

Transparency of securities financing transactions and of reuse

2014/0017(COD) - 29/01/2014 - Legislative proposal

PURPOSE: to improve transparency in securities financing transactions (SFT) and therefore in the financial system.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

BACKGROUND: the 2008 global financial crisis revealed important regulatory gaps in the financial system. It also highlighted the need to improve transparency and monitoring not only in the traditional banking sector but also in areas where non-bank credit activities took place, **called “shadow banking”**.

Confronted with new legislative developments in the banking sector, including structural measures, it is possible that banks will shift parts of their activity into less regulated areas as shadow banking. At the end of 2012 global shadow banking assets accounted for EUR 53 trillion, representing about half the size of the regulated banking system and mainly concentrated in Europe (around EUR 23 trillion) and in the United States (around EUR 19.3 trillion).

On 19 March 2012, the Commission published a [Green Paper](#) on shadow banking, and on 4 September 2013, it published [a Communication](#) on the subject. It stressed that the complex and opaque nature of securities financing transactions (SFTs) makes it difficult to identify counterparties and monitor risk concentration. This also leads to the built-up of excessive leverage in the financial system. A **High-Level Expert Group** chaired by Erkki Liikanen adopted a report on reforming the structure of the Union banking sector in October 2012. The report recognised the risks of shadow banking activities such as high leverage and pro- cyclicity, and it called for a **reduction of the interconnectedness between banks and the shadow banking system**, which had been a source of contagion in a system-wide banking crisis.

Actions regarding these matters have been international and coordinated through the G20 and the **Financial Stability Board (FSB)** which, in August 2013, adopted a policy framework consisting of **eleven Recommendations** addressing shadow banking risks in securities lending and repos. These Recommendations were subsequently endorsed in September 2013 by the G20 Leaders.

In order to closely follow market trends regarding entities whose activities qualify as shadow banking, in particular in the area of securities financing transactions, the Commission feels it **necessary to implement transparency requirements**.

The [proposal regarding structural reforms](#) of the EU banking sector, which is presented in a package with this proposal, is the final piece of the new regulatory framework, ensuring that even the largest banks in the EU become less complex and can be effectively resolved, with minimum implications for tax payers.

IMPACT ASSESSMENT: the impact assessment concludes that a combination of different measures is necessary including reporting of SFTs to trade repositories, disclosure on the use of SFTs to fund investors, and the need for prior consent to rehypothecation of the financial instruments. The latter must be transferred to an account opened in the name of the receiving counterparty before rehypothecation can take place.

This will ensure that the shadow banking activity of using SFTs is properly supervised and regulated. The use of SFTs as such will not be prohibited nor limited by specific restrictions but be more transparent.

CONTENT: the Regulation aims at enhancing financial stability in the EU by means of **increasing transparency of certain market activities**, such as SFTs, rehypothecation and other financing structures having equivalent economic effect as SFTs.

The Regulation introduces measures to **improve the transparency in three main areas**: (1) the monitoring of the build-up of systemic risks related to SFT transactions in the financial system; (2) the disclosure of the information on such transactions to the investors whose assets are employed in these or equivalent transactions; and (3) the contractual transparency of rehypothecation activities.

In practice, the proposed measures will cover the FSB recommendations, these being:

The obligation for competent authorities to collect additional data on the use of SFTs: the draft Regulation creates a Union framework under which financial or non-financial counterparties of a SFT will efficiently report the details of the transaction to trade repositories.

This information will be centrally stored and easily and directly accessible to the relevant authorities, such as ESMA, ESRB, the ESCB, for the purpose of identification and monitoring of financial stability risks entailed by shadow banking activities of regulated and non-regulated entities.

The requirement that requires fund managers be transparent towards their investors: in order to enable investors to become aware of the risks associated with the use of SFTs and other financing structures, fund managers should include detailed information on any recourse they have to these techniques in regular reporting intervals. The existing periodical reports that UCITS management or investment companies and AIF managers have to produce will be supplemented by this **additional information** on the use of SFTs and other financing structures.

The requirement for financial intermediaries to provide sufficient disclosure to their clients in relation to re-hypothecation of assets: any rehypothecation should therefore take place only with the express knowledge of inherent risks and prior consent of the providing counterparty in a **contractual agreement** and should be appropriately reflected in the securities accounts.

The counterparty receiving financial instruments as collateral will be allowed to rehypothecate them only with the express consent of the providing counterparty and only after having them transferred to its own account.

BUDGETARY IMPLICATIONS: the proposal involves the hiring of two new temporary agents at EBA from January 2016. The new tasks will be carried out with the human resources available within the annual budgetary allocation procedure, and in line with the financial programming for agencies.

DELEGATED ACTS: the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union.