

PRESS RELEASE

ESMA reports on shadow banking, leverage and pro-cyclicality

The European Securities and Markets Authority (ESMA) has issued today a [report](#) on securities financing transactions (SFTs), leverage and pro-cyclicality in the EU's financial markets. ESMA's report assesses whether the use of SFTs leads to the build-up of leverage which is not yet addressed by existing regulation, how to tackle such build-up, and whether there is a need to take further measures to reduce its pro-cyclicality.

SFTs allow market participants to access secured financing. SFTs involve the temporary exchange of cash against securities, or securities against other securities – such as securities lending, repurchase transactions, buy-sell/ sell-buy back transactions, or margin lending transactions.

On the other hand, SFTs also contribute to the build-up of leverage in the financial system, which is relevant from a financial stability perspective. A leveraged financial system can be vulnerable to “runs”, generate contagion risk and increase pro-cyclicality.

Steven Maijor, ESMA Chair, said:

“The ESMA report is an important stock-take of European SFTs markets. Looking at the sheer size of repo transactions only, with over EUR 5tn in gross amount outstanding, it shows the importance of bringing transparency to these activities. Besides being an important means of non-bank financing, the leverage SFTs create need to be looked at from a systemic risk angle.

The ESMA report also shows that it is too early, at this stage, to draw definitive conclusions on the efficiency of numerical haircut floors on non-centrally cleared SFTs to reduce pro-cyclicality in the EU. Having access to high-quality SFT data is essential to assess the scope and calibration of numerical haircut floors.”

While remaining cautious when considering the introduction of new quantitative regulatory requirements on SFTs, ESMA recommends to:

- introduce the Financial Stability Board's (FSB) qualitative standards in the methodology used to calculate haircuts;
- address the pro-cyclicality of collateral haircuts in central counterparties in the context of the European Market Infrastructure Regulation (EMIR) review;

- assess the possible extension of the FSB's scope for numerical haircut floors, in particular to government bonds, and the calibration of these floors using SFTR data which will become available in 2018; and
- assess pro-cyclicality and the potential need for further policy tools once sufficient data becomes available.

SFTR will introduce transparency, improve risk monitoring

To make the report, ESMA cooperated with the European Banking Authority (EBA) and the European Systemic Risk Board (ESRB), and relied on various sources of information. At this stage granular supervisory data are lacking, which will only become available once the SFT-Regulation (SFTR) data reporting obligation begins in 2018.

The SFTR aims to increase the transparency of shadow banking activities. It will require both financial and non-financial market participants to report details of their SFTs to an approved EU trade repository. These details will include the composition of the collateral, whether the collateral is available for reuse or has been reused, the substitution of collateral at the end of the day and the haircuts applied.

Background

SFTs are secured (i.e. collateralised) transactions that involve the temporary exchange of cash against securities, or securities against other securities. If the collateral giver defaults, the collateral taker retains the collateral to cover the potential losses. Although they have economically equivalent effects, SFTs differ greatly in the size, purposes and market practices they serve in EU financial markets, with different implications in terms of pro-cyclicality risks.

Pro-cyclicality refers to changes in risk management requirements or practices that are positively correlated with business or credit cycle fluctuations and that may cause or exacerbate financial instability.

ESMA is mandated to monitor risks to financial stability and has issued several reports in this regard.

Notes for editors

- [2016/1415 Report on securities financing transactions \(SFTs\), leverage and procyclicality in the EU's financial markets.](#)
- [ESMA Reports on Trends, Risks and Vulnerabilities and ESMA Risk Dashboards.](#)
- ESMA's mission is to enhance investor protection and promote stable and orderly financial markets.

It achieves these objectives through four activities:

- assessing risks to investors, markets and financial stability;
 - completing a single rulebook for EU financial markets;
 - promoting supervisory convergence; and
 - directly supervising specific financial entities.
- ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

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