

**Minutes of the European Repo Committee meeting held on 16 January, 2013 in Luxembourg**

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| Present:      | Mr. Godfried De Vidts<br>Mr. Andreas Biewald<br>Mr. Edward McAleer<br>Mr. Ulf Bacher<br>Mr. Michel Semaan<br>Mr. Eduard Cia<br>Mr. Nicholas Hamilton                                   | ICAP (Chairman)<br>Commerzbank<br>Morgan Stanley<br>Newedge Group<br>Nomura<br>UniCredit Bank AG<br>JP Morgan (Co-chair, ERC Ops)                          |
| On the phone: | Mr. Simon Kipping<br>Mr. Eugene McGrory<br>Mr. Romain Dumas<br>Mr. Tony Baldwin<br>Mr. Ronan Rowley<br>Mr. Sylvain Bojic<br>Mr. Guido Stroemer<br>Mr. John Serocold<br>Ms. Lisa Cleary | Bank of America Merrill Lynch<br>BNP Paribas<br>Credit Suisse<br>Daiwa Capital Markets<br>Deutsche Bank<br>Société Générale<br>UBS<br>ICMA<br>ICMA         |
| Also Present: | Mr. Stefan Knoblauch<br>Ms. Heike Eckert<br>Mr. Alexandre Gautier<br>Mr. Cédric Quéméner<br>Mr. Richard Comotto<br>Ms. Lalitha Colaco-Henry<br>Mr. David Hiscock                       | Eurex Clearing (for item 1)<br>Eurex Clearing (for item 1)<br>Banque de France (for item 4)<br>EBF (for item 3)<br>ICMA Centre<br>ICMA (Secretary)<br>ICMA |
| Apologies:    | Mr. Herminio Crespo Urena<br>Mr. Stephen Malekian<br>Mr. Grigorios Markouizos<br>Mr. Olly Benkert<br>Mr. Jean-Michel Meyer<br>Mr. Stefano Bellani<br>Mr. Tony Platt                    | BANKIA<br>Barclays Capital<br>Citigroup<br>Goldman Sachs<br>HSBC<br>JP Morgan<br>Morgan Stanley (Co-chair, ERC Ops)  |

**Welcome by the Chairman**

The Chairman welcomed the Committee members and guests to Luxembourg and noted that a number of Committee members had been unable to attend the meeting due to cancelled flights and had dialled into the meeting instead. He thanked Clearstream for their hospitality in hosting the meeting.

## 1) Update on Interoperability between the ICSDs and Eurex Clearing

Ms. Heike Eckert and Mr. Stefan Knoblauch gave a presentation on Eurex Clearing's position on the triparty settlement interoperability model currently being discussed by the ICSDs.

The Chairman said that the ECB had made it clear that market participants and infrastructure providers must work together to develop triparty settlement interoperability. This point was emphasised by Mr. Benoît Cœuré, Member of the Executive Board of the ECB, in his speech at Clearstream's 17th Global Securities Financing Summit in Luxembourg.<sup>1</sup> It is anticipated that the ECB will shortly be sending a questionnaire on settlement interoperability to market participants (via COGESI and possibly the MMCG).

In the following discussion supported by a presentation (not available) Mr. Knoblauch noted that a couple of years ago, the ICSDs had proposed two different operating models. Model 1 was based on the Clearstream model which is the current operating model for Eurex Clearing. Adopting Model 1 would be much easier and cheaper for Eurex Clearing. Model 2 was the model chosen by the ERC, but implementing the model would require Eurex Clearing to build a new system. There is a difference between managing only one Collateral Management System (CMS), which is Eurex Clearing's current operating model, versus managing many CMSs, where Eurex Clearing would have to manage the exposure of a number of different systems, which would be very complex. On inquiry of the committee Eurex Clearing gave a rough indication of the projected investment cost estimated for the potential implementation of Model 2. It was noted that each of the firms on the ERC Committee spend millions liaising with each of the individual CMSs or for optimising their internal collateral management.

When asked about the impact of the implementation of T2S, Mr. Knoblauch noted that Eurex Clearing is still evaluating the different alternatives available to find the best solution to take forward their model.

