggested in the white paper previously mentioned, we believe that authorities' needs will be better served through the early implementation of enhanced position data surveys. Furthermore, we perceive a significant distinction between periodic position data reporting and transaction data reporting, as the former would be far easier to introduce and is likely to meet most of the needs in relation to systemic risk management. Any incremental benefit of the latter may well be outweighed by the significant extra burdens that transaction data collection would imply.

We would also urge authorities to work together to avoid duplication of data collection between any data repositories and other regulatory reporting needs.

Recommendation 3: The total national/regional data for both repos and securities lending on a monthly basis should be aggregated by the FSB which will provide global trends of securities financing markets (e.g. market size, collateral composition, haircuts, tenors). The FSB should set standards and processes for data collection and aggregation at the global level to ensure consistent data collection by national/regional authorities and to minimise double-counting at the global level.

As previously communicated the Associations remain at the FSB's disposal to work with the Technical Data Experts Group in establishing standards. When considering standards and processes authorities will need to provide assurance that data provided will, at all times, be properly protected and be treated as confidential (unless there is specific prior agreement to the contrary).

Recommendation 4: The Enhanced Disclosure Task Force (EDTF) should work to improve public disclosure for financial institutions' securities lending, repo and wider collateral management activities, taking into consideration the items noted above.

We note that the Policy Document recommends that the Enhanced Disclosure Task Force ("EDTF") considers expanding their disclosure recommendations relating to collateral management activities. We are strongly supportive of the EDTF and its achievements to date and we believe that the EDTF can play a key role in bridging potential gaps between standardised minimum regulatory disclosure requirements and dynamic disclosure reflective of current market situations and user needs. We understand that the EDTF is considering this request from the FSB in the context of EDTF's existing recommendations and is expected to conclude on its views both for this specific ask, as well as considering its role in these matters more broadly, at its forthcoming meeting in early December. We are supportive of an industry led response to Recommendation 4 and will respect the collective view of the EDTF on this proposal.

Recommendation 5: Authorities should review reporting requirements for fund managers to end-investors against the FSB's proposal, and consider whether any gaps need to be addressed.

We agree fully that fund managers who engage in securities lending or repo should disclose information about their activities to their clients. Existing regulations exist in this area such as for UCITS funds which require the disclosure of quite detailed information about their securities lending activities. As authorities look to implement the policy recommendation they should be mindful that reporting of securities lending and repo activity is commensurate with other matters of interest to investors.

Recommendation 5 includes suggestions as to what could be reported by managers, including some items that go further than UCITS requirements. A prescriptive requirement to report too much detail could lead to annual reports becoming unduly long/complex, and ultimately less effective in conveying key messages for all but the most sophisticated investors.

Recommendation 6: Regulatory authorities for non-bank entities that engage in securities lending (including securities lenders and their agents) should implement regulatory regimes meeting the minimum standards for cash collateral reinvestment in their jurisdictions to limit liquidity risks arising from such activities.

Cash is an important and very desirable form of collateral for securities lenders. Regulation in this area should be aimed at ensuring that risks are understood and managed, whilst at the same time not creating a regime that effectively removes cash as an option. We believe that the policy recommendations generally meet this objective, but careful attention will need to be given by authorities as to how these are implemented. The recommendations permit lenders to assume some maturity mismatch risk, whilst requiring careful management of liquidity risks. Although not strictly addressed in the recommendation, securities lenders should have the choice to implement cash collateral reinvestment strategies, compliant with the standards, through both fund and segregated account structures.

Securities lenders however should be allowed to use cash for other purposes (such as margin for derivatives transactions), provided that the liquidity risks are understood and managed. (See also our response to Q14 above.)

Recommendation 7: Authorities should ensure that regulations governing re-hypothecation of client assets address the following principles:

- Financial intermediaries should provide sufficient disclosure to clients in relation to re-hypothecation of assets so that clients can understand their exposures in the event of a failure of the intermediary;***
- In jurisdictions where client assets may be re-hypothecated for the purpose of financing client long positions and covering short positions, they should not be re-hypothecated for the purpose of financing the own-account activities of the intermediary; and***
- Only entities subject to adequate regulation of liquidity risk should be allowed to engage in the re-hypothecation of client assets.***

We agree that the terms “rehypothecation” and “re-use” have not historically been consistently defined and believe that the FSB’s definition of these is a good one. Authorities should be mindful of the distinctions that exist between the two when considering regulation.

Recommendation 8: An appropriate expert group on client asset protection should examine possible harmonisation of client asset rules with respect to re-hypothecation, taking account of the systemic risk implications of the legal, operational, and economic character of re-hypothecation.

We have no specific comment on this recommendation.

Recommendation 9: Authorities should adopt minimum regulatory standards for collateral valuation and management for all securities lending and repo market participants.

We welcome this recommendation and note that both Associations have published best practice papers^{6,7} covering marking to market and margining for repo and securities lending transactions, which are widely adopted. We believe that the standards suggested, including the daily marking to market of collateral (and lent positions) and the daily collection of variation margin, represent best practice.

Recommendation 10: Authorities should evaluate, with a view to mitigating systemic risks, the costs and benefits of proposals to introduce CCPs in their inter-dealer repo markets where CCPs do not exist. Where CCPs exist, authorities should consider the pros and cons of broadening participation, in particular of important funding providers in the repo market.

We agree with the FSB that, for much of the activity in these markets, the pros and cons of using CCPs are balanced. A high proportion of the repo market is centrally cleared and CCP options have quite recently been introduced for the securities lending market. According to the ECB's "Euro Money Market Survey 2013", "71% of all bilateral repo transactions were cleared by central counterparties (compared with a revised figure of 56% in 2012)".

