

MEMO# 29210

July 31, 2015

EU Securities Financing Transactions Regulation

[29210]

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TO: ICI GLOBAL REGULATED FUNDS COMMITTEE No. 43-15
ICI GLOBAL SECURITIES LENDING & REPO TASK FORCE No. 3-15
ICI GLOBAL SHADOW BANKING TASK FORCE No. 1-15
INTERNATIONAL COMMITTEE No. 41-15 RE: EU SECURITIES FINANCING TRANSACTIONS REGULATION

On 17 June 2015, the Presidency of the Council of the European Union (EU) and European Parliament reached political agreement [\[1\]](#) on the Securities Financing Transaction Regulation (SFTR). [\[2\]](#) The final text of the SFTR is expected to be published in the Official Journal of the EU by the end of the year. The SFTR introduces new obligations for funds engaging in securities financing transactions (SFTs), including securities lending and repo transactions. These obligations include detailed reporting to regulators, enhanced disclosure to investors, and restrictions on the re-use of collateral.

Background

At international level, the FSB has examined financial stability issues related to securities lending and repo transactions. [\[3\]](#) This work has included an interim report [\[4\]](#), consultation [\[5\]](#) and policy framework [\[6\]](#), and recommendations concerning haircuts for non-centrally cleared SFTs. [\[7\]](#)

The European Commission also identified SFTs as a source of systemic risk for the stability of the financial system [\[8\]](#) and in January 2014 adopted a proposal for a SFTR [\[9\]](#) The purposes of the SFTR include enhancing the transparency of SFTs, enabling regulators, supervisors and investors to assess and monitor bank-like risks as well as the level of interconnectedness in the financial system. [\[10\]](#)

The scope and obligations under the SFTR are outlined below. Several aspects of the reporting obligations for funds under the SFTR will be subject to elaboration in implementing measures by ESMA, with subsequent adoption by the European Commission. As discussed in further detail below, similar reporting obligations are being developed by other national authorities, such as proposals by the US SEC.

As described in our letter to the FSB [\[11\]](#), we have supported initiatives that seek to

improve the quantity and quality of data available to regulators to detect financial stability risks and develop appropriate policy responses. While we have emphasised the need for flexibility in international standards to allow national or regional regulators to better and more efficiently implement a reporting framework, we also have encouraged regulators to reduce the burden of reporting for funds. To achieve this, we have urged regulators to develop frameworks that result in greater consistency in reported data.

Scope of the SFTR

The SFTR lays down rules on the transparency of SFTs and captures a “counterparty” to an SFT, including managers of UCITS [\[12\]](#) and AIF [\[13\]](#). Notably, the SFTR applies, in certain instances, to a counterparty to an SFT that is located in a third country, including if the SFT is concluded through the EU branch of the counterparty. [\[14\]](#)

Under the SFTR, SFTs include repurchase transactions (“repos”); securities or commodities lending and securities or commodities borrowing; buy-sell back transactions or sell-buy transactions; and; margin lending transactions. [\[15\]](#) Each type of SFT is defined in the SFTR. [\[16\]](#)

Reporting obligations

Scope and dates of application

SFT counterparties are required to report the details of SFTs to trade repositories (TRs) [\[17\]](#) or, where a TR is not available, to ESMA. [\[18\]](#) This reporting obligation applies to AIF and UCITS managers where a fund under their management is an SFT counterparty. [\[19\]](#) Fund managers will be required to report:

- i. Transactions concluded more than 18 months before the date of entry into force of the delegated acts under the Regulation specifying the reporting obligations, if such transactions either have open maturity or at least 180 days remaining until maturity; [\[20\]](#) and
- ii. All transactions concluded on, or after that date. [\[21\]](#)

Both parties to an SFT must report details of an SFT they have concluded to a TR or to ESMA. Due to a phased-in reporting schedule, some counterparties to SFT transactions may have an obligation to report the details of a transaction before AIF and UCITS managers are required to begin reporting. The table below specifies the compliance date for reporting by certain types of entities.

