EACH response to the ESMA discussion paper ‘Draft RTS and ITS under the Securities Financing Transaction Regulation’

April 2016
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1. Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties Clearing Houses (CCPs) in Europe since 1992. EACH currently has 20 members from 15 different European countries and is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciate the opportunity to provide feedback to the draft RTS and ITS for Securities Financing Transaction Regulation.

Before responding to concrete questions, we would like to highlight several comments that refer to the SFTR RTS and ITS and which do not refer to any particular question included in the consultation paper.

CCPs are significant users of SFTs, as well as providing a role in clearing transactions. Under Article 45(2) of Commission Delegated Regulation (EU) No. 153/2013, CCPs are required to invest 95% or more of the cash collateral that they hold in non-cash assets, such as government bonds. This is recognised in the Discussion Paper at paragraphs 216 and 269(b). However, we note that there seems to be no mechanism for SFT reporting to distinguish between cleared transactions and ‘CCP as user’ transactions (i.e. transactions where the CCP is investing its own capital or the cash collateral deposited by its Clearing Member).

Regarding the proportionality of the reporting obligation, the current scope contemplated under the proposed reporting framework is very wide, as it encompasses transactions, lifecycle events, collateral (including value and substitutions), and settlement details. This approach will result in a significant amount of data, which may not be practically reported. We also expect that some difficulties will arise in linking these elements together, for instance linking collateral with trades. As a result, it may be difficult for market participants and regulators to interpret the reported data and therefore achieve the transparency objective of the SFTR.

We expect that the implementation of SFTR reporting will result in significant costs for all market participants, given the complexity, level of granularity and quantity of information requested under the proposed framework. A simplification of the reporting process, focusing on key data elements only (such as counterparties, transaction value, settlement maturity, collateral amount and identity of custodian) would significantly reduce the implementation costs and would also improve data quality.

EACH members are furthermore very concerned about the potential duplication of reporting and regulation implied at paragraph 269, p. 82 of the Discussion Paper and its consequences for CCPs. In our view, the rationale for SFT regulation cannot be CCP supervision because EMIR already provides CCP’s regulators the access to all the information referred to here. Replicating it in a trade repository to which different regulators have access
has from our point of view no purpose, rationale or benefit if those regulators are not the CCPs' supervisors.

Finally, we foresee a general characterisation problem with respect to prime brokers under the Draft Rules at paragraph 250, p. 76. Prime brokers that hold a basket of securities as custodian and that may offer overdrafts or daylight lending, for example, should not be regarded as engaging in SFT, as this will lead to a conglomeration of reporting of little use. Paragraph 250 indicates that the full composition of their collateral portfolio (which may include loan participations) would need to be reported.

We are also concerned that a custodian might become subject to an SFT if it sends its client a bill and has a lien. This would prove an issue for CCPs and all other users of custodians. Custody relationships should be excluded from the reporting regime; even if a debt arises at any point as such debts commonly arise as a result of securities settlement.
2. Responses to specific questions

Q25: Do you agree with the proposed list of event types and technical actions? If not, which ones should be included or excluded?

The Draft Rules require reporting in the event of a ‘lifecycle event’ consisting of a rate change for a floating rate repo. This is in our view an onerous burden, especially if it means reporting to a trade repository that, for example, a bank’s base rate has changed. We would suggest instead that a new report should only be made if the contractual terms on rates are amended.

Q29: Are the proposed rules consistent with the existing market conventions for determination of buyer and seller? If not, please provide alternative proposals.

In paragraph 140, page 40, the position of the buyer and seller seems to be confused (back to front). Under market conventions, the buyer is usually the person to whom the securities are initially transferred, not the person to whom credit is extended (usually the seller). See, by way of analogy, the language used in the Global Master Repurchase Agreements published by ICMA and SIFMA (available at http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/global-master-repurchase-agreement-gmra/).

Q30: Are you aware of any other bilateral repo trade scenario? With the exception of tri-party agents that are documented in section 4.2.5, are there any other actors missing which is not a broker or counterparty? Please elaborate.

