



ICMA

International Capital Market Association

Opening & Update on recent developments

Godfried De Vidts, Chairman of the ERC

**European Repo Council
General Meeting**

**Amsterdam
27 October 2010**

- **Numerous consultations – we responded where appropriate**
- **Conference call with Commission re short selling**
- **ERC White Paper as a response to many regulatory debates ensuring a comprehensive overview of the impact on the repo markets.**
- **IOSCO Technical Committee with industry stakeholders**
- **CPSS report « Strengthening repo clearing and settlement arrangements » was published**

Updates for members of the European Repo Council

- **Spanish market endorses CCP model**
- **Awaiting Greece**
- **SLRC asked to extend our survey to include evergreen repo's**
- **Next survey Dec 9th**
- **Euro GC – Estonia to join Jan 2011**
- **Regulatory agenda remains important**
- **Next meeting to be hosted by JPMorgan Chase in Paris February 15th (TBC)**



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Contacts

Thank you, Ladies and Gentlemen

Contacts and information:

<http://www.icmagroup.org/getdoc/22ac9685-388f-426d-9074-56c63ed5c156/European-Repo-Council.aspx>



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Patrick Pearson

Head of Financial Markets Infrastructure Unit (Unit G2)
European Commission's Internal Market Directorate General





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Update on Regulatory Issues

David Hiscock, ICMA



**European Repo Council
General Meeting**

**Amsterdam
27 October 2010**

European Market Infrastructure Regulation (“EMIR”)

- European Commission published its consultation paper “**Derivatives and Market Infrastructures**”, on 14.06.10
 - In preparation for a European Market Infrastructure Regulation (“EMIR”)
 - ERC submitted a response concerning the repo oriented aspects
- European Commission published its EMIR proposal - “**Regulation on OTC derivatives, central counterparties and trade repositories**”, on 15.09.10
 - EMIR proposal is a Regulation (i.e. directly applicable across the EU)
 - Proposed scope of the Regulation is wide
 - Certain exemptions are explicitly foreseen
- The aim is for the new rules to be effective as of 2013

EMIR – Article 47.1

- Settlement
 - 1. **A CCP shall, where available, use central bank money to settle its transactions.** Where central bank money is not accessible, steps shall be taken to strictly limit credit and liquidity risks
- There is no doubt that this proposed article will receive further scrutiny, including from central banks, as the draft Regulation moves through the European legislative process
- We are concerned that this provision is not properly articulated and suggest that amendment is necessary
 - We strongly encourage you to review this with your policy teams as the impact is potentially substantial and could prove negative for the markets

CPSS – Strengthening repo clearing and settlement

- Committee on Payment and Settlement Systems issued “**Strengthening repo clearing and settlement arrangements**”, on 15.09.10
 - Presents a **comprehensive survey of the clearing and settlement arrangements for repos** in selected CPSS member countries
 - **Identifies several issues** related to clearing and settlement arrangements for repos that have the potential to affect the resilience of repo markets
 - **Outlines options and measures** to address these issues

International standards for CCPs

- CPSS and IOSCO published their consultation “**Guidance on the application of 2004 CPSS-IOSCO Recommendations for Central Counterparties (CCPs) to OTC derivatives CCPs**”, on 12.05.10
 - ERC responded concerning repo oriented aspects of this
 - CPSS-IOSCO published the submissions received
- This work will be incorporated in their general review of international standards for financial market infrastructures
 - Launched by CPSS and IOSCO in February

“Large exposures” – treatment of CCP exposures

- CCPs exposures have markedly increased significance as reforms are promoted to incentivise and/or require their greater usage
 - In March ERC responded to the UK FSA’s CP09/29, seeking clarification regarding the treatment of “large exposures” to CCPs
 - FSA CP10/17 “Strengthening Capital Standards 3” includes CP09/29 feedback
 - **It appears that the UK FSA (and CEBS) are affirming that, where possible, large exposures to CCPs will benefit from exceptional treatments**

European Commission – short selling proposals

- Commission launched a “**short selling**” public consultation, on 14.06.10
 - ERC responded by submission of a copy of its 13 July “White Paper”
- Commission issued a **draft legislative proposal** on 15.09.10
 - Proposes a two-tier transparency model
 - Persons entering into short sales of shares or sovereign debt must, at the time of the sale, have borrowed (or arranged to) the instruments ready to settle
 - Trading venues must ensure there are adequate arrangements in place for the buy-in of shares or sovereign debt where there is a failure to settle
 - Certain exemptions are provided for
 - Competent authorities have certain incremental emergency powers
 - Aim is for new rules to be effective from July 2012

