

Press release

Press enquiries:
+41 76 350 8138

Joe.Perry@fsb.org

Ref no: 2/2017
25 January 2017

FSB publishes reports on the re-hypothecation of client assets and collateral re-use

The Financial Stability Board (FSB) today published two reports:

- i. [*Re-hypothecation and Collateral Re-use: Potential Financial Stability Issues, Market Evolution and Regulatory Approaches*](#) – This report describes potential financial stability issues associated with, and explains the evolution of market practices and current regulatory approaches relating to, re-hypothecation of client assets and collateral re-use. It examines the possible arguments for and challenges of harmonising regulatory approaches to re-hypothecation of client assets, and also describes possible residual financial stability risks associated with collateral re-use.
- ii. [*Non-Cash Collateral Re-use: Measure and Metrics*](#) – This report incorporates input from the early-2016 consultation and finalises the measure and metrics of non-cash collateral re-use in securities financing transactions that authorities will monitor for financial stability purposes. The FSB will collect from FSB members national aggregated data related to the measure and metrics from January 2020 as part of its global securities financing data standards.

The practices of re-hypothecation of client assets by financial intermediaries and of re-use by market participants of collateral received both have the effect of increasing the availability of collateral in the financial system, reducing the cost of using collateral, and consequently reducing transaction and liquidity costs. At the same time, however, as highlighted during the 2007-09 global financial crisis, re-hypothecation and collateral re-use may also pose potential risks to the financial system. For example, they may create operational impediments that hinder clients from promptly accessing their securities in the event that a financial intermediary faces insolvency. They may also contribute to a build-up of leverage by allowing a given pool of collateral to underlie a larger set of transactions and increase interconnectedness among market participants.

The first report describes the different regulatory approaches to re-hypothecation in use in various jurisdictions. These approaches differ reflecting their roots in national/regional securities laws and other legal regimes that vary across jurisdictions. However, all such regulatory approaches are designed to protect re-hypothecated client assets within their jurisdictions. The report also highlights improvements in risk management practices associated with re-hypothecation by market participants such as prime brokers and their clients since the crisis. Furthermore, regulators have also strengthened the relevant client asset protection regimes. Based on these observations, the FSB concluded that there is no immediate case for harmonising regulatory approaches to re-hypothecation. At the same time, however, the FSB

encourages jurisdictions to implement Recommendation 7 in its [Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos](#) published in August 2013, which provides a common basis for authorities to design their regulations with respect to re-hypothecation of client assets.

With respect to collateral re-use, the FSB considers that appropriately monitoring collateral re-use at the global level will be an important step towards obtaining a clearer understanding of global collateral re-use activities in the securities financing markets. It therefore reaffirms the importance of implementing its [Standards and Processes for Global Securities Financing Data Collection and Aggregation](#) published in November 2015, which will now include data elements related to a non-cash collateral re-use measure and to some associated indicators (i.e. metrics). These non-cash collateral re-use measure and metrics are defined in the second report.

The FSB furthermore encourages authorities to consider monitoring collateral re-use activities beyond securities financing transactions as appropriate. Since market practices evolve, the FSB highlights the need to review the scope, measure and metrics of collateral re-use. This is planned to be undertaken five years after the launch of the global data collection with regard to non-cash collateral re-use, with a continued discussion with market participants as appropriate.

Notes to editors

The reports published today mark further progress in the FSB's efforts to promote resilient market-based finance by addressing financial stability risks in securities financing transactions, such as securities lending and repos.

For the purposes of the reports published today, re-hypothecation is defined narrowly as "any use of client assets by a financial intermediary" (e.g. broker-dealers). Meanwhile, collateral re-use is not limited to client assets and broadly includes "any use of assets delivered as collateral in a transaction by an intermediary or collateral taker".

The FSB published policy recommendations to dampen procyclicality and other financial stability risks in securities financing transactions such as repos and securities lending in August 2013 and subsequently in November 2015. Recommendation 7 in the August 2013 report set out the following principles that regulations governing re-hypothecation of client assets should address:

- Financial intermediaries should provide sufficient disclosure to clients in relation to re-hypothecation of assets so that clients can understand their exposures in the event of a failure of the intermediary;
- In jurisdictions where client assets may be re-hypothecated for the purpose of financing client long positions and covering short positions, they should not be re-hypothecated for the purpose of financing the own-account activities of the intermediary; and
- Only entities subject to adequate regulation of liquidity risk should be allowed to engage in the re-hypothecation of client assets.

Also, Recommendation 8 of the August 2013 report recommended the creation of an expert group to examine possible harmonisation of client asset rules with respect to re-hypothecation, taking account of the systemic risk implications of the legal, operational, and economic

character of re-hypothecation. The first report published today responds to this recommendation.

In addition, the FSB has been working to improve reporting and transparency of securities financing markets, based on Recommendations 2 and 3 of the August 2013 report. The FSB has developed, in cooperation with market participants, standards and processes for global securities financing data collection and aggregation that are relevant for financial stability monitoring and policy responses. These standards and processes will allow the FSB to collect from national/regional authorities aggregated data on repos, securities lending and margin lending, based on consistent definitions and minimal double counting at the global level. The finalised standards were [published](#) in November 2015 and the FSB has started work on the detailed operational arrangements to initiate the official data collection and aggregation at the end of 2018. As stated in the reports published today, data related to collateral re-use will be transmitted to the FSB for global aggregation from January 2020.

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with 65 other jurisdictions through its six regional consultative groups.

The FSB is chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.fsb.org.