European Securities and Markets Authority

ESMA'S QUESTION & ANSWER (Q&A) TOOL

QUESTION SUBMISSION FORM

IDENTIFICATION

1. *Name of entity*

International Capital Market Association

2. *Country of incorporation / Residence*

Other - please specify below

Switzerland

3. *E-mail address / Other contact details*

andy.hill@icmagroup.org

4. *Sector*

Other

LEGISLATIVE REFERENCE

5. ***Level 1***

Central Securities Depositories Regulation (CSDR) Regulation (EU) No 909/2014

6. *Article/s of Level 1 Legislative Act*

Article 7(4)(b)

7. *Other relevant Act/s or Guidance*

Delegated Regulation (EU) 2018/1229 supplementing Regulation (EU) No 909/2014: Article 22(2)

QUESTION

8. *Subject matter*

Mandatory buy-ins and open securities financing transactions

9. *Question*

Should "open" securities financing transactions (SFTs), or similar financing transactions, where the earliest contractual maturity is less than 30 business days, be considered out of scope of the mandatory buy-in requirements?

10. *Proposed answer*

Securities financing transactions that do not have a pre-determined end-date and/or can be terminated by the lending party within a timeframe of less than 30 business days from the intended settlement date of the initial leg of the SFT, should be considered out of scope of the buy-in obligation. This is also consistent with other regulatory treatments of such SFTs (e.g. for LCR and NSFR purposes), as well as how these transactions are treated from a risk perspective.

11. *Relevant background*

Open trades

Open trades, which are effectively rolling 1-day trades, can be closed by either party, usually with one or two days' notice. Open trades are very common (constituting 77% of European securities lending transactions according to the most recent ISLA Securities Lending Market Report[1], and 6% of the outstanding European repo market according to ICMA's latest European Repo Survey[2]). Open, or similarly structured SFTs, have become increasingly important for:

- liquidity and collateral management;
- managing balance sheets in light of the additional costs of implementing new Basel capital rules;
- providing lenders and beneficial owners with the flexibility to recall less-liquid securities should they sell them (which becomes even more important after the introduction of CSDR settlement discipline); and
- reducing costs and settlement risks associated with rolling-over transactions.

Market response to including in scope

If open SFTs were considered to be in scope of the CSDR buy-in requirements, firms would simply stop using them and replace them with rolling short-dated (e.g. 1-week) SFTs that would be out of scope. The net effect of this would be to increase costs, settlement risk, and overall market inefficiency.

[1] https://www.isla.co.uk/system/files/2018-09/Completed%20ISLA%20Report%20Sep%2018.pdf

[2] https://www.icmagroup.org/assets/documents/Market-Info/Repo-Market-Surveys/No-35-June-2018/ICMA-European-repo-market-survey-number-35-conducted-June-2018.pdf

Similar SFTs

There are a number of SFT structures that are essentially the same as open trades in the sense that the earliest contractual maturity of the transaction is short-dated (often with one or two days' notice by either party). These include short-dated 'evergreen' structures that are originally termed for less than 30 business days with an option for either party to execute early termination (again before 30 business days), or termed transactions with a 'call', allowing either party to terminate the trade at an earlier date, usually with one or two days' notice. The same reasoning for deeming vanilla open trades out of scope should also apply, in the case that the earliest contractual termination date is within the 30 business day threshold outlined in CSDR.

If such transactions were to come into scope the market response, in many cases, would be to revert to rolling short-dated SFTs, in place of these more efficient structures. Again, this would lead to an increase in cost and settlement risk, while making it more challenging for firms to manage their balance sheet and liquidity requirements. In other words, bringing open-SFTs into scope will not increase the number of in-scope transactions: it will change market behaviour, reducing efficiencies and increasing settlement risk.