Recommendation 11: Changes to bankruptcy law treatment and development of Repo Resolution Authorities (RRAs) may be viable theoretical options but should not be prioritised for further work at this stage due to significant difficulties in implementation.

We fully support the FSB's position and agree that these options should not be prioritised at this stage.

ⁱ Since the early 1990's, the [International Capital Market Association](#) (ICMA) has played a significant role in promoting the interests and activities of the international repo market, and of the product itself. The ICMA [European Repo Council](#) (ERC) has become the industry representative body that has fashioned consensus solutions to the emerging, practical issues in a rapidly evolving marketplace, consolidating and codifying best market practice. The discussions that take place at the ICMA ERC meetings underpin the strong sense of community and common interest that characterises the professional repo market in Europe.

ⁱⁱ The [International Securities Lending Association](#) (ISLA) is a trade association established in 1989 to represent the common interest of participants in the European securities lending market. It has 90 members comprising insurance companies, pension funds, asset managers, banks and securities dealers.

⁶ <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/repo0/>

⁷ http://www.isla.co.uk/images/PDF/BestPractice/market%20to%20market%20for%20equity%20loans_2009.pdf

APPENDIX TO ISLA/ERC FSB CONSULTATION RESPONSE



ICMA EUROPEAN REPO COUNCIL

16 October 2013

ICMA European Repo Council White Paper

Enhancing the transparency of the European repo market

Introduction:

The purpose of this White Paper is to summarise the current work of the International Capital Market Association's ("ICMA's") European Repo Council ("ERC") to develop its thinking concerning the appropriate way in which to enhance transparency in respect of the European repo market, whether that may be through the establishment of a repo data repository ("DR") or otherwise.

Background to the ERC:

The ERC was established by ICMA in December 1999, to represent the cross-border repo market in Europe. It is composed of the vast majority of practitioners in this market, who meet regularly to discuss market developments in order to ensure that practical day-to-day issues are fully understood and dealt with adequately. To ensure the flow of adequate information twice yearly ICMA ERC General Meetings are organised, which are widely attended. The appendix to this White Paper briefly elaborates on the ICMA ERC's efforts to build and sustain the European repo market; including through the publication of ICMA's bi-annual survey of the European repo market, which for more than 12 years has provided a measure of transparency in respect of the size and evolution of the market.

Overall commentary:

The ERC notes that, notwithstanding the public availability of ICMA's bi-annual survey of the European repo market¹, there is scope to enhance transparency of the market – both in the context of information made available for the benefit of public authorities and, on a more limited basis, in the public arena.

This is a topic of much current discussion, including in the context of official initiatives on repos and securities lending which are being pursued as part of the shadow banking project designed to ensure the completeness of financial regulatory reforms responsive to the financial crisis. The move to a market based upon secured, rather than unsecured, financing has also prompted close attention to this topic on the part of the central banking community.

Repo data repositories – the state of play:

The ERC has taken stock of a number of different published documents pertinent to this topic. Some details differ between these, yet there are also a number of common elements. Drawing upon the ERC's document review, a summary of the state of play is included in Annex A below. The simple comparative table included in Annex A highlights how the European Systemic Risk Board's ("ESRB's") March 2013 proposals are the most granular, moving to a level of detail somewhat beyond that in the most recent Financial Stability Board ("FSB") paper (August 2013) – which itself went a little further than the fairly consistent set of data attributes suggested by earlier Federal Reserve Bank of New York ("FRBNY"), FSB and European Central Bank ("ECB") papers.

Issues about a repo data repository in need of further discussion:

The ERC strongly believes that there needs to be in-depth discussion of a wide range of issues about a potential repo DR. Whilst there are no doubt even more detailed questions which may have to be explored at some stage, a summary of the main issues currently identified by the ERC is presented in Annex B below. There will be significant costs to providing data, but the ERC recognises that there is the potential, in time, for market efficiency benefits related to trade-matching and reconciliation; and more efficient regulatory reporting requirements.

Considering product coverage, the ERC believes that the essence of the market will be captured if repo reporting requirements are taken to also encompass buy-sellback/sell-buyback; borrow vs. cash/loan vs. cash; and fee-based borrow/fee-based loan transactions (some of which may be traded under Global Master Securities Lending Agreement ("GMSLA") – the securities lending market's equivalent of the Global Master Repurchase Agreement ("GMRA") – rather than under GMRA itself). Seeking to also capture other transactions such as secured loans and pledges would not currently add much extra value (other than to avoid incentivising such alternatives, by virtue of their then having lower reporting burdens).

Where possible, data should be taken from electronic systems such as automatic repo trading systems (ATS), central counterparties (CCP), third-party affirmation systems and tri-party repo agents. These institutions may cover as much as two-thirds of the European repo market. Use of these sources will of course require controls to eliminate duplication in reporting. However, it is doubtful that securities settlement systems (including T2S) will be able to add useful data.

There is a concern about the possible temptation to call for the widest conceivable data sets, with the idea that "data mining" may reveal important facts – when such an approach is more likely to lead to data overload and opaqueness. More data will not automatically and linearly translate into a better understanding of the structure and evolution of the market. One of the lessons from the crisis is that some already existing and useful sources of market data were not used. The extent of data requests need to be considered, proportionate and targeted. From experience of the semi-annual repo survey, the ERC is also aware that the interpretation of data is the greatest challenge. It will therefore remain important that there continues to be close consultation between the industry and regulators.