Type of entity [\[22\]](#) Date reporting obligations are applicable after entry into force of delegated act [\[23\]](#) MIFID “Investment firms”, CRD “Credit Institutions” and similar third country entities requiring authorisation or registration. [\[24\]](#) 12 months CCPs, CSDs and similar third country entities and similar third country entities requiring authorisation or registration. 15 months Managers of UCITS and AIF, and other financial counterparties including insurance undertakings and IORPs 18 months “Non-financial counterparties” 21 months

Transactions must be reported to a TR or to ESMA within 190 days of the dates outlined above. [\[25\]](#) SFT counterparties must maintain records of SFTs- concluded, modified or terminated [\[26\]](#) – for at least five years but can delegate the reporting. [\[27\]](#).

Content of reports

The SFTR specifies the general content of reports to be submitted by each party to a TR or to ESMA including at least the following information: [\[28\]](#)

- the parties to the SFT and, where different, the beneficiary of the rights and obligations arising from it;
- the principal amount; currency; assets used as collateral and their type, quality and value; the method used to provide collateral; whether collateral is available for reuse; in cases where it is distinguishable from other assets, whether it has been reused; any substitution of the collateral; the repurchase rate, lending fee or margin lending rate; haircut; value date; maturity date; first callable date; and market segment.

ESMA will develop technical standards to specify additional detail which may include reporting:

- position level collateral data where appropriate; [\[29\]](#)
- cash collateral reinvestment; and
- securities or commodities being lent or borrowed. [\[30\]](#)

ESMA also will develop draft implementing technical standards for the format and frequency of reports. [\[31\]](#) In developing the technical standards, ESMA must consider international developments and standards agreed at EU and global level.

Reports to third country trade repositories

The SFTR permits reporting to TRs located in a third country, subject to the completion of an equivalence and recognition process. [\[32\]](#) It is envisaged that TRs recognised in accordance with EMIR [\[33\]](#) may apply for an extension of services to act as a TR for the purpose of the SFTR.

Transparency towards investors

The Regulation requires UCITS and AIF managers to inform investors on their use of SFTs and total return swaps (TRS). Specifically, managers must make disclosures in both pre-contractual documents and periodic reports, [\[34\]](#) 18 months [\[35\]](#) and 12 months [\[36\]](#) after the entry into force of the Regulation respectively.

The Regulation annexes specify the information to be disclosed as outlined below. ESMA also may develop technical standards for disclosure for different types of SFT and TRS. [\[37\]](#)

SFT Information in fund reports

UCITS annual and semi-annual reports and AIF annual reports must include the following information: [\[38\]](#)

- The amount of securities and commodities on loan as a proportion of total lendable assets defined as excluding cash and cash equivalents;
- The amount of assets engaged in each type of SFTs and total return swaps expressed as an absolute amount (in the fund's currency) and as a proportion of the fund's assets under management (AUM)
- Ten largest collateral issuers across all SFTs and total return swaps (break down of volumes of the collateral securities and commodities received per issuer's name)
- Top 10 counterparties of each type of SFTs and total return swaps separately (Name

of counterparty and gross volume of outstanding transactions)

- Share of collateral received that is reused, compared to the maximum amount specified in the prospectus or in the disclosure to investors;
- Cash collateral reinvestment returns to the fund;
- Safekeeping of collateral received by the fund as part of SFTs and total return swaps
- Number and names of custodians and the amount of collateral assets safe-kept by each
- Safekeeping of collateral granted by the fund as part of SFTs and total return swaps
- The proportion of collateral held either in segregated accounts or in pooled accounts, or in any other accounts
- Data on return and cost for each type of SFTs and total return swaps broken down between the fund, fund manager and third parties (e.g. agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFTs and total return swaps

In periodic reports, for each type of SFT and TRS, the following aggregate transaction data must be included:

