

March 2021

ISLA & ICMA response to the Basel Committee on Banking Supervision's Consultation on the technical amendments for minimum haircut floors on Securities Financing Transactions:

The International Securities Lending Association (ISLA) and The International Capital Markets Association (ICMA) would like to take this opportunity to raise our memberships' broader concerns on the implications of the BCBS minimum haircut framework, related to non-centrally cleared Securities Finance Transactions (SFTs), with respect to securities lending and borrowing and repurchase and reverse repurchase (repo) transactions.

ISLA & ICMA members fully support the BCBS' overall policy goals, to address financial stability risks that may arise from SFTs. Members acknowledge that while SFTs, such as securities lending and repo transactions, play a crucial role in supporting price discovery and secondary market liquidity, they may also be used to take on leverage as well as maturity and liquidity mismatched exposures, which may pose risks to financial stability.

We note that under the scope of the rule, as it is currently drafted, a significant number of SFT transactions would be captured that are not entered into, for the purpose of generating leveraged returns, such as securities lending and borrowing transactions. The Financial Stability Board (FSB) states in a report¹ titled 'Transforming Shadow Banking into Resilient Market-based Finance' in 2015, that the framework looks to '*limit the build-up of excessive leverage outside the banking system, reduce the procyclicality of such leverage, guard against the risk of regulatory arbitrage, and maintain a level-playing field*' however, there is no distinction between specific transactions that are for the purpose of financing and therefore do increase leverage, and for transactions such as securities lending and borrowing that are merely used to source a particular security, rather than for financing. Both ISLA and ICMA fear that this could unintentionally result in an increase in activity and intermediation, transferring these SFTs from banks to less regulated entities, thus not meeting the core purpose of the framework.

These potential unintended consequences were also highlighted in the EBA policy advice on the Basel III reforms on SFTs, August 2019² – '*As noted in that ESMA report³, the consistent treatment would ensure a level playing field in the EU financial system and address all potential sources of leverage outside the banking sector, while preventing the risk of regulatory arbitrage. Conversely, in the absence of a framework for non-bank-to-non-bank transactions, the application of haircut floors exclusively for bank-to-non-bank transactions may just lead market participants to shift their activities in the shadow banking sector. It should be noted that this potential effect was also mentioned by institutions in their feedback for the purposes of the CFA.*'

As such ISLA and ICMA strongly recommend that the BCBS clearly excludes these SFTs (securities borrowing and lending) from the scope of the framework, as their purpose is outside the concern of the policy, and implementing the policy as it stands, could consequently affect the functioning of these types of transactions, with a negative effect on the market. It is important to note that securities lending is a low risk, discretionary activity for asset owners and managers, and any fundamental changes to the current market structure may result in pushing lenders away from the market, therefore reducing market liquidity.

¹ [Financial Stability Board - Transforming Shadow Banking into Resilient Market-based Finance](#)

² [EBA POLICY ADVICE ON THE BASEL III REFORMS ON SECURITIES FINANCING TRANSACTIONS EBA- | 2 August 2019](#)

³ [Report on securities financing transactions and leverage in the EU Report prepared under the mandate in Article 29\(3\) SFTR](#)

Although the proposed technical amendments are welcomed by the memberships, in particular for borrowers (the counterparty paying the haircut on the collateral posted), ISLA and ICMA would request that all transactions where the bank is paying a haircut on the collateral posted to the securities lender, are deemed out of scope of the minimum haircut floors, in accordance with CRE56⁴ and provided for in a separate amendment.

The most frequent motives for a bank to borrow securities are to source superior collateral to improve their liquidity position, for example through a collateral upgrade, as well as to facilitate client short sale transactions. Current market practice within the industry is for the party that is initiating the borrow, to pay the haircut on the collateral delivered. The haircut is not determined by the relative asset quality of the two legs, or credit worthiness of the two parties. The framework should make clear that it is applicable to the party receiving the collateral and hence the party determining the haircut, and not the collateral provider, who as the haircut payer, will always fail to meet the minimum haircut threshold.

The exclusion of the haircut payer in securities borrow transactions, should be further independent of:

- a) the type of collateral posted to the lender (non-cash securities or cash) and;
- b) whether the lender can re-pledge or re-sell the securities collateral received respectively;
- c) how any cash collateral received is re-invested by the lender.

The vast majority of securities are borrowed from large custodian agent lenders, where non-cash collateral is usually held by a Tri-party Collateral Manager, acting on behalf of the agent lender and the borrower, and therefore these securities are not generally rehypothecated, thus the lender will not be able to create leverage in this way.

ESMA, in the previously mentioned report, stated that *'Numerical haircut floors for non-centrally cleared transactions, such as those set out by the FSB, can only be introduced and calibrated following a thorough analysis using granular SFT data (which will become available after the full implementation of the SFTR), and following careful assessment of the scope'*. As the final stage of SFTR implementation went live in January 2021, both ISLA and ICMA agree that further analysis is required prior to implementation of these rules.

Both ISLA and ICMA would welcome the opportunity to engage on this topic and would encourage further discussion. We remain at your disposal to answer any questions you may have.

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⁴https://www.bis.org/basel_framework/chapter/CRE/56.htm?inforce=20230101&published=20200327

About ISLA:

International Securities Lending Association (ISLA) is a leading industry association, representing the common interests of securities lending and financing market participants across Europe, Middle East and Africa. Its geographically diverse membership of over 160 firms, includes institutional investors, asset managers, custodial banks, prime brokers, and service providers. Working closely with the global industry as well as regulators and policymakers, ISLA advocates the importance of securities lending to the broader financial services industry. ISLA supports the development of a safe and efficient framework for the industry, by playing a pivotal role in promoting market best practice, amongst other things. ISLA sponsors the Global Market Securities Lending Agreement (GMSLA) and the annual enforceability review in over 60 jurisdictions globally. Through member working groups, industry guidance, consultations and first-class events and education, ISLA helps to steer the direction of the industry and is one of its most influential voices on the European and global stage. <https://www.islaemea.org/>

About ICMA:

ICMA is the trade association for the international capital market with around 600 member firms in over 60 countries, including issuers, banks, asset managers, central banks, infrastructure providers and law firms. It performs a crucial central role in the market by providing industry-driven standards and recommendations for issuance, trading and settlement in international fixed income and related instruments. ICMA liaises closely with regulatory and governmental authorities, both at the national and supranational level, to help to ensure that financial regulation promotes the efficiency and cost effectiveness of the capital market. More information available at <https://www.icmagroup.org/>