International
Capital
Market
Association

ICMA

Second Meeting of the Collateral Initiatives Coordination Forum

Monday 30 April 2012

Location: 23, College Hill, London, EC4R 2RP

Time: 15:00 – 17:00

Attending:	Representing:
Godfried De Vidts (Chairman)	
Marcus Zickwolff	EACH (dialling in)
Scott Nygaard	EBF
Soraya Belghazi	ECSDA (dialling in)
Cedric Gillerot	ECSDA (dialling in)
Jarkko Syyrila	EFAMA (dialling in)
Paul Richards	ICMA
David Hiscock (Secretary)	ICMA
Nathalie Aubry-Stacey	ICMA
John Serocold	ICMA
Christiane Valansot	IMA
Catherine Brady	ISDA (dialling in)
Hugh Gibson	ISLA (dialling in)
Mike Johnstone	LMA
Julian Le Fanu	NAPF
Joyce Martindale	NAPF
Alex McDonald	WMBA

Minutes

1. Introduction

Welcoming the participants, the Chairman opened the meeting. Commenting on the focus now placed upon collateral, he mentioned concerns over the likely lack of availability of sufficient amounts of, high quality, collateral to meet demands. The Chairman also touched upon new regulatory concerns, including the proposed EU CSD Regulation, with its proposals for mandatory buy-ins, and shadow banking, where others, such as TheCityUK's International Regulatory Strategy Group (IRSG), are doing complementary work. He pointed out that any imposition of mandatory minimum collateral haircuts would have significant knock-on effects.

The Chairman then observed that more attention needs to be given to the mobilisation of collateral, i.e. allowing it to be in the right place at the right time. Achieving this requires that the plumbing be properly fixed, including through finally making progress with the continuing Giovannini barriers to EU cross-border clearing and settlement arrangements. The recently established European Post-Trade Steering Group (EPTSG) is revisiting some of these points, but is not yet tackling root causes. Inefficient national solutions continue to present barriers, as a result of which different collateral assets trade over different timeframes.

2. CICF website

The Chairman invited the Secretary to describe work to date on the establishment of the CICF's website. The Secretary reported that, as agreed at the inaugural meeting, a CICF website page has been created, hosted on the ICMA website. This landing point provides links to a series of supplementary CICF website pages. The first supplementary page provides a list of the participating associations. The second provides a description of the background to the CICF and the third gives access to the agreed minutes of CICF meetings.

Further supplementary CICF website pages then provide links to a range of collateral related resources. Firstly, there is a page designed to carry links to collateral related resources published by CICF participants. This has been populated with various pertinent ICMA and ISDA website links and all CICF participants are invited to advise the CICF secretariat of relevant items to extend this initial coverage. Secondly there is a similar page designed to carry links to collateral related resources promulgated by official bodies. The CICF secretariat has populated this with links to obviously applicable items from IOSCO, IMF, BIS, European Commission, ECB and ESMA sources and would welcome suggestions as to how to build up this virtual library. Finally there is a page which links to some collateral related training courses and to the "Securities Lending Guides", as found on the SLRC's website page. Again all CICF participants should offer further suggestions to the CICF secretariat.

There was a brief discussion in which the Secretary affirmed that the intention is to focus on the use of links to documents on other websites, rather than to upload copies. The Secretary thanked Mr Le Fanu for a couple of suggested enhancements.

3. Guide to collateral

The Chairman invited the Secretary to introduce the draft paper circulated with the meeting materials. The Secretary explained that, following from suggestions made at the inaugural meeting, this is a first attempt at creating a short guide to some very basic information about what collateral is, who uses collateral and why. Simple illustrations show examples of the cash and collateral flows in secured borrowing, repo, securities lending, OTC derivatives and central bank open market operations. Akin to the case of the Securities Lending Guides (as mentioned under #2 above), this introductory paper might be published and could be supplemented by further papers, for example on a topic such as collateral management.

In the ensuing discussion, it was noted that this is a helpful start and that the use of diagrams in such materials is a particularly useful element. It was highlighted that an example should be developed to illustrate the case of an interposed CCP, given the increasing emphasis placed upon the utilisation of such arrangements. It was noted that other intermediaries, such as prime brokers or general clearing members, may also be playing a role. It was also pointed out that the types of collateral should contemplate funds as collateral and that it should be highlighted that collateral is a risk management overlay, designed to mitigate an underlying counterparty credit risk. A few other specific points were mentioned to improve the initial draft and the Secretary invited all CICF participants to submit any further comments to be considered for the next draft.

4. Regulatory developments impacting collateral

The Chairman offered a briefing on a series of points.

The EPTSG, which brings together the European Commission, the ECB, ESMA and industry representatives, had its inaugural meeting on 23 March. This new body follows earlier expert groups, most recently including the European Commission's Expert Group on Market Infrastructure (EGMI). The EPTSG's initial areas for discussion are completing the dismantlement of the Giovannini barriers; safe and efficient collateral provision and management; crisis management of post-trade infrastructure' and innovation and technological and process standardisation. AFME's Mr Frey is involved in the EPTSG and will hence be able to report back to the CICF in future meetings; and the CICF Chairman will also be an EPTSG invitee.