Three situations appear to be missing from contemplation in the Discussion Paper:

- Where the broker acts as principal to the transaction (e.g. a matched principal) as opposed to a purely executing broker. Note that this is particularly an issue if the transaction is cleared and a clearing member is then interposed.
- Indirect clearing and other ‘longer chain’, beyond the simple CCP-clearing member-client chain (i.e. where a bank is itself not a Clearing Member). EMIR has many provisions on indirect clearing which need reflecting here.
- As set out in the introduction above, the position of CCPs as users of SFTs (e.g. investing collateral on its own account or on the account of its clients). CCPs are significant users of SFTs. Under Article 45(2) of Commission Delegated Regulation (EU) No. 153/2013, CCPs are required to invest 95% or more of the cash collateral that they hold in non-cash assets, such as government bonds. This is recognised in the consultation paper at paragraphs 216 and 269(b) but there is no mechanism for SFT reporting to distinguish between cleared transactions and ‘CCP as user’ transactions.

Q32: Do you agree with the description of the repo scenarios?

In our view, the description in Scenario 5 should also reflect how FCM-cleared transactions operate. CM1 and CM2 in this model will be liable as principal for the transactions to the CCP, but are also acting as agent for Counterparties 1 and 2 respectively in clearing the transaction. The reporting protocol should still work however. Please see also the answer to question 34.
Q33: Are you aware of any other repo scenarios involving CCPs?

EACH believes that the Draft Rules do not consistently contemplate, or clarify the treatment of, a CCP that is not acting in its capacity as a CCP but rather in its capacity as an end-user of SFTs, e.g. when investing the proceeds of margin, or for the purposes of its own treasury management functions for the purposes of raising liquidity. Under Article 45(2) of Commission Delegated Regulation (EU) No. 153/2013, CCPs are required to invest 95% or more of the cash collateral that they hold in non-cash assets, such as government bonds. Whilst there is recognition of this function in paragraphs 216 and 269(b), EACH thinks that ESMA need to ensure this is considered throughout the Draft Rules and that ‘clearing’ reporting fields clearly identify, and distinguish between, the capacities in which the CCP is acting. The CCP in its capacity as end-user does appear to be contemplated, for example, in paragraph 272 but there is no different reporting field specified for CCP-as-user transactions. This could cause confusion if transactions to which CCPs are party are reported as uncleared by counterparties or by CCP. Please see also the answer to questions 30, 32 and 65, and the introduction.

Q34: Are there any other scenarios that should be discussed? Please elaborate.

Please see the answer to question 32. We see a general characterisation problem under the Draft Rules with respect to repos executed under ISDA master agreements. It is in our view not clear if they are to be treated as derivatives or SFTs.

Q45: What potential issues do reporting counterparties face regarding the reporting of the market value of the securities on loan or borrowed?

Users are required to report the market value of collateral on a daily basis, irrespective of whether the collateral composition for the SFT(s) does not change. As a consequence, there are likely to be significant difficulties and cost implications for users in complying with the Draft Rules.

If the Draft Rules are intended to build on the EMIR framework, it may be best for the daily reporting of collateral to be phased in to the timing of the Final Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, by sector. This is because many Non-Financial Counterparties and funds will not be engaging in daily collateral exchange before this time. Moreover, delegated reporting is likely to be complicated for these kinds of data, owing to confidentiality concerns.

Q46: Do such securities lending transactions exist in practice?

Please see also the answer to question 47. The proposals under the Draft Rules do not in our view distinguish between standalone securities lending transactions and those playing a role in a wider transaction, for example, a stabilisation.

Uncollateralised transactions would not seem to be a shadow banking activity with which this consultation is concerned, because there is no cash changing hands. In our view, ESMA would be better recommended to consider more generic anti-evasion procedures than to catch
simple securities transactions. Securities transactions are subject to separate reporting under MiFID II which should not be duplicated here. There is a risk that a reporting obligation in respect of ‘SFT without credit’ would cover simple securities transfers and custody arrangements, especially where assets are held with repositories or custodians in jurisdictions that do not recognise trusts.

Query also the basis for requesting daily valuations of securities, rather than when the transaction is first entered into (FSB guidance does not appear to require daily reporting).

