

MEMO# 26871

January 14, 2013

ICI Letter in Response to FSB Consultation on Securities Lending and Repo Markets

[26871]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 5-13
ICI GLOBAL SECURITIES LENDING & REPO TASK FORCE No. 2-13
INTERNATIONAL MEMBERS No. 5-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 3-13
SEC RULES MEMBERS No. 6-13 RE: ICI LETTER IN RESPONSE TO FSB CONSULTATION ON SECURITIES LENDING AND REPO MARKETS

In November, the Financial Stability Board [\[1\]](#) published for comment policy recommendations for addressing financial stability risks in the securities lending and repo markets (the “Consultation”). [\[2\]](#) The Consultation makes recommendations for minimum regulatory standards in a number of areas, including enhanced transparency, regulation of securities financing, and improvements to market structure.

ICI submitted the attached comment letter responding to the FSB Consultation from the perspective of U.S. registered investment companies (“registered funds”) that participate in the securities lending or repo markets. The letter offers general support for the FSB’s efforts to identify and address systemic risk concerns in these markets, but it opposes certain recommendations in the Consultation on the grounds that the proposed regulatory standards would inappropriately intrude on areas best left to national regulators or market forces. There are three general comments in the letter, along with a number of comments responding to specific recommendations in the Consultation.

General Comments

- The letter urges the FSB to clearly distinguish securities lending from repos in making its final recommendations. Although they are both categories of collateralized finance, securities lending and repo markets are distinct and often quite different. While some of the FSB’s recommendations may apply to both markets, the letter argues that most should be tailored to address the unique issues presented in each context.
- The letter strongly supports the FSB’s efforts to address systemic risks, but points out

that it is critical that the FSB take a balanced approach to its recommendations. The letter recommends that, in its final report, the FSB explicitly recognize not only the potential risks with regard to securities lending and repo financing, but also the benefits of those activities and the ways in which existing regulation or market practices in some jurisdictions already mitigate systemic risks.

- Given the differences in securities lending and repo markets around the world and differences in the extent of existing regulation, the letter encourages the FSB to take a less prescriptive approach with its final recommendations, encouraging national regulators to consider its recommendations in light of the particular circumstances in their market, rather than directing them to adopt a specific type of requirement.

Specific Comments

- The letter supports the FSB's efforts to ensure that authorities have the information they need to effectively monitor securities lending and repo markets for systemic risks, but offers three principles to guide regulators in gathering data, recommending that authorities should: (1) request only the information they need to monitor for systemic risks in the markets; (2) gather that information in the most efficient way reasonably available; and (3) have appropriate systems and procedures in place to ensure the confidentiality and security of such information before requesting it from market participants.
- The letter expresses support for a globally harmonized approach to the collection of data by regulators, but also suggests that the process by which regulators gather data will need to be developed through further consultations with industry and a careful review of existing processes and available information.
- The letter generally supports the public release of data on an aggregated basis, to the extent such disclosure advances the goal of mitigating systemic risk. That said, the letter strongly opposes the public disclosure of the economic terms of securities lending transactions, such as fee splits. The letter argues that it would be difficult to disclose aggregated data on these terms in a meaningful way, and even if that could be done, such disclosure is unnecessary to mitigate systemic risks.
- The letter opposes the FSB's recommendations with respect to corporate disclosure and fund manager disclosure, arguing that the FSB should defer to local authorities on these types of disclosure issues, which have little or no connection to systemic risk.
- The letter argues that the FSB's focus on repo haircuts is misplaced. It points out that the FSB's recommendations appear based on supposed pro-cyclical trends in haircuts for which there is no historical evidence, at least for tri-party repo in the United States, and disregard the fact that many buyers enter into a repo based primarily upon the seller's capacity to pay the repurchase price, rather than upon the value and liquidity of the collateral. The letter notes that collateral is just one factor when deciding what form or amount of credit to extend to an institution.
- The letter also forcefully opposes the FSB recommendations that would set specific fixed or minimum floors for repo haircuts. The letter states that ICI fundamentally disagrees with any attempt to regulate the negotiated terms of market transactions such as repos, and believes that a number of problems (correctly identified and acknowledged in the Consultation) would result from the establishment of minimum numerical floors for repo haircuts, especially at the very high levels discussed in the Consultation.
- Finally, the letter argues that it is unnecessary for the FSB to set forth specific minimum regulatory standards on collateral valuation and management. Specifically, the letter urges the FSB to redraft its final recommendations on collateral management not limit repo market participants to collateral that they are able to hold

outright following a counterparty failure. The letter points out that, as set forth in the Consultation, the FSB's recommendation might be misinterpreted to restrict repo buyers only to collateral that they could have purchased outright and held indefinitely for investment, which would be inconsistent with the fundamental nature of a repo and would unduly restrict the market without lessening the risk of a "fire sale" of collateral following a counterparty default.

Next Steps

The FSB notes, in the Consultation, that it expects to publish final recommendations in September 2013.

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Securities Regulation - Investment Companies

[Attachment](#)

endnotes

[1] The FSB was established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. Information about the FSB is available at <http://www.financialstabilityboard.org>.

[2] Strengthening Oversight and Regulation of Shadow Banking, A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, Financial Stability Board (18 November 2012), available at http://www.financialstabilityboard.org/publications/r_121118b.pdf. The FSB's initial discussion paper on this topic was published earlier in 2012. See Securities Lending and Repos: Market Overview and Financial Stability Issues, Interim Report of the FSB Workstream on Securities Lending and Repos, available at http://www.financialstabilityboard.org/publications/r_120427.pdf. ICI's comment letter on the interim report can be found at https://www.financialstabilityboard.org/publications/c_120806p.pdf (the "2012 ICI Letter").