- Type and quality of collateral;
- Maturity tenor of the collateral broken down in across several specified categories;
- Currency of the collateral;
- Maturity tenor of the SFTs and total return swaps broken down in across several specified categories;
- Country of domicile of counterparties;
- Settlement and clearing (e.g., tri-party, Central Counterparty, bilateral)

Information in pre-contractual documents

UCITS prospectuses and AIF investor disclosure must include: [\[39\]](#)

- General description of the SFTs and total return swaps used by the fund and the rationale for their use
- Overall data to be reported for each type of SFTs and total return swaps
 - Types of assets that can be subject to them;
 - Maximum proportion of AUM that can be subject to them;
 - Expected proportion of AUM that will be subject to each of them.
- Criteria used to select counterparties (including legal status, country of origin, minimum credit rating)
- Acceptable collateral: description of acceptable collateral with regard to asset types, issuer, maturity, liquidity as well as the collateral diversification and correlation policies
- Collateral valuation: description of the collateral valuation methodology used and its rationale, and whether daily mark-to-market and daily variation margins are used
- Risk management: description of the risks linked to SFTs and total return swaps , as well as risks linked to collateral management, such as operational, liquidity, counterparty, custody and legal risks and, where applicable, the risks arising from its reuse
- Specification of how assets subject to SFTs and total return swaps and collateral received are safe-kept (e.g. with fund custodian);
- Specification of any restrictions (regulatory or self-imposed) on reuse of collateral
- Policy on sharing of return generated by SFTs and total return swaps : description of the proportions of the revenue generated by SFTs and total return swaps that is

returned to the fund, and of the costs and fees assigned to the manager or third parties (e.g. the agent lender). The prospectus or disclosure to investors shall also indicate if these are related parties to the manager.

Reuse of Collateral

Parties may reuse collateral subject to conditions, including that: [\[40\]](#)

- The providing counterparty has been informed, in writing, by the receiving counterparty of the risks and consequences involved in the right of use of collateral, including in the event of the default of the receiving counterparty;
- The providing counterparty has granted its prior express consent to a security collateral arrangement or has expressly agreed to provide collateral by way of a title transfer collateral arrangement;

The right of reuse of collateral is without prejudice to stricter requirements in the UCITS Directive and AIFM Directive and does not affect national law concerning the validity or effect of a transaction. [\[41\]](#)

Administrative sanctions

The Regulation lays down requirements in respect of administrative sanctions and the reporting of breaches, particularly concerning obligations in respect of reporting and the right of reuse. [\[42\]](#)

Next Steps

The SFTR must pass through the jurist-linguist process and a final text is expected by the end of the year. Delegated acts, technical standards and other implementing measures will follow. Upon the entry into force of delegated acts, reporting obligations will apply as described above.

A review in the effectiveness, efficiency and proportionality of obligations under the Regulation will be conducted by the European Commission, after consulting with ESMA, 24 months after the commencement of reporting obligations. [\[43\]](#)

Other related regulatory initiatives

In parallel to the development of the SFTR, regulatory authorities in other parts of the world are considering, or have developed, reporting obligations of relevance to funds concluding securities lending and repo transactions. For instance, the US SEC has issued proposals ("Proposed SEC Reporting Rules") that would modernise the reporting requirements for registered investment companies (RICs) and registered investment advisers. [\[44\]](#) The proposals require the reporting of certain information directly to the Commission (through a new Form N-Port and Form N-CEN, to be reported on a monthly and annual basis respectively) and amendments to Regulation S-X, which would require standardised, enhanced disclosure in financial statements.

The reporting basis, and the channel for submitting reports, differs between the proposed SEC reporting rules and the SFTR. Important aspects of the reporting obligations under both sets of rules will also be subject to further elaboration and, as such, the comprehensive obligations to which funds will be subject are not yet known. However, once implemented some fund complexes may be subject to obligations under both sets of rules. Table in the Annex to this memo provides a comparison, based on the current proposals, of the reporting obligations, of relevance to funds, under the proposed SEC reporting rules and the SFTR.

