International
Capital
Market
Association

ICMA

Minutes of the European Repo Committee meeting held on April 25, 2012 in London

Present:	Mr. Godfried De Vidts	ICAP (Chairman)
	Mr. Simon Kipping	Bank of America Merrill Lynch
	Mr. Eugene McGrory	BNP Paribas
	Mr. Grigorios Markouizos	Citigroup
	Mr. Andreas Biewald	Commerzbank
	Mr. Romain Dumas	Credit Suisse
	Mr. Tony Baldwin	Daiwa Capital markets
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Olly Benkert	Goldman Sachs
	Mr. Jean-Michel Meyer	HSBC
	Mr. Stefano Bellani	JP Morgan
	Mr. Rajen Patel	Morgan Stanley (substitute)
	Mr. Michel Semaan	Nomura
	Mr. Sylvain Bojic	Société Générale
	Mr. Guido Stroemer	UBS
	Mr. Eduard Cia	UniCredit Bank AG
On the phone:	Mr. Herminio Crespo Urena	BANKIA
	Mr. Ulf Bacher	Newedge Group
Also Present:	Mr. Andrew Hauser	Bank of England (for Item 1 only)
	Mr. Nicholas Hamilton	JP Morgan (Deputy Chair, ERC Ops)
	Mr. Richard Comotto	ICMA Centre
	Ms. Lalitha Colaco-Henry	ICMA (Secretary)
	Mr. David Hiscock	ICMA
	Ms. Lisa Cleary	ICMA
	Mr. John Serocold	ICMA
Apologies:	Mr. Stephen Malekian	Barclays Capital
	Mr. Edward McAleer	Morgan Stanley (substitute)
	Mr. Tony Platt	Morgan Stanley (Chair, ERC Ops)
	Mr. Kevin McNulty	ISLA

Welcome by the Chairman

The Chairman thanked Mr. Romain Dumas and Credit Suisse for kindly hosting the meeting and welcomed everyone in attendance and on the phone.

1. Update on the Securities Lending and Repo Committee

Mr. Andrew Hauser said that the Bank of England has always had a keen interest in repo markets, given its monetary operations. However, it has also had a broader role through the Securities Lending and Repo Committee (SLRC). Mr. Hauser noted that, as the newly appointed Chairman of the SLRC, he was seeking to revive the group, which had atrophied somewhat over the years. Accordingly, he is looking for more ERC members to join the SLRC and welcomed the invitation to join the first part of the ERC meeting.

Regulatory interest in repo is now much greater. Because of the Bank's role in market operations, the Bank's main focus is to ensure that the repo market works efficiently and safely. One of the key messages that the Bank has for regulators is that they should understand the repo markets better.

David Rule is heading up the workstream at the FSB looking at repo and securities lending. The SLRC has formed a working group to look at (1) the implications of putting more repo through CCPs; and (2) the role of increased transparency and whether a trade repository would be welcome. The SLRC are hoping that their work will help to inform the FSB in this area.

The Chairman said that two ERC studies by Richard Comotto had been published – one was titled Haircuts and initial margins in the repo market[1] which was published in February; the other Shadow banking and repo was published in March. Mr. Comotto also has published an article in The Banker which responds to the article in the same journal by Sharon Bowles. Additionally, a further article has now been published in the FT[2] which questions the evidence underlying the proposal for a mandatory collateral haircut made by Lord Turner in the recent Rostov lecture and at the EU Commission conference on shadow banking. One of the salient points to note from Mr. Comotto's article is that, given the outstanding value of the combined US and European repo markets (in the range of EUR 15 – 20 trillion), a minimum mandatory haircut in the region of 20% (as theorised in a recent study by Andrew Haldane, Executive Director for Financial Stability at the Bank of England) would theoretically take as much as EUR 4 trillion of liquidity out of the repo market, four times more than the ECB's 3-year Long Term Refinancing Operations (LTROs).

The Committee noted that a number of the shadow banking initiatives are welcomed by the industry. Some accounts always receive a haircut while others always pay a haircut and this is not ideal. However, the challenge for regulators is that they need to understand the interrelation between the repo markets and other markets, such as the government cash bond market and the wider economy. For instance, a 20% or similar haircut would annihilate the government bond market as it is very closely linked to the repo market, and for this to happen in the current economic climate would be very destabilising.

