Response of the Bond Dealers of America to
Consultative Document
Strengthening Oversight and Regulation of Shadow Banking
A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos
18 November 2012

The following responses are based upon input by members of the Bond Dealers of America (BDA). BDA is a Washington, D.C.-based trade association representing middle-market securities dealers and banks focused on fixed income. For information regarding BDA members, visit www.bdamerica.org.

Q1. Does this consultative document, taken together with the earlier interim report, adequately identify the financial stability risks in the securities lending and repo markets? Are there additional financial stability risks in the securities lending and repo markets that the FSB should have addressed? If so, please identify any such risks, as well as any potential recommendation(s) for the FSB's consideration.

Yes, this document adequately outlines the risks in the repo and securities lending market. BDA does not think it addresses the speed for which unwinds take place in a stress event.

Q2. Do the policy recommendations in the document adequately address the financial stability risk(s) identified? Are there alternative approaches to risk mitigation (including existing regulatory, industry, or other mitigants) that the FSB should consider to address such risks in the securities lending and repo markets? If so, please describe such mitigants and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?

In the instances where a firm caused a counter party exposure the reaction by the market to mitigate loss was swift with buy ins and sale of collateral. Recommendations on transaction repositories, historical reporting of transactions, limitations of market participants will do little to limit this financial risk. Market participants will react much faster than anything the FSB will implement. The implementation of minimum haircuts on asset classes could stay ahead of a stress event.

Q3. Please explain the feasibility of implementing the policy recommendations (or any alternative that you believe that would more adequately address any identified financial stability risks) in the jurisdiction(s) on which you would like to comment?

A trade repository (TR) would be difficult and expensive to implement. A central counterparty (CCP) for repos would be difficult and would almost have to be

implemented by one of the two clearing banks or the Fed as most repos are for Fed items.

Q6. Do you agree with the information items listed in Box 1 for enhancing transparency in securities lending and repo markets? Which of the information items in Box 1 are already publicly available for all market participants, and from which sources? Would collecting or providing any of the information items listed in Box 1 present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided to replace such items.

While agreeing that this would increase transparency, disclosing terms, asset type, counter party, and rates in both the repo and securities lending would allow competitors to garner valuable information that is essentially proprietary and confidential.

Q7. Do you agree TRs would likely be the most effective way to collect comprehensive market data for securities lending and/or repos? What is the appropriate geographical and product scope of TRs in collecting such market data?

Citing concerns in Q6, a TR raises questions as to cost to set up a TR, what would be done with the data and who would be the ultimate beneficiaries or owners of the collected data. Firms may be more comfortable posting this data to a regulatory body, such as FINRA, as a supplemental report knowing the data would be confidential.

Q8. What are the issues authorities should be mindful of when undertaking feasibility studies for the establishment of TRs for repo and/or securities lending markets?

Q8. It is obvious that the industry would have to pay for the establishment of the TR when costs and spreads are already razor thin.

Q9. Do you agree that the enhanced disclosure items listed above would be useful for market participants and authorities? Would disclosing any of the items listed above present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be disclosed instead.

Yes, this information would be useful for market participants and authorities and for that reason it would disclose confidential and proprietary information. There could be confidential customer information disclosed, such as doing reverse repos or sec lending, that could be a violation of legal agreements.

Q11. Are the factors described in section 3.1.2 appropriate to capture all important considerations that should be taken into account in setting risk-based haircuts? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?

BDA does not believe there should be a regulatory approach to what is a market driven activity. Participants in this market have different levels of risk tolerance that could require different haircut levels, just as different banks may require more or less equity in a lending transaction based on their risk tolerance.

Q12. What do you view as the main potential benefits, the likely impact on market activities, and possible unintended consequences of introducing a framework of numerical haircut floors on securities financing transactions where there is material procyclicality risk? Do the types of securities identified in Options 1 and 2 present a material procyclical risk?

This will prevent some of the larger firms from being too leveraged. While not a fan of numerical haircuts, it is not BDA middle-market firms that abuse the excess leverage that the large firms and banks enjoy. This would not have a material impact on BDA members and may be one of the few proposals that is out in front on a potential stress event.

Q20. Do you agree with the principles set out in Recommendation 9?

Language in margin agreements seem to be sufficient in disclosing to customers that lending firms have the right to re-hypothecate their securities bought on credit to finance their debt. Current regulations prohibit securities firms from re-hypothecating fully paid for segregated customer securities. There are several market participants, such as trust companies, that re-hypothecate customer securities to enhance yields in portfolios and they should not be eliminated from participation.

Q21. Do you agree with the proposed minimum standards for valuation and management of collaterals by securities lending and repo market participants? Are there any additional recommendations the FSB should consider?

BDA believes this is already in place in the equity securities lending market as the vast majority of positions are marked to market on a daily basis. Market participants are doing this in most repo transactions and do not believe that a regulatory standard should be implemented.

Q22. Do you agree with the policy recommendations on structural aspects of securities financing markets as described in sections 4.1 and 4.2 above?

Current Risk Management Association contracts for Repurchase Agreements and Securities Lending address ownership and liquidation of collateral in a stress event such as a participant failure. Allowing a CCP or bankruptcy laws to intervene in this process could cause additional liquidity stresses by counter-parties of the distressed firm.

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