European Securities and Markets Authority

ESMA'S QUESTION & ANSWER (Q&A) TOOL

QUESTION SUBMISSION FORM

IDENTIFICATION
1. Name of entity
International Capital Market Association
2. Country of incorporation / Residence
Other - please specify below
Switzerland
3. E-mail address / Other contact details
andy.hill@icmagroup.org
4. Sector
Other
LEGISLATIVE REFERENCE
5. Level 1
Central Securities Depositories Regulation (CSDR) Regulation (EU) No 909/2014
6. Article/s of Level 1 Legislative Act
Article 7(4)(b)
7. Other relevant Act/s or Guidance
Article 22(2) of Commission Delegated Regulation supplementing Regulation (EU) No 909/2014 with regard to regulatory technical standards on settlement discipline
QUESTION
8. Subject matter
Mandatory buy-ins and open securities financing transactions
9. Question
Should "open" securities financing transactions (SFTs), or similar financing transactions, where the earliest contractual maturity is less than 30 business days be considered out of scope of the mandatory buy-in requirements?

10.	*Proposed answer*
	Securities financing transactions that do not have a pre-determined end-date and/or can be terminated by the lending party within a timeframe of less than 30 business days from notification should be considered out of scope of the buy-in obligation.
11.	*Relevant background*
	<u>Open trades</u> Open trades, which are effectively rolling 1-day trades, can be closed by either party, usually with one or two days' notice. Open trades are very common (constituting 77% of European securities lending transactions according to the most recent ISLA Securities Lending Market Report[1], and 6% of the outstanding European repo market according to ICMA's latest European Repo Survey[2]). Open, or similarly structured SFTs, have become increasingly important for: • liquidity and collateral management; • managing balance sheets in light of the additional costs of implementing new Basel capital rules; • providing lenders and beneficial owners with the flexibility to recall less-liquid securities should they sell them (which becomes even more important after the introduction of CSDR settlement discipline); and • reducing costs and settlement risks associated with rolling-over transactions. <u>Market response</u> If open SFTs were considered to be in scope of the CSDR buy-in requirements, firms would simply stop using them and replace them with rolling short-dated (e.g. 1-week) SFTs that would be out of scope. The net effect of this would be to increase costs, settlement risk, and overall market inefficiency.

[1] https://www.isla.co.uk/system/files/2018-09/Completed%20ISLA%20Report%20Sep%2018.pdf
[2] https://www.icmagroup.org/assets/documents/Market-Info/Repo-Market-Surveys/No-35-June-2018/ICMA-European-repo-market-survey-number-35-conducted-June-2018.pdf

In the event that open trades are deemed to be in-scope once they reach 30 business days, the likely result is that borrowers of securities on open will simply act to close those trades before the 30-days is reached, while simultaneously opening a new open trade to maintain the original position. Thus, there will be an administrative burden for the market, rather than the mere passage of time actually bringing open trades into scope.

However, this also creates a conflict of interests between lenders and borrowers. While borrowers of securities will wish to close-out open trades before they reach 30 business-days, and become in-scope of mandatory buy-ins, lenders of securities will have a strong preference that their open loans do reach 30 business days, since an in-scope end-leg will afford them greater protection in the event of the borrower failing to return the securities on time; particularly if this is linked to an onward cash sale. Thus, lenders may not take kindly to borrowers closing and re-opening trades as they approach the 30-day mark. Removing the difference payment asymmetry from the regulation (Article 7(6)/RTS Article 35) would help to resolve this conflict of interests, as would deeming open trades out-of-scope.

Similar SFTs

There are a number of SFT structures that are essentially the same as open trades in the sense that the earliest contractual maturity of the transaction is less than the 30-business day threshold. These include short-dated 'evergreen' or 'extendable' structures that are originally termed for less than 30 business days with an option for either party to execute early termination (again before 30 business days). The same reasoning for deeming vanilla open trades out of scope should also apply. If such transactions were to come into scope (say once they reached 30 business days) the market response would be either to terminate them early or to revert to rolling short-dated SFTs. Again, this would lead to an increase in cost and settlement risk, while making it more challenging for firms to manage their balance sheet and liquidity requirements.