Annex - Comparison of reportable information under SFTR and proposed SEC reporting rules [\[45\]](#)

Type of information EU SFT Regulation US SEC's Proposed Rules [\[46\]](#) Transaction-level [\[47\]](#)

- Parties [\[48\]](#) to the SFT and, where different, the beneficiary of the rights and obligations arising from it+
- For securities lending transactions, the full name and LEI of counterparty.b
- For repo transactions, identity of the counterparty.c
- Repurchase rate+ c
- Lending fee+
- Margin lending rate+
- Maturity date+ c
- Maturity tenor [\[49\]](#) at aggregate transaction level for each type of SFT and TRS#
- Value date+
- Market segment+
- First callable date+
- Principal Amount +c

Collateral

- Type, quality, value and assets used as collateral+ including aggregate transaction data for each type of SFT and TRS#
- For repurchase transactions, principal amount and value of collateral and category [\[50\]](#) of investments most closely representing collateral.c
- For securities lending transactions:
 - Whether any amount of the investment represented reinvestment of the cash collateral and, if so, the dollar amount of such reinvestment.c
 - Whether any portion of the investment represented non-cash collateral received to secure loaned securities and, if so, the value of the securities representing such non-cash collateral.c
 - Gross income from securities lending, including income from cash collateral reinvestment.sx

- Maturity tenor of collateral [\[51\]](#) at aggregate transaction level for each type of SFT and TRS#
- Currency of collateral+ including aggregate transaction data for each type of SFT and TRS#
- Method used to provide collateral+
- Whether collateral is available for reuse+
- Share of collateral received that is reused, compared to the maximum amount specified in the prospectus or in the disclosure to investors
- Cash collateral reinvestment [\[52\]](#) returns to the fund#
- Substitution of collateral

Portfolio-level

- The amount of securities and commodities on loan as a proportion of total lendable assets defined as excluding cash and cash equivalents, to be reported in annual and half-yearly reports.#
- For securities lending transactions, the aggregate value of securities on loan, monthly average of the value of securities on loans, whether the fund loaned securities during the reporting period.n

The amount of assets engaged in each type of SFTs and total return swaps expressed as an absolute amount (in the fund's currency) and as a proportion of the fund's assets under management (AUM).# Custody

- Safekeeping of collateral received by the fund as part of SFTs and TRS#
- Number and names of custodians and the amount of collateral assets safe-kept by each#
- Safekeeping of collateral granted by the fund as part of SFTs and total return
- The proportion of collateral held either in segregated accounts or in pooled accounts, or in any other accounts#

Financial information

- Policy on sharing of return generated by SFTs and total return swaps : description of the proportions of the revenue generated by SFTs and total return swaps that is returned to the fund, and of the costs and fees assigned to the manager or third parties (e.g. the agent lender).
- Types of payments [\[53\]](#) made to securities lending agents and cash collateral managers.sx
- For securities lending transactions: [\[54\]](#) sx
- the net income from securities lending, and the terms governing the compensation of the securities lending agent, including any revenue sharing split; and
- the details of any fees paid directly or indirectly, including fees paid for cash collateral management and any management fee deducted from a pooled vehicle in which cash collateral is invested.

Fund Information

- General description of the SFTs and TRS used by the fund and the rationale for their use.b
- Whether the fund is authorised to engage in securities lending transactions.sx
- Information about borrower defaults in respect of securities lending transactions. n
- Return and cost for each type of SFT and TRS broken down between the fund, fund manager and third parties (e.g. agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFT and TRS#
- For securities lending transactions, The dollar amount of fees paid by the fund for securities lending related activities and services including borrower rebates and cash collateral management services. sx

Risk Management

- Description of the risks linked to SFTs and total return swaps , as well as risks linked to collateral management, such as operational, liquidity, counterparty, custody and legal risks and, where applicable, the risks arising from its reuse
- For securities lending arrangements, information about indemnification arrangements.n

Information on third-parties

- The prospectus or disclosure to investors shall also indicate if [third parties (e.g. the agent lender)] are related parties to the manager.
- Information about each securities lending agent; n
- Information about collateral managers, including any affiliation with the fund's adviser. n

