The Securities Financing Transactions Regulation and Investment Funds

**What is the SFTR?**

The regulation on transparency of securities financing transactions and of reuse ("SFTR") entered into force on 12 January 2016 and applies from that date, subject to certain transitional provisions. The SFTR introduces measures addressing:

- reporting of securities financing transactions ("SFTs") to trade repositories;
- reporting and disclosure requirements for UCITS and alternative investment funds ("AIFs") using SFTs and total return swaps ("TRS"); and
- requirements applicable to counterparties to collateral arrangements engaged in rehypothecation (not limited to those relating to SFTs).

**What is the scope of the SFTR?**

SFTs are defined in the SFTR to include:

- repurchase transactions;
- securities or commodities lending or borrowing;
- buy-sell back transactions or sell-buy back transactions; and
- margin lending transactions.

The SFTR is very broad in its application and applies to all counterparties in SFT markets including UCITS and AIFs, and any counterparties engaging in rehypothecation. Specifically, the SFTR is stated to apply to:

- a counterparty to a SFT that is established:
  - in the EU, including all of its branches irrespective of where they are located; and
  - in a third country, if the SFT is concluded in the course of operations of an EU branch;
- UCITS management companies and UCITS investment companies;
- AIFMs authorised under the Alternative Investment Fund Managers Directive ("AIFMD");
- a counterparty engaging in reuse that is established:
  - in the EU, including all its branches irrespective of where those branches are located;
  - in a third country where either:
    - the reuse is effected in the course of the operations of a branch in the EU; or
the reuse concerns financial instruments provided under a collateral arrangement by: (a) a counterparty established in the EU; or (b) a branch in the EU of a counterparty established in a third country.

Importantly, the SFTR does not provide for an exemption for counterparties who enter into small numbers of SFTs (unlike the European Market Infrastructure Regulation ("EMIR"), where a low volume exemption does exist).

The term “counterparty” includes financial and non-financial counterparties. The definition of financial counterparties includes investment firms authorised under the Markets in Financial Instruments Directive ("MiFID"), a UCITS and its management company and AIFs managed by AIFMs authorised or registered under the AIFMD. The definition also includes other EU regulated entities such as credit institutions, insurance companies, central counterparties, central securities depositories and institutions for occupational retirement provision, together with third country entities that would require authorisation or registration if they were established in the EU. This note focuses on the impact of the SFTR requirements on UCITS and AIFs.

### Reporting SFTs

**What is the reporting requirement?**

The SFTR requires counterparties to an SFT to report certain details of the transaction to a trade repository within one working day of the conclusion, modification or termination of the SFT. The report must be made to a trade repository established and registered in the EU or established in a third country and recognised by the European Securities and Markets Authority ("ESMA"). If there is no available trade repository to record the details of SFTs, counterparties can report the details to ESMA.

Similar to the EMIR reporting regime, both parties to an SFT are required to report the details of the transaction to a trade repository. However, it is also possible to delegate the reporting of SFTs. Where a UCITS or AIF is counterparty to an SFT, the UCITS management company or AIFM is responsible for reporting on behalf of the fund.

**What must be reported?**

The SFTR provides that the reports must at least include details of:

- the parties to the SFT and, where different, the beneficiary of the rights and obligations arising therefrom;
- the principal amount;
- currency;
- assets used as collateral and their type, quality and value;
- the method used to provide collateral;
- whether collateral is available for reuse;
- where collateral is distinguishable from other assets, whether it has been reused;
- any substitution of collateral;
- the repurchase rate, lending fee or margin lending rate;
Further details to be included in the reports will be specified in regulatory technical standards ("RTS") mandated by the SFTR, and prepared by ESMA. In drafting the RTS, ESMA is required to take into consideration the existing technical standards made under EMIR. ESMA is also required to develop implementing technical standards ("ITS") in relation to the format and frequency of reports. ESMA issued a consultation paper on the draft RTS and implementing technical standards on 30 September 2016.

**When does the reporting requirement apply?**

The reporting requirements under the SFTR are being phased in and the commencement of the reporting date depends on when the European Commission adopts the RTS relating to the reporting obligation and on the type of reporting counterparty. UCITS and AIFs will be required to comply with the reporting requirements 18 months after the reporting obligation RTS enter into force.

