

**Minutes of the European Repo Committee meeting held on March 11, 2013**

**Location:** Le Grand Hotel Intercontinental, 2 rue Scribe, 75009 Paris, France

**Time:** 14.30-17.00

**Attending:**

Godfried De Vidts (*Chairman*), ICAP Securities plc, London

Edward McAleer (*Vice-Chairman*), Morgan Stanley & Co. International PLC

Ulf Bacher, Newedge Group SA

Tony Baldwin, Daiwa Capital Markets Europe Limited

Stefano Bellani, J. P. Morgan Securities Ltd.

Olly Benkert, Goldman Sachs International

Andreas Biewald, Commerzbank AG, Frankfurt?

Sylvain Bojic, Société Générale

Romain Dumas, Credit Suisse Securities (Europe) Limited

Simon Kipping, Bank of America Merrill Lynch

Grigorios Markouizos, Citigroup Global Markets Limited

Andrea Masciovecchio, Intesa Sanpaolo S.p.A.

Eugene McGrory, BNP Paribas

Jean-Michel Meyer, HSBC Bank plc

Ronan Rowley, Deutsche Bank AG

Michel Semaan, Nomura International plc

Guido Stroemer, UBS AG

**Also attending:**

Harald Bänsch, UniCredit Bank AG (*replacing Eduard Cia*)

Lisa Cleary, ICMA Limited, London

Richard Comotto, ICMA Centre

David Hiscock, ICMA Limited, London

**Apologies:**

Eduard Cia, (*Vice Chairman*), UniCredit Bank AG

Stephen Malekian, Barclays Capital Securities Limited

## **1. Settlement incentives**

Mr Stefan Knoblauch and Mr Marcus Zickwolff summarise a presentation on Eurex Clearing's view of negative rate repo transactions, highlighting the following:

- There is high settlement efficiency across the serviced markets in Eurex Clearing with 98.52% of special trades settling on time, and the majority of the remainder settle the day after.
- Where there is failure to deliver on the first leg of a repo, then the term leg is accelerated, obligations are offset and the repo rate is settled (for the full term).
- Where there is failure on the term leg, Eurex Clearing may make a replacement purchase as from 5 days following the delivery date.
- There is regular communication between Eurex Clearing and the repo parties, in order to encourage settlement.
- In a negative rate scenario, Eurex Clearing performs multilateral settlement netting between Eurex Repo and Eurex Bonds, across all pending transactions.
- The buy-in tool within Eurex Clearing announces the ISIN of securities for buy-in and can respond if such securities are registered within the system. Buy-ins cannot be 'passed on' as under the ICMA Rules & Recommendations for the Secondary Market.

Mr Knoblauch reports that Eurex Clearing has received feedback from its biggest 16 members that it is key that Europe has a harmonised fails penalty regime and suggests that the market must reach consensus here- penalties or compensation? In what form? Can these be passed on? Eurex Clearing is open to using the market standard and does not want to develop their own regime. The committee agree that a consistent approach is essential to avoid arbitrage.

Mr De Vidts reminds Eurex Clearing that the ERC committee is yet to receive a letter confirming commitment to the triparty interoperability initiative.

## **2. Election of a new Chairman and Vice-Chairmen**

Following a discussion and respective vote, Mr De Vidts is reappointed as Chair of the ERC committee for a term of one year until the ERC AGM in 2014. Edward McAleer and Eduard Cia are reappointed as Vice Chairman of the ERC committee for a term of one year until the ERC AGM in 2014.

## **3. Minutes approved**

Minutes of the ERC committee meeting held on January 16<sup>th</sup> 2013 in are unanimously approved.

## **4. Meeting with the Public Sector Issuer Forum (PSIF)**

Mr Tony Baldwin and the Chairman report on their meeting with the PSIF, held on February 26<sup>th</sup>. The meeting was attended by DMOs, issuers and supranational representatives.

Mr Baldwin presented the work of the ERC, including the Repo Funds Rate project and the proposed repo facility at the ECB. Perhaps the liveliest part of the discussion was on the topic of the proposed financial transaction tax (FTT) and its effect on the secondary market.