Counterparty information

- Settlement and clearing (e.g., tri-party, Central Counterparty, bilateral), at aggregate level for each type of SFT or TRS#
- For a repurchase agreement, identity of the counterparty and LEI, if any; whether the

repo is tri-party; whether the repo is cleared by a central counterparty; repurchase rate; and maturity date.c

- Country of domicile of counterparties, at aggregate level for each type of SFT or TRS#
- Top 10 counterparties of each type of SFTs and total return swaps separately (Name of counterparty and gross volume of outstanding transactions), to be reported in annual and half-yearly reports (Section A, Annex)
- For securities lending transactions, aggregate value of all securities on loan to each counterparty.b
- Ten largest collateral issuers across all SFTs and total return swaps (break down of volumes of the collateral securities and commodities received per issuer's name)

Key:

Information to be provided in the UCITS half-yearly and annual reports and the AIF's annual report in accordance with Section A, Annex, SFTR

Information to be provided in the UCITS half-yearly and annual reports and the AIF's annual report in accordance with Section A, Annex, SFTR + Obligation of a counterparty to an SFT to report information to a trade repository or to ESMA in accordance with Article 4(7), SFTR * Information to be included in the UCITS Prospectus and AIF disclosure to investors in accordance with Section B, Annex, SFTR b Proposed reporting obligation in Part B, proposed Form N-PORT c Proposed reporting obligation in Part C, proposed Form N-PORT n Proposed reporting obligation in Part C of proposed Form N-CEN sx Proposed reporting obligation under proposed amendments to Regulation S-X

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endnotes

[1] More transparency for securities financing transactions: Council and Parliament agree new rules, Press Release, 17 June 2015, available from <http://www.consilium.europa.eu/en/press/press-releases/2015/06/17-ecofin-transparency-securities-financing-transactions/>

[2] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on reporting and transparency of securities financing transactions and amending Regulation (EU) No 648/2012 - Confirmation of the final compromise text with a view to agreement, 26 June 2015, available from http://www.consilium.europa.eu/en/press/press-releases/2015/06/pdf/st10197_en15_pdf/ ("SFTR").

[3] Shadow Banking: Strengthening Oversight and Regulation: Recommendations of the Financial Stability Board, 27 October 2011, available from http://www.financialstabilityboard.org/wp-content/uploads/r_111027a.pdf

[4] Securities Lending and Repos: Market Overview and Financial Stability Issues, Interim Report of the FSB Workstream on Securities Lending and Repos, 27 April 2012, available from http://www.financialstabilityboard.org/wp-content/uploads/r_120427.pdf

[5] Consultative Document, Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, 18 November 2012, available from http://www.financialstabilityboard.org/wp-content/uploads/r_121118b.pdf

[6] Strengthening Oversight and Regulation of Shadow Banking: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, 29 August 2013, available from http://www.financialstabilityboard.org/wp-content/uploads/r_130829b.pdf

[7] Strengthening Oversight and Regulation of Shadow Banking: Regulatory framework for haircuts on non-centrally cleared securities financing transactions, 14 October 2014, available from http://www.financialstabilityboard.org/wp-content/uploads/r_141013a.pdf

[8] Green Paper on Shadow Banking, European Commission, 19 March 2012, available from http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_en.pdf; Communication from the Commission to the Council and the European Parliament: Shadow Banking – Addressing New Sources of Risk in the Financial Sector <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52013DC0614>

[9] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on reporting and transparency of securities financing transactions /* COM/2014/040 final - 2014/0017 (COD), available from <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014PC0040> . See also Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union, available from <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0510>

[10] Recital 2, SFTR

[11] Letter from Dan Waters, Managing Director, ICI Global to Secretariat of the Financial Stability Board, dated 12 February 2015, Re: Proposed Standards and Processes for Global Securities Financing Data Collection and Aggregation, available from <https://www.iciglobal.org/pdf/28734.pdf>

[12] Article 2(1)(b), SFTR, refers to UCITS management companies and UCITS investment companies in accordance with Directive 2006/65/EC.

