



MARKET GUIDANCE: SECURITIES FINANCING TRANSACTIONS REGULATION

The London Bullion Market Association (LBMA) is an independent market association representing the global markets for gold, silver, platinum and palladium. Participants in these markets include financial institutions, central banks, refiners, mining companies, mints, traders, transporters and security companies. LBMA represents 143 companies active in the precious metal markets in over 30 countries. LBMA is focused on adding value to the global precious metals industry by setting standards and developing market services, thereby ensuring the highest levels of integrity, transparency and quality.

Background

LBMA welcomes the guidelines published by ESMA in January 2020 on the reporting obligations under the Securities Financing Transactions Reporting (SFTR) and in particular under Articles 4 and 12 (the ESMA Guidelines).

LBMA has formed two Working Groups since the publication of the ESMA Guidelines; one focusing on the scope and application of SFTR to precious metal transactions and one focusing on the operational reporting of those transactions deemed to be Securities Financing Transactions (SFTs). These Working Groups comprise legal, compliance and operations representatives from some of the LBMA members, in the wholesale precious metals market.

While the ESMA Guidelines have helped market participants' preparation for implementation, the market requires additional clarification on several areas. The Working Groups have identified the following provisions set out in this document as common issues for market participants.

Market guidance

This paper therefore sets out the market view on how to apply SFTR and the ESMA Guidelines to precious metals transactions. This guidance is based on market interpretation and discussion. Each market participant is responsible for its own compliance and interpretation. LBMA encourages each participant to seek their own legal advice in the interpretation of SFTR and the ESMA Guidelines.

LBMA notes some of the ambiguities in the ESMA Guidelines, however market participants should use best efforts to apply existing regulatory and market guidance where possible to ensure accurate reporting. Having a market position will help to avoid any reporting inconsistencies, underreporting or over reporting. For the defined terms referred to in this paper, please see the enclosed annex.

Section 1

Under Section 3.1.1.8 of the ESMA Guidelines, ESMA provides that commodities transactions entered into for operational and/or industrial purposes are not reportable.

In implementing this exemption, market participants should classify on an individual counterparty basis rather than an individual transaction basis. Market participants should therefore determine whether their contractual relationship is with a Financial Counterparty (FC) or a Non-Financial Counterparty (NFC). By classifying on a counterparty basis, market participants can determine whether the transactions entered into during their contractual relationship with the counterparty are for financing purposes, as typical with an FC, or for operational/industrial purposes, as typical with an NFC. Market participants should follow the guidance below when classifying a counterparty as an FC or NFC and apply the above exemption as appropriate.

Transactions with FCs

Where a commodities transaction is entered into between FCs, the FCs should determine between themselves whether they are conducting the transaction for non-financing purposes and whether the operational/industrial purpose exemption therefore applies.



Transactions with NFCs

All potentially in-scope commodities transactions entered into by NFCs will be considered to be conducted for operational/industrial purposes. NFCs may enter into precious metal transactions for operational/industrial purposes if they are end-users of the metal and wish to hedge their price risk or cover temporary short positions. NFCs do not contribute to systemic risk therefore, in the market's view, qualify for the operational/industrial purpose exemption.

In applying the above exemption, market participants should send the market-standard representation letter drafted by LBMA to the NFC. This will ensure consistency throughout any representation letters received by counterparties from market participants. The letter will notify counterparties that the operational/industrial purpose exemption is deemed to apply to all transactions entered into throughout their contractual relationship and therefore does not require reporting under SFTR. The letter should request the counterparty to notify the market participant if it believes a particular transaction is not for an operational/industrial purpose and therefore ought to be in scope for reporting purposes.

Market participants should determine an appropriate and proportionate review process for counterparties to confirm the exemption continues to apply.

Section 2

Q1 paragraph 14c of Section 3.1.1 of the ESMA Guidelines provides that "Forward sales in commodities that are transactions between two counterparties in which commodities are i) purchased by the buyer from the seller on the spot leg and ii) sold to the seller by the buyer on a specified date against a specified price on the forward leg" must be reported under SFTR.

Q9 paragraph 84 of Section 3.1.2.4 the ESMA Guidelines provides that "an SFT requires a linkage between the opening and the closing leg of the transaction".

The joint association letter dated 20 February 2020 raised the issue of linkage between the opening and closing legs of transactions in order for them to be in scope of SFTR. The market awaits guidance on how to report two linked transactions as one SFT following the letter's submission. In the absence of regulatory guidance, market participants should apply their own analysis which may lead to inconsistencies or over/under reporting.