The Chairman said that if Eurex Clearing can commit to Model 2 then Euroclear will improve the Bridge. This was set out in the letter from the CEO of Euroclear that was circulated to the CCPs and the Committee. However, Mr. Knoblauch responded by saying that the CBF and CBL settle in real-time in a manner that is highly efficient. Euroclear uses an automatic securities allocation<sup>2</sup> process which only runs every hour and the Bridge also runs once an hour, which is too slow for Eurex Clearing. These hourly cycles will consume liquidity which will be costly to market participants and increases the settlement risk to Eurex Clearing. Ms Eckert also noted that she was worried about the statement made at the December 2012 ERC meeting about a step-by-step approach for the bridge improvement which is not sufficient. The settlement related enhancements are a prerequisite for the potential launch of an interoperable GC Pooling basket. It was also noted that the Eurex Clearing securities lending model where both ICSDs are involved for the collateralisation of the lending exposures is purely an intra-ICSD settlement model, in contrast to the triparty settlement interoperability model being proposed for repo.

Ms. Eckert said that Eurex Clearing was open to support the project if the ICSDs commit to improve the Bridge to support the current clearing hours for Repo products at Eurex Clearing in a near to real-time manner in order to not increase settlement risks. However, any

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<sup>1</sup> A copy of the speech can be found here:  
<http://www.ecb.europa.eu/press/key/date/2013/html/sp130116.en.html>

<sup>2</sup> The Euroclear collateral management system is called 'AutoSelect'.

commitment on the part of Eurex Clearing would first require internal approval of the investment and must be assessed by their risk committee. The Chairman said that the ICSDs and Eurex Clearing would have to move forward on the project together and at the same time.

Mr. Knoblauch also noted that for Eurex Clearing to support the project they would need to know that there will be a return on investment. As a significant number of ERC Committee members are already participants of GC pooling, it is difficult to estimate the potential additional volume. Ms. Eckert stressed that Eurex Clearing had concluded that at this point in time the current offering is meeting the demands of Deutsche Borse Groups customers. Eurex Clearing is evaluating the adoption of the model to support the initiative of the ERC, still, there needs to be the reliable support by the repo community.

The Chairman said that triparty settlement interoperability was needed in order for the repo market to grow. Additionally, the CPSS/IOSCO standards require open access from the wider market (bilateral or through MTFs) so the CCPs will have to consider greater interoperability. The Committee also felt that as market participants they want to be free to choose both settlement location and settlement provider.

Wrapping up the discussion, Eurex Clearing stated that in general evaluations would take place to permit repo collateral potentially being held at global custodians or other CSDs against a stringent risk assessment, business priorities and the regulatory framework. The Committee highlighted that no differentiation between who could connect or not should be made. In response to the ERC Committee request to clarify what happens next, Ms. Eckert offered to provide Eurex Clearing's written statement on their willingness to support the project and the required pre-requisites; one major pre-requisite is that agreement would equally be obtained from the ICSDs, to upgrade the bridge to be more efficient and operate until much later in the day to support the current offering of Eurex Clearing. The Chairman concluded the discussion by highlighting that he would get in touch directly with Euroclear to clarify the issues and, upon receiving their commitment (as already highlighted in their recent letter), together with Eurex Clearing's written statement the project should proceed. The Chairman highlighted the need for all parties to work promptly on progressing the requested changes; and that a firm deadline for all parties to be concurrently operational will need to be clarified.

## **2) Settlement incentives in low and negative interest rate environments**

This item was postponed till the March meeting.

## **3) French collateralisation of credit claims project**

Mr. Alexandre Gautier said that the Banque de France has been considering using credit claims as collateral because during the crisis credit claims had proved themselves as being a resilient and stable form of collateral. Moreover, the value of credit claims tends to be very stable over time. There is an increasing need for collateral, given the ever greater number of transactions going through clearing houses and CCPs. Accordingly, there is a need to consider new sources of collateral. Increasing use of credit claims as collateral could help to foster real economy financing especially for SMEs.

The Banque de France project seeks to build a safe and simple financial instrument, based on eligible credit claims, to be used in bilateral transactions. These instruments are for use by commercial banks as collateral. They will not be considered to be an ABS.