The Committee also noted that the US has far greater transparency, given the haircut data published by the NY Fed (although it is recognised this remains a sample). This transparency has

[1] Alternatively, see: http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Repo-Markets/Haircuts%20and%20initial%20margins%20in%20the%20repo%20market_8%20Feb%202012.pdf

[2] See the article "Haircuts on repos will jeopardise recovery" published in the London FT on 3rd May 2012: http://www.ft.com/cms/s/0/3889138a-92cb-11e1-b6e2-00144feab49a.html#axzz1uSQPSEr3 (FT log-in required)

clearly helped firms both internally and externally. It has helped to inform the debate within firms about where they stand with their haircuts vis-a-via the industry. The Fed data also helps inform the debate on funding.

The market has witnessed a shift from unsecured to secured funding which has been a very good thing from a risk-management perspective. However, any imposition of significant haircuts on the secured interbank market is very worrying. Firms will have to go to central banks for even more money. There is also the difficulty of unilaterally imposing haircuts and how one would manage the resulting credit exposures. Moreover, if a haircut were to be imposed, which side of the trade would you impose it on? Instead, a better way forward would be through the use of capital charges.

The Committee also noted the potential impact of the CSD Regulation, which is of significant concern. The European Commission wants to impose fail penalties as a way of making the market more efficient. However, this is highly problematic because of the lack of sufficiently robust and efficient settlement infrastructures and accordingly, the CSD Regulation could be very disruptive to the way markets operate. Some of the national CSDs are unable to cope effectively with cross-border trades which results in a significant number of settlement fails. Imposing penalties on market participants using such CSDs will not address the real issue of unsatisfactory settlement infrastructure. Instead, the regulators should make clear to the national CSDs that if they are unwilling or unable to improve the services they provide the market should migrate to more sophisticated solutions like those provided by the ICSDs.

Returning to the proposed minimum mandatory haircut, it was noted that regulators and politicians are increasingly advocating the introduction of such a haircut. However, the CGFS data on haircuts does not support the assumption that haircuts are a source of procyclicality for the majority of the repo market, though certain assets, such as ABS may be such a source. The 2007 – 2009 data showed that haircuts were not increased but instead credit lines were withdrawn. Moreover, even if a minimum mandatory haircut is imposed by regulators, haircut levels may nevertheless go up in times of market turmoil.

2. Minutes of the previous meeting

The draft minutes of the last ERC Committee meeting, held on February 21st 2012 in London, were unanimously approved without comment and accordingly will be published on the ICMA website.

3. European Repo Council haircut survey

Mr. Richard Comotto noted that 17 banks had provided haircut data which revealed that the pilot survey had been too loosely drawn, which may have made it difficult to arrive at meaningful conclusions. For example, very few firms applied haircuts to government bonds and the bulk of haircuts that were applied were close to 0%. However, some were applying haircuts of up to 8%. The data did reveal that the range of haircuts being applied by firms is very wide. Some Committee members also indicated that the data they had sent in was indicative, based on their risk departments statistics, rather than being based on actual trades.

The Committee agreed that there is a need to obtain better data and that the Committee should try

to act pre-emptively. It was agreed that the ERC would approach the ICSDs and tri-party agents for haircut data. It was noted that the ICSDs are unable to identify repo trades separately from cash bond trades. The CCPs would also be asked if they could provide data on their haircut tables. Mr. Richard Comotto would formulate a set of questions to be included in the next semi-annual repo survey. In this regard, it would be crucial to ask the right questions. Repo survey participants would have to be informed of the new category of survey questions by mid-May.

4. ERC Operations Group update

Mr. Nicholas Hamilton said that after the last European Repo Committee meeting in February, a number of drafting points had been identified in the previous draft of the Margin Best Practices paper and that these had now been rectified. The amendments made to the document now meant that the practices being advocated would be compliant with the latest ISO Standards. The Committee asked for clarification about section 3.2 of the draft which concerns forward starting repos. The Committee felt that a framework should be set up for forward starting repos and this would enable more banks to use such repos in the future. It was decided that the ERC Operations Group should be asked to look at how best to explain the convention for the margining of forward starting repos in the Margin Best Practices paper, but that publication of the paper should not be delayed over this issue. Instead, the Group should work on a clarification of the convention, which would address both the treatment of forward starting repos and the margining of interest rate exposures.

