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ADVOCATES AND LEGAL CONSULTANTS

Consultation Period for Reporting Guidelines under the Securities Financing Transaction Regulation drawing to a close

Securities Financing Transactions (“SFTs”) involve any transaction where securities are used to borrow cash, or vice versa. These consist of repurchase agreements (repos), securities or commodities lending activities, sell/buy-back transactions (and vice-versa) and margin lending. In practice, ownership of the security temporarily changes in return for cash temporarily changing ownership. At the end of an SFT, ownership of the security and the cash reverts to the original owner plus or minus a small fee depending on the nature of the transaction. In this regard, SFTs resemble collateralised loans.

A security subject to an SFT can be reused by the counterparty taking ownership. Whilst this provides liquidity and enables counterparties to reduce funding costs it can create complex collateral chains between traditional banking and “shadow banking” (non-bank credit intermediation) which could in turn give rise to financial stability risks.

The Securities Financing Transaction Regulation (EU) 2015/2365 (“SFTR”) aims to increase the transparency of SFTs and the reuse of collateral, by requiring counterparties to report details of concluded SFTs, modifications and terminations to a central trade repository registered with ESMA. This reporting is aimed at better understanding the effects of shadow banking and to address the risks posed by SFTs, such as the build-up of leverage in the financial system.

The SFTR applies to any counterparty to an SFT that is established in the EU or third country counterparties where the SFT is concluded in an EU based branch. It also applies where a security is reused by counterparties established in the EU, where reuse is effected in the course of operations of an EU based branch of a third country counterparty or where the reuse concerns securities provided under a collateral arrangement by a counterparty established in the EU or an EU branch of a third country counterparty. The SFTR also applies independently to UCITS management and investment companies and AIFMs as it sets out transparency requirements in relation to any use they make of SFTs and Total Return Swaps.

SFT details must be reported no later than the working day following the conclusion, modification or termination of the transaction. Counterparties are required to keep records of all SFTs that they have concluded, modified or terminated for at least 5 years following the termination of the transaction. Minimum details to be reported include the parties to the SFT (and where different, the beneficiary of any arising rights or obligations), the principal amount, the currency, the assets used as collateral, their quality, whether the collateral is available for reuse, and whether it has in fact been reused.

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SFTR came into effect on 12 January 2016. However, reporting requirements under Article 4 of the Regulation were scheduled to come into effect not earlier than 12 months after the date of entry into force of delegated acts adopted by the European Commission. Article 33 of the SFTR provides for different application dates depending on the type of financial reporting counterparty involved. The delegated acts, consisting mostly of regulatory technical standards (“RTSs”) were adopted by the Commission and published in the EU’s Official Journal on 22 March 2019 and came into force on 11 April 2019. Credit institutions and investment firms will be required to comply with the reporting requirements within 12 months of April 2019, Central Counterparties and Central Securities Depositories within 15 months, and all other financial institutions, including insurance undertakings, pension funds UCITS and AIFs within 18 months. Non-financial counterparties will have 21 months to comply from April 2019.

ESMA published a consultation on the reporting guidelines under Article 4 (and Article 12 relating to the transparency and availability of data held by trade repositories) on 27 May 2019. ESMA held an open hearing on the consultation paper on 15 July 2019 and will consider all comments on the consultation paper received before 29 July 2019. ESMA expects to publish a final report on the Guidelines on Reporting SFTR in Q4 2019 to supplement the RTSs adopted by the Commission.

Following the introduction of the European Market Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Regulation (MiFIR), it is anticipated that the SFTR will complete the transaction reporting ecosystem.

For more information or advice on this matter, please contact one of our Investment Services lawyers.