The ERC considers that if there is to be a DR for repo it would be ideal from an oversight perspective to just have one globally, but this would be operationally challenging. Allowing instead for Europe, Middle East and Africa ("EMEA"); Asia-Pacific ("APAC"); and North America DRs would accommodate varying legal, compliance and regulatory issues which exist in each local region, but pragmatically it may prove that it is most practical to consider having repo DRs per currency or currency block, or, in the case of the EU, a regional coverage. Having multiple DRs will require a global aggregator.

Notwithstanding the above, the ERC considers, particularly if the repository data were transaction based, that instances of data having to be provided to multiple repositories would be hard to avoid, owing to cross border and cross currency transactions or collateral movements.

The ERC is concerned that the provision of transaction-level data gives rise to important questions regarding access levels, transaction data capture and confidentiality, but presuming these can be suitably resolved (which links to questions regarding a) the appropriate governance model for a repo DR; b) the method and responsibility for data submission; and c) data security) the collection of transaction data would be possible. If transaction data is appropriately gathered into a DR, either the DR or the supervisory authorities should then be able to combine this data to create necessary position data information; and accordingly the ERC would not support being required to provide both transaction and position level data. Using a DR to aggregate transaction-level data into position data would also reduce a major source of errors; given the difficulties of ensuring contributors interpret categories consistently.

The ERC is very strongly of the opinion that if transaction-level data is collected in a DR this data should then be used to satisfy as many regulatory reporting needs as possible. A very considerable volume of data on repo transactions is already collected in the EU from credit institutions through national supervisory reporting requirements based on the Financial Reporting (FINREP) framework and there is also significant additional reporting. There is no reasonable case for firms having to provide transaction-level data and separately report data that is derivative of this. Moreover, a trade-off between DR and other reporting requirements would help to ensure strong support for a DR across the industry. Hence, the ERC believes that a process should be established to identify and remove pre-existing reporting requirements that can prospectively be met by use of DR data (the ERC notes that this concept is already being recognised in the work of the European Securities and Markets Authority (“ESMA”), which is seeking to allow for the elimination of prior transaction-reporting obligations for derivatives as new, more extensive, reporting to derivatives’ trade repositories comes into force).

The more data that is to be monitored, the more work it will be to provide it and the harder it will be for the stakeholders to consume it; and to extract the data elements and trends that they require. Hence, the ERC sees that it would be sensible to firstly capture what is most urgently needed in order to monitor material risks; and then, if experience shows there is still a need to go further, build on this over time. Some data on transactions are not currently centrally compiled by many firms and will take time, and not inconsiderable investment, to mobilise (at a time, when huge demands are being placed on finite IT resources). It will be particularly challenging to provide information regarding life-cycle events (e.g. collateral substitution) and it is not clear that such events are especially significant.

Albeit that it would not provide transparency regarding smaller firms who may be running repo positions which are inappropriate in the context of their other balance sheet positions, the ERC believes there is a good case for starting by focusing reporting on those with regular and significant involvement in the repo market; as this will present a suitable picture of the market’s overall health. The ERC notes that its bi-annual repo survey has captured the majority of the major repo-active banking entities, but not all, whereas the regulatory community will be able to ensure full compliance by mandating the participation of all relevant institutions. Furthermore, whilst there will no doubt be an understandable interest in capturing daily data, the initial burdens associated with this will be significant, so the ERC considers that there is a case for starting with a more measured approach, such as the timely reporting of weekly data.

Early guidance would be helpful to the industry on whether data submissions to a DR would need to be matched before submission or whether the DR might offer that functionality. If third-party trade-matching agents will be required, what regulatory requirements will they have to meet?

The ERC's perspective on surveys, position data and transaction data:

Annex A includes a short note of the FSB Workstream 5 ("WS5") August 2013 "Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos", which includes five finalised recommendations related to improvements in transparency; and discusses the quite detailed proposals made in the ESRB's March 2013 paper on market transparency. In light of these papers and considering the issues already highlighted in the section of this paper above, the ERC considers that there is a strong rationale to proceed promptly with official market surveys. Following from this the ERC sees a good case for the development of data repositories to capture position data in respect of securities financing transactions ("SFTs"), but believes that the jury is still out regarding whether there should have to be data repositories capturing transaction data in respect of SFTs.

The ERC perceives that there are solid grounds for arguing that position data is adequate for monitoring systemic risk and providing transparency in the SFT markets. These arguments are set below.

Most importantly, at this stage, using position data probably offers the quickest results. The ERC feels that the FSB should be receptive to this argument as, in November 2012, WS5 recommended a set of (mandatory and comprehensive) market-wide surveys – which means position data – to be run by national/regional authorities but co-ordinated by the FSB, to quickly increase market transparency and inform the design of data repositories (although WS5 did concede that some authorities may decide that a survey would suffice). The ERC is supportive of this recommendation and seeks to help focus thinking on this by offering a questionnaire as a basis for discussion. An initial draft proposal is described below to illustrate the ERC's preliminary line of thought, but the ERC wishes to reserve the right to further develop this in order to properly represent an agreed, collective market view.

The ERC considers that the attraction of a questionnaire-based survey is that it is able to yield a comprehensive picture of the market in a very short space of time. In contrast to a data repository, there should not be major legal issues and it is a relatively cheap way in which to progress. The ERC believes that it would also provide the FSB, national regulators and reporting firms with useful experience and be good range-finding exercise for the work still needed to design a data repository. The ERC observes that there have been difficulties experienced with derivatives trade repositories and the Russian repo repository reporting requirement (which is separately elaborated on further below). The ERC proposes that such a survey should run for a couple of years in order to build up the necessary experience.

The ERC anticipates that the survey should be followed by permanent data repositories collecting position data rather than transaction data.

