ABBL Answer to the FSB Consultation Paper on “Transforming Shadow Banking into Resilient Market-based Finance”

The Luxembourg Bankers’ Association (“ABBL”) is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations.

The ABBL counts amongst its members universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (“PSF”), financial service providers and ancillary service providers to the financial industry.

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**General Comments**

The ABBL welcomes the possibility to comment the FSB Consultation Paper on “Transforming Shadow Banking into Resilient Market-based Finance”.

The ABBL has always supported the objective to enhance the resilience of markets and to counter cyclical risks. However, regulation should not hamper the efficiency of markets. As such, we believe that lots of measures have already been adopted that are participating to building stronger and resilient markets. Notably, the FSB notes in the Consultation Paper that one of the objectives of the proposal is to identify potential cyclical effects on collateral re-use. However, several measures adopted so far such as the Liquidity Coverage Ratio, the Leverage Ratio, EMIR, MiFIR, SFTR participate in building a stronger market being able to identify and mitigate potential cyclical effects on collateral market and taken to the extreme if at some stage at the top of the business cycle there are more cushions to build for adverse times, being counter-cyclical also mean that in bad time more risks have to be taken, all in all one shall not over-expect from these measures, it would be illusory to consider removing cycles, a more decent aim may be to mitigate them.

In addition, the ABBL would like to underline the risks impeding on market liquidity if stringent rules are to be adopted on collateral reuse. Collateral reuse is particularly important for market liquidity, as it is an efficient and fast way to exchange liquidity throughout the market. Viewing collateral use as only risky is seeing only one side of the coin, if collateral is used it is also because it brought many advantages to the economy and economic operators. As a consequence, by imposing stringent rules on collateral such as reporting, constrains on reuse, etc., it can lead to an increase in the price of using collateral and to less efficient use of these collaterals. Indeed, it makes complex the use of collateral that should remain simple in order to provide liquidity when needed. To conclude one shall bear in mind that a transaction in a collateral agreement is from the “lender” a transaction secured by a guarantee or underlying assets.
Specific Questions

Section 2 / Q1. Does the proposed scope of transactions for data collection (Scope A) provide a practical basis for the meaningful measure of non cash collateral reuse? If not, please explain how you think the scope should be broadened and the reasons why this alternative scope is more appropriate than the proposed scope.

First and foremost the ABBL thinks that the data to collect shall bear some risk or necessities, as reporting… cost a lot of money and is generally a lengthy process to deploy at operational level. We have some fear that by collecting too much data or “mis-calibrating” them supervisory authorities will be swamped in useless seas of data. We note that may of these reuse are intra-day thus presenting nearly no open risk to the markets and its participants as a consequence supervisors will capture a lot of noise but few if any relevant risk exposure. The ABBL favours the approach A and strongly opposes extending data collection to OTC derivatives. Indeed, it will be practically difficult to collect data on such instrument, notably because some of OTC derivatives are often used for hedging purposes where they are customized and cannot enter into a specific category. In addition, these derivatives are often of a contractual nature. As such, in the EU following the Securities Financing Transaction and Reuse Regulation, reuse will be subject to strict information procedure. Thus, extending data collection to OTC derivatives is not necessary at the very least in the EU environment.

Section 3 / Q2. Are there any practical issues (e.g. updating current business practices, IT systems) in relation to the three measures of collateral re-use that are set out in this Section? Are there any ways to improve these measures?

Exact Measure
As stated in the FSB consultation, the data on collateral posted in SFTs are available. However, we can see issues in collecting data on own encumbered assets per institution. The global own encumbered assets as on balance sheet assets are available but detailing these per institution might necessitate new adaptations and in a context of already very low rates at a global level may simply render the use unattractive.

Approximate Measure
For the time being, the collection of data on collateral eligible for reuse might not be clearly identifiable. However, in light of the European regulation on Securities Financing Transactions and Reuse the eligibility for reuse should be clearly identified. If well understood, the own assets represent the assets of a given type available for collateralisation. This should be clearly stated
and exemplified in the FSB consultation, so as to determine the potential challenges. Furthermore we would like to remind the extreme complexity market operators and authorities faced with the arrival of the trade repositories in the context of the OTC derivatives reporting and could not stress enough the need for a targeted and careful approach in the deployment of options in related environment like these.

**Indirect Approximation**

The indirect approximation requires making use of data on collateral received and posted. As stated in the consultation, such data should be available, notably in the EU the REPO Council already present data on a regular basis.

**Further comment**

As for all new reporting obligations, some practical challenges, notably in terms of IT structures might appear unavoidable. It is important to adopt reporting solution that fit the current reporting obligations and practices.

**Q3. For the first measure, are there any practical issues in reporting whether collateral you posted is in the form of “own assets” or in the form of assets that were received as collateral in a previous transaction?**

For the time being, by design of banking activity: taking cash deposit from clients on their balance sheet and being organised through omnibus account for securities holding it can be in practice difficult to segregate between own assets and assets received as collateral in a previous transaction unless they are only held under pledged agreement not REPO (real legal buying). It is especially true as the way collateral is treated depends of the way collateral has been exchanged. It can vary from repo or reverse repo to pledge collateral.