**Which SFTs must be reported?**

The reporting obligation covers all SFTs which:

- are concluded on or after the reporting start date;
- were concluded before, and remained outstanding on, the report start date and either: (a) had a remaining maturity exceeding 180 days after the reporting start date; or (b) had an open maturity and actually remain outstanding for 180 days after the reporting start date.

**Record-keeping**

The SFTR requires counterparties to an SFT to keep records of the SFT for at least five years following its termination. This record-keeping obligation applies to UCITS and AIFs from 12 January 2016.

**Transparency**

The SFTR contains new rules on investor transparency, which supplement the requirements of the UCITS Directive and the AIFMD. In particular, UCITS managers or investment companies and AIFMs must make certain pre-contractual disclosures and will need to supplement their existing periodic reports with detailed information on any recourse they have to the use of SFTs and TRS.

**Pre-contractual Disclosure**

In relation to pre-contractual disclosure, the SFTR provides that a fund’s investment policy with respect to SFTs and TRS should be clearly disclosed in pre-investment documents. Either the UCITS prospectus or the disclosure required to be made by AIFMs to investors under the AIFMD (typically a prospectus) must specify the SFTs and

| - haircuts; |
| - the value date; |
| - the maturity date; |
| - the first callable date; and |
| - the market segment. |
TRS that the funds are authorised to use and include a clear statement that those transactions and instruments are used. The annex to the SFTR sets out further details of what this pre-contractual disclosure should include, as follows:

- general description of the SFTs and TRS used by the fund and the rationale for their use;
- the following data for each type of SFT and TRS that can be subject to them;
  - types of assets;
  - maximum proportion of assets under management ("AUM"); and
  - expected proportion of AUM.
- criteria used to select counterparties (including legal status, country of origin, and minimum credit rating);
- acceptable collateral (that is, a description of acceptable collateral with regards to asset types, issuer, maturity, liquidity, collateral diversification, and correlation policies);
- collateral valuation (that is, a description of the collateral valuation methodology used and its rationale, and whether daily mark-to-market and daily variation margins are used);
- risk management (that is, a description of the risks linked to SFT and TRS, as well as risks linked to collateral management, such as operational, liquidity, counterparty, custody and legal risks).
- specification of how assets subject to SFTs and TRS and collateral received are kept safe (for example, if they are held with a custodian);
- specification of any restrictions (regulatory or self-imposed) on reuse of collateral; and
- policy on sharing of return generated by SFTs and TRS (that is, a description of the proportions of the revenue generated by them that are returned to the fund, to the manager or retained by third parties).

**When do the pre-contractual disclosure requirements apply?**

Funds constituted after 12 January 2016 must meet these pre-contractual disclosure requirements from the date of constitution. UCITS and AIFs constituted before 12 January 2016 can avail of an 18 month phase in period so that pre-existing funds must comply with the pre-contractual disclosure requirements from **13 July 2017**.

UCITS and AIFs constituted before 12 January 2016 will therefore need to review relevant fund documentation to assess whether they can rely on existing disclosures to meet the SFTR requirements, or whether amendments are necessary in light of the SFTR’s more detailed rules, as is likely to be the case. This would be particularly relevant to AIFs, which are not currently subject to detailed disclosure rules in relation to repurchase agreements and stocklending.

