



To: Messrs. Shiina; Noss; Thorn; Nagel
Copy: GFMA
ISLA

July 2, 2019

Re: Follow-up to discussion on BCBS SFT Minimum Haircut Framework

Dear Yasushi, Joe, Thomas, and Scott

On behalf of the ICMA European Repo and Collateral Committee (ERCC), I am writing to you to follow-up on some of the points we discussed when you met with the GFMA/ICMA delegation on April 5 2019. In particular, we wanted to respond to some of your questions related to the implementation of the BCBS SFT Minimum Haircut Framework with respect to securities lending and borrowing (SLB).

As we discussed, while the ERCC fully supports the policy goal of the framework to limit the leverage in the shadow banking sector (including securities lenders), it remains concerned that its scope may unintentionally capture a significant proportion of securities financing transactions (SFTs) that are not for the purpose of generating leverage and which would result in an economically unviable increase in the capital costs for banks entering into those transactions (as illustrated by the GARP 2018 SFT Haircut Study Follow-up Quantitative Impact Study – already shared with the FSB and BCBS). This would have broader implications for market efficiency and stability. We are especially concerned with impact to securities lending where the purpose of this market is not to create levered returns on assets.

Non-cash-collateralised securities lending

The ERCC understands that the framework is intended to apply to transactions where the primary motive is to provide financing leverage, rather than to borrow or lend specific securities. The ERCC also agrees that a requirement for the lending party to attest to the borrowing bank that they are not using the collateral received in order to create leverage is an effective means of achieving this objective. However, it is difficult to understand why this would only apply in the case of cash-collateral, and not in the case of non-cash collateral. Given the fungibility of both cash and non-cash collateral in creating leverage (as acknowledged in the framework's treatment of "collateral upgrades"), it would seem inconsistent that the exemption could not be applied in the case of both cash and non-cash collateral where the purpose of the transaction is not to provide financing.

We would therefore advocate to extend this attestation to non-cash collateral for consistency and to avoid unintended consequences.

Pledge structures

In our meeting we also raised the concept of “pledge structures”. Such structures provide for transactions in which a lender will transfer title of securities to a borrower with a simultaneous agreement by the borrower subsequently to transfer title of equivalent securities to the lender on a fixed date or on demand and on the basis that the borrower’s obligations will be secured by a pledge over the full collateral amount. “Initial Margin Pledge Structures” are already utilized by market participants, whereby the haircut or initial margin (IM) in a repo or securities lending transaction is secured on a pledge basis. The contractual frameworks for these transactions are often bilateral in nature, although ISLA has developed standardized documentation (linked to the GMSLA) to support pledge structures, while ICMA is looking to develop similar documentation linked to the GMRA.

Since the pledged collateral cannot be re-used (and therefore could not be mobilized to generate leverage), the ERCC would be interested to learn the BCBS’s view on the use of such pledge structures to collateralize SLB transactions and whether this would effectively qualify such transactions for the exemption from the minimum haircut framework.

Why this matters to the ERCC

The ERCC is the main industry representative body for Europe’s repo and collateral markets. While the SLB market does not fall directly under the remit of the ERCC, it is an integral and almost inseparable component of the broader SFT and collateral market. Repo Desks undertake SLB transactions as a normal course of their day-to-day financing and collateral management activity, particularly from the perspective of sourcing specific securities to support market-making and client trading. Without the supply of these securities through the SLB market, not only would the repo market lose access to a vital supply of securities and collateral, but this would also impact the ability of investment firms to provide market-making services or other important investment activities that involve the short-selling and/or borrowing of securities.

The ERCC would be very happy to provide more details on the points raised in this letter, to answer any questions you might have, and to continue to support the implementation of the framework in order to achieve its policy goals.

Sincerely

A handwritten signature in black ink, appearing to read "De Vidts", with a long horizontal line extending to the right.

Godfried De Vidts

Senior Advisor, ICMA European Repo and Collateral Committee