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<tr>
<th>Q47: Do you agree with the proposal to explicitly identify non-collateralised securities or commodities lending transactions in the reporting fields? Please elaborate.</th>
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<td>Please see also the answer to question 46. The proposals under the Draft Rules do not in our view distinguish between standalone securities lending transactions and those playing a role in a wider transaction, for example, a stabilisation.</td>
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<th>Q65: Are there other entities that do not act as counterparties but can be involved in the transaction chain (e.g. brokers or intermediaries)?</th>
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<td>Generally, the roles of guarantors are not covered by reporting obligations. Whilst this is consistent with EMIR, we note that guarantors are much more common in SFTs than in derivatives and they are an important part of SFT economics. Please see also the answer to question 33.</td>
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<th>Q78: Are there any situations different from the described above where the actual transfers between headquarters and branches or between branches can be considered transactions and therefore be reportable under SFTR? Please provide specific examples.</th>
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<td>We refer to paragraph 4.3.2.2, p. 57-58. ECH believes that clarification is needed as to what the last column is meant to refer to. Is this whether or not the ‘branch’ reporting field needs to be completed? Are we correct in understanding that branch reporting is not applicable only if (1) there is no EU nexus at all (so no reporting obligation), or (2) the SFT is between EU entities/EU branches?</td>
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Q80: Do you agree with the proposal to link the legs of a cleared transaction by using a common identifier?

Prior UTIs

We note that the concept of Prior UTI is introduced in the reporting, meaning that the original 52-digit unique trade identifier of the trade must be provided by the members in their trade report to the CCP and that the CCP in turn must store this information in its system and provide it in its reporting. The reason for using prior UTIs is for competent authorities to be able to track the chain of trades. We understand that this is the first time that this requirement is proposed in Europe and in our view will require substantial system changes for CCPs, as well as mandatory API changes for members.

We understand that the recording of prior UTIs is important from regulators’s point of view, however we note that:

- This requirement will have a high impact on CCPs and members and require substantial API changes;
- As the UTI needs to be issued by the bilateral counterparts and reported to the CCP it remains unclear to us what should happen if no prior UTI or differing prior UTIs are reported by the bilateral counterparts. We do not think making the prior UTI a mandatory matching field for CCP novation is a good idea – this would seriously constrain the novation of bilateral transactions into central clearing, preventing proper risk management and therefore increasing systemic risk;
- The new draft EMIR RTS/ITS does include a 52 alphanumeric digit ‘Report Tracking Number’ but there are no requirement on this being globally unique or the actual prior UTI, even though the need for prior UTIs on derivatives trades should be at least equally important for regulators; and
- The CPMI-IOSCO report on global harmonization of UTIs is still in a consultative stage.

In order to ensure a consistent approach at global level, especially for derivatives which are traded and cleared in a global market, we therefore request that the introduction of this requirement is aligned with the finalization of the UTI standards at global level and the new draft EMIR RTS/ITS. We believe that this would also ensure consistent reporting regime between EMIR and SFTR is implemented.

UTI generation

EACH believes that there is no detail on how UTIs are generated. If this is to be the means by which cleared and uncleared trades, or CCP-as-end-user trades are distinguished, then this should be made more explicit. See also comment on use of shared UTIs for cleared trades in the answer to question 81 below. The intention of this section (paragraphs 208 – 215) appears to be to ‘link’ cleared chains of contracts through shared UTIs for all transactions in the chain. This would involve considerable work for only temporary benefit. This is because CCPs will be regularly netting the transactions of clearing members, such that there will inevitably be no
Q81: Could you suggest robust alternative ways of linking SFT reports?

Please see also the answer to question 80. EACH believes that there is no detail on how UTIs are generated. If this is to be the means by which cleared and uncleared trades, or CCP-as-end-user trades are distinguished, then this should be made more explicit. The intention of this section (paragraphs 208 – 215) appears to be to ‘link’ cleared chains of contracts through shared UTIs for all transactions in the chain. This would involve considerable work for only temporary benefit. This is because CCPs will be regularly netting the transactions of clearing members, such that there will inevitably be no link between the CCP-CM1 and CCP-CM2 transactions after an offsetting trade is submitted for clearing. Either CM1 or CM2 could close out the transaction independently by submitting an opposite transaction with CM3 for clearing.