The ERC feels that position data should satisfy the primary aim of the FSB, which is "more granular data on securities lending and repo exposures amongst large international financial institutions" to detect "concentrations of risk, such as large exposures to particular institutions and heavy dependence on particular collateral asset classes". The ERC believes that this calls for position data, not transaction data.

It appears to the ERC that, in its August 2013 paper, the FSB exaggerates the benefits of transaction data. The ERC asserts that transaction data was not needed to highlight the propensity of lenders in the US tri-party repo market to run. Traditional concentration ratios would have revealed this risk. Similarly, liquidity/maturity transformation and relative amounts of different types of collateral would have been revealed by position data.

Furthermore, the ERC feels that position data should also be able to meet the requirements of the ESRB, which stated, in March 2013, that “the monitoring of individual transactions is not critical for its financial stability objective”. The ESRB detailed the main benefits of a repository of position data (as opposed to transaction data) as likely to include lower running costs, being more straightforward to set up and avoiding the need for the repository to have to aggregate data, but allowing adaptable analytical overlays to be constructed that would be similar to those available with transaction data. It also noted that the collection of transaction data might be complicated because some of the commercial terms of certain SFTs (e.g. collateral) are not determined at the point of trade or are subject to change post trade.

In contrast, the ERC does not see that the case for transaction data has yet been convincingly made by the authorities. The ESRB suggests that granularity at transaction level could be useful for micro-prudential supervision, such as detecting market abuse, and for recovery and resolution plans. But transaction data for micro-prudential supervision (and recovery and resolution) is already collected where it is needed, i.e. for SIFIs. Moreover, it is not altogether clear to the ERC that transaction data is required for micro-prudential supervision. The ESRB argued that, “it is critical for micro-prudential supervisors to assess a firm’s reliance on SFTs for funding and maturity transformation, as well as an institution’s concentration of exposure to counterparties, collateral and fire-sale risks, especially given that these may trigger a firm’s failure”. The ERC perceives that all of these risks can be adequately measured with position data, which thus appears entirely suitable for firm-level supervision.

The ERC also highlights that, on the other hand, it would be difficult to collect data at transaction level for securities lending. The ESRB notes that, “It is also important to acknowledge that market practices in some SFT market segments could prevent from collecting data on a transaction basis in a meaningful manner. For instance this could be the case when collateral is managed on a pooled basis, as can occur with some securities lending or some repo transaction”. Meanwhile, the FSB has stressed the need for the consistent measurement of repo and securities lending in order to avoid reporting-driven switching.

The ERC acknowledges that its inclination to prefer the use of position data does then mean that it is arguing in favour of a lower cost approach. However, since the ERC feels that there are good reasons to promote the use of position data in meeting the authorities’ needs, the ERC feels that if there is nevertheless official desire to push towards a requirement based on transaction data there is a justifiable case for the ERC to insist upon a proper cost-analysis of transaction versus position data. Just how much incremental regulatory value would finer granularity yield? It appears to the ERC that the case for transaction data is in large part limited to speculation that such data might be “interesting”, but academic research cannot alone justify the extra costs of transaction data collection.

The ERC observes that the ESRB does seem conscious of the high cost of collecting transaction data, inasmuch as it has stated that “implementing a trade repository could involve high costs” and suggested that, in order to justify the cost, a transaction-reporting data repository should probably be designed to provide more than just surveillance (it might, for instance, be fully integrated into the SFT post-trade value chain by supporting trade matching/confirmation or legal certainty if market

participants and authorities were to consider that this would add value). Unfortunately, however, that is for now as far as the ESRB's consideration of cost goes.

The ERC sees that, inevitably, non-trivial reporting costs would have to be passed on to customers, which would affect market liquidity by raising the cost of intermediation. The impact of very granular reporting requirements on market efficiency would also be felt at a time when finite and already stretched IT budgets already face the challenge of meeting many other new and uncoordinated regulatory requirements. It is quite possible that business lines that are subject to the most detailed reporting requirements (such as SFT) might be squeezed out of business models. There is therefore considerable scope for unintended macro-economic and market consequences.

The ERC feels that it is important to bear in mind that there would also be a high cost to regulators in terms of the direct costs of processing high volumes of data, opportunity costs (distraction), the practical difficulty of interpreting highly granular data (with the risk of not seeing the wood for the trees) and the challenges of aggregating atomic data into meaningful information. Demands for more granular data would also mean longer lead times until functioning reporting systems could be put in place and made to operate efficiently.

The ERC recognises that a further argument for position data has been provided by the ESRB, who noted that "most of the key risks to financial stability arising from SFTs tend to build up gradually". In other words, trends are more important than isolated events. But the ERC feels that this means that more highly aggregated data should be quite capable of alerting regulators to emerging issues well in advance. While more aggregated data categories may not allow the immediate identification of the precise source of a significant change in one or more of the categories, there should be adequate time to initiate focused enquiries.

The ERC would also argue that the precision allowed by transaction data is simply not needed given the scale of global or regional flows.

Moreover, more aggregated data has the advantage of minimising problems of classification. The more granular the data, the more difficult it becomes to allocate assets. And the effort to classify is subject to rapidly diminishing returns, easily becoming a distraction rather than an aid. The ERC highlights that, in this respect, the ESRB is on weak ground in suggesting (Table A2 of its Occasional Paper No.2 of March 2013) that "In the long run, data should be granular enough to capture new instruments..." It is an impossible task to predict innovation in detail; and in practice, new instruments can adequately be detected in unusual changes in existing categories (e.g. evergreen repos have swelled the standard category of open repos), even in case such a change is falls within whatever is the residual category.

