Single Collateral Management Rulebook for Europe
common rules for managing collateral

EUROPEAN CENTRAL BANK
EUROSYSTEM

Status update on ongoing work

Triparty Collateral Management Expert Group

CMH-TF
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Introduction

- Modification of triparty transactions
- Handling of negative cash flows in a triparty context
- TPA contribution to harmonisation of tax processes
- Next steps

Modification of triparty transactions

It is possible to modify certain attributes of the triparty transaction during its lifecycle. A set of modification types have been defined for this purpose as listed in the table below.

Purpose	Description	Identifier
1. Rate Adjustment	Change to the rate used in the underlying transaction	RATA
2. Margin Adjustment	Change to margin. Used in DVP securities lending transactions in order to perform a free of payment principal adjustment.	MADJ
3. Closing Date Adjustment	Change of the closing date. Must be sent in advance of the closing date.	CDTA
4. Collateral Adjustment	Change to collateral. Used when collateral giver manually allocates the securities to the transaction (never sent or received by the Collateral Taker)	CADJ
5. Automatic Allocation Adjustment	Automatic / manual settlement adjustment to change the collateral allocation mode from manual to automatic or vice versa.	AADJ
6. Data Adjustment	Change of other data not listed above.	DADJ

Modification of triparty transactions

The Expert Group discussed the way modifications of triparty transactions are handled across TPAs namely:

- *What types of attributes can be modified?*
  - It was noted that this differs per TPA which can be as a result of the product behind e.g. transactions involving CCPs may impose additional restrictions on the types of attributes to be modified vs. transactions involving commercial banks

- *Single modification vs. multiple modification?*
  - Should it be possible to modify multiple attributes of a triparty transaction via or a single instruction or should a separate instruction be sent per attribute?

The Expert Group concluded that a single modification per instruction would be the preferred practice (particularly in case the instruction requires matching) but that multiple modifications could also be handled. The Expert Group would like to collect views from TPA users in the CMH-TF

Negative cash flows

- **A harmonised process has been defined for the handling of corporate action payments whereby the cash proceeds are firstly credited to the Collateral Taker and later remitted to the Collateral Giver.**

- **In the case of negative cash flows** (i.e. a coupon payment with a negative interest rate which results in a cashflow from the owner of the security to the issuer), **a question has arisen as to whether the same flow should be followed.**

- **The Triparty Expert Group reviewed the question and confirmed that the same flow should be followed** i.e.
  (i) The TPA debits the Collateral Taker as part of the standard CA process
  (ii) The TPA has a compensation mechanism in place to collect the proceeds from the Collateral Giver and reimburse the Collateral Taker on the same day.

TPA contribution to harmonisation of tax processes

Background

- TPAs agreed that there is a clear need for improvements in tax processing (in accordance with the harmonisation needs previously identified in the context of CMH-TF Activity 3: Taxation Processes) and that there is now an opportunity to progress this work (e.g. by providing input to upcoming work in the context of the HLF).

- TPAs have contributed to the work by providing best practices from Japan and US.

- In the Japanese case it is noted that tax status on interest is determined based on the applicable contract (e.g. Global Master Repurchase Agreement (GMRA), Global Master Securities Lending Agreement (GMSLA) etc.).

TPA contribution to harmonisation of tax processes

Japanese example

- **In Japan, the treatment of tax on bonds for overseas investors is straightforward**. Tax Exemption is managed through an application form in which investors are eligible for exemption at a set rate. As a result, historically, Triparty agents supported record date allocation on tax exempt flows only. However, this carried some risk, for example if the documentation expired it resulted in a difference in tax rate.

- **In June 2019, the Japanese Tax authorities (JSDA) published a circular which announced changes to their approach with respect of tax documentation for Japanese Bonds (including JGBs, municipal bonds and corporate bonds) for Repo/Securities Lending transactions.** Prior to the circular, withholding tax was determined based on the tax status of who had ownership of the bond on interest payment date. The announcement changed this and outlined the tax status should now be determined on the tax status of who is due to actually or finally receive the interest or equivalent on payment date – the economic owner of the asset. **This has, at least for Triparty, simplified the process, reduced the risk and expanded the opportunity to use Japanese assets as collateral.** The announcement applies to all types of Repo/Securities Lending transactions.

TPA contribution to harmonisation of tax processes

Japanese example

- **This announcement had a positive impact for Triparty from a documentation perspective.** Although record date allocation could previously be supported, this was purely for tax exempt flows only. By determining the tax status of the collateral provider as the one who ultimately receives the interest benefitted triparty agents. Firstly, it reduced documentation requirements and possible difference in tax rates. Secondly, it allowed collateral providers to face a wider range of collateral receivers, adding to the liquidity of the market and use of Japanese Fixed Income as collateral.

Conclusion

- **In Japan, in particular for Triparty, there is a streamlined process which facilitates the allocation of collateral over record date.** The approach ensures assets can be allocated over record date and distribution of coupons/proceeds is managed efficiently. Through identifying the economic owner of the assets as the identifiable taxable entity, it aligns itself with the intention of the Repo/Securities lending agreements.

TPA contribution to harmonisation of tax processes

US example

- **In the US, Record date allocations within Triparty is standard for US clients.** Under US Law, through the Master Repo Agreement (MRA) – a title transfer document – it manages to bifurcate ownership from an economic and legal perspective. In the contract it clearly states that the seller (collateral provider) will receive all economic interest in the collateral (Income, corporate actions etc) whilst also ensuring the legal ownership remains with the collateral receiver.

- **From a tax perspective, this makes managing the process very simple, as the taxable entity is the collateral provider.** This is made somewhat easier for US clients through the DTC Settlement Link. In this account, which is in the collateral providers name, DTC recognise and automatically pay the proceeds directly to the collateral provider.

TPA contribution to harmonisation of tax processes

US example

- **As a result of the above legal and tax processes being straightforward, operationally supporting allocation over record date is simple.** On BNY Mellon's US business, allocation over record date is standard which has a significant positive impact for market participants who do not have to manage spikes in collateral which can not be utilized within secured financing transactions.

Conclusion

- **From a US perspective,** although it is simpler as it is one jurisdiction**, the clarity in legal documentation over economic and legal ownership as well as the operational process to support payment provides for a seamless solution.** This significantly boosts liquidity, supporting the use of collateral.

Upcoming work

- TPA contribution to work on harmonisation of tax processes - TPAs will look further at the applicable contracts in Europe to see how this process can be supported.

- Finalisation of updated SCoRE document to following the stabilisation of the ISO 20022 messages in order to reflect outcome of the discussions.