Linked Transactions

Market participant should assume that precious metals spot/forward transactions are in scope for SFTR reporting only where the first and second leg are sufficiently linked (Linked Transaction). A Linked Transaction involves entering into both legs of the transactions simultaneously with the same counterparty. Market participants should also consider whether associated transactions executed for risk management purposes are also in scope.

Where market participants have identified a Linked Transaction, they should consider whether the transaction has been entered into for operational/industrial purposes. If the transaction has been entered into for financing purposes, the Linked Transaction would be reported as a buy-sell back transaction.

Linked Transactions between FCs

Market participants should assume that precious metals spot/forward transactions which have been identified as a Linked Transaction that is conducted between FCs is always for financing purposes and therefore is in scope of SFTR reporting. There may be exceptions to this assumption therefore market participants should apply their own analysis to verify the purposes of the Linked Transaction.



Linked Transactions with NFCs

Market participants should assume that precious metals spot/forward transactions which have been identified as a Linked Transaction that is conducted with an NFC is always for operational/industrial purposes and therefore is not in scope of SFTR reporting. There may be exception circumstances to this assumption therefore market participants should apply their own analysis to verify the purposes of the Linked Transaction.

Section 3

Market participants should agree as far as possible which fields ought to be reported for each transaction and how using the same type of reporting template in order to ensure consistent reporting across the market.

Reporting Linked Transactions

Market participants should report Linked Transactions using the Buy-Sell Back reporting template. Referring to Section 2, Linked Transactions require market participants to report two trades as a single buy-sell back or repurchase transaction, leading to the following issues:

- i. Establishing a single UTI for separate transactions;
- ii. Populating the relevant price fields;
- iii. Determining the method for calculating and agreeing the Valuation/Collateral Value fields, especially when on a spot/forward transaction where the maturity of the spot leg has passed;
- iv. Amendments or lifecycle events on spot/forward transactions.

The issue of collateral is prevalent to the points set out above as market participants are currently unable to split the cash collateral component by transaction given the practice that spot/forward transactions are collateralised under a framework agreement along with other derivatives. We also reiterate the issues raised in the joint association letter dated 20 February 2020 on multiple UTIs, collateral and valuation and look forward to receiving guidance on how to address these issues. The absence of additional regulatory guidance may lead to inconsistencies in market participants' reporting, therefore market participants should follow the below guidance where possible until additional guidance is made available.

To address issue (i), market participants should generate and share one UTI.

To address issue (ii), market participants should use the price of the metal from the spot transaction to complete the relevant price fields.

To address issue (iii), the value date should be taken from the contractual settlement date of the spot transaction. The maturity date should be taken from the contractual settlement date of the forward transaction. Similarly, the principal amount on the value date and on the maturity date should be taken from the respective notional amounts of the spot and forward transactions. Market participants should calculate the collateral market value by multiplying the collateral quantity by the price per unit from the spot transaction. The price per unit refers to the market price of the metal rather than the price of the trade.

LBMA continues to work with its Working Groups to address issue (iv) and intends to update this guidance document in due course.

Reporting Precious Metal Lending/Borrowing

Market participants should report precious metal lending/borrowing transactions using the Commodities Lending reporting template with the type of SFT set to SLEB. As these transactions are not collateralised, no collateral-related fields will apply.



Market participants should contact their counterparties to agree an approach to using a common UTI for these types of transactions. Should counterparties fail to reach an agreed approach, market participants should generate and share one UTI for all precious metal lending/borrowing transactions to their counterparties at time of execution.

Section 4

Applying the regulatory guidance regarding Article 2(2) available on the date of this paper, market participants should treat commodities transactions with non-EU central banks as reportable. Only transactions with EU central banks, equivalent public bodies in Member States and the Bank for International Settlements are currently excluded from reporting obligations.

Regarding the UK's departure from the EU, under the powers delegated to the UK authorities under Article 2(4), the European Commission and HM Treasury have amended Article 2(2) in both the EU and UK respectively to ensure the exemption covers all UK and EEA central banks and equivalent public bodies at the end of the transition period.

There are similar exemptions in MAR and EMIR which have been extended to certain third country banks and public bodies. It would be helpful to know if similar extensions to third countries bodies are anticipated under SFTR and, if so, what that anticipated timing would be.

LBMA remains available to answer any questions you may have on the contents of this paper and welcomes the opportunity to discuss these issues in more detail.

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ANNEX: DEFINED TERMS

Article 2(2)

Article 2(2) of SFTR provides that Articles 4 and 15 do not apply to:

- (a) members of the European System of Central Banks (ESCB), other Member States' bodies performing similar functions, and other Union public bodies charged with, or intervening in, the management of the public debt; or
- (b) the Bank for International Settlements.