It seems to that ERC that the sub-text of proposals for very granular data seems to be that very detailed statistical reporting will provide all the answers that a regulator may want. But the ERC believes that this would not be case in practice. Useful interpretation of SFTs requires a good understanding of the market and the many dimensions to these instruments (particularly their operational and legal characteristics). As has been experienced in the case of risk measured using VaR, seemingly precise numbers can give a dangerous illusion of perfect measurement. The ERC would suggest that requiring very granular data risks encouraging a culture of data mining and academic research detached from the realities of the market.

If, notwithstanding the above ERC reasoning, the authorities insist on proceeding directly to transaction-level data repositories, the ERC considers that:

- If transaction data is to be collected, then there is no valid case for also asking for position data. Unfortunately, the FSB is suggesting both transaction and periodic position data reporting.
- There should be a trade-off with current regulatory reporting requirements to eliminate duplicative reporting.
- There needs to be an audit of the regulatory usage of transaction data in case more data is demanded in the future.
- Very firm safeguards would be needed to protect confidentiality.
- Transaction data should not include life-cycle events such as margining, manufactured payments or substitution. Events such as substitution are not material, e.g. in tri-party repo, the rate has been estimated at around 5%.

ERC proposal for a questionnaire:

The first questionnaire illustrated in Annex C of this paper represents the ESRB's implied "ideal". It is based on the work published by the ESRB in its March 2013 Occasional Paper No.2. The table in Annex C summarises the ESRB's analysis of what position data it felt would be needed to monitor the systemic risks of SFTs. The requirements were elaborated in the tables in the appendices to its paper.

In the ERC's view, the ESRB's ideal questionnaire is significantly over-specified in places. So, a second more "proportionate" questionnaire, as illustrated in Annex C of this paper, has been drafted to take account of the problems identified by the ERC with the ESRB's analysis. These perceived problems are discussed below. However, the ERC in fact feels that the questionnaire could perhaps be quite reasonably stripped down further and accordingly the ERC wishes to reserve the right to examine this aspect in order to properly represent an agreed, collective market view.

- Geographical and currency coverage

The ESRB appears to recognise that micro-granularity is unnecessary when it is discussing the degree of aggregation needed for asset type and credit quality, but not for geographical distribution and currency (ESRB, table 3). Thus, it suggests a breakdown of business by each and every country. The ERC believes that this is impractical given the number of countries and the importance of anonymous trading; pointless given the minute amounts of business done with most countries; and misleading given that many counterparties are parts of global entities. It should be sufficient to give a breakdown by sub-region, e.g. EU, eurozone, non-eurozone EU, etc.

In terms of currency, the ESRB has identified (ESRB, table 3) the "most-traded" currencies as including USD, EUR, JPY, GBP, AUD, CHF, CAD, HKD, SEK, KRW, NZD, SGD, NOK, MXN and INR. The ERC considers that this is far too wide. The ICMA survey data suggests that just four currencies account for almost 95% of the European market; six account for 98%; and seven probably account for over 99%. In several of the ESRB's identified currencies, there is little or no SFT market (e.g. KRW, NOK, SGD and INR). The ESRB also suggests (ESRB, table A2) limiting initial currency reporting to a group such as USD, EUR, GBP, JPY, CHF, RMB, AUD, CAD and NZD. Existing ICMA survey data suggests that even this would be too wide for purposes of the European zone. The RMB, AUD, CAD and NZD are immaterial in Europe.

- Counterparty analysis

It is not clear to the ERC how granular the ESRB wants the classification of counterparties to be. In ESRB, table 3, it mentions "banks plus the most important non-banks that are active in SFT

markets". In ESRB, table A2, it lists "investment banks, commercial banks, custodian banks and firms looked at by FSB WS3 such as money market funds, hedge funds, pension funds, asset management firms (including ETF providers), cash collateral reinvestment programmes, insurance companies, securitisation vehicles, large corporates and debt management offices" as well as intra-group counterparties. The ERC observes that some of these will be difficult, at least in a European context, for reporting entities to distinguish, e.g. cash collateral reinvestment programmes and the custodial operations of commercial banks.

The ERC considers that fine counterparty granularity is not justified by the need to adjust for double-counting. This only really needs to be eliminated from the aggregate market size, as it is unlikely that it will systematically distort particular analyses of the data or disguise emerging issues.

The ESRB seeks to demonstrate the need for fine granularity in its appendix B. However, the ESRB perceives that the problems it identifies are created entirely by the assumption that CCP-cleared and tri-party business cannot be attributed. However, such attribution could be provided directly from CCPs and tri-party agents.

- **Market structure analysis**

The ESRB proposes that firms distinguish between business they have transacted "bilaterally" (i.e. directly by phone or electronic messaging), whether transactions are cleared across CCPs and whether transactions are managed by a tri-party agent. The ERC sees that one problem here is that these categories are inconsistent. Some "bilateral" transactions are registered post-trade with CCPs; and some transactions (GC financing) are both cleared across CCPs and managed by a tri-party agent, whilst all other tri-party transactions are bilateral.

- **Haircuts**

Experience in the ERC of trying to measure haircuts suggests that it is not possible to get meaningful averages for wide categories of collateral and counterparty. The ERC proposes that a more productive approach would be a periodic survey of the haircuts imposed by major firms on individual benchmark securities selected to represent the range of types of widely-traded collateral in transactions with specific named counterparties selected to represent typical institutional types.

Observations on the Russian trade repository experience:

The ERC notes that repos are included amongst the transactions required to be reported in the case of the recently established Russian trade repository. The ERC considers that there are a number of lessons which may already be taken from this Russian experience, particularly since, notwithstanding its smaller scale and probably lesser degree of complexity, the implementation process has not been particularly smooth. Derived from the experience of some of its members the ERC has compiled some more detailed observations on this process, as reflected in Annex D below.