*This topic is further discussed under item 6.*

#### **5. Update on Interoperability and extension of cut-off times for repo**

Mr De Vidts discusses the results of the ad hoc COGESI meeting of February 27th hosted by the ECB. At the ad hoc meeting, the ERC and ERC Operations Group responses to the two COGESI surveys ((i) infrastructural requirements supporting liquidity management at end of day; and (ii) minimum common features of triparty interoperability)) were discussed. The final ERC and ERC Operations Group responses that were sent to COGESI were in substantially the same form as the near-final drafts circulated to Members on February 11th.

Mr De Vidts report that he has discussed this issue with the Chair of Cogesi and the EBF. Changes are required at custodian bank level. The I(CSD)s may be able to accept repo up til 5pm but there is no gain if the custodian banks will not release collateral after 3pm. This remains a key topic as T2S will not of itself deliver a triparty solution. T2S will not function as intended if the problems of interoperability and restrictive cut off times are not resolved.

#### **6. Financial Transaction Tax (FTT)**

The Committee discuss the effect a FTT would have on the repo/triparty market and consider what actions can be taken. It is noted that this a politically driven issue. It is suggested that, as a result, the market need to provide the authorities with an alternative tool to push their political agenda.

The detrimental effect of the FTT proposals is not fully understood but there is still sufficient political appetite to push a proposal through. The committee asks whether the proposals can be refined to make them more palatable and whether or not this will even be possible. Some feel that it remains essential to evidence the hugely negative effect of these proposals on the real economy.

The FTT proposals undermine the regulators' aims to shape efficient markets with secured funding and closely managed risk. It will be important to explain why repo activities are important and why transactions are short term and high volume. The officials proposing this don't appreciate the reason for all of these short term collateral movements and mean to discourage it. The market must explain why such funding is important and why these activities should be protected. Our reasoning must place repo in the context of real economy funding, e.g. banks funding themselves over night to account for deposit activity.

To the extent that individual firms have done their own studies into FTT impact, committee members are asked to send such studies to Richard Comotto (on a confidential basis). Mr Comotto is tasked with putting a paper together which should estimate the contraction of the short term repo market in Europe and explain the serious negative consequences for other financial markets and the real economy.

**7. FSB Shadow Banking workstream**

Mr De Vidts refers the committee to this morning's AGM presentations where this workstream was discussed.

**8. RepoFund Rate and Eurepo Fixing**

Mr. Romain Dumas and the Chairman provide feedback on their meeting with the EBF and the latest developments regarding the Eurepo Fixing. A working group comprised of representatives from 7 banks is looking into the development of [the Repo Fund Rate]. Participation from other banks is encouraged. If the ERC committee is supportive of this index then the EBF should be lobbied.

On the topic of Eurepo it is suggested that the EBF should issue a questionnaire asking for market feedback on this rate. This would likely confirm the lack of success of this benchmark and the EBF may confirm that Eurepo should be discontinued.

**9. Repo resolution authority**

The Committee discuss the recent comments of William C. Dudley, President and Chief Executive Officer, FRB NY, who has said:

*"Turning first to the issue of tri-party repo reform, there is still considerable work to do. In particular, the risk that investors will run at the first sign of trouble persists. That is because the costs of running are very low relative to the potential costs of staying put. The potential costs of staying are elevated in part because investors often don't have the capacity to take possession of the collateral or liquidate the collateral in an orderly way should a large dealer fail. Both aspects result in run risk, fire sale risk and potential financial instability.*

*Let me be clear. We must deal with the fire sale issue in tri-party repo and the heightened run risk it creates. I believe there are three potential ways forward, all of which are superior to the status quo. First, tri-party repo transactions could be restricted to open market operations (OMO) eligible collateral.<sup>11</sup> Such collateral would likely remain quite liquid during a time of crisis.<sup>12</sup> In addition, such collateral could, in a crisis, potentially be passed directly by a broker-dealer to the discount window under Section 13.13 authority, or, because of beneficial treatment under Section 23A of the Federal Reserve Act, be financed by a banking affiliate that would then itself borrow at the discount window. Thus, one could construct an effective lender of last resort backstop for an OMO-eligible- only tri-party repo system.*

*However, there are also some significant disadvantages to such an approach. The less liquid collateral could just migrate to be financed elsewhere, with associated run and fire sale risks. Also, given that housing finance reform could cause the agency debt and agency mortgage-backed securities (MBS) of Fannie Mae and Freddie Mac to be replaced by something different that was not OMO eligible under the Federal Reserve Act, the share of assets that are OMO eligible could diminish over time. Finally, this approach would do little to mitigate the risk of fire sales of a defaulted dealer's collateral by its investors once a dealer is bankrupt.*