**Periodic Reporting**

The annex to the SFTR also sets out requirements relating to the information that must be provided in a UCITS’ half-yearly and annual report and an AIF’s annual report. The following information must be included in the reports:
<table>
<thead>
<tr>
<th>Type of Data</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global data</td>
<td>The amount of securities and commodities on loan as a proportion of total lendable assets.</td>
</tr>
<tr>
<td></td>
<td>The amount of assets engaged in each type of SFT and TRS expressed as an absolute amount and as a proportion of the fund’s AUM.</td>
</tr>
<tr>
<td>Concentration data</td>
<td>Top ten collateral issuers across all SFTs and TRS.</td>
</tr>
<tr>
<td></td>
<td>Top ten counterparties of each type of SFT and TRS separately.</td>
</tr>
<tr>
<td>Aggregate transaction data for each type of SFT</td>
<td>Type and quality of collateral.</td>
</tr>
<tr>
<td>and TRS separately (to be broken down into categories)</td>
<td>Maturity tenor of the collateral broken down in the following maturity buckets: less than one day; one day to one week; one week to one month; one month to three months; three months to one year; above one year; and open maturity.</td>
</tr>
<tr>
<td></td>
<td>Currency of the collateral.</td>
</tr>
<tr>
<td></td>
<td>Maturity tenor of the SFTs and TRS broken down in the following maturity buckets: less than one day; one day to one week; one week to one month; one month to three months; three months to one year; above one year; and open transactions.</td>
</tr>
<tr>
<td></td>
<td>Country of domicile of counterparties.</td>
</tr>
<tr>
<td></td>
<td>Settlement and clearing (for example, tri-party, central counterparty, bilateral).</td>
</tr>
<tr>
<td>Data on reuse of collateral</td>
<td>Share of collateral received that is reused, compared to the maximum amount specified in the prospectus or in the disclosure to investors.</td>
</tr>
<tr>
<td></td>
<td>Cash collateral reinvestment returns to the fund.</td>
</tr>
<tr>
<td>Safekeeping of collateral received by the fund as</td>
<td>Number of custodians and the amount of collateral assets kept safe by each custodian.</td>
</tr>
<tr>
<td>part of SFTs and TRS</td>
<td></td>
</tr>
<tr>
<td>Safekeeping of collateral by the fund as part of</td>
<td>The proportion of collateral held either in segregated accounts or in pooled accounts, or in any other account.</td>
</tr>
<tr>
<td>SFTs and TRS</td>
<td></td>
</tr>
<tr>
<td>Data on return and cost for each type of SFT</td>
<td>Data broken down between the fund, fund manager and third parties (such as agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFT and TRS.</td>
</tr>
<tr>
<td>and TRS</td>
<td></td>
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</tbody>
</table>
When do the periodic reporting requirements apply?

The periodic reporting requirements apply from 13 January 2017. ESMA has recently updated its questions and answers documents on the application of the UCITS Directive and the AIFMD to clarify that the required information must be included in the next annual or half-yearly report published after 13 January 2017, even though this may relate to a reporting period beginning before that date.

Collateral Reuse

The SFTR sets out new rules relating to the transparency of reuse of collateral under all collateral arrangements, not just those in respect of SFTs, including a requirement to disclose the risks and consequences of: (a) granting a right of use of collateral provided under a security collateral arrangement; or (b) concluding a title transfer arrangement. The receiving party must obtain the express written consent of the providing party in respect of a security collateral arrangement that includes a right of reuse or the provision of collateral under a title transfer arrangement.

“Reuse” is defined in the SFTR to mean the use by a receiving counterparty, in its own name and on its own account or on account of another counterparty of financial instruments received under a title transfer collateral arrangement or a security collateral arrangement.

It should be noted that the provisions on collateral reuse in the SFTR are without prejudice to stricter sectoral legislation, such as the UCITS requirements, and any national laws which establish a higher level of protection for providing counterparties.

Key Dates

The table below summarises the key dates for compliance with the SFTR.

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Date for Compliance</th>
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<tbody>
<tr>
<td>Record-keeping requirement in respect of any SFT concluded, modified or terminated</td>
<td>12 January 2016</td>
</tr>
<tr>
<td>Transparency requirements relating to periodic reports of UCITS and AIFs</td>
<td>13 January 2017</td>
</tr>
<tr>
<td>Transparency requirements relating to pre-contractual documents</td>
<td>12 January 2016 for UCITS and AIFs constituted after 12 January 2016</td>
</tr>
<tr>
<td></td>
<td>13 July 2017 for UCITS and AIFs constituted prior to 12 January 2016</td>
</tr>
<tr>
<td>Requirements relating to reuse of financial instruments received under a collateral arrangement</td>
<td>13 July 2016</td>
</tr>
<tr>
<td>Reporting requirement obliging UCITS and AIFs to report details of SFTs to trade repositories</td>
<td>18 months after the date of entry into force of the relevant technical standards</td>
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</table>
Please get in touch with your usual Asset Management and Investment Funds Group contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

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