Short selling proposals – Article 13

- The draft Regulation **places the onus on the trading venue (or CCP) to buy-in applicable securities** to ensure delivery for settlement
 - The trading venue is also required to pay cash compensation to the buyer
- **We consider that it should not be the trading venue that buys-in the securities, or imposes/quantifies penalties**
 - Buy-in procedures are established in legal frameworks like the GMRA
 - They need a sound legal basis, as is already the case with the two ICSDs
 - Best practice should be extended to the national CSDs
- We are concerned that this provision is not properly articulated and suggest that amendment is necessary
 - We strongly encourage you to review this with your policy teams as the impact is potentially substantial and could prove negative for the markets

Strengthening the resilience of the banking sector

- Basel issued consultation on **capital and liquidity**, on 17.12.09
 - Parallel European Commission consultation issued 26.02.10
 - ERC responded to both, from a repo market perspective
- Basel announced broad agreement on these reforms on 26.07.10
 - Further announcement on 12.09.10 regarding calibration and timing

Markets in Financial Instruments Directive (“MiFID”)

- CESR’s **Technical Advice to the European Commission in the Context of the MiFID Review** and Responses to the European Commission Request for Additional Information were published on 29 July
 - Areas covered by the MiFID review include:
 - Transparency pre & post trade – both equity & non-equities securities
 - Transaction reporting
 - Underwriting and placing
 - Client classification and counterparties
 - Investor protection and intermediaries
 - Further CESR advice papers / feedback published 13 October
- European Commission consultation paper (November) and legislative proposals (April 2011) will now follow

Potential new UK resolution rules for failing entities

- HM Treasury proposals to strengthen the UK's ability to **deal with any future failure of an investment bank**, issued on 16.12.09
 - Follows from a consultation exercise conducted earlier in 2009; and
 - Builds on steps taken in the 2009 Banking Act to resolve failing retail banks
 - ERC submitted its response on repo specific aspects
- HM Treasury launched a further consultation, “**Special administration regime for investment firms**”, on 16.09.10
 - Being carefully considered, particularly from a legal perspective
 - check for any contradiction of the rights which repo creditors would expect to enjoy