[13] Article 2(1)(c), SFTR

[14] Article 2(1)(a)(2), SFTR

[15] Article 3(6), SFTR

[16] Article 3(5)-(5c), SFTR

[17] Article 4(1), SFTR

[18] Article 4(3), SFTR

[19] Article 4(1b) and Article 4(1ba), SFTR

[20] Article 4(1)(a), SFTR

[21] Article 4(1)(b), SFTR

[22] Defined in Article 3(1)(2), SFTR

[23] Article 28(2)(a) in respect of the delegated act to be adopted pursuant to Article 4(7), SFTR

[24] Third country entities which would require authorisation or registration in accordance with the legislation mentioned in the relevant sub-section of Article 3(1) if they were established in the Union

[25] Article 4(1a), SFTR

[26] Article 4(2), SFTR

[27] Second paragraph, Article 4(1a), SFTR

[28] Article 4(7), SFTR

[29] Article 4(7)(b), SFTR

[30] Article 4(7)(c), SFTR

[31] The format shall include global legal entity identifiers (LEIs), international securities identification numbers (ISINs) and unique trade identifiers. Article 4(8), SFTR

[32] Article 19, SFTR

[33] REGULATION (EU) No 648/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, available from <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648>

[34] Half-yearly and annual reports for UCITS and the annual report of AIFs

[35] Article 28(2)(ba), SFTR, for funds that are constituted before the date of entry into force of the Regulation

[36] Article 28(2)(b), SFTR

[37] Article 13(3) and Article 14(3), SFTR

[38] Section A of Annex to SFTR

[39] Section B of Annex to SFTR

[40] Article 15

[41] Article 15(3)

[42] Article 20, SFTR

[43] Article 26, SFTR

[44] See ICI Memo 29036 dated 28 May 2015, RE: SEC Proposes new reporting requirements for Registered Investment Companies and Registered Investment Advisers, available from <https://www.ici.org/vgn-ext-templating/v/index.jsp?vgnextoid=e2c71e3e2179d410VgnVCM1000001c0210acRCRD&vgnextchannel=dd7ff697c7215210VgnVCM10000043010a0aRCRD&vgnextfmt=default>

[45] All references to repos in this table include reverse repos.

[46] SEC Proposed Investment Company Reporting Modernization Rules, available from <http://www.sec.gov/rules/proposed/2015/33-9776.pdf>

[47] Article 4(7)(c)(ii) of the SFTR requires details to be provided on securities or commodities being lent or borrowed, depending on the SFT.

[48] Article 7(8) of the SFTR envisages that ESMA will develop draft implementing technical standards specifying the format of reports, including global legal entity identifiers (LEIs), or pre-LEIs until the Global Legal Entity Identifier System is fully implemented; international securities identification numbers (ISINs); and unique trade identifiers.

[49] Maturity tenor of the SFTs and total return swaps broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one month to three months, three months to one year, above one year, open transactions (Section A, SFTR)

[50] The Commission notes that the categories used for reporting collateral would track the categories currently used to report tri-party repurchase agreement information to the Federal Reserve Bank of New York

[51] Maturity tenor of the collateral broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one month to three months, three months to one year, above one year, open maturity (Section A, SFTR)

[52] Article 4(7)(c)(i) of the SFTR requires details to be provided on cash collateral reinvestment, depending on the SFT.

[53] Specifically, the fund would be required to disclose whether the adviser has made any of the following payments to one or more securities lending agendas or cash collateral managers during the reporting period: a revenue sharing split, non-revenue sharing split (other than an administrative fee), administrative fee, cash collateral reinvestment fee, and indemnification fee.

[54] In its comment letter to the SEC, the ICI is recommending that this requirement be omitted from the proposed amendments to Regulation S-X and instead be included in the portion of Form N-PORT that will not be published for public consumption

should not be considered a substitute for, legal advice.