Regarding the repo deal matching and affirmation work, the Working Group had concluded that most firms are compliant but that a lot of manual processing is being carried out. The Working Group is now looking into how automation can be increased. To this end, the Working Group is looking at the services provided by a number of providers such as Omgeo, BondLend, Swift and Euroclear.

The Ops Group has also been working with Monte Titoli to optimise real time gross settlement into cross-border markets. However this continues to be a work in progress. The Group has also been providing technical input on tri-party interoperability while a sub-group has been formed to consider the impact of T2S.

5. LCH.Clearnet and the price of margin

Mr. Stephen Malekian had raised a concern at the previous meeting regarding the price of collateral posted with LCH.Clearnet Ltd as margin. LCH.Clearnet Ltd does not use the full/dirty price when crediting collateral that is posted as margin and instead, only a flat/clean price is used. This matter has been raised with LCH.Clearnet which has indicated that it expects the problem to be resolved by June.

6. CSD Regulation and buy-ins and 11. Negative interest rate repos

The Chairman noted that the problem with the CSD Regulation was the same one that the Committee had had with the short selling regulation. Accordingly, an unrelated third party may

unilaterally decide to buy-in the bonds, irrespective of whether the parties to the trade may wish such an outcome. This is seen as an undesirable outcome for market makers, hedge funds, asset managers etc. The imposition of daily fines for late settlement will also destroy the economics of the trade and the suggested proposal for a single settlement cycle of T+2 and mandatory buy-in two days later on T+4 does not fit into the T+5 provisions currently set out in the GMRA. The Chairman said he would raise these concerns with the Commission.

It was noted that one reason for the persistence of the Commission with this proposal was the "US effect" where there had been a significant level of fails in the US mortgages market last year. However, the fails penalties system was extended to cover mortgages so the issue has largely been resolved.

Mr. Sylvain Bojic noted that the EU situation regarding fails is different to that in the US where Europe has an established culture of negative repos whereas the US does not.

The GMRA 2000 did not mention negative repos and so to address this omission the ERC Recommendation was developed in 2004. The Recommendation provides that market participants entering into a repo transaction (whether a repurchase transaction or a buy/sell back transaction) in which the rate of interest payable by the seller on the purchase price will be negative agree that if the repo seller fails to deliver the purchased securities on the purchase date then (i) the buyer may terminate the transaction (and this right should continue for every day that the seller fails to deliver); and (ii) for every day that the seller fails to deliver the purchased securities the repo rate should be zero.

The GMRA 2011 includes similar wording on negative rate transactions. However, Mr. Bojic pointed out that this does not resolve the issues that surround negative rate repos, and the issue of a "free lunch" in particular. The seller is not really penalised for failing to deliver the securities on time whilst offering initially at a negative level. In the GMRA 2011, because there is no mention of the pricing rate being considered to be nil during a fail, the buyer may terminate a failing transaction and yet have to pay the repurchase price including negative interest rates. Either the buyer (a) is not penalized at all for not delivering securities back on time (he may have paid a negative level initially but once the repo has ended, irrespective of the reason, no further interest is calculated as the pricing rate is deemed to be zero), or (b) is left with the threat of a mini close-out, with substantial risk and P&L impacts.

Mr. Bojic suggested that one solution may be to impose a penalty on a buyer who fails to deliver securities on time for as long as such failure continues. This would not prevent the seller from exercising their rights to terminate the transaction by way of a mini close-out, whilst the fail continues. To this end, it may be worth thinking about adopting the wording in the GMSLA 2010, which provides that "In respect of each Loan, the payments (...) shall accrue daily in respect of the period commencing on and inclusive of the Settlement Date and terminating on and exclusive of the Business Date upon which Equivalent Securities are delivered or Cash Collateral is repaid".

The Committee agreed that, by adopting a more robust market practice for negative repos and fails, the industry might be able to mitigate the more acute elements of the CSD Regulation. It would be important that any fails penalty procedure adopted by the ERC would work for both the repo and cash markets as well as CCP participants otherwise basis risk could be created. The Chairman also agreed to discuss this proposal with the ECB. The Committee agreed to consider Mr. Bojic's paper

further in advance of the next Committee meeting in June. The ERC Ops Group would have to be involved as well.

