The International Securities Lending Association
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Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel,
Switzerland

15 December 2014

Consultation Document: Regulatory Framework for Haircuts on Non-Centrally Cleared Securities Financing Transactions

Dear Sirs,

We appreciate again the opportunity to respond to the latest FSB Workstream 5 consultation on the regulation of haircuts on securities financing transactions ("SFTs"). As you will see below we have provided responses to some of the consultation matters that our members have expressed views upon. In addition we have taken the opportunity to provide some brief commentary on the finalised framework for haircuts for non-centrally cleared SFTs between banks and non-banks where our members believe there would be value in some additional clarifications from the FSB. As always we remain at your disposal.

ISLA Response to Annex 4: Proposed application of numerical haircut floors to non-bank-to-non-bank transactions

Q1. Do you agree that the application of the framework of numerical haircut floors as described in Section 3.3 to non-bank-to-non-bank transactions will help to reduce the risk of regulatory arbitrage and would maintain a level playing field?

We generally agree that the application of the framework of numerical floors should be extended to cover non-bank to non-bank transactions. This would ensure a level playing field between all market participants and be consistent with the FSB's objective of using haircut regulation to limit the build-up of leverage outside of the banking system.
That said we do not believe that the level of transactions between non-bank entities is material and FSB and regulators should consider the costs of implementing the regime (which are likely to be higher than for transactions involving banks) versus the benefits of doing so. It is possible that application of numerical floors for bank to non-bank entities, together with tightening bank capital and leverage constraints will increase the attractiveness of SFTs between non-banks. Of course the FSB and regulators around the

world should be in a position to monitor trends in this regard as a result of the agreed transparency recommendations.
We believe however that intra-group transactions should be exempted from the numerical floors. Intra-group transactions are often undertaken to meet regulatory demands (such as where collateral is moved from a group entity that holds collateral securities centrally, to a market facing entity that is licensed to provide services to clients in a particular jurisdiction) and applying numerical floors to intra-group transactions would appear to be unnecessary. The haircut floors should be restricted to circumstances where the transaction occurs with another non-related legal entity.
Finally we believe that the same exemptions that apply to government securities, and certain cash collateral and collateral upgrade transactions should also apply to any framework for non-bank to non-bank financing.

Q2. In your view, how significant is the current level of non-bank-to-non-bank transactions? Do you expect that level to increase going forward and why? What types of non-bank entities are, or could be, involved in such transactions?

We do not collect data on the level of non-bank to non-bank securities finance activity, however anecdotally we understand this to be a very small proportion of the overall market today. It would be reasonable to expect that given a more challenging prudential regulation environment for banks that the non-bank sector could grow. We believe that this would be much more likely if national/ regional regulators implement tougher standards for numerical floors for bank to non-bank financing than recommended by the FSB. Should regulators impose higher floors than the levels published by the FSB we would expect that this would incentivise firms to transact business in circumstances where the floors are lower (for example with entities in differently regulated jurisdictions).

Q3. Do the approaches set out above cover all potential approaches in applying numerical haircut floors to non-bank-to-non-bank transactions? Are there any other approaches? If so, please describe.
Q4. Please provide any comments you have on the strengths and weaknesses of the approaches set out above, as well as any other approaches you believe the FSB should consider. What issues do you see affecting the effective implementation of numerical haircut floors for non-bank-to-non-bank transactions?
Q5. What forms of avoidance of the numerical haircut floors are most likely be employed for non-bank-to-non-bank transactions? Which of the proposed implementation approaches is likely to be most effective in preventing such avoidance?

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Q6. If different entity-type regulations are used, do you see the need to ensure comparative incentives across different entity types? If so, please describe any potential mechanisms that may help ensure comparative incentives across entity types?
Q7. If market regulation is used, should the FSB consider setting a materiality threshold of activity below which entities do not need to register? If so, what could be an appropriate level for such a threshold?

We generally do not have strong views about the implementation approaches available to regulators but believe that the FSB has identified the possible options for applying the framework.
Given the global nature of the SFT markets it would be highly desirable if the implementation approach was broadly consistent in key markets.
As stated earlier we believe that intra group transactions should be exempted from the application of numerical floors.

Q8. Do you see the need for a phase-in period in applying numerical haircut floors to nonbank-to-non-bank transactions, and if so how long should it be and why? Does the appropriate phase-in period vary depending on which approach is followed? Should it vary by jurisdiction based on the size and importance of the non-bank-to-non bank sector or should it be consistent across jurisdiction.

We have no specific suggestions but recognising that implementation of haircut regulation for all non-bank entities is likely to be more complex than for banks, and the fact that we do not consider it likely that the level of non-bank to non-bank activity is currently material, regulators should be given considerable time to implement measures. This will ensure there is sufficient time to consider the most appropriate methods of implementation and to allow for appropriate consultation with stakeholders.

ISLA Comments on the FSB Regulatory Framework for Haircuts on Non-Centrally Cleared Securities Financing Transactions

We would also like to take this opportunity to provide some comments on the October Haircuts Framework where members have raised questions to us regarding its interpretation. Whilst we understand that the detailed implementation of the framework will be a matter for national and regional regulators, we believe it may be helpful if the FSB could consider providing clarification to increase the chances of a globally consistent approach.

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Qualitative Standards for Haircuts.
It is customary that where institutional investors lend securities against collateral (cash or other securities) that the lender imposes a haircut on the collateral they receive. This is important as the lending of securities by these investors is considered to be a discretionary activity in which the risks are managed to low levels. We would expect that securities lenders would comply with the qualitative standards when setting haircuts on the collateral they receive. It is important in this context that the lender is considered as the collateral receiver (rather than the borrower of the securities being lent). This situation is managed in the framework for numerical floors whereby cash collateral and collateral upgrade securities lending transactions are exempted.
It would be helpful if the FSB could offer some clarification in this regard.

Numerical Floors.
Regarding the exemptions for cash collateralised securities lending (3.3), we understand (and agree with) the rationale for exempting cash collateral. Two types of reinvestment are exempted and we note that in the case of cash collateral that is reinvested in accordance with the FSB's minimum standards, the counterparty (cash collateral provider) may rely on representations by the lender that this is the case. For the other condition, where the maturity profile of the loans and collateral reinvestment does not give rise to material liquidity mismatch, the framework does not explicitly state that the counterparty may rely upon representations by the lender. We believe that implementation of this recommendation will only be practicable if representations may be given and relied upon and would appreciate clarification of this.

Regarding collateral upgrade transactions (3.4) we note that the framework states that the exemption for securities lending (where collateral received is not reused) "could" be exempted from the haircut floors. We note the use of the word "could" and wonder in what circumstances regulators might choose not to allow this? We see no policy reason why these transactions, where the primary motive of the transaction is not financing, should be in scope for the application of numerical floors and would appreciate clarification of the FSB's position on this.

We hope that this response is helpful to the FSB and look forward to working further with you on this matter.

Yours sincerely,

Kevin McNulty
Chief Executive

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