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# Securities Financing Transactions: Case Study on the Situation in Switzerland

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## **Securities Financing Transactions: Case Study on the Situation in Switzerland**

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### **Abstract**

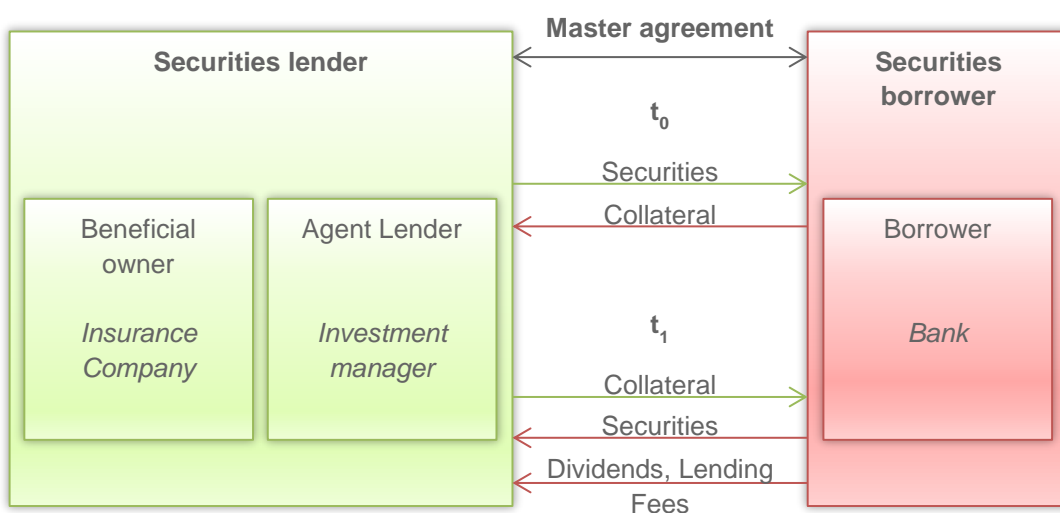
This paper presents aggregated data from a survey on securities financing transactions (SFTs) in Switzerland. The survey of Swiss market participants including banks, insurers, fund managers, pension funds, and corporates aimed at assessing the scale of the SFT market in Switzerland, with a particular focus on the size of the non-bank to non-bank sector. The survey was undertaken against the backdrop of recently adopted recommendations by the Financial Stability Board pertaining to SFTs. Findings show that the size of the non-bank to non-bank sector is of marginal importance as at least one bank is involved in the vast part of the outstanding transaction volume reported.

# 1 Introduction

## 1.1 Securities Financing Transactions

Securities financing transactions (SFTs) are transactions in which securities (e.g. shares or bonds) are used as collateral to borrow cash or other securities, and vice-versa. SFTs include repurchase agreements (repos) and securities lending and borrowing transactions (SLB). In a repo transaction, securities are sold for an agreed period of time until the securities' seller repurchases them.<sup>1</sup> In a SLB transaction securities are temporarily transferred to a third party in exchange for collateral, in the form of shares, bonds or cash.<sup>2,3</sup> SFTs can be conducted by banks as well as non-banks. Figure 1 illustrates how a SFT typically works.

Figure 1: Example of a Securities Financing Transaction



Source: based on Bank of England<sup>4</sup> (simplified)

<sup>1</sup> Kraenzlin, S. (2007) *The characteristics and development of the Swiss franc repurchase agreement market*, Financial Markets and Portfolio Management, vol. 21, Issue 2, p. 243. For a global study on how repo markets function worldwide, see e.g. Committee on the Global Financial System (2017) *Repo market functioning*, CGFS Papers No 59.

<sup>2</sup> For definitions and additional information on securities lending transactions, see e.g. International Securities Lending Association (2016) *Securities Lending Market Report*, September 2016 (available at <http://www.isla.co.uk/wp-content/uploads/2016/10/ISLA-SL-REPORT-9-16-final.pdf>) and International Capital Market Association (2017) *Securities Lending* (available at <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/securities-lending>).

<sup>3</sup> Bank of England SLRC (2010) *Securities Lending: an Introduction Guide*, p. 2 (available at [http://www.bankofengland.co.uk/markets/Documents/gilts/sl\\_intro\\_green\\_9\\_10.pdf](http://www.bankofengland.co.uk/markets/Documents/gilts/sl_intro_green_9_10.pdf)).

<sup>4</sup> Bank of England SLRC (2010) p. 3.