The ECB's contact group on euro securities infrastructures (COGESI) has created an ad hoc group on collateral harmonisation. This group is having its initial meeting on 3 May, hosted by the ECB in Frankfurt and chaired by Ms Daniela Russo. The CICF Chairman is himself a member of this ad hoc group, which also includes representatives of central banks, banks, banking associations, CSDs, and CCPs. The 3 May agenda includes an update on recent developments in relation to collateral harmonisation and specific reviews of work on (i) triparty settlement interoperability; (ii) the use of credit claims as collateral for bilateral repos; and (iii) existing Eurosystem procedures for credit claims. As both items (i) and (ii) relate to specific initiatives of ICMA's European Repo Council (ERC), which the CICF Chairman also chairs, a brief description was provided regarding their nature and latest progress.

Shadow Banking was the topic of a 27 April, Brussels conference organised by the European Commission, alongside the current comment period, open until 1 June, in respect of its March Green Paper. This included significant official contributions from Paul Tucker (Deputy Governor for Financial Stability, Bank of England) and Lord Turner (Chairman, UK FSA), who also delivered the recent Rostov lecture "Securitisation, shadow banking and the value of financial innovation". Two recently published papers written by Richard Comotto (Senior Visiting Fellow at the ICMA Centre) have provided important contributions to the debate in this area, commenting on haircuts and initial margins in the repo market (February 2012); and shadow banking and repo (March 2012). A separate short briefing paper by Richard Comotto (the basis for his insight article "Haircuts on repos will jeopardise recovery", printed on page 32 of the 3 May London Financial Times) also challenges the basis upon which minimum haircuts are being proposed as a tool to mitigate procyclicality.

Seeking to avoid overlap, work on shadow banking will be coordinated with other efforts (such as discussed at this morning's IRSG meeting – where it was agreed that the ERC should lead commentary from the repo market perspective). In ensuing discussion it was identified that other CICF participants present were either not currently planning to respond to the Commission's Green Paper on shadow banking, or were unsure of their association's intentions in this regard. In part, this reflects the fact that there are conflicting priorities drawing attention elsewhere (a particularly significant example being EIOPA's intentions for the regulation of pension funds). The Chairman noted that the FSB's shadow banking project is driving the policy setting agenda for now, but the European Commission may yet add their own detailed ideas.

The Secretary noted the recent ESA discussion papers regarding standards required to support the agreed version of EMIR. Pursuant to these, ICMA's ERC has submitted two short responses to ESMA, focussing on certain non-derivatives implications and aspects of this new regulation on CCPs and trade repositories. The Chairman noted the need for some focus on the treatment of non-CCP cleared OTC contracts; and that debate over collateral treatment has arisen in work on standards supporting AIFMD.

Moving on to the proposed CSD Regulation, the Chairman expressed his view that this should be of interest to all CICF participants. The buy-in proposals are of particular significance, as they seek to mandate that an unrelated party (market infrastructure) will, in case of fails, conduct a buy-in after just four days. This is notwithstanding that the current EU post-trade environment is not built in such a way as to ensure that there will be timely trade settlement. It was noted that a likely consequence of this would be an increased reluctance to lend out securities, thereby restricting collateral availability.

Mr Serocold observed that there is likely to be even more differentiation between the most obviously liquid collateral and other securities. He clarified that the CSDR anticipates a standard settlement period of trade date (T) plus 2 days (T+2), with penalties in case of fails and mandatory buy-ins 4 days after intended settlement. It is expected that this would reduce cash trading market liquidity, as operational risk costs outweigh expected trading spread gains. This will make it harder to source required collateral assets. The Chairman pointed out that the fact that EU trading is spread across a range of infrastructures means no one of them will have a view of any offsets which might already exist as between bilateral counterparties.

On a separate point, the Chairman noted that at the 6 April symposium on CCP clearing of OTC derivatives, hosted by the Federal Reserve Bank of Chicago, an official pragmatically conceded that, in case it proved to be necessary, a failing CCP would finally be bailed out to avert negative systemic consequences. He also commented that it is problematic that central banks take collateral against their lending but do not themselves give out any collateral when taking in cash deposits, the effect of which is a significant net withdrawal of collateral liquidity from the market.

5. Other collateral developments

The Chairman drew attention to the work of Peter Norman, in his capacity as the DTCC/CSFI Post-Trade Fellow, which is thus far reflected in his interim report. He also noted that, following its 2015 go-live date, TARGET2-Securities (T2S) will present a unified pool of € denominated collateral securities. There is a lot of work to be done before this new processing platform is realised, but a significant amount of programme development has already been completed.