Thank you, Ladies and Gentlemen

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Legal Update

Lisa Cleary, ICMA Ltd

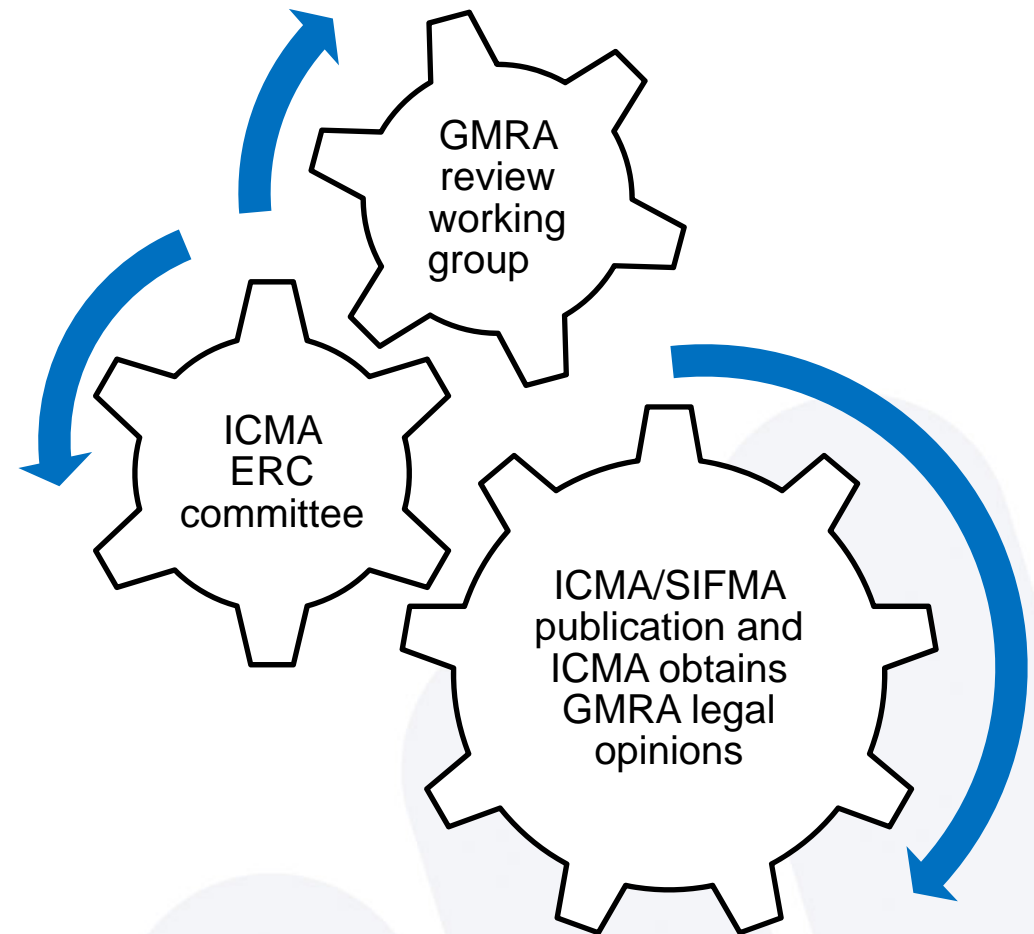


- The Global Master Repurchase Agreement responded well to the challenges of the financial crisis.
- In order to ensure that the agreement remains the foremost industry standard master agreement for the cross border repo market, ICMA's European Repo Committee put together a working group to consider whether any amendments are necessary to the 2000 version of the agreement.

- In regular meetings over the last year, the working group has considered various factors including:
 - lessons learned from the financial crisis;
 - amendments made to other master agreements;
 - bilateral feedback of GMRA users; and
 - recommendations recently published by the European Financial Markets Lawyers Group (EFMLG).

- The changes range from administrative amendments (e.g. systems references), to amendments which affect the key provisions of the agreement.
- Issues & ideas being considered include, in particular:
 - Elective and automatic events of default;
 - Additional events of default;
 - Change to default notification;
 - Introduction of cross default clause.

- GMRA review working group draft proposal
- ICMA ERC committee consultation
- ICMA/SIFMA publication
- ICMA commission 2011 legal opinion exercise, including coverage of GMRA 2010



- ICMA is coordinating a project to establish a system whereby financial institutions may use bilateral and syndicated loans as repo collateral under the GMRA.
- This project represents an important innovation in the financial markets and will have long term implications for the stability of the financial systems.

- Basic principles:
 - A borrower under a loan appoints a person with access to the clearing system to act as its agent.
 - The loan is ‘immobilised’ in the clearing system and full legal title will be transferred exclusively by means of matching ‘buy’ and ‘sell’ instructions entered into the clearing system by eligible counterparties.
 - Payments under the loan are made through the clearing system to the person recorded as the legal owner of the loan in the clearing system.
 - The terms of the loan and the rules of the loan repo system will form a single agreement between the borrower, the clearing system, the lender and the repo counterparty.

- Directive 2009/44/EC dated 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims.
- Main provisions:
 - extends settlement finality to “credit claims” (i.e. loans)
 - no clawback on insolvency for transfers through clearing system
 - “credit claims” treated as “financial collateral” that can be appropriated to satisfy a debt without formality/court proceedings
 - no registration requirements (BUT no mandatory exception from formalities connected with ensuring enforceability of transfers as against borrower/obligor under loans)

- In 2011 ICMA expects to obtain opinions on the GMRA 1995, 2000 & 2010 in 62 jurisdictions.
- Opinions address enforceability of netting provisions and recharacterisation risk.
- Basic counterparty coverage (companies, banks and securities dealers) and extended counterparty coverage (also includes insurance companies, hedge funds and mutual funds).
- Opinions available at: <http://www.icmagroup.org/legal>

Thank you, Ladies and Gentlemen

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European Repo Council

19th European repo market survey
conducted in June 2010



Headline numbers

- **June 2010** **EUR 6,979 billion**
- December 2009 EUR 5,582 billion
- June 2009 EUR 4,868 billion
- December 2008 EUR 4,633 billion
- June 2008 EUR 6,504 billion
- December 2007 EUR 6,382 billion
- June 2007 EUR 6,775 billion
- December 2006 EUR 6,430 billion
- June 2006 EUR 6,019 billion
- December 2005 EUR 5,883 billion
- June 2005 EUR 5,319 billion
- December 2004 EUR 5,000 billion
- June 2004 EUR 4,561 billion