According to the Financial Stability Board (FSB), SFTs can play a crucial part in the financial system, as they can offer services, such as providing liquidity and facilitating market making,<sup>5</sup> and thus allow for credit intermediation.<sup>6</sup> Such credit intermediation can provide a valuable alternative to bank funding to support real economic activities.<sup>7</sup> However, these transactions may also entail financial stability risks, as they can facilitate credit growth outside the banking system, can lead to the build-up of excessive leverage outside the reach of prudential liquidity and capital regulation, and they can also increase procyclicality within the financial system.<sup>8</sup>

## 1.2 Recent International Developments relating to Securities Financing Transactions

Because SFTs can also involve non-banks, these transactions are considered as so-called shadow banking activities (also termed market-based finance). The shadow banking sector and its oversight have been on the agenda of the G20, the FSB and various standard-setting bodies since the global financial crisis. In this context, the FSB, which coordinates the development and the implementation of international standards in the area of financial regulation, developed and adopted a number of recommendations regarding SFTs.<sup>9</sup>

Against the backdrop of these recommendations and to assess the size and the importance of the shadow banking segment in the Swiss SFT market, a national working group of Swiss authorities, comprising the State Secretariat for International Financial Matters (SIF), the Swiss National Bank (SNB) and the Swiss Financial Market Supervisory Authority (FINMA), conducted a survey of Swiss market participants in 2016.

## 2 Swiss Case Study on Securities Financing Transactions

### 2.1 Design of the Survey

To assess the scale of the Swiss SFT market and in particular the importance of non-bank to non-bank activities in this market, the working group first evaluated existing data metrics. These metrics, which include the Liquidity Coverage Ratio (LCR) reporting, the banking statistics, and data from the SIX Repo trading platform, provide helpful insights on the Swiss SFT market. Table 1 summarizes and compares these data sources against the recent FSB recommendations for SFTs (see Section 1.2). However, because these sources do not comprehensively capture the SFT activities of all relevant market players in Switzerland, in particular non-bank to non-bank transactions, the working group conducted a survey with a number of relevant market participants.

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<sup>5</sup> FSB (2013) *Strengthening Oversight and Regulation of Shadow Banking. Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*, p. 4.

<sup>6</sup> The FSB defines “credit intermediation involving entities and activities (fully or partly) outside of the regular banking system” as shadow banking activities. Some authorities and market participants prefer to use other terms such as “market-based finance” instead of “shadow banking” (FSB (2016) *Global Shadow Banking Monitoring Report 2016*)

<sup>7</sup> FSB (2013), p. ii.

<sup>8</sup> FSB (2013), pp. 4 et seq.

<sup>9</sup> See FSB (2013) and FSB (2014) *Strengthening Oversight and Regulation of Shadow Banking. Regulatory framework for haircuts on non-centrally cleared securities financing transactions*: These FSB recommendations are built on four pillars: (i) improvement of transparency to recognize emerging risks and excessive build-ups and vulnerabilities, (ii) specific regulatory requirements regarding the re-use of cash collateral and the re-hypothecation of securities, (iii) standards for structural elements, especially the promotion of central counterparties, and (iv) securities valuation methods, including numerical haircut floors for non-bank to non-bank SFTs.

**Table 1: Overview of Data Coverage by existing Reporting Sources**

|              | FSB recommendations <sup>10</sup>                     |  | LCR-reporting  | Banks statistics   | SIX Repo trade platform  |
|--------------|---|--|--|--|--|
| Instruments  | Repo  | SLB                                      | Repo, SLB  | Repo, SLB (if cash collateral)                                 | Repo   |
| Institutions | All financial market participants of the jurisdiction |  | Banks in Switzerland (incl. foreign subsidiaries and branches) | Banks in Switzerland (incl. foreign subsidiaries and branches) | 150 market participants (incl. foreign banks and insurance companies <sup>11</sup> ) |
| Frequency    | Daily   | Monthly (regular snapshots)              | Monthly  | Monthly  | Daily  |
| Granularity  | Trade-level and stock data                            | Detailed stock data                      | Stock data   | Stock data   | Trade-level  |
| Maturity     | All ( <i>high level of granularity</i> )              | All ( <i>high level of granularity</i> ) | ≤ 30 days  | All  | All  |
| Currencies   | All ( <i>high level of granularity</i> )              | All ( <i>high level of granularity</i> ) | All  | All  | Diverse  |

The survey was carried out between June and July 2016. Participants were asked to report outstanding volumes of securities lending, securities borrowing, repos, and reverse-repos<sup>12</sup> as of year-end (2013, 2014, and 2015) by counterparty types (i.e. bank, non-bank, central counterparties<sup>13</sup> (CCP)). The survey did not control for double counting (i.e. the same transactions could have been reported by both counterparties).<sup>14</sup> The survey contained additional, complementing questions, such as the estimated average volume of transactions per month and the use of sovereign bonds or cash as collateral.