**Q4. Are there other measures of collateral re-use that the FSB should consider for financial stability purposes?**

In Europe, new rules on collateral are being introduced by the SFTR regulation in 2018 and EMIR regulation in the US the Dodd Franck act required similar rules at the very least for the derivative instruments. Given all the data that are already collected we thus believe the framework is sufficiently solid and does not need further specifications, but there may be a need to first do some research on existing available data.
Section 4 / Q5. Do you have views on any of the six metrics related to collateral re-use that are set out in this Section? If so, please indicate the metric(s) and explain the views you have.

The objective of the FSB proposal is to identify, by means of being provided information on collateral reuse, potential cyclical effects on collateral re-use. We believe that the measures adopted so far such as the Liquidity Coverage Ratio, the Leverage Ratio, EMIR, MiFIR, SFTR participate in building a stronger market being able to identify and mitigate potential cyclical effects on collateral market. We would further like to stress that by trying to capture more transactions, there may be a risk to capture “noise” namely a lot of totally riskless transactions and thus having difficulties mapping or evidencing new trends.

We believe the combination of the six metrics can be more confusing than having only few metrics. There would at least be some additional clarification notably whereas the specific formulas:

4.1 we sympathise with the global apprehension of collateral use, however a simple addition may not reflect net position within a group, we encourage the FSB to take into account netting effect across entities of a same group,

4.2 we are not sure how to compute this and if the information will be relevant what is exactly meant by “Reuse” is this the number of time of reuse, the amount...?

4.4 we note that there is a common practice of relying (at least in the EU) on third party REPO agent, how should concentration be handled and would it truly represent concentration if computed at the agent level whose business is to ensure diversification?

We do not believe to the usefulness of the collateral circulation length metric. In addition we do not believe that the length of the collateral chain is what truly matters. Rather, we believe that some focus may target the velocity of collateral exchanges.

Finally, we do not consider the metrics for velocity is appropriately calibrated. We have difficulties to understand how the metric can represent velocity of collateral. idem

Q6. Are there any other metrics related to collateral re-use that the FSB should consider for financial stability purposes? If so, please define the metric(s) and explain how the metric could be used for financial stability purposes.

We do not see any other metrics related to collateral re-use that could be used for financial stability purposes. Except for the comments on metrics made above.
Section 5 / Q7. In your view, are the data elements set out in Table 1 appropriate for calculating the collateral re-use measures in Section 3? Are there alternative data elements that the FSB should consider? If so, please explain the data elements and the reasons.

We believe there are several data elements that are burdensome to report relative to the added-value of reporting these elements. In other words, we do not believe that collateral re-used should be reported on top of collateral received eligible for re-use. We believe, that reporting only one element should be sufficient. Similarly, it might not be necessary to report own assets encumbered as well as own assets.

The reports should avoid duplications, and burden as much as possible notably in the EU reporting through Trade Repositories (in the context of EMIR or SFTR or MIFIR) shall largely be enough.

Q8. Are there any practical issues on the data elements for calculating the collateral re-use measures that are set out in Table 1?

Without any guidance on the exact reports, it seems premature to foresee any practical issues on the data elements to be reported. Clarification on the reports, on the market value of data expected should be provided so as to be able to find any practical challenge.

Q9. In your view, should the collateral types for measuring collateral re-use align with those set out in the November 2015 global securities financing data standards as set out in Table 1? If not, please explain which collateral types you think are appropriate for the collateral re-use measure(s).

When synergies are possible, these should be sought as much as possible. Thus, collateral types for measuring collateral re-use should align with those set out in the November 2015 global securities financing data standards. In addition, the types of collaterals listed in the November 2015 is sufficiently broad and clear to capture efficiently all types of collateral.

Section 6 / Q10. Are there any views on the data architecture issues related to measuring collateral re-use as set out in this Section? Do you see any statistical issues arising as a result of the proposed aggregation approach?

The FSB paper states that there should be none double counting issue. However, in light of the data aggregation, we are doubtful of having no double counting issues, not only it was nearly
impossible to achieve under the EU MIFID I reporting, it does not seem to work well either under EMIR and in this case we may even be faced with cross regions reporting (US/Asian counterpart to EU or others) which would make things even more complex originating from different legal environment. Especially, the table 4 for example, draw the total amount of collateral received, collateral posted and collateral re-used. Knowing that to be re-used the collateral should be received or posted by another bank, there will always be double counting of the same collateral, which by definition is re-used. Thus, instead of having these kind of data, a proportion of collateral received which is re-used, and a proportion of collateral posted which is re-used should be calculated.

Q11. Are there any other views on other aspects of this document?

Again, the ABBL is of the view the proposed reporting is not supported by any strong rationale. Primarily we note the difficulty to differentiate true potentially risky transactions from pure noise, in our view only position still open at the end of the business day shall be caught in any such reporting. The measures taken so far, such as the November 2015 global securities financing data standards are already allowing more transparency in collateral re-use and Securities Financing Transactions. We also fear that increasing reporting obligations on collateral, coupled with other measures such as the LCR or the SFTR regulation, will de facto increase the cost of lending/borrowing collateral. In fine, it will contravene to the main purpose of using and re-using collateral that is easing liquidity in short term. In consequence, it might increase the price of banking services to end customer.