Concluding remarks:

The ERC is actively considering the many and various matters touched upon in this White Paper and will continue to evolve its thinking in light of on-going developments, particularly as the public authorities continue to firm up their views regarding what is necessary. The views expressed in this White Paper therefore remain subject to change over time; but the ERC is nevertheless at your disposal to discuss any of the points made in this White Paper.

Annex A:

Repo data repositories – the state of play

In November 2012, the **FSB** WS5 compared the pros and cons of the alternative methods of providing market transparency: market surveys, regulatory reporting and trade repositories (“TRs”). It came out in favour of TRs and recommended that:

- The FSB **consult** on the appropriate geographical and product scope of TRs.
- Depending on its findings, the FSB should then establish a **working group**, involving market participants, to identify the appropriate scope and undertake a feasibility study for one or more TRs at a global level.
- In the meantime, it should encourage national/regional authorities to undertake **feasibility studies** for the establishment of TRs for individual repo and securities lending markets, which it should coordinate and facilitate.
- In addition, WS5 recommended that the FSB should coordinate a set of (mandatory and comprehensive) market-wide **surveys** by national/regional authorities to increase transparency for financial stability purposes and inform the design of TRs. Such market-wide surveys should make publicly-available aggregate summary information on securities lending and repo markets on a regular basis. WS5 conceded that some authorities may decide that a survey suffices.

WS5 suggested a single global TR or a few regional repositories for securities lending, given the mainly cross-border nature of the market, but that each repo market might be covered by its own TR, reflecting the currency segmentation of repo.

WS5 highlighted the work of the **FSB Data Gaps Group** to provide “a consistent framework to pool and share relevant data on the major bilateral linkages between **large international financial institutions** and their common exposures to and funding dependencies on countries, sectors and financial instruments”. It has done work on legal and operational challenges of collecting data globally and on protocols under which regulators may share data.

The FSB’s aim is “more granular data on securities lending and repo exposures amongst large international financial institutions” to detect concentrations of risk, such as large exposures to particular institutions and heavy dependence on particular collateral asset classes. In line with this limited objective, it has identified eight transactional attributes for repo (see table).

Meanwhile, the Vice-President of the **ECB** proposed a DR for repo transactions in the euro area. This initiative has been recently supported by a report of the European Parliament, which invited the European Commission to submit a legislative proposal for the creation of such a database by the end of 2013, after undertaking a feasibility study. Formerly, the ECB has a similar market transparency objective to the FSB and has identified eight/nine transactional attributes for repo (see table).

The **ESRB** published a paper on market transparency in March 2013 and has started collecting data, by means of regulatory reporting, on the re-use of non-cash collateral and re-investment of cash collateral. The ESRB noted that the monitoring of individual transactions is not critical for its financial stability objective. It has nevertheless identified 18/20 transactional attributes for repo (see table).

The ESRB set out various TR options. The principle choice is between capturing:

- **transaction data**, with all the relevant details, including time stamp and matching confirmation – in other word, flows reported to the TR within a pre-agreed time lag on a trade-by-trade basis from the confirmation desk in the back office; or
- **trade exposure data** – in other words, positions or stocks at regular points in time, captured by regularly collecting from market participants a log of open transactions at the time of reporting (e.g. on a weekly basis) from risk management systems.

The ESRB suggests that, in order to justify the potentially significant differences in running costs, a transaction-reporting TR should probably be designed to provide more than just surveillance, assuming that the two TR options provide identical data quality for surveillance purposes. It could, for instance, be fully integrated into the SFT post-trade value chain by supporting trade matching/confirmation or legal certainty if market participants and authorities were to consider that this would add value.

For reasons of competition and national interest, the ESRB envisages several TRs established globally. On the basis of the main SFT “market clusters” (e.g. the European Union (“EU”), North America and the APAC region). This means that, if a global solution cannot be implemented, then at least each main geographical zone should attempt to implement its own solution for collecting data to monitor risks in SFT markets.

All banks would have to report and – at the very least – the most important non-banks active in a given SFT market cluster such as the EU.

As most of the key risks to financial stability arising from SFTs tend to build up gradually, the ESRB believes that macro-prudential supervisors do not need daily data. It sees the adequate frequency of data for macro-prudential monitoring purposes falling within a range bounded between once a month and once a quarter. For jurisdictions with particularly dynamic SFT markets (such as the United States, the EU and Japan) a monthly monitoring frequency may perhaps be more appropriate, especially given the short-term nature of a significant proportion of SFTs.

Data should be the most recent, in order to ensure that an up-to-date picture of the distribution of risks in SFT markets is provided. Consequently, the timeliness of data is dependent upon both the dynamics of the SFT markets monitored (in developed SFT markets, for example, data in excess of two weeks old would probably qualify as being stale) and conditions in SFT markets (monitoring in times of market distress potentially requires more up-to-date data).

However, the ESRB sees TRs as also catering for micro-prudential supervisors (and potentially resolution authorities), for whom, the need for frequent and timely data is most likely greater, given that firms can lose access to SFT markets fairly quickly. Consequently, micro-prudential authorities would need weekly to monthly monitoring, based on a daily reporting lag. The EC want a TR to collect data in real time.