Participation in the survey was voluntary and based on the agreement that only aggregated and anonymized data would be published. In total, 25 market players received the survey, including banks, fund managers, insurers, pension funds, and corporates. The sample was selected to cover a range of industries within the bank and non-bank segments and to include specifically major non-bank market participants known to be active in the SFT market. In total, 22 market players responded to the survey. The results of the survey, presented below, were subsequently validated through discussions with market participants that responded to the survey.

## 2.2 SFT Activity in Switzerland: Results of the Survey

Figure 2 presents the aggregated reported transaction volumes outstanding as of year-end 2013, 2014 and 2015. The key stylized facts can be summarized as follows: first, the volume of SLBs is considerably larger than that of reverse repos and repos. Second, the size of the SLB market is 120-130 billion Swiss francs, i.e. roughly 20 percent of the Swiss Gross Domestic Product (GDP), while outstanding volumes of repos and reverse repos amounted to between 10 and 50 billion Swiss francs. Third, reported volumes are relatively stable over the three years with the exception of reverse repos volumes which increased by around one third.

<sup>10</sup> Based on FSB (2013), pp. 6-10 and simplified for purposes of comparison.

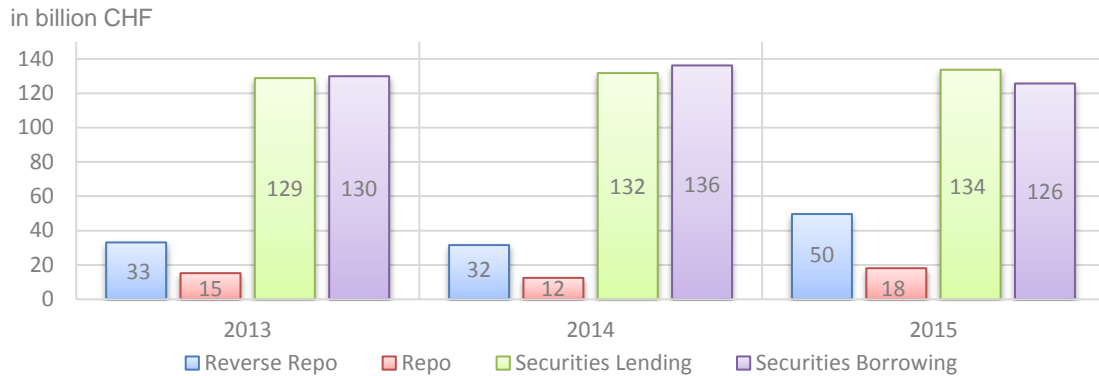
<sup>11</sup> List of participants: <https://www.six-repo.com/dam/downloads/publications/repo-participant-list.pdf>.

<sup>12</sup> In a repo transaction, the participant acts as cash taker, while in a reverse repo transaction, the participant acts as cash provider.

<sup>13</sup> Central counterparties (CCPs) serve many securities and derivative markets, allowing participants to have exposure to the CCP instead of bilateral exposures to each other (FSB (2013), p. 17).

<sup>14</sup> Thus, the survey may suffer from a double counting and hence an overestimation of the respective transaction volumes.

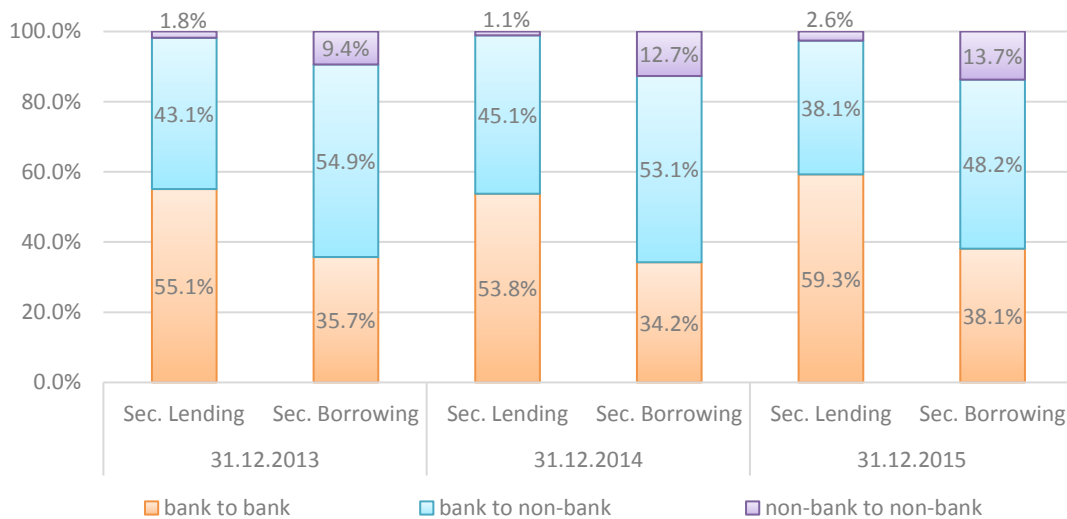
**Figure 2: Reported Securities Financing Transaction Volumes**



Source: FINMA, SIF, SNB survey.

