

ICMA EUROPEAN REPO COUNCIL

European Securities and Markets Authority (ESMA)
103, Rue de Grenelle
75007 Paris
France

29 May, 2014

Dear Sirs,

Response submission from the ICMA European Repo Council

Re: ESMA Consultation Paper – “Draft Regulatory Technical Standards on major shareholdings and indicative list of financial instruments subject to notification requirements under the revised Transparency Directive”

In advance of your deadline of 30 May 2014, this letter provides feedback on behalf of the International Capital Market Association’s (“ICMA’s”) European Repo Council (“ERC”), regarding the inclusion of repurchase agreements in the indicative list of financial instruments that may be subject to notification requirements under the amended Transparency Directive (TD).

Background

The ERC was established by ICMA in December 1999, to represent the cross-border repo market in Europe. It is composed of practitioners in this market, who meet regularly to discuss market developments in order to ensure that practical day-to-day issues are fully understood and dealt with adequately.

The repo market is one of the largest and most active sectors in today’s money markets. It provides an efficient source of money market funding for financial intermediaries while providing a secure

home for liquid investments. Repo is also used by central banks as their principal tool in open market operations to control short-term interest rates. Repos are attractive as a monetary policy instrument because they carry a low credit risk while serving as a flexible instrument for liquidity management, which benefits the functioning of financial markets. Central banks are also able to act swiftly as lenders of last resort during periods of market turbulence by way of the repo market.

In the international repo market, ICMA's Global Master Repurchase Agreement (GMRA)¹ provides a robust legal framework for documenting repo transactions. Supervisory authorities recognise the effect of the GMRA netting provisions for regulatory capital and large exposure requirements provided, inter alia, that a reasoned legal opinion has been obtained to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would find that, where a counterparty fails owing to default, bankruptcy, liquidation or any other similar circumstance, the regulated firm's claims and obligations pursuant to the GMRA would be limited to a net sum under the law of the relevant jurisdiction(s), and meets certain other requirements. Against this background, ICMA obtains and annually updates legal opinions on the GMRA, currently from 62 jurisdictions worldwide, for the benefit of its members. These opinions cover both the enforceability of the netting provisions of the GMRA as well as the validity of the GMRA as a whole.

In a repo, at the start of the transaction, one party (the Seller) sells securities to another party (the Buyer) for cash with an agreement to repurchase equivalent securities at a future date or on demand. The transaction is collateralised, with the cash securing the seller's securities and the securities securing the buyer's cash. In the event of default, the collateral can be sold and exposure to the defaulting party can be netted off. It is worth emphasising that repo involves the *sale* of collateral – i.e. there is an outright transfer of legal title to the collateral to the Buyer and that the Buyer is only obliged to sell back *equivalent* securities (i.e. securities that are economically but not legally identical to those purchased at the start of the repo) at the end of the repo.

The inclusion of repurchase agreements in the indicative list

The ERC notes that ESMA has proposed that repurchase agreements be included in the indicative list of financial instruments that may be subject to notification requirements under the TD. If the purpose of the list is to provide assistance regarding the types of financial instruments which are expected to be disclosed by an investor, the ERC recommends that ESMA provide further detail about which repurchase agreements could be caught by the TD. This is because the vast majority of repurchase agreements use fixed income securities as the underlying collateral rather than equity securities and presumably it is not ESMA's intention that such fixed-income repos be notifiable under the TD.

While the GMRA does contemplate the possibility of equity securities being used as the underlying (and hence the development of the GMRA Equities Annex), we believe that such transactions are limited. Instead, it is our understanding that securities financing transactions using equity securities

¹ The GMRA is a standard master agreement for repo transactions. The first version of the GMRA was published in 1992 and was followed by substantially revised versions in 1995, 2000 and 2011. For copies of all versions of the GMRA, see: <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/global-master-repurchase-agreement-gmra/>

as the underlying would typically be done as securities lending transactions rather repo transactions under the GMRA. In any case, Clause 4(b) of the GMRA Equities Annex provides:

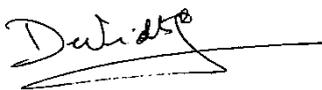
“Where any voting rights fall to be exercised in relation to any Purchased Securities or Margin Securities which are equities and in respect of which Equivalent Securities or, as the case may be, Equivalent Margin Securities have not been transferred or a Cash Equivalent Amount has not been paid, neither Buyer, in the case of Purchased Securities, nor the transferee, in the case of Margin Securities, shall have any obligation to arrange for voting rights of that kind to be exercised in accordance with the instructions of the other party in relation to such Purchased Securities or Margin Securities, unless otherwise agreed between the parties.”

Because there is the possibility for the parties to agree an arrangement for voting rights to be exercised by the Buyer in accordance with the instructions of the Seller, the ERC feels that it is right that repurchase agreements be included in the indicative list. However, in order to avoid any confusion or misunderstanding about the nature of most repo transactions and for the avoidance of doubt, the list should make clear that it is limited to repurchase agreements where the underlying collateral consists of equity securities to which voting rights attach.

Concluding remarks

The ERC appreciate the valuable contribution made by the ESMA's examination of the issues articulated in this consultation paper and would like to thank ESMA for its careful consideration of the repo oriented points made in this response. The ERC remains at your disposal to discuss any of the above points.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Godfried de Vidts', with a long horizontal line extending to the right from the end of the signature.

Godfried de Vidts
Chairman, European Repo Council
Board member, ICMA

cc : *ICMA European Repo Committee*