Since the direct mobilisation of credit claims is not presently possible in France, the Banque de France is looking to create a new credit claims mobilisation vehicle, which will issue the collateral instruments. The vehicle will not be rated by credit rating agencies but will instead be rated by national central banks or the IRB. It is also essential that the underlying credit claims are eligible in the Eurosystem. The Banque de France is currently working on having the credit claims vehicle added to the ECBs common list. It is not envisaged that there will be a listing on a regulated market, though the vehicle will be tradable in the OTC markets.

The Chairman noted that Mr. Gautier had been invited to make a presentation at the ERC Council AGM on March 11<sup>th</sup>.

#### **4) Eurepo developments (awaiting feedback)**

Mr. Cédric Quéméner said that the EBF's focus was currently on reforming EURIBOR, but they were also considering the Eurepo fixing. The EBF is looking at which of its benchmarks to keep and how to reform those that are retained. This work will be done in conjunction with regulators, central banks and market participants. In this regard, it is important for the EBF to remain neutral. The EBF will also look to implement the recently published EBA/ESMA guidelines.

The EBF will shortly be asking the panel banks that contribute to the Eurepo fixing whether they wish to keep the Eurepo fixing and whether the calculation and management of the fixing should be reformed. It is hoped that the responses from the panel banks will be that the Eurepo fixing should be retained, albeit in amended form. The EBF will also have to ascertain whether there are any market contracts that are tied to the Eurepo fixing and what impact any amendment of the Eurepo fixing would have on such contracts. It is also anticipated that there will be changes at the calculating agent level shortly.

The EBF have welcomed the BrokerTec/MTS RepoFunds Rate initiative but feels that it is not a valid proxy for the Eurepo fixing due to its segmented nature. Any new Eurepo fixing would have to be of a larger scope than the BrokerTec/MTS indices. It is hoped that any revised Eurepo fixing will be complementary to the BrokerTec/MTS indices.

There will be a meeting of the EURIBOR Steering Committee on January 24<sup>th</sup> which will consider how to define a prime bank. ESMA and the EBA have also been invited to this meeting. In the longer term, it is anticipated that the composition of the EURIBOR Steering Committee will be changed and will include academics, other trade associations (including associations that represent consumers) and regulators. Once the governance of the EURIBOR Steering Committee has been finalised, it will be rolled out to the other EBF benchmarks.

The Committee stressed the need to develop a solution for the secured market as soon as possible. While the BrokerTec/MTS indices are a good start, more is needed. The whole market, including central banks, hedge funds etc. needs to be involved in the development of a secured market fixing. It was also noted that the credibility of the Eurepo fixing was in question as it is not backed up with data. Moreover, it is unclear who uses it or for what

purposes. It is possible that the panel banks will argue that the Eurepo fixing should be discontinued for this reason. Nevertheless, the market needs a secured financing benchmark that is supported by real data.

Mr. Quéméner also noted the EBF's concern about the CCPs and their capacity and willingness to support market initiatives. The EBF has not had any communication from the CCPs to the effect that they are willing to play a role in developing market benchmarks. Moreover, the CCPs are seen as a potential source of increased risk as the market becomes increasingly dependent on such institutions.

The Chairman concluded that the Committee agree that the Eurepo fixing needs to be reformed. The Committee also encourages private initiatives like the BrokerTec/MTS RepoFunds Rate indices. The ERC is committed to working with the EBF to reform the Eurepo fixing, with the EBF in the lead on such work. By way of next steps, the Committee will wait to hear back from Mr. Quéméner about the results of the Eurepo questionnaire.

## **5) Minutes of the previous meeting**

The draft minutes of the last meeting, held on December 4<sup>th</sup> 2012 in London were unanimously approved by the Committee without comment. These minutes will now be published on the ICMA website with unrestricted access.

## **6) Regulatory Update**

Mr. David Hiscock said that the ERC response to the FSB's consultation on Shadow Banking had been sent on Monday, January 14<sup>th</sup>. He noted that the Chairman will be travelling to New York as he had been invited to a meeting with the FSB on January 29<sup>th</sup>, which will be held in three parts – repo, securities lending and prime brokerage. A conference call for the Committee to brief the Chairman will be arranged for January 23<sup>rd</sup>.

