Regulatory Headwinds for Securities Lending

2015 CASLA Conference

Michael McAuley
Kristin Missil
Scott Olson

Canadian Securities Lending Association

Regulatory Headwinds

Regulation	Status	Comments	Potential Impacts		
			Borrowers	Agent Lenders	Clients
EU Financial Transaction Tax	European Commission issued in February 2013 a proposal for a common financial transaction tax that would be applied by 11 participating EU member states. Discussions between the 11 member stares are ongoing. On 27 January 2015 the Finance Ministers of the participating member states issued a public statement renewing a commitment to make progress. Target implementation date is 1 January 2016, but many observers see this as unrealistic.	• Currently includes securities lending and repo transactions • Proposal has extra-territorial reach and could effect transactions outside the member states on a global scale • Transaction taxes implemented in France and Italy currently exclude temporary transfers including securities lending and repo	• Increased transaction costs	• Potential increased reporting, withholding and payment requirements	• Reduced demand and revenue for affected transactions

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US Risk-Based Capital Requirements	Finalized July 2013. US rules may be amended once Basel Committee revises the standardized approach. In December of 2014 Basel published a consultative document proposing revisions to the standardized approach for credit risk. Advanced approaches banks must meet minimum capital requirements under the advanced approaches and the standardized approaches.	• For certain large US bank holding companies, the Collins amendment establishes a floor requiring such institutions to calculate risk weighted assets under both standardized and advanced approaches and meet minimum capital requirements under both approaches • Non-US institutions are not subject to the Collins amendment. However, in December of 2014 Basel published a consultative paper on the design of a capital floor based upon the standardized approach • More favorable treatment for securities financing transactions and derivatives cleared through a QCCP	• Many US borrowers are currently leverage constrained • Capital constrained borrowers may demand more transactions be collateralized by cash • May seek to do some transactions through QCCPs • May look to match currencies between loan and collateral	• Significant increase in capital cost to provide various types of counterparty default indemnification	• May see increased demand for broader set of non-US collateral • May see increased cost for indemnification • May see lower demand for low spread transactions

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Large Exposures / Counterparty credit limits (Basel III, DFA 165)	Basel standards finalized April 2014. Intended full implementation on January 2019. US expected to repropose DFA 165(e) regulations later this year.	• Sets limitations on total credit exposure of large institutions to unaffiliated counterparties • Differences between Basel and US proposals include: overall limits; treatment of CCPs and sovereign exposures; definition of affiliates and covered companies; and treatment of intraday exposures. • Basel to review calculation methodology of credit exposure for securities finance transactions which could also apply for capital calculations under the standardized approach	• May limit traditional sources of supply due to agent lender restrictions	• May limit ability to provide various types of counterparty default indemnification • Will require counterparty diversification • May cause certain transaction to be done through CCPs • May limit amount of high-quality sovereign collateral that can be utilized	• May lead to certain transactions being done without indemnification • May require expanded list of counterparties including CCPs • May increase transactions collateralized by cash • May require expanded set of non-US collateral

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Net Stable Funding Ratio (NSFR)	The Basel Committee issued final standards in October 2014. The NSFR will become a minimum standard by January 2018. US has yet to propose regulations.	• NSFR supplements the LCR and has a time horizon of 1-year • It is intended to provide a sustainable maturity structure of assets and liabilities • Asymmetrical treatment of loans (repos, securities loans, secured loans) to non-bank financial counterparties	• Could significantly impact Borrower's funding costs and willingness to participate in overnight or short-term repo transactions with non-bank financial institutions • Could increase the cost of providing cash collateral	• Minimal impact	• Could cause disruption to repo markets and spreads • May create opportunity for longer term transactions • Increased demand for non-cash transactions • Sovereign entities may command a premium in short-term repo transactions

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US Supplementary Leverage Ratio	Supplementary Leverage Ratio effective on January 1, 2018 with reporting beginning on January 1, 2015.	• Measure of tier 1 capital divided by GAAP assets plus certain off-balance sheet items • BHCs with more than $700 billion in total consolidated assets or $10 trillion in assets under custody are required to maintain an "enhanced" supplemental leverage ratio of 5%, and any insured depository institution subsidiary is required to maintain a supplemental leverage ratio of 6% • The international Basel III leverage requirement is 3%. Previously most European countries did not have a leverage ratio	• Many large US borrowers are currently leverage constrained not risk-based capital constrained • May result in balance sheet reductions • May engage in more non-cash transactions • Could seek QCCP solution for certain trades to get additional GAAP netting benefits	• Minimal impact. Borrower default indemnification included in denominator using current exposure (collateral value – loan value) methodology	• Increased demand for non-cash transactions • May result in reduced level of repo investment opportunity • Addition of QCCPs as counterparties may allow for greater utilization and reinvestment opportunity

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Liquidity Coverage Ratio	US Regulations finalized in September, 2014. US firms began the LCR transition period on January 1, 2015 and would be required to be fully compliant by January 1, 2017 (80% for 2015, 90% for 2016). US implementation is 2 years ahead of Basel III.	• Measure of high-quality liquid assets over cash required to meet net outflows over a 30-day stress period • Makes more conservative inflow and outflow assumptions than Basel • Even matched books require some level of HQLA	• Need for term funding • Need for high quality liquid assets	• No impact	• Increased demand for term lending and term repo • Increased demand for evergreen structures • May limit opportunities for overnight repo investments • Increased demand for transformation trades (e.g. lending sovereign bonds vs. equities or other asset classes) • Increased use of securities lending as a liquidity tool (e.g. monetization trades, cash release)

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Financial Stability Board Shadow Banking Taskforce – Securities Lending and Repo Work Stream	Issued final recommendations in August 2013. US has yet to implement recommendations. FSB issued it's regulatory framework for haircuts on non-centrally cleared securities financing transactions in October of 2014.	• Recommendations address: transparency, cash collateral reinvestment, collateral valuation, reuse and rehypothecation, minimum haircuts and collateral fire sales	• May increase funding costs and limit ability to rehypothecate or reuse client assets	• Increased data reporting requirements • May increase margin requirements for certain non-cash collateral transactions and repurchase transactions	• May increase demand to borrow eligible collateral • May limit cash collateral reinvestment opportunities • May increase cost of using securities lending as a liquidity tool