Article 2(4)

Article 2(4) of SFTR provides that the Commission shall be empowered to adopt delegated acts in accordance with Article 30 to amend the list set out in paragraph 2 of this Article.

To that end and before adopting such delegated acts, the Commission shall present to the European Parliament and to the Council a report assessing the international treatment of central banks and of public bodies charged with or intervening in the management of the public debt.

That report shall include a comparative analysis of the treatment of central banks and of those bodies within the legal framework of a number of third countries. Provided that the report concludes, in particular with regard to the comparative analysis and potential effects, that the exemption of the monetary responsibilities of those third-country central banks and bodies from Article 15 is necessary, the Commission shall adopt a delegated act adding them to the list set out in paragraph 2 of this Article.

Buy-sell back transaction or sell-buy back transaction

'Buy-sell back transaction' or 'sell-buy back transaction' is defined in Article 3(8) of SFTR as a transaction by which a counterparty buys or sells securities, commodities, or guaranteed rights relating to title to securities or commodities, agreeing, respectively, to sell or to buy back securities, commodities or such guaranteed rights of the same description at a specified price on a future date, that transaction being a buy-sell back transaction for the counterparty buying the securities, commodities or guaranteed rights, and a sell-buy back transaction for the counterparty selling them, such buy-sell back transaction or sell-buy back transaction not being governed by a repurchase agreement or by a reverse-repurchase agreement within the meaning of point (9).

Counterparties

Counterparties are defined in Article 3(2) of SFTR as meaning financial counterparties and non-financial counterparties.

Financial counterparty or FC

Financial Counterparty is defined in Article 3(3) of SFTR as meaning:

- (a) an investment firm authorised in accordance with Directive 2014/65/EU of the European Parliament and of the Council (17);
- (b) a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council (18) or with Regulation (EU) No 1024/2013;
- (c) an insurance undertaking or a reinsurance undertaking authorised in accordance with Directive 2009/138/EC of the European Parliament and of the Council (19);
- (d) a UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/65/EC;
- (e) an AIF managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU;
- (f) an institution for occupational retirement provision authorised or registered in accordance with Directive 2003/41/EC of the European Parliament and of the Council (20);
- (g) a central counterparty authorised in accordance with Regulation (EU) No 648/2012;
- (h) a central securities depository authorised in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council (21);
- (i) a third-country entity which would require authorisation or registration in accordance with the legislative acts referred to in points (a) to (h) if it were established in the Union.

Margin lending

Margin lending is defined in Article 3(10) of SFTR as a transaction in which a counterparty extends credit in connection with the purchase, sale, carrying or trading of securities, but not including other loans that are secured by collateral in the form of securities.

Non-financial counterparty or NFC

Non-Financial Counterparty is defined in Article 3(4) of SFTR as meaning an undertaking established in the Union or in a third country other than the entities referred to in point (3).

Operational/industrial purpose exemption

Section 3.1.1.8 of the ESMA Guidelines provides that commodities transactions entered into for operational and/or industrial purposes which are clearly not for financing purposes, i.e. are concluded for commercial purposes, do not contribute to the systemic risk addressed by SFTR. Therefore, these market transactions should not fall under the definition of an SFT and therefore should not be reported under SFTR.

Repurchase transaction

Repurchase transaction is defined in Article 3(9) of SFTR as meaning a transaction governed by an agreement by which a counterparty transfers securities, commodities, or guaranteed rights relating to title to securities or commodities where that guarantee is issued by a recognised exchange which holds the rights to the securities or commodities and the agreement does not allow a counterparty to transfer or pledge a particular security or commodity to more than one counterparty at a time, subject to a commitment to repurchase them, or substituted securities or commodities of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a repurchase agreement for the counterparty selling the securities or commodities and a reverse repurchase agreement for the counterparty buying them.

Securities or commodities lending or securities or commodities borrowing

'Securities or commodities lending' or 'securities or commodities borrowing' is defined in Article 3(7) of SFTR as a transaction by which a counterparty transfers securities or commodities subject to a commitment that the borrower will return equivalent securities or commodities on a future date or when requested to do so by the transferor, that transaction being considered as securities or commodities lending for the counterparty transferring the securities or commodities and being considered as securities or commodities borrowing for the counterparty to which they are transferred.

Securities financing transaction or SFT

Securities financing transaction or SFT is defined in Article 3(11) of SFTR as

- (a) a repurchase transaction;
- (b) securities or commodities lending and securities or commodities borrowing;
- (c) a buy-sell back transaction or sell-buy back transaction;
- (d) a margin lending transaction.