



European Securities and
Markets Authority

Final Report

Guidelines on repurchase and reverse repurchase agreements





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Acronyms

ESMA	European Securities and Markets Authority
UCITS	Undertaking for Collective Investment in Transferable Securities



I. Executive Summary

Reasons for publication

On 25 July 2012, ESMA published a report on guidelines on ETFs and other UCITS issues (2012/ESMA/474), which included in Annex IV a consultation paper on the recallability of repurchase and reverse repurchase agreements. Among other topics, the guidelines adopted by ESMA in July 2012 addressed the issue of the use by UCITS of efficient portfolio management techniques such as securities lending. In particular, the guidelines provide that UCITS entering into securities lending agreements should be able at any time to recall any assets subject to such agreements. However, with respect to repurchase and reverse repurchase agreements, ESMA felt it necessary to further consult on the issue with a view to adopting the most appropriate approach.

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This paper sets out ESMA's guidelines on repurchase and reverse repurchase agreements. In particular, the guidelines provide that UCITS should enter into repurchase and reverse repurchase agreements on terms that allow the UCITS to recall any assets or the full amount of cash at any time. For UCITS entering into reverse repo agreements, the guidelines leave the possibility for the cash to be recalled on an accrued basis or on a mark-to-market basis. However, if cash is recallable on a mark-to-market basis, UCITS should value the reverse repo on a mark-to-market basis as well.

The guidelines, which are set out in Annex II, will be incorporated into section X of the guidelines contained in the aforementioned report published by ESMA on 25 July 2012. Then, ESMA will publish the consolidated guidelines translated in all EU languages on its website.

II. Feedback Statement

Q1: What is the average percentage of assets of UCITS that are subject to repurchase and reverse repurchase agreements? For the purposes of this question, please have regard to arrangements covered by the provisions of Article 51(2) of the UCITS Directive and Article 11 of the Eligible Assets Directive (i.e. those arrangements which do not fall under the definitions of transferable securities and money market instruments, in accordance with recital 13 of the Eligible Assets Directive). In addition, please provide input on the following elements:

- i) the extent to which assets under such arrangements are not recallable at any time at the initiative of the UCITS.**
- ii) the maximum and average maturity of repo and reverse arrangements into which UCITS currently enter. Please provide a breakdown of the maturities with reference to the proportion of the assets of the UCITS.**

1. In general respondents to the consultation were not able to provide data on the requested information. However, many of them confirmed that UCITS in general and money market funds in particular could make an extensive use of reverse repo arrangements, with some of them investing up to 100% of their assets in such agreements.
2. One asset manager indicated that its money market funds were only invested in overnight reverse repo agreements and that it was unlikely that these funds would enter into arrangements for a period longer than 7 days. The extent to which these funds are subject to repo agreements varies but it could reach as high as 80% of the assets, with 65% of the assets in average for some of them.
3. Another stakeholder indicated that their reverse repurchase agreements normally contained put and call provisions which make them readily recallable as normal time deposits. With respect to the maturity, the majority of the agreements used by this asset manager are overnight arrangements and only a few exceed a maturity of one week.

Q2: Do you agree with the proposed guidelines for the treatment of repo and reverse repo agreements? If not, please justify your position.

4. Paragraph 1a): All stakeholders agreed with the general principle that repurchase and reverse repurchase arrangements should not compromise the ability of UCITS to execute redemptions requests.
5. Paragraph 2b): Many respondents to the consultation expressed their strong disagreement with the requirement that reverse repurchase arrangements on terms that allow the assets to be recalled at any time by the UCITS should permit the UCITS to recall the full amount of cash on an accrued basis.
6. Indeed, one respondent indicated that recalling assets under a reverse repo arrangement without a cost of unwinding the transactions would be very difficult because the counterparty must price the reverse repo arrangement according to the collateral profile, FX rates, funding cost and the maturity date. For the same respondent, the objective of the guidelines should not be to impose the recallability of the assets on an accrued basis but rather to ensure that UCITS do not incur significant costs or experience liquidity issues in unwinding reverse repo arrangements. To achieve this, the

stakeholder suggested that ESMA could introduce limits on the maturity of reverse repo arrangements to reduce the cost of unwinding the positions and set limits on the liquidity profile of the arrangements.

