Trending Topics: Highlights from a BNY Mellon Markets Roundtable

At our April 2016 Buy-Side Forum in London, we gathered clients, consultants and industry experts to discuss trends around collateral management and securities lending. These trends can potentially affect market participants' day-to-day activities, counterparty relationships and documentation and are topics that are starting conversations within many organisations as each looks to plan and prepare for the evolving global financial landscape.

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SECURITIES LENDING

TREND: TRANSFER OF TITLE VS. PLEDGE
For EMEA securities lending transactions, margin is usually handled under a transfer of title arrangement. However, recent discussions with both borrowers and lenders are exploring the potential use of the pledge structure which is fairly common outside of EMEA. Driving this conversation are balance sheet and leverage ratio considerations. Under a pledge arrangement, the haircut, and in fact the full collateral amount, would receive more favourable treatment for balance sheet and leverage ratio calculations.

Impact: Current legal documentation is based on transfer of title so changing to a pledge arrangement would involve significant changes.

TREND: NON-CASH COLLATERAL
According to International Securities Lending Association (ISLA) research presented during the forum, the proportion of non-cash collateral used in securities lending transactions in EMEA continues to increase, but there may be a ceiling on this growth due to the fact that many U.S. beneficial owners can only accept cash as collateral. Equities account for a significant percentage of this non-cash collateral, while corporate bonds are out of favour due to liquidity issues.

Impact: Recognising that beneficial owner investment guidelines are a major driving force behind the assets received as collateral, beneficial owners may wish to review how equity collateral would work within their securities lending programmes.

REGULATORY ROUND-UP

Securities Financing Transaction Regulation (SFTR) – SFT technical reporting standards are due at the end of 2016 with mandatory SFT reporting by banks scheduled for one year after the technical reporting standards are delivered. Other SFTR ramifications include:

- T+1 reporting – T+1 presents issues because with non-cash collateral, a full picture of a transaction isn't available until S+1.
- Dual-sided reporting – In a securities lending transaction, dual-sided reporting isn't always achievable because certain data is only available from one participant in the securities lending trade. For example, when a lender receives collateral, either bilaterally or through a tri-party agent, only the lender or its agent knows how the collateral has been allocated and where the collateral is being held. The broker can only report on the data that the lender or its agent has supplied.
- Risk disclosure requirements – Article 15 of the SFTR covers risk disclosure requirements that will come into effect July 13. Risk disclosure is required for collateral re-use.

Markets in Financial Instruments Directive (MIFID) – Forum participants shared their thoughts on MiFID's impact on securities lending.

- Best execution requirements – MiFID's best execution requirements for agency securities lending will be challenging, and industry bodies are working on providing guidance in the form of best execution practice and principles.
- SFT reporting – MiFID also has SFT reporting requirements. There may be further changes underway, as the ECON Committee of the EU Parliament is reconsidering SFT pre-trade and post-trade transparency reporting requirements under MiFID.
- Transfer of Title – MiFID requirements do not allow transfer of title arrangements with retail clients. The distinction between professional clients (e.g., national institutions, large corporations and governments) and retail clients can become challenging when dealing with smaller local authorities. These local authorities are not defined as professional clients under MiFID, but they can elect to be treated as professional clients. This distinction will be important when assessing counterparties to financing transactions.

Central Securities Depository Regulation (CSDR) – The CSDR's mandatory buy-in provision has potential negative effects on liquidity, but it shouldn't come into effect before the transition to T2S. Industry participants are currently reviewing ESMA's proposed exclusion of repos of <30 days from the mandatory buy-in process. The CSDR also intersects with the SFTR in terms of reporting; accurate reporting under the SFTR can help manage the possibility of mandatory buy-ins and fines under CSDR. An efficient post-trade operating environment, perhaps including the use of a tri-party agent or a CCP, can help support this need for accurate reporting.

There are industry resources available that map the various regulations along the trade cycle. This mapping can help market participants prepare in terms of operations, technology and reporting.

Thank you to our Buy-Side Forum participants for sharing their insights and helping us all to gain a better understanding of collateral management and securities lending in today's market

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