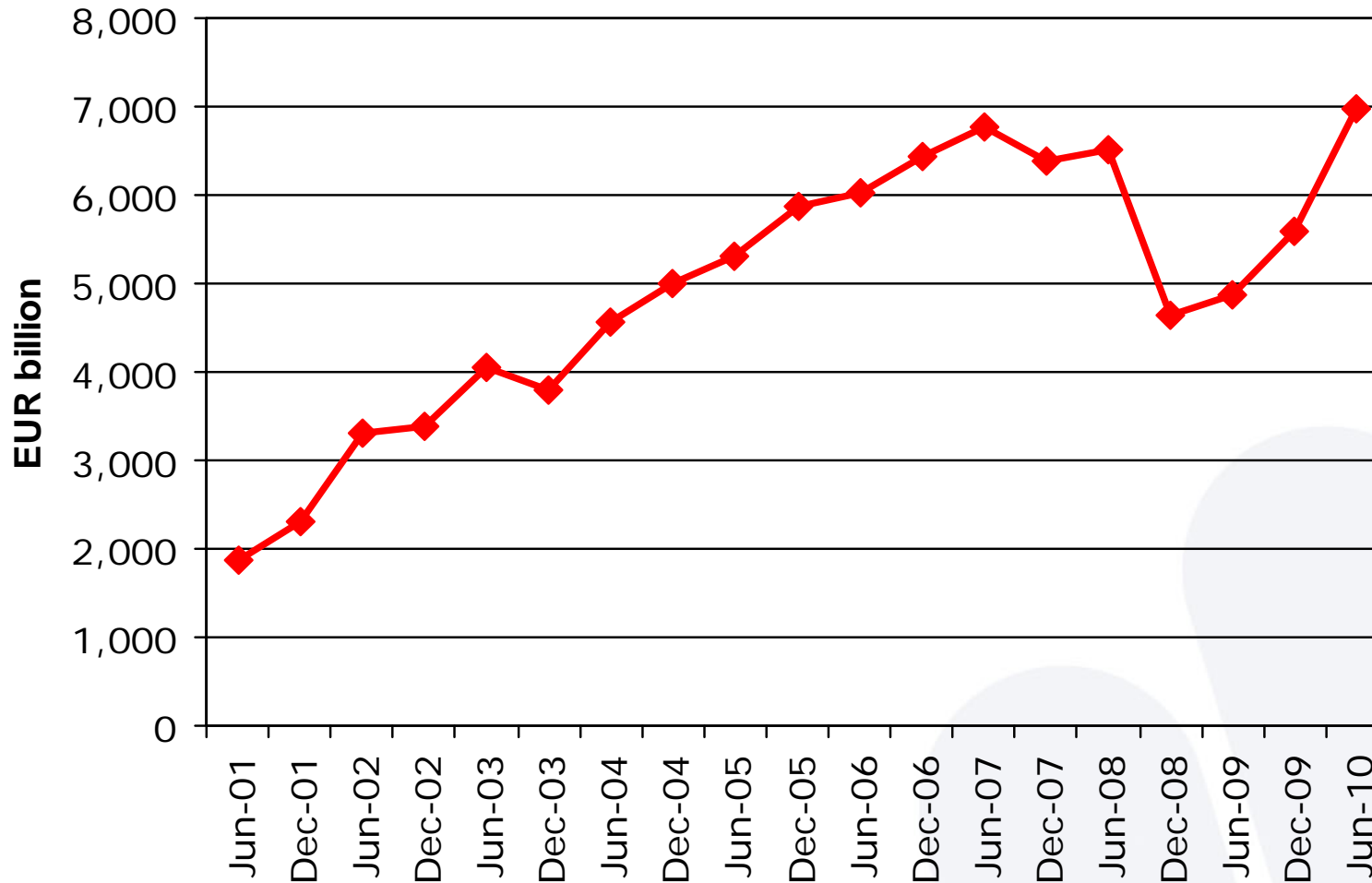


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19th European repo market survey conducted in June 2010