7. Therefore, several respondents recommended the deletion of this provision or to replace reimbursement “on an accrued basis” by “at the valuation price”. In particular, the respondents explained that it would be workable to have assets recallable at any time on a mark-to-market (MtM) basis and, should this be the case, the MtM value of the arrangements should be used by UCITS for the calculation of the net asset value. One respondent felt that reimbursement on an accrued basis could be acceptable only when UCITS need cash to execute redemption requests.
8. One respondent indicated that they did not envisage using non-recallable reverse repo arrangements.
9. It was also stressed that repayment of the cash on an accrued basis would mean that all reverse repo arrangements other than overnight reverse repos would not comply with the requirement of recallability of the assets at any time.
10. Paragraph 3a): Generally, stakeholders disagreed with this requirement on the basis that a UCITS that invests in short-term arrangements should not be forced to invest in longer-term arrangements to ensure an appropriate balance between short-term and longer-term arrangements at the level of the fund.
11. Paragraph 3c): Respondents to the consultation unanimously asked ESMA to revise the criteria for the re-investment of cash received from repo and to allow the cash to be used to clear OTC transactions. Stakeholders also expressed their concern with respect to the quantitative limit for the diversification of collateral adopted by ESMA in July 2012. In particular, respondents took advantage of the consultation to ask ESMA to revisit the issuer limit and to allow UCITS to have 100% of the collateral issued by the same issuer in the case of government bonds.
12. In light of the feedback received, ESMA decided that repurchase and reverse repurchase arrangements should allow the UCITS to recall the assets at any time. However, as suggested by stakeholders, ESMA decided to introduce the possibility of cash (in the context of reverse repo) to be recallable on a MtM basis and not only on an accrued basis. However, it was agreed that when cash is recallable on a MtM basis, the reverse repurchase agreement should also be valued on a MtM basis for the purposes of the calculation of the net asset value of the UCITS. Also, ESMA clarified that both overnight and fixed-term arrangements up to 7 days should be considered as arrangements under which assets are recallable at any time.

Q3: What are your views on the appropriate percentage of assets of the UCITS that could be subject to repurchase and reverse repurchase agreements on terms that do not allow the assets to be recalled by the UCITS at any time and that would not compromise the ability of the UCITS to execute redemption requests?

13. Many respondents were of the view that there should not be any limit on the maximum percentage of the UCITS that could be subject to repurchase and reverse repurchase agreements on terms that do not allow the assets to be recalled by the UCITS at any time. In their view, the principle that such arrangements should not compromise the ability of the UCITS to execute redemption requests would suffice.

14. However, several respondents explained that the answer depended on the conditions for early termination of the arrangements. Indeed, as explained above under paragraph 2b), if counterparties of reverse repo arrangements that allow assets to be callable at any time were obliged to reimburse the cash on an accrued basis, only overnight repo would comply with the requirement of callability of assets at any time (paragraph 1b). Therefore, according to these respondents, the appropriate threshold (were ESMA to keep such a requirement) should be up to 100% to allow UCITS to enter into longer-term reverse repo arrangements under which assets are not re-callable on an accrued basis but on a MtM basis.
15. However, if the ESMA guidelines were amended so that the callability of assets on a MtM basis is possible, these respondents were of the view that the appropriate percentage could be very low (and could even be 0% in the view of some asset managers). Indeed, one respondent clearly indicated that they agreed with the principle of callability of the assets at any time to the extent that the reimbursement and the valuation of the NAV can be on a MtM basis and not an accrued basis.
16. As explained under question 2 above, ESMA took the decision not to allow arrangements under which the assets are not callable at any time but introduced the possibility of the cash, in the context of reverse repo, to be re-callable on a MtM basis.

Q4: Do you consider that UCITS should be prohibited from entering into repo and reverse repo arrangements on terms that do not allow the assets to be recalled by the UCITS at any time? If not, please indicate possible mitigating measures that could be envisaged in order to permit UCITS to use repo and reverse repo arrangements on terms that do not allow the assets to be recalled by the UCITS at any time.

17. As explained above, some respondents explained that the response to this question would depend on the conditions under which the assets can be recalled by UCITS. For certain respondents, if the conditions were a reimbursement and a valuation of the NAV on a MtM basis, the need for UCITS to enter into arrangements under which the assets are not callable would be very low. However, if ESMA were to keep the requirement of reimbursement on an accrued basis, UCITS should be able to enter into arrangements under which assets are not callable at any time on an accrued basis (e.g. callable on a MtM basis).
18. As outlined above, some respondents indicated that possible mitigating measures could include a limit on the maturity of the arrangements that do not allow the assets to be callable at any time on an accrued basis, in order to minimise the costs of unwinding the positions.

Q5: Do you think that there should be a minimum number of counterparties of arrangements under which the assets are not callable at any time? If yes, what should be the minimum number? To answer this question, you are invited to take into account your response to question 2 above.

