

Circular 2010/2 Repo/SLB transactions

Repurchase & reverse repurchase transactions and securities lending & borrowing transactions (Repo/SLB transactions)

Reference: FINMA Circular 10/2 „Repo/SLB transactions“
 Date: 17 December 2009
 Entry into force: 30 June 2010
 Last amendment: 17 December 2009
 Legal framework: FINMASA art. 7 sect. 1 lett. b
 BA art. 3, 4
 BO art. 16-20
 SESTA art. 10, 11
 SESTO art. 29a

Addressees																						
BA			ISA			SESTA		CISA						AMLA		Other						
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Insurance intermediaries	Stock exch. and participants	Securities dealers	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset managers CISs	Distributors	Representatives of foreign CISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies	
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I. Subject and scope of application

In this Circular the Swiss Financial Market Supervisory Authority (FINMA) establishes the rules applicable to securities lending and borrowing transactions with clients (margin no. 4-20) and addresses issues pertaining to the treatment of repurchase and reverse repurchase transactions and securities lending and borrowing transactions in the context of liquidity regulations (margin no. 21-43) and risk management (margin no. 44). Repurchase and reverse repurchase transactions are referred to below as “repo transactions” and securities lending and borrowing transactions as “SLB transactions”.

The following are not considered clients: banks, securities dealers, fund management companies and insurance companies.

This Circular is addressed to banks and securities dealers. The specifications pertaining to treatment under liquidity regulations apply to securities dealers to the extent that the liquidity regulations of banks also apply to them (art. 29a SESTO).

II. Rules pertaining to SLB transactions with clients

A. General declaration and disclosure requirements

Banks and securities dealers that engage in securities borrowing transactions in the capacity of a counterparty or that broker such transactions in the capacity of agents must make advance disclosures to the clients (lenders) about the risks associated with individual transactions in an easy-to-understand manner. Cognisance thereof is to be documented separately or in the SLB contract (margin no. 12).

Clients are to be informed of the following in particular:

- The client is to be informed as to whether the bank or securities dealer is acting as the borrower and thus as the counterparty (principal) or whether they are acting solely in the capacity of an agent in brokering the transaction with a third party. In the case of brokered unsecured SLB transactions the client is to also be informed whether the bank or the securities dealer is guaranteeing the return of the securities.
- The client loses his title to the lent securities. The client only has the right against the borrower of recovery of the same type and quantity of securities; in the event of insolvency or bankruptcy on the part of the latter the client loses his entitlement to the surrender of the securities lent by him (no right of segregation of assets or preferential treatment as a creditor).
- In the event of insolvency or bankruptcy on the part of the borrower and any guarantor, the client only has a monetary claim against same in the same value, said claim not being privileged or secured under the depositor protection scheme (art. 37h BA). Only secured SLB transactions benefit from additional backing in the amount of the collateral received.
- The proprietary and participation rights and, in particular, the voting rights associated with the individual securities are transferred to the borrower for the duration of the loan (unless agreed otherwise in an individual case). However, the risk associated with any depreciation in value of the securities remains with the client.

B. Unsecured SLB transactions

Unsecured SLB transactions with individual investor clients are prohibited. Qualified investors pursuant to art. 10 sect. 3 CISA are not considered individual investor clients. 10

C. The SLB contract and its content

In going about complying with their risk management obligations, banks and securities dealers must ensure that their SLB contracts are designed so that they are effective and legally enforceable. 11

The client must expressly consent in advance to participation in an SLB transaction by way of a contract that is separate of the bank's or securities dealer's general business terms and conditions. Combining this contract with other contracts is permissible. 12

The client is to be afforded the option of excluding specific securities from an SLB transaction. 13

The client's entitlement to compensation payments in lieu of the revenue payable on the lent securities is to be covered by the contractual provisions. 14

Clients are to be remunerated for the securities lent by them (lending fee). The criteria for the calculation of this lending fee are to be established in the contract in a general manner. 15

The client may terminate the SLB contract and individual lending transactions at any time with immediate effect. This shall not apply to cases in which a fixed term is expressly established, with the lending transaction not terminating until the lapse thereof. The timeframes and conditions of the recovery of the same type and quantity of securities are to be established. 16