Mr. Bojic also noted that LCH does not have any buy-in rules and that he had scheduled a meeting with them to discuss the issue.

7. Regulatory update

Mr. David Hiscock said that the next ERC Response (due on April 30th) was to the mini-consultation[3] by the Task Force on adaptation to cross-CSD settlement in T2S (TFAX). TFAX is mandated to propose common solutions for adaptation to cross-CSD settlement in T2S. The ERC Response has now been submitted to the ECB's TFAX and focuses exclusively on the section of the consultation concerning "CSD ancillary services" (namely the processes involved in repo; triparty repo; and securities lending and borrowing from the perspective of the cross-CSD settlement).[4]

Mr. Hiscock also mentioned that the FSB's interim report on shadow banking was expected imminently, though the actual policy proposals will not be published until the end of the year.[5] The Commission has also been examining shadow banking, in parallel with the FSB, and had published its Green Paper on Shadow Banking[6] seeking feedback by June 1st. The ERC will be submitting a response which will reference Richard Comotto's two recently published papers.

Responses had also been sent to the two consultations (March 19th[7] and April 2nd[8]) relating to EMIR. ESMA is currently working on the technical standards that will underpin the EMIR. Further consultation is expected from ESMA in July, in advance of the end 2012 implementation deadline.

The Commission is working to introduce resolution measures for banks, including bail-in provisions. If necessary, certain liabilities will be written down and possibly converted into equity in order to recapitalise a troubled bank. The Commission had published a paper "Discussion paper on the debt write-down tool – bail-in" to which ICMA has responded. Notably, the ICMA response has urged that secured obligations should not be subject to bail-in, and instead bail-in measures should only apply to long-term unsecured debt. ICMA will continue to work on this issue. Mr. Hiscock also noted that, related to the bail-in proposals, asset encumbrance is increasingly being seen as an issue of systemic importance. Andrew Haldane at the Bank of England had recently given a speech[9] on

---

[3] Alternatively, see: http://www.ecb.europa.eu/paym/t2s/governance/ag/html/subadapt/index.en.html#minicon

[4] The ERC response was sent on Monday, April 30th and is available at: http://www.icmagroup.org/assets/documents/About-ICMA/International-Repo-Council/ERC-contributions/ICMA-ERC-OPS-TFAX-Topic-3-Feedback-Template_draft.xlsx

[5] The interim report has now been published and is available at: http://www.financialstabilityboard.org/publications/r_120427.pdf

[6] Alternatively, see: http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_en.pdf

[7] Alternatively, see: http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Repo-Markets/ERC-contributions/ESMA-response-re-EMIR-DTS-DP_final-19March2012.pdf

[8] Alternatively, see: http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Repo-Markets/ERC-contributions/ESMA-response-re-DRTS-DP_final.pdf

[9] Alternatively, see: http://www.bankofengland.co.uk/publications/Pages/news/2012/042.aspx

this topic, arguing that banks and other financial institutions are currently engaged in a "safety race" in which all investors are seeking to be at the front of the line in the case of a liquidation. It will be important to make clear that, as explained in Richard Comotto's latest published paper, repos do not disadvantage senior unsecured creditors.

The CPSS IOSCO paper on financial market infrastructures will be another step to increase default funds in CCPs. Arrangements will eventually be in place so that it will be the banks that will foot the bill in the case of a CCP failing and not the taxpayer.

Mr. John Serocold noted that a briefing call on MiFID II and MiFIR was being held jointly with ISDA and AFME on April 25 and that a recording of the call was available[10]. ICMA was working closely with other trade associations, each focusing on their area of specialisation. For example, ISDA was considering commodity derivatives etc. The deadline for the Parliamentary text is 10 May. The Parliament's draft report goes further than the Commission text regarding trading venues. On the other hand, the transparency provisions in the draft Parliamentary report have not been tightened to any great degree, but this is largely due to the high level at which they have been drafted; with much of the detailed provisions expected in Level 2 measures. One significant issue has been the re-categorisation of custody services from an ancillary activity to a core activity. This means that if a European Bank wishes to use a non-EU agent bank then that non-EU agent bank will have to have an EU bank services licence. This will be a particular issue for a significant number of non-EU banks such as Swiss banks.