Regarding bail-ins, Mr. Hiscock said that he is continuing to monitor the progress of the legislative proposals regarding banks. There is a European Parliament amendment which has been tabled which, if adopted, would remove the exemption for secured liabilities from the application of bail-in.

Additionally, certain benchmarks, including some minor currencies and several of EURIBOR's intermediate tenors, are to be switched off, as already has been the BBA's daily repo quote, all pursuant to the recommendations of the Wheatley Review.

## **7) Russian Trade Repository requirement to register GMRA's**

Ms. Lisa Cleary said that, as part of the suite of netting legislation developed in Russia over the last couple of years, the Russian Federal Service for Financial Markets (FSFM) adopted a regulation obliging parties to report certain transactions (including repo) which are entered into under a master agreement to a named trade repository. Such an obligation will arise once a trade repository becomes operational and both parties to a master agreement have entered into a trade reporting agreement with the relevant repository. Netting will not be enforceable unless the reporting requirement is properly fulfilled. In the event of insolvency

of a Russian counterparty, close out netting is calculated on the basis of information reported to the trade repository. There is also a fine levied against legal entities who fail to report or for later or incomplete filing. At this stage it is unclear if and how such fines could be enforced against a non-Russian entity.

The National Settlement Depository was supposed to commence operations in December last year but has been unable to do so due to technical difficulties. The FSFMs have taken this into account in providing for a gradual introduction of trade reporting requirements. The details are yet to be confirmed or legislation to enter into force.

More information will follow, alongside the publication of the GMRA legal opinion for Russia which subject to some minor amendments is now in final form. The opinion contains an annex to conform the standard GMRA with the relevant Russia law.

Mr. Nicholas Hamilton also noted that the ERC Operations Group are monitoring developments in Russia from an operational perspective.

The Chairman concluded by saying that Ms. Cleary will provide an update on legal issues at the European Repo Council AGM on March 11th.

## **8) ERC Operations Group update**

Mr. Nicholas Hamilton, co-chair of the ERC Operations Group said that a sub-committee had been set up to look at T2S, including certain key areas arising out of the TFAX consultation that had been issued last year. In particular, the sub-committee will look at triparty repo under T2S, the features of blocking/ear-marking and their potential impact on liquidity, and repo identification (which may also link to the topic of trade repositories). The Group is also keen to flush out procedural issues and operational practices that will need to be considered in the shift to T2S, such as how firms will connect to T2S (i.e. direct or indirect participation).

The Operations Group had also been assessing the extent to which the repo matching and affirmation best practices, published in July 2011, have been adopted by the market. On automation there has been some progress. The Group are continuing their assessment of what practices are being used in the market and are in the process of completing the 2<sup>nd</sup> annual matching and affirmation survey to prove the progress. Latterly the group hope to leverage the ICMA repo survey with an operational addendum to increase participation and awareness in this area.

The Group is also looking at the proposals for a trade repository and had sought to produce anonymous data on the volume of life-cycle in repo transactions. This was being done in response to discussions at the ESRB of some form of consolidated tape of repo trade information. In the repo context the volume of events would be very high and so it was felt that the Operations Group in conjunction with Mr. Comotto, could put together some data on the repo volumes for each Operations Group member, based on existing reporting and activity counts. This would also help support the discussions with the ESRB and FSB.

There have also been efforts to reach out to AFME and other industry forums to ensure that the views of the Operations Group are taken into account in such forums and that the Operations Group is seen as a source of repo expertise. The efforts to liaise with AFME had

been viewed as successful, as the work of the various groups is quite complementary, with AFME largely focusing on equities.