In August 2013, the **FSB** WS5 published its paper “Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos”. This sets out recommendations for addressing financial stability risks in this area, including enhanced transparency, regulation of securities financing, and improvements to market structure. The FSB has produced eleven finalised recommendations, of which five are related to improvement in transparency:

- Recommendation 1: Authorities should collect more granular data on securities lending and repo exposures amongst large international financial institutions with high urgency. Such efforts should to the maximum possible extent leverage existing international initiatives such as the FSB Data Gaps Initiative, taking into account the enhancements suggested in this document.
- Recommendation 2: Trade-level (flow) data and regular snapshots of outstanding balances (position/stock data) for repo markets should be collected. Regular snapshots of outstanding balances should also be collected for securities lending markets and further work should be carried out on the practicality and meaningfulness of collecting trade-level data. Such data should be collected frequently and with a high level of granularity, and should also capitalise on opportunities to leverage existing data collection infrastructure that resides in clearing agents, central securities depositories (CSDs) and/or central counterparties (CCPs). National/regional authorities should decide the most appropriate way to collect such data, depending on their market structure, and building on existing data collection processes and market infrastructure where appropriate. Trade repositories are likely to be an effective way to collect comprehensive repo and securities lending market data. Regulatory reporting may also be a viable alternative approach.
- Recommendation 3: The total national/regional data for both repos and securities lending on a monthly basis should be aggregated by the FSB which will provide global trends of securities financing markets (e.g. market size, collateral composition, haircuts, tenors). The FSB should set standards and processes for data collection and aggregation at the global level to ensure consistent data collection by national/regional authorities and to minimise double-counting at the global level.
- Recommendation 4: The Enhanced Disclosure Task Force (EDTF) should work to improve public disclosure for financial institutions' securities lending, repo and wider collateral management activities, taking into consideration the items noted above.
- Recommendation 5: Authorities should review reporting requirements for fund managers to end-investors against the FSB's proposal, and consider whether any gaps need to be addressed.

In order to take forward the work to establish standards for data collection and aggregation at the global level, and finalise a vision for the design of a regime for the data collection of repo and securities lending activity, the FSB has established a **technical data experts group**. This group will develop proposed standards and processes by the end of 2014. It will also interact closely with market participants.

The ERC is carefully evaluating all the details of this paper and will prepare a response to the associated consultation on haircuts. In the meantime the ERC, together with ISLA, has offered its continuing support to the on-going efforts of WS5, including with respect to the work to be done by the FSB's technical data experts group.

Table

	CPSS 91 (Sep-10)	MiFID (Oct-11)	FRBNY (Dec-11)	FSB (Nov-12)		ECB (Dec-12)	ESRB (Mar-13)	FSB (Aug-13)
				transaction-level	firm-level			
size	quantity (flow, stock)	quantity price	principal	principal	size of book	principal	aggregate value of repos	principal
currency		currency		(cash) currency	cash currency distribution	market value of collateral	cash currency	cash currency
collateral	collateral asset class	instrument ID	collateral type	collateral asset class	collateral asset class	type of collateral	collateral asset class	collateral type
	country of issue of collateral					issuer of collateral	collateral credit	collateral quality
	collateral credit						collateral currency	collateral currency
	collateral currency				collateral reversed in by asset class		residual maturity of collateral	
haircut	average haircut		haircut	haircut	haircut ranges by asset class	re-use of collateral	re-use of collateral	haircut
term	maturity structure	trading time/date	tenor	maturity (of repo)	repo tenor by asset class	repo maturity	purchase date	value date
				first callable date			residual term of repo	maturity date
	weighted average term						first callable date	
repo rate			interest rate	repo rate		repo rate	repo rate	repo rate
counterparty	counterparty type	counterparty ID	counterparty	counterparty	counterparty	counterparty	counterparty (borrower) type	counterparty type
		counterparty type					counterparty (lender) type	
		reporting agent ID					counterparty credit quality	
		firm ID						
market	CCP/non-CCP	trading capacity				bilateral/tri-party/CCP repo	market segment	
margining		venue ID				MTA		
transaction		venue type				frequency of MTM		
		trade reference						
		buy/sell						

Annex B:

Issues about a repo data repository in need of further discussion

1 Product coverage.

- Should DRs cover repo only?
- Or should they also include (1) securities lending/borrowing, (2) secured loans/deposits, (3) pledges, (4) margin lending, (5) synthetics and (6) collateral/liquidity swaps (however structured)? If they do not include these items, will the extra cost of reporting undesirably disadvantage repo?

2 Geographic coverage.

- How many DRs are needed?
- If there is a DR just for repo, should it be set up per currency or currency bloc? FSB WS5 says global SL TR but currency-based repo TR. For reasons of competition and national interest, the ESRB envisages several TRs established globally on the basis of the main SFT “market clusters” (e.g. the EU, North America and the Asia-Pacific region).

3 Type of data to be collected.

- Should the DR capture transaction or position data? What data can be most easily provided by firms?
- The monitoring of systemic risk does not require transaction data. The ESMA Draft Technical Standards on the Regulation on OTCD, CCP and Trade Repositories looks to transaction data and this is assumed in the CPSS/IOSCO report on Authorities’ Access to Trade Repository Data. But if transaction data is wanted by micro-prudential supervisors, market regulators and resolution authorities, there should then be a trade-off in terms of a reduction in other reporting requirements, given that these could be satisfied from transaction data. Note that the points emerging from the global conference in Basel, June 2012, included, “Data requirements for macro-prudential and micro-prudential analysis need to be aligned to reduce the reporting burden”. Note the ESMA Draft Technical Standards (para 174) about synergies between the OTCD TR and MiFID and EMIR reporting.
- To what breadth and depth should data be collected by the DR? Should the principle of proportionality apply, i.e. regulators should limit requirements to what is clearly needed to monitor material risks? There should not be excess data collection simply for random data mining or for potential academic research.
- If transaction data is required, should data on life-cycle events be collected? Do such events materially change risk?