Finally, Mr. Serocold noted that the final text of the short selling regulation had yet to be officially published.

8. Legal update

Ms. Lisa Cleary noted that the 2012 legal opinions had been updated and published and were now available on the ICMA website.[11] There were now 62 legal opinions made available to members as the Saudi legal opinion had been discontinued. The newly commissioned Qatar legal opinion would be published shortly. The legal opinion for Russia was still a work in progress as secondary legislation had yet to be finalised. A Russian translation of the GMRA 2011 was also being prepared and would be made available to members shortly.

Work on the legal opinion exercise for 2013 would start in November and Ms. Cleary requested members to consider what changes, if any, were required in terms of the coverage of the opinions.

The guidance notes to the GMRA 2011, buy/sell back annex to the GMRA 2011 and bills annex to the GMRA 2011 had also been published on the ICMA website.[12] There are also two outstanding points relating to the GMRA 2011. The first concerns negative rate repos while the second relates to clause 6(j), which is a condition precedent clause. Recent litigation which had focused on an

[10] Alternatively, see: http://www.icmagroup.org/About-ICMA/media/Conference-calls-for-ICMA-Members/

[11] Alternatively, see http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/GMRA-Legal-opinions

[12] Alternatively, see http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/global/

equivalent condition precedent clause 2(a)(iii) of the ISDA Master Agreement has now concluded. The GMRA review working group would look to see what steps, if any, ISDA will take in the light of the court decision before taking any decisions regarding clause 6(j) of the GMRA.

Turning to credit claims, Ms. Cleary noted that ICMA was looking to refresh the legal work that had been carried out two years ago, looking at the feasibility of using credit claims as repo collateral under French, German and English law.

The Chairman noted that the Banque de France has set up a working group "Collateral Loan Underlying Repos" looking at developing credit claims as collateral. The Group is looking at adopting the "Fond Commun de Titrisation (FCT) non tranché et auto-souscrit", such that credit claims would be transferred to a FCT, which would issue bonds whose principal and interest would be backed by the flow of repayment of the credit claims transferred. The bonds would not be settled, that is to say that the risk level would be consistent/equivalent across all the bonds. These instruments would be self-subscribed and would not be listed on a regulated market (in order to avoid the rating by CRAs). Unfortunately, this is purely a domestic initiative that is not taking account of attempts at European harmonization.

9. Draft Repo Code of Conduct

Mr. Comotto said that he is expecting that he will have finished drafting the Code of Conduct by June. He will circulate an early draft to Committee members in order to obtain feedback on the breadth of coverage for the Code. Mr Comotto noted that one of the main underpinning ideas behind the Code is to help reduce the number of queries that are received on issues such as margining, etc, and the consequent number of disputes. The question was whether it was worth promulgating standards of conduct. It was agreed that it would be worth considering scope after a first draft has been circulated.

The Committee considered whether the ERC should advocate some form of certification exam on the Code. There was some discussion about how ICMA would enforce such a requirement. One option could be to include the mechanics into the GMRA, so that "enforcement" would become a contractual matter.

10. Calculation of interest in floating rate repos

Mr. Comotto noted that his paper on the calculation of interest in floating rate repos had been amended since the Committee had seen it last. The ICSDs are adopting a convention for fixing interest rate refixing dates that may not be in line with all market practice. An example was a floating-rate repo indexed to a 1-month rate with a purchase date of 25 November 2012. The first refixing date would be 26 December (because of Christmas) but the second refixing date would be 25 January 2012, not 26 January. This was in order to avoid compression of the day counts of the latter periods. It was noted that this was the same convention used for swaps. It was agreed to follow this convention for floating-rate repos and include it in the paper.

The question also arose about business days in setting purchase dates. For example, if the transaction date of a repo in USD was a Thursday and Monday was a US holiday, the purchase date

for a T+2 transaction would be Tuesday. However, a transaction agreed on Friday could have the same purchase date, if the day between the transaction date and purchase date (T+1) did not have to be a business day in the US. It was agreed that business days between transaction date and purchase date should be defined as days on which the financial centre for the currency was open.