Regarding the negative rate fails work, the draft paper by Mr. Adam Bate was circulated to the Committee. One option that had been considered was a market-wide penalty equivalent to the TMPG penalty, which was felt to be quite punitive in a European market context. The TMPG proposal had been introduced to address systemic failures in the US market. The experience in the US had revealed that when interest rates fell below 3% the number of fails increased. To remedy this, the TMPG had instituted a penalty in the form of a charge of no less than 3%. However, Mr. Comotto had looked at empirical fails data in the European repo market (bunds on ICSDs) which revealed no particular correlation between low interest rates and the rate of fails. Therefore, it would be inappropriate to implement the TMPG formula in the European market. The ERC ops working group had instead proposed a bilateral compensation charge to be applied to specific fails rather than a market-wide penalty for systematic fails. The solution put forward in Mr. Bate's paper advocates a consistent approach to the treatment of fails for both negative and positive rate environments, through a voluntary convention in the European market. The convention would impose a consistent formula to compensate rather than punish. The fail rate formula that has been suggested is intended to reflect the economics of each failed transaction and would be the difference between the particular repo rate applying to the failed transaction and the prevailing GC repo rate, or a proxy such as an overnight unsecured cash rate (e.g. LIBOR, EONIA). Mr. Comotto also noted that CCPs and the cash market would need to be consulted on any such recommendation. Mr. Hiscock asked the Committee to consider: (1) whether Mr. Bate's paper sets out a commercially appropriate approach; and (2) how such a convention should be enforced. The Chairman asked the Secretary to send a short email to the Committee setting out a brief summary of the discussion so that Committee members might thoroughly consider the papers in advance of the next ERC Committee meeting in March.

## **9) Monte Titoli**

Mr. Richard Comotto said that there had been an update from Monte Titoli last year about the development of a trade optimiser of the RTGS system for OTC and CCP guaranteed trades. The optimiser will link two or more opposite instructions of the similar quantity but with different intended settlement dates (ISDs) in the RTGS system. After some discussion with Monte Titoli, it had become clear that contrary to their initial presentation the priority in the trade optimiser is to offset instructions on the basis of age first and size second. Mr. Hamilton noted that from an operations perspective, the Group was awaiting empirical data to show improvements in settlement efficiency.

Mr. Comotto also said that the method of calculating penalties at Monte Titoli is to be changed as the current method leads to an anomaly. Currently, failed instructions at 16:00 are compared with balances at 18:00. If a bank draws on its balances between 16:00 and 18:00 to reduce fails, the reduction in balances by 18:00 will result in an increased penalty. Monte Titoli plan to compare fails 16:00 with balances at 16:00. Requests to make the comparison at 18:00 were rejected.

## **10) Legal Update**

Ms. Cleary said that there were no further points to raise.

### **11) Composition of LCR Baskets**

It was noted that on 6 January the BCBS announced its endorsement of [revised liquidity standards for banks](#), including changes to both the computation of required short-term liquidity holdings and regarding which liquid assets may be held to satisfy such requirements. Mr Biewald mentioned that he would provide further comments on the LCR during the panel the following morning.

### **12) Repo Guide to Best Practice and Repo FAQs**

Mr. Comotto said that he was waiting for comments on the Repo Code of Conduct (now re-named the Repo Guide to Best Practice). The Repo FAQs were now in near-final form. It was agreed that the Repo FAQs would be sent to the Committee with a deadline of Friday, January 25<sup>th</sup> for comments.<sup>3</sup>

### **13) Criteria for membership of the European Repo Council**

It was noted that there was no need to discuss the criteria any further at this time.

### **14) AOB and upcoming dates**

The Chairman noted that the Autoborrow issue would be postponed till the next meeting.

The Chairman said that the issue of LCH.Clearent's price of margin, (i.e. clean versus dirty price) has now been resolved subject to each firm agreeing to sign LCH's Deed of Charge. The Chairman asked that ERC Committee members seek to progress this matter internally within their firms to ensure that the Deed is duly signed.

The next **ERC Council AGM** is scheduled for **Monday, March 11<sup>th</sup>** starting at 10 AM at the Le Grand Hotel Intercontinental in Paris, hosted by Euroclear. This AGM will include elections for the new ERC Committee. The Chairman asked Committee members to note that the deadline for names of candidates standing in the elections to be sent to the secretariat is **February 8<sup>th</sup>**.

Also, on **Monday, March 11<sup>th</sup>** there will be a meeting of the new **ERC Committee** in the afternoon starting at 2 PM. A subsequent ERC Committee meeting will be held in the margins of ISLA's annual conference in Prague on **18 June 2013**.

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<sup>3</sup> The Repo FAQ's have subsequently been published on the ICMA website and can be accessed: <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/frequently-asked-questions-on-repo/>