Headline numbers



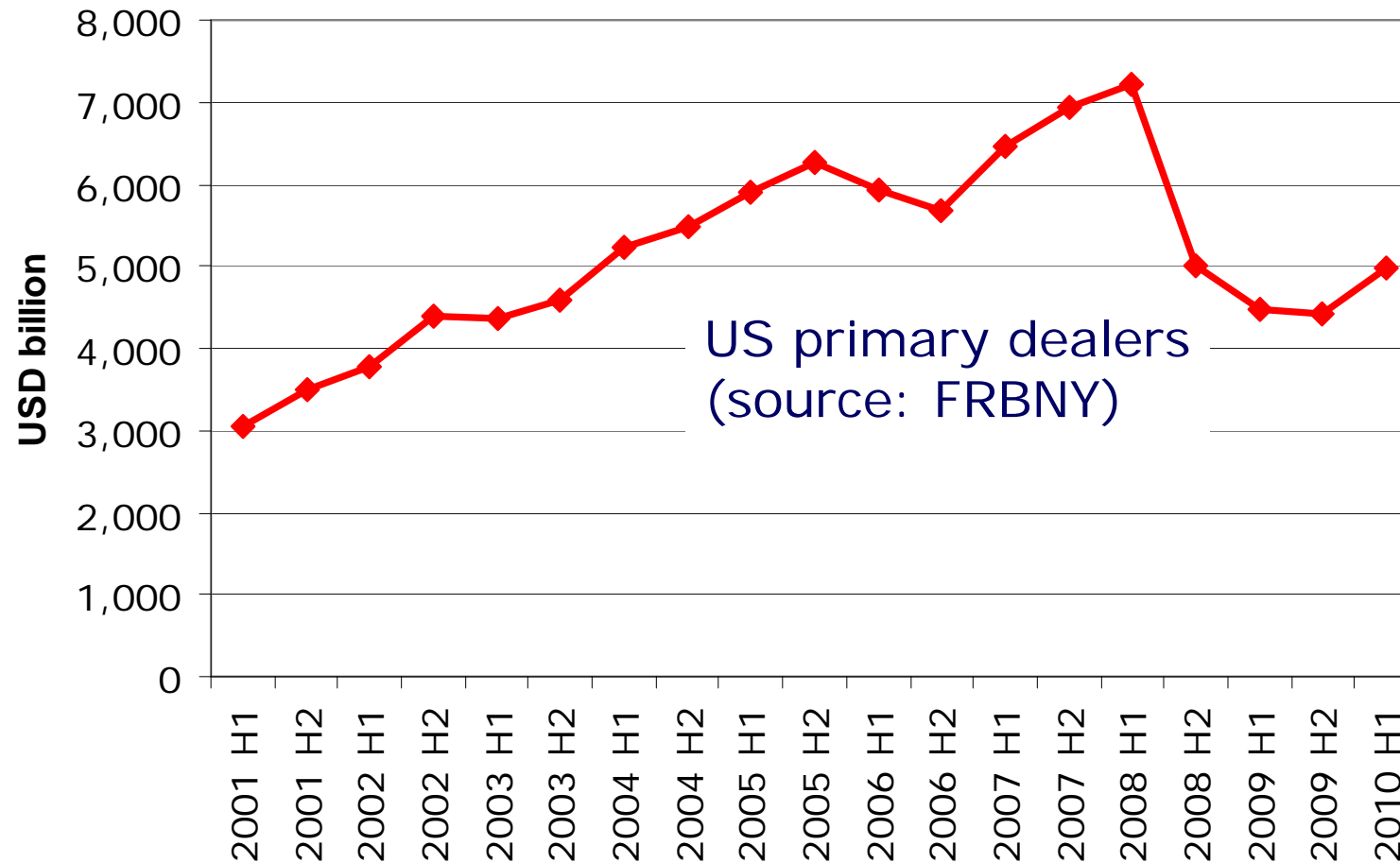


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19th European repo market survey conducted in June 2010

US market





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Comparable market growth

- 50 respondents in last 3 surveys
 - +43.0% year-on-year
 - +29.7% since June 2009



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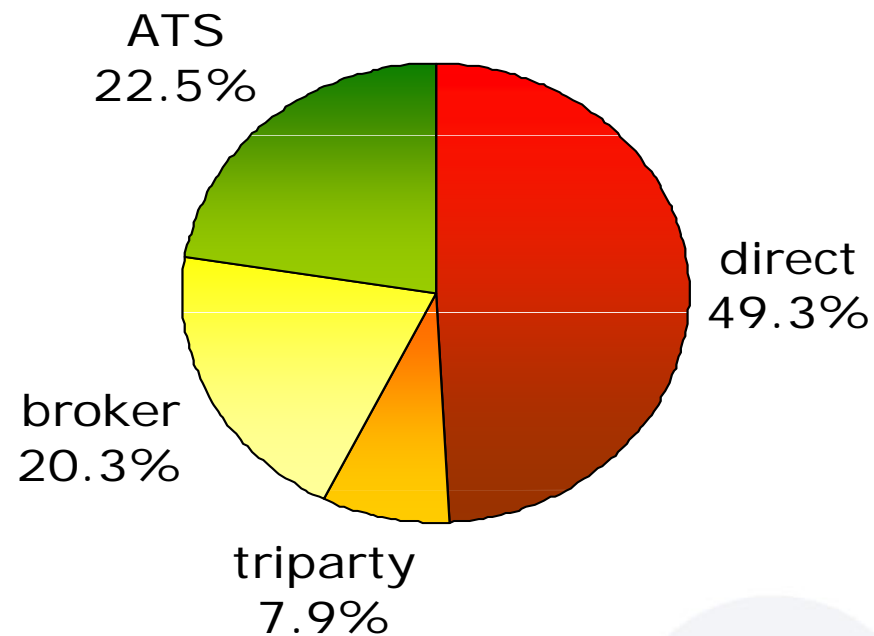
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19th European repo market survey conducted in June 2010