Next, the Chairman highlighted the use of funds as a form of collateral, noting, for example, the March launch of Clearstream's Funds as Collateral Committee. It was observed by the buyside that some problems seem to exist with such use of funds. Returning to the topic of credit claims as collateral it was highlighted that not all central banks follow the same policy; and the Chairman flagged that some of the collateral relaxation measures which have been taken by central banks indeed contradict the push to achieve harmonisation. It was observed that there does seem to be increasingly serious interest to use loans as collateral, notwithstanding that there are still a number of legal constraints. The Chairman pointed out that the ERC's current credit claims initiative focusses on the possible use of claims under German, French and English law; and also pulls in Luxembourg and Belgian law analysis as a result of the location of the two engaged ICSDs. Given the need for collateral to meet all increased demands, these new development directions can be expected to persist.

6. Potential CICF White Paper

The Chairman then indicated that he sees value in the development of a CICF White Paper on the topic of Collateral Fluidity. He explained that the ERC's 2010 European repo market White Paper had identified details of a number of settlement inefficiencies, with a particular focus on cases in Greece, Italy and Spain. Whilst some progress has been made there remains a need to resolve such infrastructural barriers. This needs to occur in concert with the transition to T2S, such that these problems are not imported into the new unified environment. With these problems solved and the transition to T2S achieved, there would then be an appropriately robust post-trade settlement infrastructure to serve as a basis for the move to standardised T+2 settlement and the market discipline measures, as contemplated by the proposed CSD regulation. The Chairman proposed that the CICF secretariat draft and circulate a paper analysing the desirable steps and the supporting rationale. With CICF support, particularly including from the buyside, this could become a very valuable document to aid policy setters in bodies such as the European Commission and the ECB.

It was observed that another important contribution to aid official policy making would be good quality data on infrastructure performance, including trends. This could help size problems such as that of late settlement, which may in fact be quite small when seen in context of the overall amounts being satisfactorily settled. Ideally ECSDA and EACH could contribute to the provision of such information, whilst providing any necessary degree of aggregation and data confidentiality. The ECSDA noted that they have previously attempted to assess settlement efficiency and found it to be high (98%). To show evolution against this they are seeking to repeat this exercise. The Chairman acknowledged the potential value of this, but noted that really getting to the root of problems may dictate more detailed analysis (e.g. distinguishing experience in cross-border versus domestic settlements). It was suggested that global custodians may also be in a position to contribute usefully to analysis.

The Chairman indicated that, particularly as they were unfortunately unable to attend this CICF meeting, further discussions should be held with AFME to best ensure that efforts of their post-trade group are informed of these discussions, and vice-versa. Efforts should be continued to use the CICF as a conduit for the flow of collateral related information amongst associations.

7. Other business

The Chairman expressed the view that there is a coming debate about encumbrance, which will be of great significance to those involved with collateral. This prompted a short discussion in which comments were made about the interaction of encumbrance with concerns over leverage, the impact it can have on ratings, and how the perspectives of unsecured investors sit alongside those of secured investors. Besides potential developments from a regulatory perspective there could be changes in market practices, for example through the application of covenants. It was emphasised that even the starting questions of how to define and measure encumbrance are tricky to address, as are other subsequent questions such as how to monitor encumbrance. It was noted that regulations already complicate the situation, for instance by requiring that the best quality collateral assets remain tied up in bank liquidity buffers. It was suggested that there may be a case for supplementing the CICF website with links to good materials on the topic of encumbrance, possibly including research.

Attention was drawn to the recent launch of market making across a derivative curve settling on the Repurchase Overnight Index Average ("RONIA"). RONIA is an overnight, sterling-secured money market benchmark, which tracks actual sterling-secured overnight funding rates and is compiled as a daily weighted average of sterling overnight Delivery By Value (DBV) gilt repo transactions. It is anticipated that clearing, through LCH, will become possible.

Returning to discussion of the proposed CSD Regulation, the question was asked as to whether there could, rather than mandatory buy-in, be a system of required "borrow-in"? The Chairman commented that this might be sensible, noting that it is always possible, where really necessary, to privately initiate a buy-in.

Conclusion and next steps

It was agreed that the CICF secretariat should continue to develop the CICF website page, possibly including materials linked to the topic of encumbrance. CICF participants should contribute by providing the CICF secretariat with relevant links to their own and other suitable content.

It was agreed that the CICF secretariat should continue to coordinate efforts to prepare the short paper covering collateral fundamentals. Other CICF participants should contribute drafting suggestions to help this process. Once agreed, this paper should be published. Supplementary papers may subsequently be produced, as agreed in future discussions.

It was agreed that the CICF secretariat should draft the proposed CICF White Paper on Collateral Fluidity, with a first draft to be circulated in June. CICF participants should contribute comments on this draft, which the CICF secretariat will assimilate. The CICF secretariat's aim would be to formulate an agreed final version of this White Paper, suitable for subsequent publication and distribution.

As agreed at the inaugural meeting, CICF participants should inform the Secretary of other associations whose participation in CICF may be desirable.

The Chairman thanked everyone for having participated and suggested that the CICF should regroup in September – the exact date was left to be settled in the coming weeks. There being no further business, the Chairman then closed the meeting.