International
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Press release

News from the International Capital Market Association (ICMA)

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ICMA report highlights essential interplay between central bank and commercial bank money in securities settlement

(London, UK) The International Capital Market Association's European Repo Council (ERC) today launched a report which sheds light on the workings of the payment infrastructure that underlies the settlement of transactions in securities in Europe, including repo transactions. The report on "The interconnectivity of central and commercial bank money in the clearing and settlement of the European repo market" maps the different routes by which financial institutions exchange money and securities.

The ICMA report has been produced in the context of regulatory efforts to reduce systemic risk by better underpinning the smooth functioning of clearing and settlement in Europe. Regulators have turned to the issue of whether specialised securities clearing and settlement entities, designated 'Financial Market Infrastructures' (FMIs) - Central Securities Depositories (CSDs), International Central Securities Depositories (ICSDs) and central counterparties (CCPs) - should make and receive payments in 'central' rather than 'commercial' bank money. (Central bank money is a deposit held at and transferred between accounts at the central bank, while commercial bank money is a deposit held at and transferred between accounts at a commercial bank.)

Godfried De Vidts, Chairman of ICMA's ERC said: "In commissioning this study, the ERC seeks to contribute to the wider understanding of these critical clearing and payment systems as the new post-trade legislative framework is being developed. The post-trade infrastructure of Europe must be geared towards efficient movement of collateral to where it is most economically usable, giving improved Europe-wide access to liquidity and a level playing field for all users".

The report compares central and commercial bank money, noting that, while central bank money is an inherently risk-free asset and its use gives confidence in times of crisis that payments will continue to be made, commercial bank money is nevertheless widely used, because the risks can be managed down to minimal levels and because central bank money is not always available. Central banks tend to restrict direct access to their accounts to large, systemically-important institutions. Moreover, payments in foreign currency or cross-border generally cannot be made in central bank money.

As a consequence, payments are organised on a tiered basis, with top-tier banks making payments in central bank money on behalf of themselves and lower tiers of customers, including smaller banks. Payments between the lower tiers are made in commercial bank money through top-tier banks acting as agents or, in the case of securities markets, across FMIs. Central and commercial bank money operate in tandem. Without commercial bank money, investors and intermediaries would be forced to establish a commercial bank presence in every currency zone and open an account at the central securities depository (CSD) of almost every market in which they wished to participate, however infrequently. The integration of the global financial system, in which borrowers can access the cheapest capital and investors can achieve the maximum diversification of their risk, therefore relies on flows of commercial bank money, albeit anchored against the risk of systemic instability by access to central bank money.

The report calls for balance in re-engineering the payment architecture. It highlights the critical role of commercial bank money in making multi-currency, cross-border payments and cautions that this role is becoming ever more important. As the demand for high quality collateral increases, partly at the insistence of regulators, and the supply diminishes, there is a growing need among banks to be able to mobilise collateral between currencies and across borders.

A copy of the report is available from the ICMA website

Notes for editors

1. International Capital Market Association (ICMA) and European Repo Council

ICMA represents financial institutions active in the international capital market worldwide. ICMA's members are located in 50 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants including regulatory authorities and governments.

The European Repo Council is a special interest group established under the auspices of ICMA to represent banks active in Europe's repo markets. Its members comprise the major banks active in Europe's cross-border repo markets.

ICMA maintains the standard master agreement for repo transactions, the Global Master Repurchase Agreement (GMRA). This has recently been reviewed and the 2011 version of the GMRA is available on the ICMA website.

See: www.icmagroup.org

2. ICMA Communications

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