D. Accounting statements

The bank or securities dealer must provide an accounting to the client covering compensation payments (margin no. 14) and remuneration (margin no. 15) on a periodical basis. 17

The accounting statement is to detail what securities item has been lent for what period of time and what rights the client has to remuneration and compensation payments. The client may demand additional information for calculating his entitlements in a specific case. 18

E. Custody account statements

Lent securities are to be indicated as such in custody account statements. In addition, the client is to be reminded of his ongoing participation in an SLB transaction. 19

F. Register listing

After every SLB transaction involving equity securities, the bank or securities dealer must have a listing or delisting immediately entered in the respective register unless an individual client expressly waives his right to have this done (shares for which no application for registration has been made).¹ 20

¹ This is subject to adaptation as appropriate as the result of the "nominee model" provided for in the context of corporate law reform.

III. Treatment of repo and SLB transactions under liquidity regulations (art. 16 et seq. BO)

A. General remarks

In calculating liquidity, only those securities are recognisable over which the bank may dispose of in an unrestricted manner. This prerequisite is satisfied for secured SLB transactions where the lender has had the borrower expressly grant him the right to dispose of the securities collateral in the lender's own name and on the lender's own account. 21

Securities are also recognisable where the parties have agreed to the right of substitution of transferred securities in the context of repo and SLB transactions. 22

B. Treatment of repo transactions

a) Repo transactions with recognisable securities

The funds provider may recognise the securities received by him as liquid assets (art. 16 sect. 1 lett. b–f BO). In transactions with a residual term to final maturity of up to one month, the funds provider may not recognise his outstanding claim for repayment of the money nor need he recognise his obligation to return the securities. 23

The funds recipient must deduct the transferred securities as pledged liquid assets (art. 16 sect. 3 BO). In transactions with a residual term to final maturity of up to one month, the funds recipient must recognise his obligation to effect repayment of the money (art. 17a sect. 1 BO), however he may deduct it as a short-term liability in exchange for pledging liquid assets (art. 17a sect. 2 BO). He may not recognise his claim for the return of the securities. 24

b) Repo transactions with non-recognisable securities

In transactions with a residual term to final maturity of up to one month, the funds provider may recognise his claim for repayment of the money (art. 16a BO). 25

In transactions with a residual term to final maturity of up to one month, the funds recipient must recognise his obligation to effect repayment of the money (art. 17a sect. 1 BO). 26

C. Treatment of secured SLB transactions

a) Secured SLB transactions with recognisable securities

aa) *Backing by way of cash collateral*

SLB transactions involving securities that satisfy the requirements of art. 16 sect. 1 lett. b–f BO in exchange for the provision of cash collateral are to be treated in the same manner as repo transactions with recognisable securities (see margin no. 23-24; here the funds provider corresponds to the borrower and funds recipient corresponds to the lender, and the term for giving notice corresponds to the residual term to final maturity). 27

bb) *Backing by way of recognisable securities possessing an unrestricted right of disposal*

The lender must deduct the lent securities as pledged liquid assets (art. 16 sect. 3 BO). He may 28

recognise the securities received by him as collateral (art. 16 sect. 1 lett. b–f BO). In transactions with a notice term of up to one month, the lender may not recognise his claim for the return of the lent securities nor need he recognise his obligation to return the securities received by him as collateral.

The borrower may recognise the securities borrowed by him (art. 16 sect. 1 lett. b–f BO). He must deduct the securities transferred as collateral as pledged liquid assets (art. 16 sect. 3 BO). In transactions with a notice term of up to one month, the borrower needn't recognise his obligation to return the borrowed securities nor may he recognise his claim for the return of the securities transferred as collateral. 29

cc) Backing by way of recognisable securities possessing a restricted right of disposal

The lender must deduct the lent securities as pledged liquid assets (art. 16 sect. 3 BO). He may not recognise the securities received by him as collateral due to his restricted right of disposal. In transactions with a notice term of up to one month, the lender may recognise his claim for the return of the lent securities (art. 16a BO). 30