Regulatory treatment

There are numerous examples of regulatory treatments for open, and open-like, SFTs, which effectively views them from the perspective of the earliest contractual termination date, and which is consistent with how such trades are viewed in terms of their risk exposure.
REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013

https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=EN

Article 420: Liquidity outflows

1. Pending the specification of a liquidity requirement in accordance with Article 460, liquidity outflows to be reported shall include:

(b) the current amounts outstanding of other liabilities that come due, can be called for payout by the issuing institutions or by the provider of the funding or entail an implicit expectation of the provider of the funding that the institution would repay the liability during the next 30 days as set out in Article 422;

REGULATION (EU) 2019/876 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2019

https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876&from=EN

Article 428al: Available stable funding factors

Unless otherwise specified in this Section, all liabilities without a stated maturity, including short positions and open maturity positions, shall be subject to a 0 % available stable funding factor

Article 428j: Residual maturity of a liability or of own funds

1. Unless otherwise specified in this Chapter, institutions shall take into account the residual contractual maturity of their liabilities and own funds to determine the available stable funding factors to be applied under Section 2.

2. Institutions shall take into account existing options in determining the residual maturity of a liability or of own funds. They shall do so on the assumption that the counterparty will redeem call options at the earliest possible date. For options exercisable at the discretion of the institution, the institution and the competent authorities shall take into account reputational factors that may limit an institution's ability not to exercise the option, in particular market expectations that institutions should redeem certain liabilities before their maturity.

ECB Sensitivity analysis of Liquidity Risk – Stress Test 2019
Methodological note

https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ECB_sensitivity_analysis_of_liquidity_risk-stress_test_2019-methodological_note_20190206~6771e88926.en.pdf

2.2.1.2.2 Tables 2.2 and 3.2: Cash flows – Open maturity items
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Rows 1100 and 1210 and rows 1860 and 1970: In line with the Baseline case, also under both the Adverse and Extreme shock assumptions all secured lending and capital market driven transactions with open maturity (i.e. open repos and reverse repos), both on the asset and liability side of the reporting institution, are assumed to be terminated and settled on the first relevant day following the reference date.

Bank of England PRA
Instructions for completing PRA 110

https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/regulatory-reporting/banking/pra110-instructions.pdf

Part 1: 12(d)

(d) open repos or reverse repos and similar transactions which can be terminated by either party on any day shall be reported in both the “overnight” and the “Of which: open” column 6010, unless the notice period is longer than one day in which case they shall be reported in the relevant time bucket according to the notice period.

Office of the Superintendent of Financial Institutions (Canada)
Liquidity Adequacy Requirements (LAR)
Chapter 3

https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/LAR19_chpt3.aspx
FN 16:
Open maturity secured financing transactions (including open maturity prime brokerage margin loans) can be treated as overnight maturity provided the institution can demonstrate to OSFI: i) that it can contractually and operationally collapse an open maturity trade on the next business day without incurring legal or reputational risk; and ii) that the trades are priced similarly to overnight trades.

Board of Governors of the Federal Reserve System (USA)
Liquidity Coverage Ratio FAQs

https://www.federalreserve.gov/supervisionreg/topics/liquidity-coverage-ratio-faqs.htm

1. *Treatment of Inflows from Secured Loans to Retail Clients with Open Maturities*

Question: What inflow rate should a covered company apply to margin loans to retail customers or counterparties? What inflow rate should apply to margin loans to retail customers or counterparties that do not have a stated maturity?

Answer:

The cash inflow amount for a margin loan with a retail customer or counterparty is determined under section 33(c), which applies to retail cash inflow amounts, rather than section 33(f),[11] *which applies only to wholesale customers.*

A covered company may not include margin loans to retail clients with no stated maturity in its inflow amounts under the LCR rule. Under section 33(a)(6), a covered company must exclude from its inflow amounts any amounts payable to a covered company with respect to any transaction that has no contractual maturity date (as determined by section 31). Moreover, the provisions in section 31 of the LCR rule would not cause these transactions to be treated as if they matured within the LCR rule's 30-day window. Therefore, inflows from such transactions are not eligible for inclusion in a covered company's inflow amounts.