19. According to the majority of respondents, the answer would depend on the conditions under which assets can be recalled (accrued basis vs. MtM basis). Indeed, if ESMA were to modify the guidelines and allow assets to be callable at any time on a MtM basis, there would be no need to impose a minimum number of counterparties. However, if ESMA were to decide to set a minimum number, the limit should be expressed as a maximum percentage of the net asset value of the UCITS and not as a requirement to split small transactions between counterparties.

20. For one respondent, having different counterparties should be considered best practice (with a general maximum of three or four).

21. Since ESMA decided not to permit UCITS to invest in repo and reverse repo arrangements on terms that do not allow assets to be recalled at any time, there was no need to set a minimum number of counterparties of arrangements under which the assets are not recallable at any time. Indeed, this safeguard of a minimum number of counterparties was aimed at mitigating risks introduced by repo and reverse repo arrangements that do not allow the assets to be recalled at any time.

Annex I – Cost-benefit analysis

Cost Benefit Analysis

Risk addressed / Policy objective

With these guidelines, ESMA wishes to develop an appropriate regime for the treatment of repo and reverse repo arrangements with regards to the recallability of assets subject to these arrangements. This regime is designed to ensure that UCITS which enter into repo and reverse repo arrangements can continue to execute redemptions.

Scope issues

These guidelines apply to all UCITS entering into repo and reverse repo arrangements.

Options

When developing the consultation paper ESMA considered the following options.

Efficient portfolio management techniques	Benefits	Costs	Evidence
Option 1 As adopted in the guidelines	The recallability of the assets is ensured. Level-playing field between securities lending arrangements and repurchase and reverse repurchase arrangements. Flexibility on the conditions of early termination by UCITS (e.g. reimbursement on accrued basis or on a mark-to-market basis).	UCITS will no longer be able to enter into fixed term repo and reverse repo arrangements that do not allow them to recall at any time the assets or to terminate the contract.	Feedback from the consultation
Option 2 As proposed in the Annex IV of the report on ETFs and other UCITS issues.	Option 2 leaves the possibility for UCITS to enter into fixed term repo and reverse repo arrangements under which the assets are not recallable at any time for a certain proportion of their assets (the exact proportion remaining to be determined) provided that the UCITS is able to execute redemption requests.	Option 1 is less restrictive than option2	Feedback from the consultation.
Option 3 As proposed under Box 6	Option 3 requires that UCITS entering into repo and reverse repo	UCITS would no longer be able to enter into fixed term repo and	Feedback to the previous consultation suggested this would

of the first consultation paper (ESMA/2012/44).	arrangements should have the capacity, at any time, to recall any asset subject to repo or to terminate the contract.	reverse repo arrangements that do not allow them to recall at any time the assets or to terminate the contract.	be unduly restrictive on UCITS.
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Annex II – Guidelines on repurchase and reverse repurchase agreements

I. Scope

1. These guidelines apply to competent authorities designated under Article 97 of the UCITS Directive, UCITS management companies and UCITS taking the form of self-managed investment companies.
2. These guidelines apply from [*date two months after their publication on ESMA's website*].

II. Purpose

3. The purpose of these guidelines is to protect investors by introducing requirements on the use of repurchase and reverse repurchase agreements by UCITS.

III. Compliance and reporting obligations

Status of the guidelines

4. This document contains guidelines issued under Article 16 of the ESMA Regulation.¹ In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines.
5. Competent authorities to whom these guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines are directed primarily at financial market participants.

Reporting requirements

6. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for any non-compliance by [**two months after publication**] to [**email address**]. A template for notifications is available on the ESMA website.
7. UCITS Management Companies and UCITS taking the form of self-managed investment companies are not required to report to ESMA whether they comply with these guidelines.

IV. Guidelines

8. A UCITS that enters into a reverse repurchase agreement should ensure that it is able at any time to recall the full amount of cash or to terminate the reverse repurchase agreement on either an accrued basis or a mark-to-market basis. When the cash is recallable at any time on a mark-to-market basis, the mark-to-market value of the reverse repurchase agreement should be used for the calculation of the net asset value of the UCITS.

¹ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

9. A UCITS that enters into a repurchase agreement should ensure that it is able at any time to recall any securities subject to the repurchase agreement or to terminate the repurchase agreement into which it has entered.
10. Fixed-term repurchase and reverse repurchase agreements that do not exceed seven days should be considered as arrangements on terms that allow the assets to be recalled at any time by the UCITS.