

# Securities financing transactions and rehypothecation - the current EU direction of travel

To enable our hedge fund clients to keep an eye on what's on the horizon, this short note summarises what the EU is working towards when it comes to securities financing and rehypothecation transactions.

## Background

Following the 2008 global financial crisis, the EU has had in its sights activities often referred to as shadow banking, i.e. credit intermediation involving entities and activities (fully or partially) outside the regular banking system. "The overarching aim, as reaffirmed on several occasions by the G20, is to eliminate the dark corners in the financial sector that have a potential impact on systemic risk or merely result from regulatory arbitrage and extend regulation and oversight to all systemically important financial institutions, instruments and markets."<sup>1</sup>

In that context, having examined and consulted on securities financing transactions (SFTs) and rehypothecation, the view of the European Commission is that it is important that the lack of transparency is reduced.

## Proposed regulation

This has led to the European Commission's "Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions"<sup>2</sup>.

The European Commission has described the proposed regulation as having three aims:

1. the **monitoring** of the build-up of systemic risks related to SFT transactions in the financial system;
2. the **disclosure** of information on such transactions to the investors whose assets are employed in these or equivalent transactions; and
3. the contractual **transparency** of rehypothecation activities.

Selected topics in the proposed regulation therefore include:

- A requirement to report SFT details to a trade repository on a T+1 basis. A counterparty which is subject to the reporting obligation may delegate the reporting of the details of SFTs.
- Reporting by certain fund managers (management companies of UCITS, UCITS investment companies and AIFMs) to investors of use of SFTs and other financing structures. AIFMs would need to include certain information on a pre-investment disclosure basis and in the annual report.
- Rehypothecation of customer assets should be subject to contractually-provided informed consent of the customer and the activity should be appropriately reflected in the securities accounts. The counterparty receiving financial instruments as collateral will be allowed to rehypothecate them after having them transferred to its own account.

The proposed regulation will cover:

- a counterparty to a SFT that is established:
  - in the EU, including all its branches irrespective of where they are located; or
  - in a third country, if the SFT is concluded in the course of operations of an EU branch;
- management companies of UCITS and UCITS investment companies;
- AIFMs; and
- a counterparty engaging in rehypothecation that is established:
  - in the EU, including all its branches irrespective of where they are located; or
  - in a third country, in either of the following cases:
    - the rehypothecation is effected in the course of the operations of an EU branch; or
    - the rehypothecation concerns financial instruments provided as collateral by a counterparty established in the EU or an EU branch of a counterparty established in a third country.

<sup>1</sup> European Commission "Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions" dated 29 January 2014

<sup>2</sup> 2014/0017(COD); 29 January 2014

## Current status

The proposed regulation is now at the EU parliamentary committee stage.

## Contact details

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