4 Who reports?

- Should the principle of materiality apply, i.e. only those with regular and significant repo business be asked to report? ESRB says “All banks would have to report and – at the very least – the most important non-banks active in a given SFT market cluster such as the EU”.

5 Other data.

- There is talk of collecting data on risk management (e.g. margining frequency) and interconnectedness (i.e. collateral re-use). Is this a problem?

6 **Frequency and time lags.**

- The ESRB says macro-prudential regulators need monthly or quarterly reporting (monthly for active repo markets) and a lag of no more than two weeks; while micro-prudential regulators need weekly or monthly reporting, with a lag of no more than one day. What frequency and lag can firms accommodate? What implications, if any does this have for reporting requirements, associated with short term transactions – considering that such trades, in particular overnight trades, will have closed out again even before they are reported.

7 **Governance.**

- Who should own a DR? Should DRs be public utilities (to reduce cost to industry), perhaps under central banks (who tend to be more market sensitive)?
- Who should supervise the DR?

8 **Confidentiality.**

- How should this be protected and access controlled?

9 **Infrastructure.**

- Need for standardisation of data fields (note warning from derivatives TR).
- What reporting format and communications protocols should be implemented?
- Should data be trade-matched before being reported to a DR? Is submission required by both parties? If so, and if not matched, who owns the validation and comparison of the data submissions?
- Will multiple DRs need a global aggregator?

10 **Value-added services** from a DR.

- Should DRs offer trade-matching?
- Should reporting to a DR be required for legal certainty of contract (as in Russia)?
- Should a DR produce and publish repo indices?

Annex C:

Table:

Systemic risk factor	Minimum indicator	Rationale
Facilitation of credit growth	Aggregate value	To monitor SFT with non-banks
Pro-cyclicality	Average haircut	Need is based on variation of haircuts across type and rating of collateral and type of counterparty
Maturity/liquidity transformation	Maturity distribution	Standard risk exposures
Interconnectedness	Aggregate value	To monitor (1) exposures between financial firms, (2) lengths of chains and (3) proportion of collateral issued by financial firms
	Collateral re-usable	
	Collateral re-used	
Fire sales	Collateral by: (1) asset type + rating (2) counterparty type + rating	To assess concentration of collateral held by lenders
Currency mismatch	Cash v collateral currency	Standard risk exposures
Market structure	Direct/CCP-cleared/tri-party	Need is based on perceived differences in response of these market segments to crisis

Annex D:

Observations on the Russian trade repository experience

The Russian TR (“RTR”) requirements have been developed by each of the Federal Service for Financial Markets and the Russian Central Bank, but this process was not optimised. The two sets of requirements were not jointly designed but rather just bolted together, with some consequent inefficiency and missed opportunity.

The scope of the RTR requirements covers all Russian entities and individuals and places reporting obligations on both parties to transactions involving such entities or persons. Yet a significant challenge arising from this attempt to create a comprehensive reporting regime is that not all market participants have access to the applicable reporting tools, which creates the need to introduce the concept of delegated reporting.

The RTR is in fact not a single TR, but rather two competing solutions to the imposition of the new reporting requirements, giving rise to differences in the details of the applicable reporting mechanisms. This is inefficient as setting up the reporting is costly and time consuming; and those most active in the market now find that they have to set up both sets of detailed reporting mechanisms in order to comply with the TR preferences determined by their counterparts.

Implementation timelines have not been sufficiently lengthy to accommodate proper set up and testing, so delays are being experienced. This is all increasing the costs associated with the RTR implementation, whilst at the same time not yet allowing for the realisation of ancillary benefits.

The RTR covers not just repos but also derivatives. One benefit that derivatives are proving to have is that data is more standardised, following the Financial products Markup Language (“FpML”) protocol. In light of this the RTR is seeking to promote the extension of FpML to encompass repos, in order to better support standardised reporting and data handling.

Appendix:

ERC Background

Since the early 1990's, the [International Capital Market Association](#) has played a significant role in promoting the interests and activities of the international repo market, and of the product itself.

The ICMA European Repo Council has become the industry representative body that has fashioned consensus solutions to the emerging, practical issues in a rapidly evolving marketplace, consolidating and codifying best market practice. The discussions that take place at the ICMA ERC meetings underpin the strong sense of community and common interest that characterises the professional repo market in Europe.

The ICMA ERC also plays a significant role in nurturing the development of the repo market and supporting its wider use in Europe, particularly among banks, by providing education and market information. The ICMA ERC [bi-annual survey of the European repo market](#) has become established over more than a decade as the only authoritative indicator of market size and structure and the dominant trends.

ICMA is an active force in standardising repo documentation. [The GMRA](#) is the most predominantly used standard master agreement for repo transactions in the cross border repo market.

[Membership of the ERC](#) is open to ICMA members who transact repo business in Europe. The ICMA ERC currently has 69 members, comprising the vast majority of firms actively involved in this market.

More information may be found in the one page article "Building and sustaining the European repo market", which appeared on page #31 in [Issue 26 of ICMA Quarterly Report](#) and through the [ICMA ERC's website pages](#).

¹ Reports concerning all of the IMCA ERC's bi-annual surveys of the European repo market are available at <http://icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/repo/>. The ICMA ERC also holds bi-annual General Meetings at which the surveys' compiler, Mr Richard Comotto, ICMA Centre, Henley Business School, University of Reading, regularly gives presentations of the survey results, which are available at <http://icmagroup.org/About-ICMA/icma-councils-and-committees/European-Repo-Council/minutes/>.