Figure 3 presents the reported volumes by counterparty pairs (bank to bank, bank to non-bank (and vice versa) and non-bank to non-bank)<sup>15</sup> for SLB transactions. In the SLB market segment, the shares of counterparty pairs remained relatively stable over the three-year period (2013-2015). On the lending side, the share of bank to bank transactions is slightly more than half and the share of bank to non-bank transactions slightly less than half of the overall transaction volume. The non-bank to non-bank part is marginal. On the borrowing side, the share of non-bank to non-bank transactions was larger and amounted to approximately 10 percent.

**Figure 3: Reported SLB Transactions segmented by counterparty pairs**

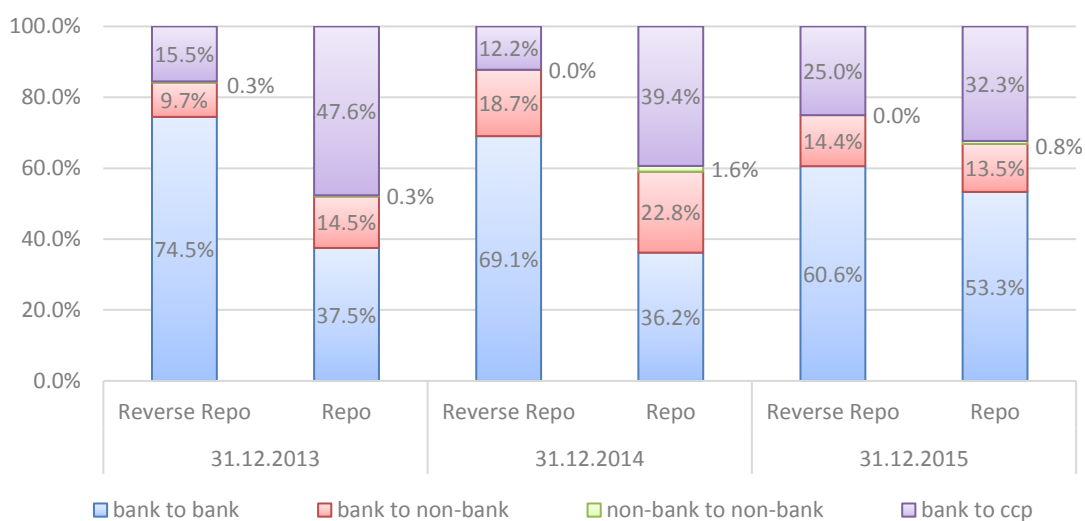


Source: FINMA, SIF, SNB survey.

<sup>15</sup> For ease of reading, bank to CCP and non-bank to CCP counterparty pairs are not depicted in Figure 3. Reported transactions including a CCP represent less than 1 percent both on the lending and on the borrowing side.

Figure 4 shows the reported volumes of repos and reverse repos by counterparty pairs (bank to bank, bank to non-bank (and vice versa), non-bank to non-bank and bank to CCP).<sup>16</sup> These shares of counterparty pairs and their evolution differs from that of SLBs. For reverse repos, the bank to bank share has slowly decreased over reported years. The share of non-bank to non-bank transactions is practically inexistent in the reports. CCPs were involved in about 20 percent of reported reverse-repos. As for repos, the bank to bank share has increased, whereas reported bank to CCP transactions have decreased over the 3 year period. While bank to CCP transactions accounted for about half of the reported repos in 2013, they only represent a third of them in 2015. The non-bank to non-bank share is less than 2 percent for repos.

**Figure 4: Reported Reverse Repos and Repos segmented by Counterparty**



Source: FINMA, SIF, SNB survey.

### 3 Conclusion

In 2016, a working group formed by Swiss authorities has conducted, on a voluntary basis, a survey of 25 market participants relevant and known to be active in the Swiss SFT market, with a particular focus on non-bank players. The survey contributes to understanding the relevance of SFT activities in Switzerland, in particular in the non-bank to non-bank market segment. A key finding regarding the structure of the SFT market is that in terms of outstanding volumes, at least one bank is involved in the vast majority of transactions. Accordingly, the outstanding non-bank to non-bank segment as of year-end is of marginal relevance. Moreover, the reported volumes remained relatively unchanged over the 3 surveyed years (2013-2015).

<sup>16</sup> For ease of reading the non-bank to CCP counterparty pair is not depicted in Figure 4. Non-bank to CCP transactions are nil.