ROPES & GRAY ALERT

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Upcoming EU Disclosure Requirements for Certain Collateral Arrangements

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The EU Regulation on Securities Financing Transactions provides a set of measures aiming to enhance regulators' and investors' understanding of "securities financing transactions".

The regulation introduces three main requirements:

- A dual-sided reporting obligation for securities financing transactions, similar to the reporting obligation that applies currently for derivatives under the European Market Infrastructure Regulation (EMIR).
- An obligation for undertakings for collective investment in transferable securities (UCITS), or their management companies, and managers of alternative investment funds authorised in accordance with the EU Alternative Investment Fund Managers Directive to give detailed disclosure to investors and prospective investors of the fund's use of securities financing transactions and total return swaps.
- Transparency obligations applicable to any right to "reuse" securities received by certain counterparties to collateral arrangements.

This Alert focuses on the transparency requirements for rights of reuse, which come into force on **July 13, 2016**.

Disclosure of Rights of Reuse

Collateral Arrangements in Scope

The requirements apply when collateral comprising securities (not cash):

- is to be received under a "title transfer" collateral arrangement; or
- is received under a "security" collateral arrangement that includes a right of reuse granted by the providing counterparty.

Securities to be received under an English law ISDA "Credit Support Annex" (CSA) or a repurchase agreement or stock loan that uses title transfer techniques fall into the first category. Securities received under a New York law CSA from a providing counterparty who has granted a right of reuse over the securities fall into the second category. The requirements apply when the securities collateral is to be received or is received by a person on its own account or on the account of another person. As a result, asset managers can incur direct obligations under this part of the regulation.

Both new and existing collateral arrangements are subject to the requirements from the entry-into-force date (July 13, 2016).

Conditions for Rights of Reuse

The conditions for exercising a right of reuse over securities collateral (e.g., receiving title to securities under an English law CSA or exercising a right of reuse over securities received under a New York law CSA) are as follows:

1. Written disclosures have been given to the providing counterparty of the risks involved in entering into a title transfer collateral arrangement or granting a right to reuse collateral provided under a security collateral arrangement. The International Swaps and Derivatives Association, Inc. (ISDA) and a number of other industry bodies, such as the International Capital Markets Association, have jointly published some standard disclosure language which can be sent to the providing counterparty in satisfaction of this requirement. That disclosure language is available here. The "asset management group" of the Securities Industry and Financial Markets Association (SIFMA) has since published a separate version of the disclosure language (available here), which is aimed specifically at "buy side" entities.

2. The providing counterparty has consented to the title transfer collateral arrangement or right of reuse. Consent can be evidenced by a signed written agreement entered into by the providing counterparty (e.g., the CSA itself).

3. The reuse by the receiving counterparty of the securities collateral (or transfer to the receiving counterparty of title to the securities collateral) is undertaken in accordance with the terms of the collateral arrangement and evidenced by a transfer of the securities from the providing counterparty's account. If the receiving counterparty is established outside of the European Union (EU) and the account is maintained in, and subject to the laws of, a non-EU jurisdiction, the reuse can be evidenced by "other appropriate means".

Counterparties in Scope

The conditions for rights of reuse in the regulation can directly affect counterparties established outside of the EU.

The following categories of counterparty are subject to the requirements:

- Counterparties established in the EU.
- Counterparties established outside the EU acting through an EU branch.
- Counterparties established outside the EU, when they receive securities collateral from either a counterparty established in the EU or a counterparty established outside the EU acting through an EU branch.

As a result, an entity established outside of the EU that receives non-cash collateral from an EU institution or an EU branch of a non-EU institution under an ISDA Credit Support Annex or a master repurchase agreement or securities lending agreement is potentially subject to the conditions for rights of reuse in the EU Securities Financing Transactions Regulation, including the requirement to give written risk disclosures to the EU institution or branch.

Please contact your usual Ropes & Gray lawyer with any questions.