12. AOB and upcoming dates meeting

EBF access to firm rankings in the ERC semi-annual repo survey - The Chairman mentioned that the EBF had requested access to the rankings of firms in the semi-annual repo survey. The EBF had requested access to firm rankings in order to know that firms applying to become members of the Eurepo Steering Committee are sufficiently active in the repo markets in order to make a substantive contribution to the work of the Eurepo Steering Committee. It was noted that the names of all firms participating in the repo survey are published in an Annex to each survey. However, the rankings of the firms for each survey are not made public.

The Committee agreed that it was committed to supporting the EBF and the Eurepo Steering Committee. To this end, the Committee decided that the ideal way forward would be for a firm, seeking to become a member of the Eurepo Steering Committee, to request that Mr. Richard Comotto disclose their latest ranking (or even their rankings for the last few surveys) to the EBF. The firm itself would then be authorising disclosure of its own ranking/s. Mr. Comotto would then be able to send the relevant information to the EBF. This should provide the EBF with the information that is needed in order to make an informed assessment of the suitability of the applicant for membership of the Eurepo Steering Committee.

EBF access to ERC Meetings as an observer – The Chairman noted that he had received a request from the EBF to attend Committee meetings as an observer. The Committee felt it was unclear what the additional benefits could be of granting the EBF observer status (and thus having an additional person at ERC meetings), given that three ERC members already sit on the Eurepo Steering Committee, thus ensuring an adequate flow of information between the two Committees. Additionally, the Committee decided that it already extends a special privilege to the EBF by sending draft minutes of meetings as soon as they are available and ahead of final approval by the Committee and publication on the ICMA website. It was felt that to grant observer status could risk a flood of requests from other associations and to grant all such requests would risk the free and open discussions currently enjoyed by Committee members. Therefore, after careful consideration the ERC decided against granting observer status to the EBF as the current information and joint membership arrangements appear to be working well. Additionally, the EBF should be invited to the European Repo Council meetings, held twice a year.

Eurepo Steering Committee development of an overnight fixing – Mr. Andreas Biewald noted that the first meeting of the working group looking into the development of an overnight fixing was to be held shortly and discussions would also be held with the European Association of CCP Clearing Houses (EACH).

Composition of LCR Baskets –It was noted that the EBA is mandated by the EU Commission to come up with a proposed definition for LCR1/2 eligible papers by 2013. The EBA has set up a subgroup on liquidity but discussions are at a very early stage. Mr. Andreas Biewald said that he will be attending the next meeting of this subgroup. Currently, the subgroup is looking at the idea of designing a

single ISIN based eligibility list, but it is more likely that the group will eventually decide that the basket should be based on broad asset classes. Once the EBA has defined the basket/s the ICSDs and CCPs will build and develop basket products.

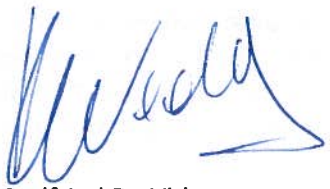
The Committee agreed that the LCR basket should be Europe-wide and that diversification within the basket will be important. Work on developing baskets may result in the development of different baskets for different purposes in different jurisdictions. The Secretary agreed that this issue would be tabled as a regular agenda item.

Use of Totem for price testing long repos – Mr. Jean-Michel Meyer said that Markit had developed the Totem product which provides market prices. However, there was some concern about inconsistencies in the calculations. It was agreed that the Secretary would invite Markit to the next Committee meeting to give a presentation on the Totem product. The Chairman noted that he would invite Bloomberg to the Committee meeting in October as there is apparently a new product (not BVAL) which measures the liquidity of each bond.

Further dates:

- The next ERC **Committee** meeting will be held on **Tuesday, June 19th at 2:00pm** in Madrid in the margins of ISLA's Annual Conference.
- A European Repo **Council** meeting is scheduled for **Thursday, September 27th** hosted by Nomura in London.
- A further ERC **Committee** meeting will be held on **Tuesday, October 9th at 2:00pm**, hosted by HSBC in London.

The Chairman:



Godfried De Vidts
Madrid, 19 June, 2012

The Secretary:

Lalitha Colaco-Henry