Sent by email

To: Stefano Perin, Team Lead, Capital Market & Treasury Experts Division, European Central Bank
Isabelle Vaillant, Director of Regulation, European Banking Authority

Copy: Dr. Armin Leistenschneider, Head of Division, DG Horizontal Line Supervision/ Capital Markets and Treasury Experts Division, European Central Bank

January 7, 2022

Re: Treatment of open-securities financing transactions under the Liquidity Coverage Ratio

Dear Mr. Perin and Ms. Vaillant

We are writing to you on behalf of ICMA's European Repo and Collateral Committee (ERCC) to draw attention to an important netting treatment applied by banks under the Liquidity Coverage Ratio.

It is standard practice for supervised banks to net inflows/outflows on open reverse repos or securities borrowing with open repos or securities lending for the purposes of LCR. The basis for this is the fact that open securities financing transactions (SFTs) are effectively treated as rolling short-term SFTs, based on the relevant notification period of the transaction (which in most cases is 24 or 48 hours). This is consistent with the EBA Guidelines on the handling of open-SFTs, which states: *open repos or reverse repos and similar transactions which can be terminated by either party on any day shall be considered to mature overnight unless the notice period is longer than one day in which case they shall be reported in the relevant time bucket according to the notice period.*[1]

It has been brought to the attention of the ERCC that there have been discussions within the ECB's Capital Markets and Treasury Experts Group (CME) as to whether open-SFTs could be considered as "contingent inflows" or "outflows" from the perspective of the LCR calculation, rather than as overnight or very short-dated SFTs, with possible implications for the ability of supervised banks to net open-SFTs. This could in effect result in an asymmetrical treatment of open-SFTs, depending on whether they generate inflows or outflows, with potentially adverse consequences for banks' ability to manage their LCR. In a worst-case scenario, banks would record no inflow value from their open-repos/loans while reporting a full outflow for their open-reverses/borrows.

The likely behavioural impact of this would be for supervised banks to no longer transact open-SFTs and instead transact overnight or very short-dated SFTs on a rolling basis. The underlying economics of the transactions would be identical, but this would at least allow for the ability to net inflows and outflows. However, replacing open-SFTs with rolling overnight or very short-dated SFTs would have a number of potential adverse consequences. Open-SFTs are used widely in the short-term financing markets. According to the most recent ERCC European Repo Market Survey, 7.5% of outstanding repos

[1] Annex XXIII: Instructions for completing the maturity ladder of Annex XXII

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in the European market are on an open basis (roughly €650bn). For securities lending, the proportion of open-transactions is significant (77% according to a recent ISLA Securities Lending Market Report). There are clear advantages for firms entering into open-SFTs, including:

- more flexible liquidity and collateral management;
- balance sheet management;
- complying with the EU UCITS term restrictions on SFT activity;
- providing lenders and beneficial owners with the flexibility to recall less-liquid securities should they sell them; and
- reducing costs and settlement risks associated with rolling-over transactions.

It is also important to consider that while banks will be able to switch from using open-SFTs to rolling overnight or very short-dated SFTs, with all the associated efficiency loss and increased settlement risk, this presents a more fundamental issue for many buy-side firms, including pension funds and asset managers, that are restricted from lending securities on a fixed-term basis. This would cut-off an important source of collateral supply to the market and would come at a time when there are growing concerns around the availability of certain classes of high-quality liquid assets, as well as the ability for certain fund types to access the repo and securities lending market.

A further possible unintended consequence of such a revised treatment of open-SFTs could be a migration of repo activity to jurisdictions that take a less restrictive view.

We would be very keen to engage with the EBA and ECB CME in any discussions related to the potential treatment of open-SFTs under LCR and are happy to elaborate on any of the points raised in this letter, in particular around the likely impacts of limiting the capacity for netting.

Kind regards,

G. Alle

Gareth Allen
Managing Director, Global Head Investment and Execution – Group Treasury, UBS
ERCC Chair

Alexander Westphal
Director, ICMA
Secretary to the ERCC