INVESTMENT COMPANY INSTITUTE

MEMO# 27734

November 29, 2013

ICI and ICI Global Submit Comment Letter to the FSB on Securities Lending and Repo Haircuts

[27734]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 96-13
ICI GLOBAL SECURITIES LENDING & REPO TASK FORCE No. 6-13
INTERNATIONAL MEMBERS No. 54-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 33-13
SEC RULES MEMBERS No. 109-13 RE: ICI AND ICI GLOBAL SUBMIT COMMENT LETTER TO THE FSB ON SECURITIES LENDING AND REPO HAIRCUTS

As you know, the Financial Stability Board recently published policy recommendations for addressing financial stability risks in the securities lending and repo markets, along with a further consultation with proposals on minimum standards for methodologies to calculate haircuts and a framework of numerical haircut floors. [1]

ICI and ICI Global submitted the attached joint letter in response. The letter reiterates many of the concerns we expressed in earlier letters to the FSB and the overall view that the FSB's focus on haircuts is misplaced and its recommendations inappropriately dictate terms best left to the parties to negotiate.

Before providing comments on the margin consultation, the letter expresses disappointment that the FSB chose to include in its final policy recommendations a section on fund manager disclosure to end investors, adopted word-for-word from its 2012 consultation. The letter reiterates our belief that it is inappropriate for the FSB to single out fund managers for a discussion on the appropriateness of their investor disclosures, particularly given that the FSB does not attempt to draw any link to financial stability concerns in this context. It also suggests that the disclosure suggested by the FSB may well be excessive for many registered funds that engage in only a limited amount of securities lending or repo.

The main part of the letter focuses on two sections of the margin consultation: Section 2, which sets forth minimum standards for methodologies used to calculate haircuts, and Section 4, which proposes specific numerical floors for haircuts. In both sections, we oppose the FSB's proposals.

With regard to Section 2, the letter gives a number of reasons why the FSB should not adopt its proposed minimum margin methodologies. These include that the FSB’s recommendations will not achieve their goal of preventing the build-up of excessive leverage, that their focus on margin haircuts is misplaced because haircuts have not been pro-cyclical, and that detailed methodologies may have the practical effect of establishing de facto numerical standards. The theme throughout is that market participants should be free to set their haircuts at levels consistent with their own credit policies, trading practices, and other factors specific to the market participant.

Similarly, with regard to Section 4, the draft letter expresses fundamental opposition to the idea that the FSB should attempt to set specific fixed or minimum numerical haircut floors. Again, the theme is that we believe that the economic terms of a repo are best set by market forces, responding to current market conditions and a multitude of other factors that regulations can never adequately capture.

The letter does, however, support the FSB’s formulation of the scope of its proposed framework of numerical haircut floors. The scope is limited to situations where the primary motive is to provide financing to non-banking entities, and excludes cash-collateralized securities lending, transactions backed by government securities, and transactions where the non-bank is providing financing, such as where it is the repo cash lender.

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Securities Regulation - Investment Companies

Attachment

endnotes

[1] See Memorandum No. 27560, dated September 12, 2013. The consultation is in Annex 2 of Strengthening Oversight and Regulation of Shadow Banking, Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, Financial Stability Board (August 29, 2013), available at http://www.financialstabilityboard.org/publications/r_130829b.htm.