Q82: Are the different cases of collateral allocation accurately described in paragraphs 221 - 226? If not, please indicate the relevant differences with market practices and please describe the availability of information for each and every case.

Many SFTs are based on a temporary exchange or loan of cash or securities against some kind of collateral. Since collateral is such a big part of the transactions, ESMA has proposed highly detailed requirements for how the collateral should be reported, down to listing the individual collateral components for each trade, and their respective values. The problem is that as far as we can see, there is no differentiation in the draft RTS/ITS between reporting of the collateral that is part of the contractual agreement (e.g. the specific bond in a bond repo contract) and collateral that is posted in line with the EMIR clearing provisions (e.g. on a portfolio basis to cover the general counterparty risk. For us as a CCP this is troublesome because:

- For cleared SFTs, the CCP does not actually hold the underlying components but only passes these along between the counterparties. Instead the CCP calculates a margin requirement for each of the parties that needs to be covered using separate collateral. This requirement is calculated on a portfolio basis based on the members’ net exposure. It is therefore unclear to us how to report this type of collateral both on a trade by trade, and on an individual collateral instrument basis;
- Some EACH members allow clearing members to clear repos (under SFTR) and derivatives (under EMIR) in the same collateral portfolio allowing margin offsetting between the different types of instruments. As the value of the collateral posted to cover the margin of the whole combined portfolio is already reported under EMIR it would need to be reported twice;

We assume that reporting of collateral to cover a CCP’s margin requirement will not become part of the SFTR reporting. We suggest that separate fields for portfolio-based collateral are introduced in line with the EMIR reporting standards and that when the collateral is already reported in full under EMIR it should be possible to only include a reference to the collateral
portfolio code in the reporting under SFTR. In accordance with the EMIR reporting requirements it shouldn’t be required to specify this collateral on an instrument level. We note that the paper stresses the goal to align the reporting under SFTR with EMIR and other regulations is expressed in the discussion paper. We fully agree with this goal and would like to highlight that, in our view, there are several instances (such as those described above) where the proposed requirements do not fully align.

Furthermore, ESMA’s proposed amendments to the EMIR ITS/RTS in turn refer to alignment with MiFIR and on-going work by CPMI-IOSCO to harmonize reporting of OTC derivatives. In light of this we would appreciate if ESMA could include further discussion on when it envisions the reporting to be consolidated between the different regulations and – when discrepancies exist – provide a discussion on which reporting formats will persist. This would help affected parties to make better design decisions in their technical implementation and plan for expected system changes in the coming years.

**Q85: Do you foresee any issues on reporting the specified information for individual securities or commodities provided as collateral? If yes, please elaborate.**

Please see also the answers to questions 87 and 93. In our view, the Draft Rules do not fully take into account delivery by value (‘DBV’) repo trades, which are frequently executed on a short term basis. Under DBV repos, where cash is borrowed or lent (often overnight only) against collateral, a settlement system may automatically select and deliver collateral securities whose identity is of little interest provided they satisfy pre-agreed criteria. The substitution of securities is common and frequent. This may present practical difficulties in implementing the proposed reporting of collateral (in particular the level of detail contemplated in question 85 and the unique identification contemplated in question 87), collateral pools and collateral baskets. The value of, and potentially parameters for, such collateral (rather than composition) should be sufficient as reporting fields.

The text in paragraph 231, page 71, suggests additional entities will now have LEIs, including Issuers and the UK government. We would appreciate clarification as to whether this is indeed ESMA’s intention.

**Q87: Would you agree that the reporting counterparties can provide a unique identification of the collateral pool in their initial reporting of an SFT? If no, please provide the reasons as to why this would not be the case.**

Please see also the answers to questions 85 and 93. In our view, the Draft Rules do not fully take into account delivery by value (‘DBV’) repo trades, which are frequently executed on a short term basis. Under DBV repos, where cash is borrowed or lent (often overnight only) against collateral, a settlement system may automatically select and deliver collateral securities whose identity is of little interest provided they satisfy pre-agreed criteria. The substitution of securities is common and frequent. This may present practical difficulties in implementing the proposed reporting of collateral (in particular the level of detail contemplated in question 85 and the unique identification contemplated in question 87), collateral pools and collateral baskets.
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**Q93 : Do you foresee any challenges with the proposed approach for reporting updates to collateral? What alternatives would you propose? Please elaborate.**