Counterparty analysis



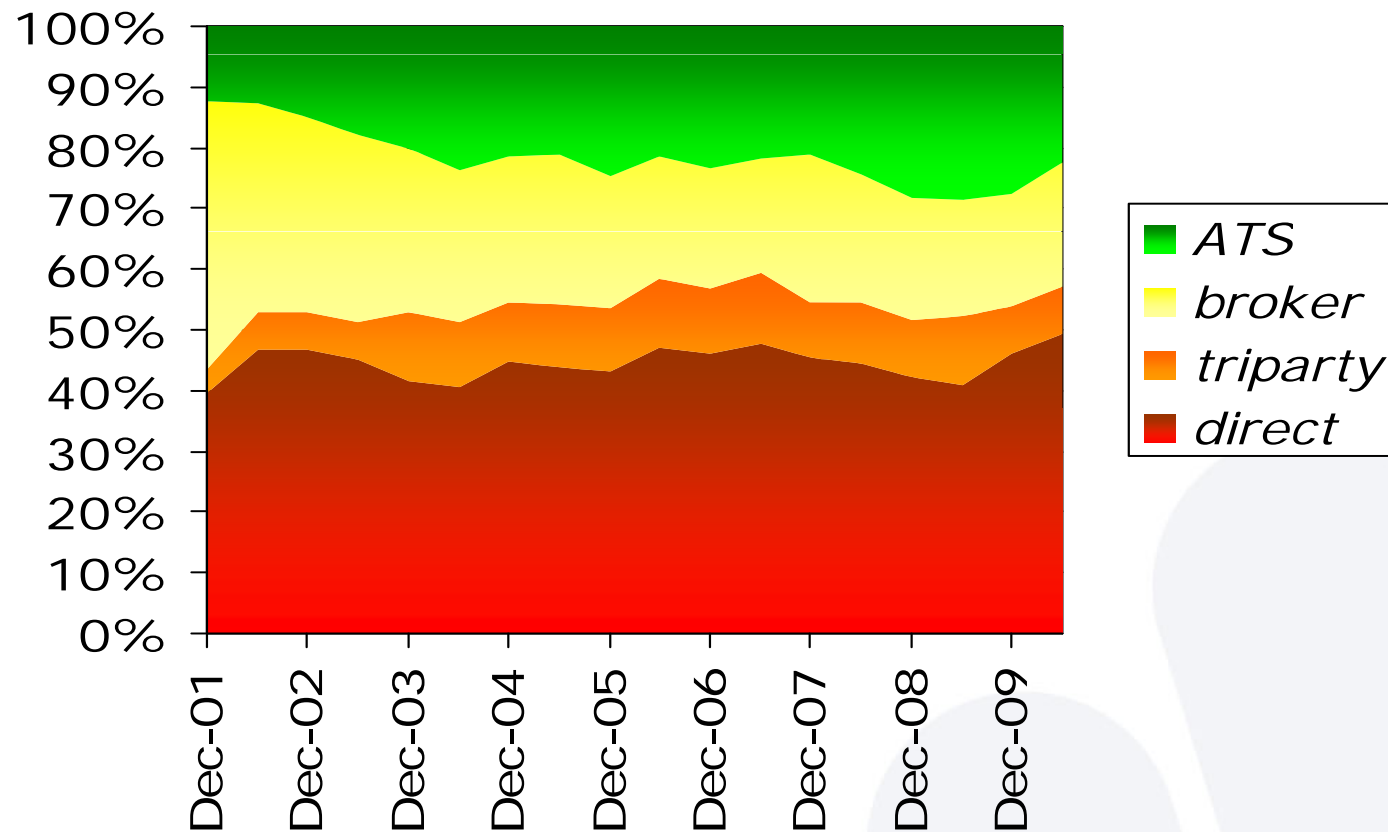


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Counterparty analysis



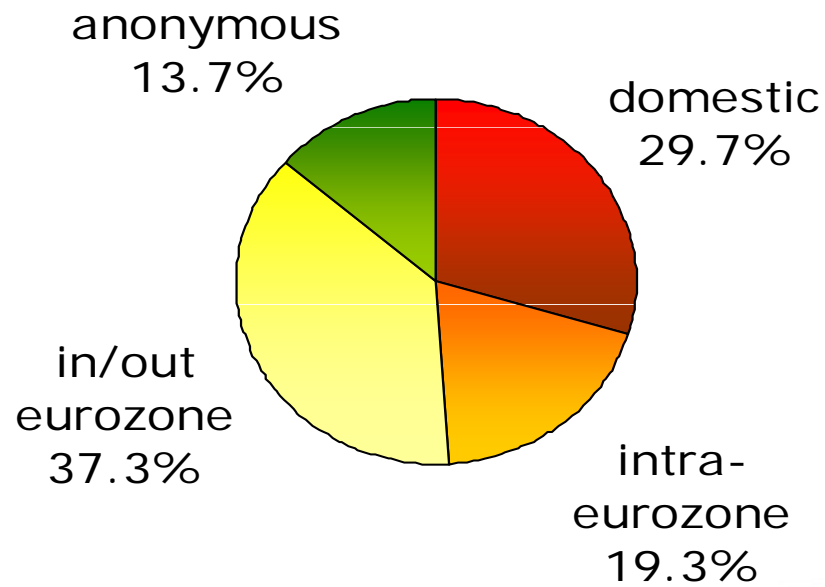


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19th European repo market survey conducted in June 2010

