

Securities Finance Regulatory Update

Securities Financing Transactions Regulation (SFTR)

June 2016

James Day, Business Executive for Securities Finance, EMEA, BNY Mellon, and Charles Morris, Senior Associate, Clifford Chance, hosted a call on the impact of the Securities Financing Transactions Regulation (SFTR). Under this regulation, securities financing transactions ("SFTs") cover a broad array of transactions including repos, stock loans, certain commodities lending/borrowing and margin lending (which includes transactions in which one counterparty extends credit in connection with the purchase, sale, carrying or trading of securities).

During the call, James and Charles discussed the SFTR's three principal requirements:

- conditions for collateral reuse;
- disclosure of securities financing transactions by UCITS and alternative investment funds to their underlying investors; and
- reports of securities finance transactions to trade repositories.

CONDITIONS FOR COLLATERAL REUSE

With collateral reuse, it's important to understand the different methods under which collateral can be taken. In many markets, collateral can either be taken on a title transfer basis or pursuant to a security interest arrangement. With title transfer, the collateral taker becomes the actual owner of the collateral securities and can reuse these securities as collateral in other transactions. With a security interest arrangement, the collateral remains the property of the collateral provider, but relatively recent EU-derived laws have allowed the collateral receiver to reuse collateral securities in other transactions.

SFTR's Article 15 places conditions around the reuse of debt and equity securities received as collateral. Under SFTR, before a collateral receiver may reuse collateral securities, it must obtain the collateral provider's express written agreement to one of the following:

- providing the collateral under a title transfer arrangement or
- the collateral receiver's right of reuse under a security interest arrangement.

In addition, Article 15 requires that the collateral receiver notify the collateral provider of the risks relating to collateral reuse. The jurisdictional scope of this notification requirement is quite broad and applies whenever there is even a tangential nexus with the European Union. In practical terms, this SFTR requirement may result in a market participant receiving hundreds of reuse notifications from their counterparties.

How BNY Mellon Can Help

BNY Mellon has worked closely with the International Securities Lending Association (ISLA) to create an industry standard reuse notification, and ISLA, along with other industry bodies, have now issued a reuse notification document to be used by market participants. If BNY Mellon acts in an agency capacity, we will send and receive these reuse notifications on behalf of clients that contract with the BNY Mellon institutional



For more information on BNY Mellon securities finance capabilities or to continue this SFTR discussion, please contact us.

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bank, the London branch of The Bank of New York Mellon or CIBC Mellon. If a securities borrower wishes to send BNY Mellon notification letters for the transfer of collateral, BNY Mellon will collect those letters on the clients' behalf, store them and post them on the Workbench client portal. If BNY Mellon acts as a principal to a collateralised trade, we will send out the required reuse notice to the appropriate counterparty.

DISCLOSURE OF SECURITIES FINANCING TRANSACTIONS (SFTS) TO UNDERLYING INVESTORS

The SFTR also addresses concerns that fund investors weren't aware of the extent to which SFTs were being used and thus didn't fully understand their investment and the implicit risks. To help combat these issues, the SFTR introduces disclosure and transparency requirements that will come into effect over the next few years.

Under SFTR Article 13, UCITS and alternative investment fund (AIF) managers must make detailed disclosure of their funds' use of SFTs and total return swaps. These disclosures must be made on a regular basis in annual reports and, for UCITS, in their half-yearly reports as well. Details listed in these annual reports and half-yearly reports would include the top ten counterparties for each type of SFT and the funds' total return swaps. UCITS and AIFs will also have to comply with SFTR Article 14 which requires that prospectuses and offering memoranda disclose whether the fund will enter into SFTs and total return swaps, and if so, the types of deals they plan to pursue. Disclosure details in these documents will include acceptable collateral, collateral valuation and the criteria used to select counterparties.

How BNY Mellon Can Help

As an agent lender, BNY Mellon has SFT information which can help clients with this disclosure requirement. Clients can obtain this information during regular review sessions with the BNY Mellon relationship management team.

REPORTING SFTS TO TRADE REPOSITORIES

This requirement stems from concerns around the "shadow banking" sector and how SFTs potentially increase risk in ways that the prudential regulators could not monitor. Under SFTR, counterparties will need to report full details of each SFT to a registered EU trade repository, and this trade repository reporting obligation gives prudential regulators the ability to collect information on systemic risk. SFT details must be reported by the end of the next working day after the transaction is entered into, modified or terminated. If both parties to a SFT are within the scope of SFTR, both will need to report the transaction. This reporting may also be delegated to a third party.

How BNY Mellon Can Help

The SFTR trade repository reporting requirement is still being finalised, and BNY Mellon will work with the industry on its impact on the securities finance industry, especially with regard to the T+1 reporting deadline. As a tri-party collateral management provider, BNY Mellon has the information that can help our clients report SFT details, and, as we learn more about this requirement, we will work with our clients to help them with this new reporting obligation.

SFTR requirements introduce significant changes and present challenges for the securities finance industry. BNY Mellon will continue to work closely with industry bodies and our peers to understand these challenges as we all move forward in implementing these regulatory reforms.