European Securities and Markets Authority

Date: 22 June 2016

ESMA/2016/989

ISLA's 25th Annual Securities Finance and Collateral Management Conference

Vienna

Steven Maijoor

Chair

Ladies and gentlemen,

Thank you for the opportunity to speak at ISLA's 25th Annual Securities Finance and Collateral Management Conference. I will comment today on some aspects related to the availability of collateral and the reporting of repos and securities lending trades.

The first issue I'd like to cover is the demand and supply of collateral and specifically the concerns expressed by some about the reduced availability of collateral. Let me start with a few facts on the collateral availability. As you well know, firms can source collateral by using various types of transactions, including Securities Financing Transactions (SFTs). Some recent surveys by European industry associations, including ISLA, show that the size of SFT markets has remained relatively stable over the last few years. The gross notional amount of repos in Europe has been close to 5.5 trillion euros since 2011. And the amount of securities on loan globally remains close to 2 trillion euros, including around 500 billion in EU securities. Government bonds constitute the bulk of collateral used in these transactions, highlighting the role that these transactions play in ensuring an efficient allocation of high-quality collateral in the system.

However, I am aware that these headline numbers provide an incomplete picture of the situation in collateral markets and may conceal important underlying developments. Indeed, ESMA recognises that the current economic conditions, combined with regulatory changes, have had a very significant impact on the environment in which market participants operate. In securities lending markets, the growth of non-cash collateral trades for collateral transformation purposes offers a good illustration of how markets have adapted to this new environment.

Taking a step back it is very plausible that regulatory changes have had a broad impact on the availability of collateral in the financial system. In the banking sector, capital requirements and leverage ratios have reportedly reduced repo market activity, and thereby the supply of collateral. Within ESMA's remit, EMIR contributed to a huge increase in the demand for collateral. Despite this, predictions of a major shortage of collateral in the system do not seem to have materialised, although ESMA continues to closely monitor market developments.

It is important to recognise the efforts undertaken by the financial services industry that have helped to reduce the probability of collateral shortage. Collateral management innovations and services that seek to improve the fluidity of collateral movements or the efficiency of collateral allocation, are in that sense very important. The current work of regulators on measures to estimate the re-use of collateral will also play a major role in our understanding of the potential risks and benefits associated with this practice.

Regulation is only one of the forces that have led to structural changes in SFT markets. The current unusual monetary policy with very low levels of interest rates creates strains on the profitability of EU financial institutions and this has an impact on the availability of collateral, although the exact relationship is a complex one. On the one hand, some securities financing activities have declined as trades became non-profitable. On the other hand, low interest rates create an incentive for asset holders to make a larger portion of their assets available for lending, in order to generate extra returns.

Regarding ECB quantitative easing, it is also very challenging to assess the net effects of bond purchases by central banks on collateral availability due to the multiple transmission channels. Our internal research shows for example that QE has increased the premium to be paid for high-quality government bond collateral in repo markets. However, this effect was soon offset by the ECB's securities lending programme.

Let me now turn to the current work on defining the SFT reporting regime in the EU. As all of you know, the EU launched a Regulation on Securities Financing Transactions, which we call SFTR. It is about transparency of the SFTs and the reuse of collateral. In that respect, SFTR is the EU's contribution to the global efforts to address what some call "shadow banking" activities. I personally do not think there is much of a shadow, or even banking for that matter, as it is a traditional securities market activity. However, we at ESMA are also convinced of the need to shed light on those transactions and allow regulators to build a more complete picture of potential financial stability and systemic risks coming from SFT activities. It is common knowledge that in many cases SFTs are linked to the use of derivatives and we are very aware that without visibility around SFTs, regulators will not have the correct understanding of the exposures of their supervised entities.

ESMA has learnt a lot from the EMIR experience, which was a major reporting regime introduced in a big-bang way in the EU in February 2014. We know that it is of the utmost importance to set up a reporting regime that works, that is streamlined as much as possible and that allows the relevant regulators to correctly assess the data. In this respect, ESMA expects the industry to continue to contribute to this process with the common goal of reaching the best solution.