*The second option is to have a mechanism or process to facilitate the orderly liquidation of a defaulted dealer's collateral. One could imagine a mechanism that was funded by tri-party repo market participants and potentially backstopped by the central bank. This would have the*

*advantage of dealing with the entire tri-party repo market and not artificially favoring one type of collateral over another. It would also push against the underpricing of liquidity and credit risk during good times by forcing market participants to pay for the costs of a liquidation facility up front.*

*Because no single market participant has a strong incentive to develop such a mechanism, however, sustained regulatory pressure may be required to reach such a solution. From the perspective of the tri-party repo borrowers and investors, the status quo undoubtedly is viewed as superior because neither group is forced to fully bear the externalities associated with their actions. Instead they anticipate that emergency liquidity would be made available in the event of a future systemic crisis.*

*Third, if borrowers and investors did not embrace an orderly collateral liquidation mechanism, supervisory oversight could be brought to bear to limit the use of tri-party repo funding on the grounds that it is still an unstable source of funds. For example, the use of tri-party repo could be restricted unless borrowers demonstrated that there was an adequate means of orderly collateral liquidation upon the failure of a major dealer.”*

The committee discuss whether we need to worry about this approach being taken in Europe? It is noted that a lot of negative discussions about repo arise out of the analysis of problems in the US tri-party market being projected onto the European market.

It is highlighted that the FSB consultation paper discussed the idea of a repo resolution authority but concluded that this would not be further developed at this stage. This does not mean that the market should dismiss the possibility. It is queried whether there are trade-offs here which the market should explore? Would the establishment of a repo resolution authority ease other areas of concern where regulatory intervention would be more damaging to the market?

The Chairman asks the committee to consider this issue for further discussion at the next committee meeting.

#### **10. Negative interest rate repo fails**

The Committee discuss proposals for an ERC Recommendation on the active management of fails to incentivise timely settlement.

The committee notes that the market is awaiting the publication of the EACH proposals in relation to fails. In the meantime, the market may be able to normalise their views with engagement with brokers, CCPs and cash market industry groups. There must be harmonisation between the regimes for CCPs, in the cash market and under the GMRA.

John Serocold reports that discussions within ICMA's Secondary Market Practices Committee have resulted in a proposal for an auction buy-in procedure. The challenge will be to trigger such a procedure in a timely manner so as to avoid a mismatch with the repo market. As this idea develops, Mr Serocold will keep the ERC committee informed.

#### **11. Monte Titoli**

The committee is referred to the presentation given by Tony Platt at this morning's AGM.

**12. ERC Operations Group update**

The committee is referred to the presentation given by Nicholas Hamilton and Tony Platt at this morning's AGM.

A housekeeping matter is raised in relation to attendance of and participation in the ERC Operations Group. Committee members are asked to speak with their Operations colleagues to ensure that they are proactively engaging in this forum.

**13. Repo Guide to Best practice**

Mr. Comotto updates the Committee on the progress that has been made on the draft Repo Guide to Best Practice (previously named the Repo Code of Conduct), on which Mr. Michel Semaan and Mr. Guido Stroemer have been providing comments. The draft will be circulated for comments in the course of the next week. Mr Comotto highlights a recent enquiry from the Bank of England about the scope to merge the Repo Guide to Best Practice with the Gilt Repo Code and Securities Lending Code. The committee is asked to consider this when providing feedback on the draft.

**14. Legal update**

The committee is referred to the presentation given by Lisa Cleary at this morning's AGM.

**15. Regulatory update**

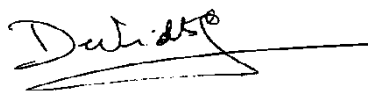
The committee is referred to the presentation given by David Hiscock at this morning's AGM.

**16. AOB and upcoming dates**

A further ERC Committee meeting is proposed to be held on **18 June 2013**, in the margins of ISLA's annual conference in **Prague**. \*An interim meeting has since been arranged on 7 May at ICMA's offices in London.

2 May, 2013  
CL/rt

The Chairman:



Godfried De Vidts

The acting Secretary:



Lisa Cleary