

**MEMO# 26196**

May 29, 2012

## **ICI Submits Letter on FSB Report on Securities Lending and Repos**

[26196]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 28-12  
INTERNATIONAL MEMBERS No. 19-12  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 36-12  
SEC RULES MEMBERS No. 44-12 RE: ICI SUBMITS LETTER ON FSB REPORT ON SECURITIES LENDING AND REPOS

Last month, the Financial Stability Board (“FSB”) requested comment on a report that identified a number of ways that securities lending and repurchase agreements (“repos”) might pose risks to financial stability. [\[1\]](#) The Report, along with any comments received, will form the basis for the FSB’s policy recommendations on ways that regulators around the world might strengthen the regulation of securities lending and repos. Those policy recommendations are expected by the end of the year.

On May 25, ICI submitted the attached comment letter on the report. The overarching theme of the letter is that securities lending and repo financing in the U.S. are subject to a number of regulatory requirements that, while designed to protect investors, also serve to allay the financial stability concerns highlighted in the Report. The remainder of the letter is briefly summarized below.

The letter very briefly describes the role registered investment companies in the U.S. play in the securities lending and repo markets. In doing so, it highlights the work of a special Task Force on Tri-Party Repo Infrastructure (the “Task Force”), which was formed in September 2009 under the auspices of the Payments Risk Committee, a private sector body sponsored by the Federal Reserve Bank of New York (the “FRBNY”). ICI participated on the Task Force along with several representatives from ICI member firms.

The letter then addresses certain of the financial stability concerns raised in the Report, including concerns over transparency, collateralization and counterparty risk, indemnification, and procyclicality.

Transparency. The Report suggests that it may be appropriate to consider, from a financial

stability perspective, whether transparency could be improved in either securities lending or repo markets. The letter states that, from their perspective as highly regulated, highly sophisticated institutional investors, U.S. funds have not found the level of transparency relating to securities lending or repo activities to be problematic. The letter describes the amount of market information available to securities lenders, and cautions against requirements for a real-time “ticker” or “consolidated tape” of securities loans. The letter argues that it would be difficult for any ticker to capture the information relevant to each securities loan, and that any marginal benefits of a securities loan ticker would be outweighed by its costs. The letter also describes the substantial amount of market information available in the repo market, highlighting in particular the market data now published by the FRBNY and the implementation, in response to a Task Force recommendation, of three-way repo trade confirmations. Lastly, the letter describes the amount of corporate disclosure U.S. funds provide about their activities as securities lenders or participants in the repo market.

**Collateralization and Counterparty Concerns.** The Report states that there are “financial stability risks associated with collateral re-use, whether arising from repo, securities lending, re-hypothecation of customer assets or margining of OTC derivatives.” In response, the letter states our base assumption that the FSB’s concerns in this regard do not stem from U.S. funds, because of the many regulatory requirements pertaining to collateralization in connection with securities lending and repo transactions. It then goes on to describe those regulatory requirements. It also describes, with respect to repos, the notable risk reducing recommendations of the Task Force that have now been implemented, including delaying the daily “unwind” of most tri-party repo transactions to move from early morning to mid-afternoon and the implementation of automated collateral substitution capabilities. The letter also describes the ways that money market funds deal with counterparty risk in repos, noting that money market funds are distinct from other lenders in the repo market in that they only deal with the highest quality counterparties. The letter also highlights the ways the repo markets are better prepared to deal with potential dealer defaults as a result of the recommendations from the Task Force. Lastly, the letter addresses a concern in the Report over the valuation of collateral, noting that in the U.S., all collateral must be marked-to-market daily.

**Indemnification.** The Report notes that many agent lenders indemnify their customers against the risk of borrower default, and suggests that such indemnification could incent the lender to look to its agent as the effective counterparty and avoid screening and monitoring the borrower. The letter argues against this proposition, concluding that an indemnity is unlikely, in our view, to cause funds to be any less rigorous in screening, monitoring, and approving borrowers.

**Procyclicality.** The Report expresses a concern that there is potential for securities lending and repo financing to influence the level of risk-taking within the financial system in a procyclical way. The letter expresses ICI’s belief that U.S. fund participation in securities lending or repo did not play a significant procyclical role in the financial crisis, and cautions the FSB to carefully consider the potential for unintended consequences that might come from policy recommendations designed to limit procyclicality.

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## [Attachment](#)

### **endnotes**

[1] See Financial Stability Board, Workstream on Securities Lending and Repos, Securities Lending and Repos: Market Overview and Financial Stability Issues, available at [http://www.financialstabilityboard.org/publications/r\\_120427.pdf](http://www.financialstabilityboard.org/publications/r_120427.pdf) (the “Report”).

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