Please see also the answers to questions 85 and 87. In our view, the Draft Rules do not fully take into account delivery by value (‘DBV’) repo trades, which are frequently executed on a short term basis. Under DBV repos, where cash is borrowed or lent (often overnight only) against collateral, a settlement system may automatically select and deliver collateral securities whose identity is of little interest provided they satisfy pre-agreed criteria. The substitution of securities is common and frequent. This may present practical difficulties in implementing the proposed reporting of collateral (in particular the level of detail contemplated in question 85 and the unique identification contemplated in question 87), collateral pools and collateral baskets. The value of, and potentially parameters for, such collateral (rather than composition) should be sufficient as reporting fields.

**Q94 : Is it possible to link the reports on changes in collateral resulting from the net exposure to the original SFT transactions via a unique portfolio identifier, which could be added to the original transactions when they are reported?**

EACH believes that the provisions requiring reporting of collateral reuse may be unworkable or render delegated reporting unworkable, because (a) the counterparties would expect to be able to delegate reporting to their banks but will not necessarily want to share information on the percentage of reuse of their securities with them; and (b) if collateral reuse is calculated on an aggregate/net basis across transactions with counterparties with the same underlying, no single entity will have visibility on that aggregate information.

This therefore appears to require a third party to be involved (whereas currently, we understand reporting under EMIR is often carried out by one or other member of the transaction). Concentration of reporting services in a limited number of third party service providers may itself give rise to additional risks relating to security and dependency.

The fields (yes/no) are also unhelpful, given that reuse will likely happen mostly on a partial basis. We would suggest the data to be captured is whether reuse is permitted (and the parameters if so) or not. The actual exercise of reuse rights (and percentages thereof) will be a function of other external factors. Please see also answer to question 117.

**Q99 : Do you agree with the description of funding sources mentioned above?**

We foresee a general characterisation problem with respect to prime brokers under the Draft Rules at paragraph 250, p. 76. Prime brokers that hold a basket of securities as custodian and that may offer overdrafts or daylight lending, for example, should not be regarded as engaging in SFT, as this will lead to a conglomeration of reporting with little use. Paragraph 250 indicates that the full composition of their collateral portfolio (which may include loan participations) would need to be reported.
Q117: Which alternatives do you see to estimate the collateral re-use?

Please see the answer to question 94. In our view, the provisions requiring reporting of collateral reuse may be unworkable or render delegated reporting unworkable, because (a) the counterparties would expect to be able to delegate reporting to their banks but will not necessarily want to share information on the percentage of reuse of their securities with them; and (b) if collateral reuse is calculated on an aggregate/net basis across transactions with counterparties with the same underlying, no single entity will have visibility on that aggregate information.

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The fields (yes/no) are also unhelpful, given that reuse will likely happen mostly on a partial basis. We would suggest the data to be captured is whether reuse is permitted (and the parameters if so) or not. The actual exercise of reuse rights (and percentages thereof) will be a function of other external factors.

Q120: Do you agree with the rationale for collection of information on the settlement set out in this section?

For cleared SFTs, the CSD reported at registration of a trade may be different to the CSD at which settlement actually takes place. Indeed, some collateral may settle in different CSDs, and the actual place of settlement is only known on the settlement date. We therefore recommend that these fields should not be mandatory for cleared SFTs or that this data may be reported once, at end-of-day on the settlement date.

Q133: What are the expected benefits from full reconciliation? What are the potential costs from TR and counterparty perspective to adopt a full reconciliation approach? In terms of the matching of data, which of the data fields included in Section 6.1 can be fully reconciled and for which ones certain degrees of tolerance has to be applied? Please provide concrete examples. Please elaborate.

The Draft Rules propose double-sided reporting for SFTs. However, many participants propose under EMIR to move to single-sided reporting (although query then how reuse of collateral will be reported). We would strongly request a coordinated determination on this issue more generally should take place, in order to ensure a rational approach that avoids the development of an expensive double-sided system for SFTs that may be replaced. This should be considered in the context of paragraph 291 onwards, which requires reports to be fully reconciled.

Please note that one EACH member does not support the answer this question.

- END -