The borrower may recognise the securities borrowed by him (art. 16 sect. 1 lett. b–f BO). He must deduct the securities transferred as collateral (art. 16 sect. 3 BO). In transactions with a notice term of up to one month, the borrower needn't recognise his obligation to return the borrowed securities nor may he recognise his claim for the return of the securities transferred as collateral. 31

dd) Backing by way of non-recognisable securities

The lender must deduct the lent securities as pledged liquid assets (art. 16 sect. 3 BO). In transactions with a notice term of up to one month, the lender may recognise his claim for the return of the lent securities (art. 16a BO). 32

The borrower may recognise the securities borrowed by him (art. 16 sect. 1 lett. b–f BO). In transactions with a notice term of up to one month, the borrower must recognise his obligation to return the borrowed securities (art. 17a sect. 1 BO). 33

b) Secured SLB transactions with non-recognisable securities

aa) Backing by way of cash collateral

SLB transactions involving securities that do not satisfy the requirements of art. 16 sect. 1 lett. b–f BO in exchange for the provision of cash collateral are to be treated in the same manner as repo transactions with non-recognisable securities (see margin no. 25-26; here the funds provider corresponds to the borrower and funds recipient corresponds to the lender, and the term for giving notice corresponds to the residual term to final maturity). 34

bb) Backing by way of recognisable securities possessing an unrestricted right of disposal

The lender may recognise the securities received by him as collateral (art. 16 sect. 1 lett. b–f BO). In transactions with a notice term of up to one month, the lender must recognise his obligation to return the securities received as collateral (art. 17a sect. 1 BO). 35

The borrower must deduct the securities transferred as collateral as pledged liquid assets (art. 16 sect. 3 BO). In transactions with a notice term of up to one month, the borrower may recog- 36

nise his claim for the return of the securities transferred as collateral (art. 16a BO).

cc) Backing by way of recognisable securities possessing a restricted right of disposal

The lender may not recognise the securities received by him as collateral due to a lack of an unrestricted right of disposal. 37

The borrower must deduct the securities transferred as collateral as pledged liquid assets (art. 16 sect. 3 BO). In transactions with a notice term of up to one month, the borrower may recognise his claim for the return of the securities transferred as collateral (art. 16a BO). 38

dd) Backing by way of non-recognisable securities

SLB transactions in which neither the securities lent nor the securities collateral received satisfy the requirements of art. 16 sect. 1 lett. b–f BO shall have no impact on the liquidity shown in the liquidity statement. 39

D. Treatment of non-secured SLB transactions

a) Unsecured SLB transactions with recognisable securities

In unsecured SLB transactions with the bank acting as the lender, the bank must deduct the lent securities as pledged liquid assets (art. 16 sect. 3 BO). In transactions with a notice term of up to one month, the lender may recognise his claim for the return of the lent securities (art. 16a BO). 40

In unsecured SLB transactions with the bank acting as the borrower, the bank may recognise the borrowed securities (art. 16 sect. 1 lett. b–f BO). In transactions with a notice term of up to one month, the borrower must recognise his obligation to return the borrowed securities (art. 17a sect. 1 BO). Transactions in which the obligation to return the borrowed securities is honourable at sight at any time are to be included under the offsettable short-term liabilities in the liquidity statement. 41

b) Unsecured SLB transactions with non-recognisable securities

Unsecured SLB transactions in which the securities lent or borrowed by the bank do not satisfy the requirements of art. 16 sect. 1 lett. b–f BO shall have no impact on the liquidity shown in the liquidity statement. 42

E. Liquidity statement

Banks are to report in the liquidity statement (art. 20 BO) the respective fair value of the total securities available for an unsecured SLB transaction, the amount of the unsecured borrowed securities thereof, and the portion thereof used for treasury purposes (use in the context of liquidity management and liquidity control). This information is to be reported in shorter intervals should FINMA so request. 43

IV. Risk management

Banks and securities dealers that engage in unsecured securities borrowing transactions involving client portfolios in the capacity of a counterparty or that broker such transactions in the ca- 44

capacity of agents must have a concept in place with defined standard processes that take account of any conflicts of interest in times of tight liquidity.

V. Audit

Audit firms are to review compliance with this Circular pursuant to the requirements of FINMA Circular 08/41 “Audit Matters” and record the findings of their audit activities in the audit report submitted by them. 45

VI. Transition period

A transition period until 31 December 2010 applies to the implementation of margin no. 4-16 with regard to existing SLB transactions with clients. 46