It is also true that SFTR is a new reporting regime, which will require certain adaptations to your systems. ESMA would like to echo Commissioner Hill's statement regarding the reporting burden in the EU and aims to structure SFTR reporting and data collection in a way that the relevant parties only need to undertake limited updates to their systems to ensure compliance with the SFTR reporting obligation. The co-legislators have also clearly indicated their intention to minimise additional operational costs for market participants by building on pre-existing infrastructures, and operational processes and formats which have been introduced with regard to reporting derivative contracts to trade repositories. In that context, ESMA, to the extent feasible and relevant, is mandated "to minimise overlaps and avoid inconsistencies between the technical standards" adopted pursuant to SFTR and those adopted pursuant to Article 9 of EMIR.

ESMA has demonstrated that it is practical and receptive to industry practices on many occasions. As you may recall, it was ESMA who suggested the use of trade repositories for MiFIR and SFTR reporting. Earlier this year ESMA also proposed to amend the draft MiFIR standard on transaction reporting due to an unintended omission in the final stage of drafting the technical standard. The amendment introduced by ESMA relates to the list of instances that are not considered to be reportable transactions for the purpose of Article 26 of MiFIR and ensures that investment firms do not submit transaction reports for transfers of collateral, which would be costly and most probably not bring any supervisory benefit.

Going back to the SFTR work, two months ago ESMA closed the first of the two planned consultations. ESMA consulted on detailed reporting scenarios, tables of fields and posed 145 questions related to (i) the reporting of SFTs, (ii) the specificities of collateral and its reuse, (iii) the requirements related to trade repository registration and (iv) the process of data collection and data management. We have received very useful and detailed feedback from a wide range of stakeholders and we are in the process of preparing our full consultation, which should be launched in the next few months.

Following the initial assessment of responses, ESMA intends to continue the interactions with the relevant trade associations, such as ISLA, to corroborate its understanding of the feedback received and the relevant way forward. The current structure and market practices in securities lending make these transactions appear to be one of the most complex types of SFTs. We very much appreciate the discussions that have taken place so far with ISLA and other market participants and we look forward to continuing this cooperation.

As mentioned earlier, to reduce the impact on the market, in the course of drafting the reporting rules under SFTR ESMA is taking into account the existing standards for reporting under EMIR, the proposed amendments which were submitted to the European Commission last year, as well as existing industry standards. Although MIFID II and MIFIR have different objectives compared with SFTR and EMIR, to the extent feasible ESMA is working on ensuring the standardisation of rules and requirements under these three reporting regimes. In this respect, ESMA has proposed the use of the ISO 20022 standard for SFT reporting.

To be clear, this doesn’t mean that all the data fields reported under SFTR, EMIR and MiFID would be exactly the same, which would put into question why three reporting regimes were envisaged in the first place. But where the same type of information is required, it should be as standardised as possible. ESMA expects that this would allow the relevant stakeholders to reuse components across the three pieces of legislation and to leverage on existing processes and systems.

Another important element of SFTR is the emphasis on data quality and data management. Although the standardisation of reporting will certainly contribute to this objective, it is worth noting that SFTR also puts the onus on trade repositories as central market infrastructures to contribute to the quality of the data. In that respect, the specific requirements on which ESMA is working would cover the establishment of efficient processes for validation of the SFT reports, reconciliation of data and standardised feedback to reporting parties. ESMA is working to define those requirements with a significant level of precision as ESMA believes that the accurate definition of the data collection requirements will facilitate the reporting process and will ensure a higher level of data quality.

Trade repositories have already gathered significant experience under EMIR, as they process on a weekly basis more than 350 million submissions, and ESMA expects that under SFTR they will be better prepared right from the start. ESMA understands also that good data quality will translate into greater usability of the trade repository data by regulators and by the public in general.

The current timeline for SFTR is that it will kick off in the second half of 2018. This should allow the reporting parties to develop or adapt the relevant reporting systems in place following the implementation of the MIFID II and MiFIR reporting requirements. The timeline of the EMIR review is in the hands of the Commission, and in light of the recent messages by Commissioner Hill, it would seem unlikely that it would collide with the commencement of reporting under SFTR.

To conclude, the financial crisis demonstrated the need for regulators to be able to monitor the evolution of SFT markets, the availability of collateral, and innovations such as new forms of collateral, and new types of trades. SFTR establishes a very robust framework on reporting, data collection and data management. Standardisation and harmonisation of reporting are high on ESMA’s agenda. We expect that the further feedback and information that we will receive in the course of the ESMA consultations will be useful to better frame the reporting regime. We look forward to a continued dialogue on this topic with stakeholders in general and ISLA in particular.

Thank you for your attention.