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REQUIREMENT ON BUY-SIDE ENTITIES TO ISSUE SFTR RISK WARNING STATEMENTS TO COUNTERPARTIES

WHAT IS THIS?

If you receive securities collateral under repos, stock loans or TRSs you may need to notify your counterparties of the risks to them in posting securities collateral to you. This is regardless of the fact that these risks will in fact already be well known and understood by the sell-side.

WHY?

The EU Regulation on Transparency of Securities Financing Transactions[1] (SFTR) requires[2] that risk warnings be given to providers of securities collateral that transfer their collateral on either (i) a title transfer basis, or (ii) a custody basis to a recipient granted a right of rehypothecation. This applies equally to brokers and end-users. As such, your counterparties will be under an obligation to provide you with a risk warning where you have contracted to deliver securities collateral either through title transfer or into custody with a right of rehypothecation given.

Examples of the types of agreements that could give rise to a counterparty having to deliver securities collateral on a title transfer basis are ISDA Credit Support Annexes, and stock loan and repo agreements such as the Global Master Securities Lending Agreement or the Global Master Repurchase Agreement.

WHO DOES THIS COVER?

The entities that need to give the risk warning are collateral receivers that are:

- incorporated in the EU; or
- incorporated outside the EU if their counterparty is
  - established in the EU; or
  - an EU branch of a counterparty established in a third country.

It is therefore important to note that non-EU entities will be caught by this requirement if they accept securities collateral from European banks.

WHEN DO I NEED TO DO THIS?

The obligation takes effect on **12 July 2016**. It will apply to existing collateral arrangements as at that date, and all future transactions where collateral is received.

HOW SHOULD I NOTIFY MY COUNTERPARTIES?

A number of industry bodies have acted to produce a standard risk warning statement (the Risk Statement), which is available here. The Risk Statement is drafted as a single use document. Although you may have multiple agreements with a single counterparty that give rise to a need to give a notice, the Risk Statement need only be given once per counterparty. The Risk Statement does not need to be re-sent if you enter into a new collateral agreement with a counterparty to which you have sent the Risk Statement in the past.

If you are a fund manager, the Risk Statement must be given on behalf of each fund or other entity you manage, to each trading counterparty that is entitled to give such fund securities as collateral. If you manage multiple funds, we suggest (i) adding an addendum to the Risk Statement in which you list all of your current funds, and (ii) stating in your covering email to each counterparty that you give the Risk Statement on behalf of each of those funds listed.

The Risk Statement may be rebranded if required. Alternatively, market participants are free to create their own disclosure notice that complies with the SFTR if preferred.

There is no obligation for you to get an acknowledgement of the Risk Statement. All that is necessary is to keep a record that the communication was sent.

There is no need to take action if you receive a risk warning from a counterparty, unless any of the disclosures made in the warning give you concern.

[1] Regulation (EU) 2015 / 2365. The Regulation came into force on 12 January 2016. Our briefing note covering the SFTR in its entirety is available here.
[2] Article 15 of the SFTR.

CONTACT DETAILS

Please contact your usual contact in the Macfarlanes Derivatives & Trading team if you have any questions.

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JUNE 2016

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