Geographical analysis



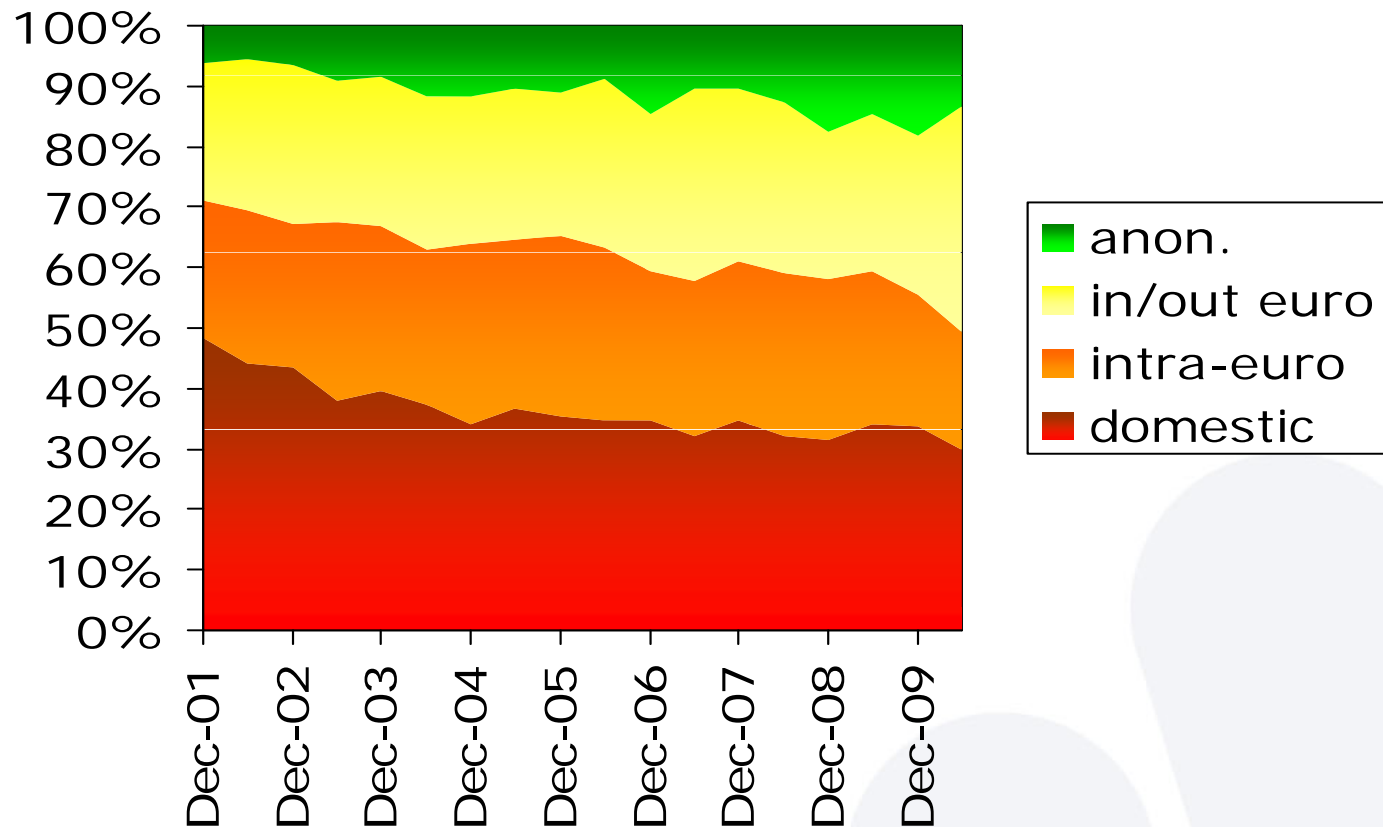


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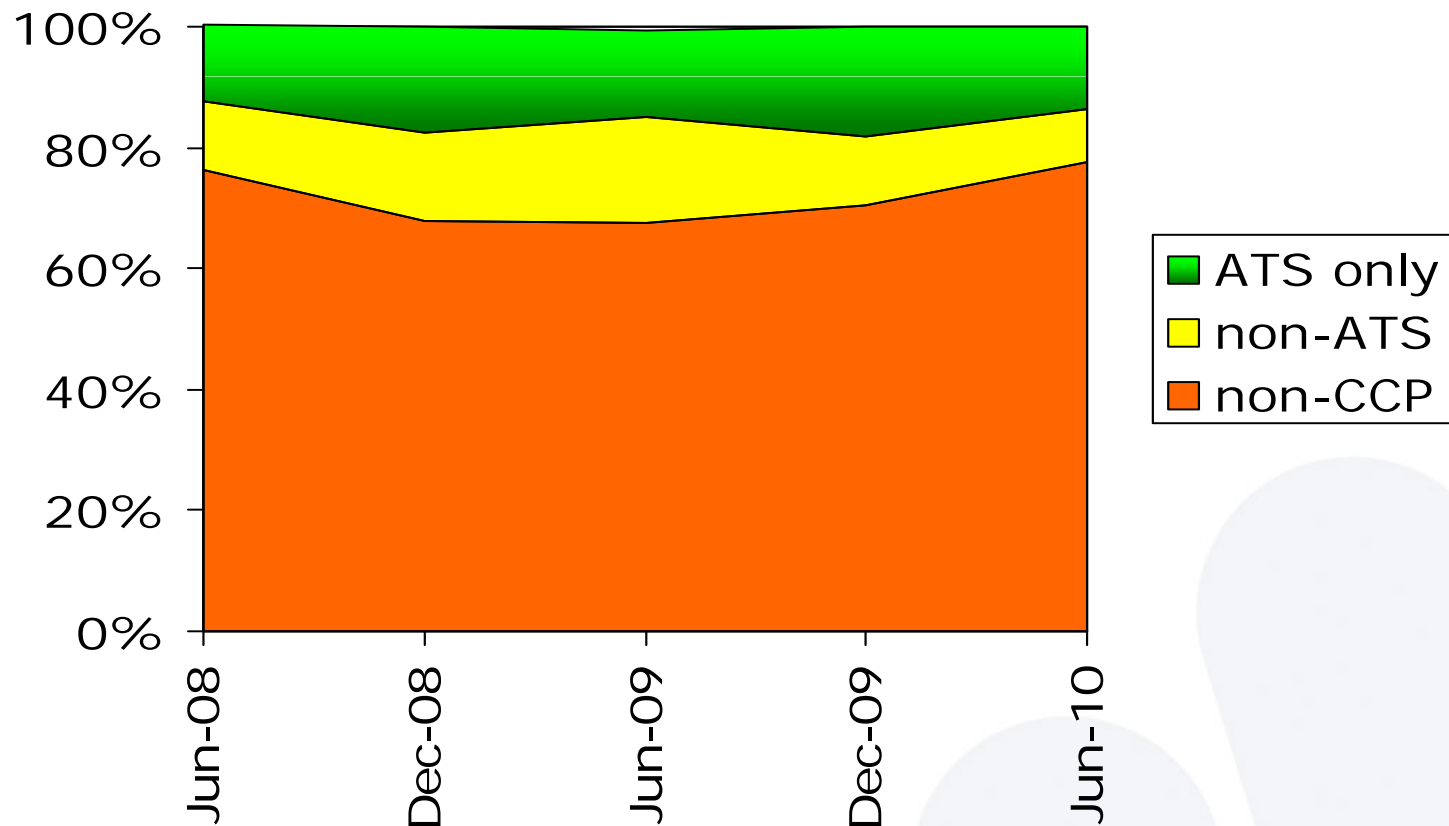
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19th European repo market survey conducted in June 2010

Geographical analysis



Business cleared across CCP



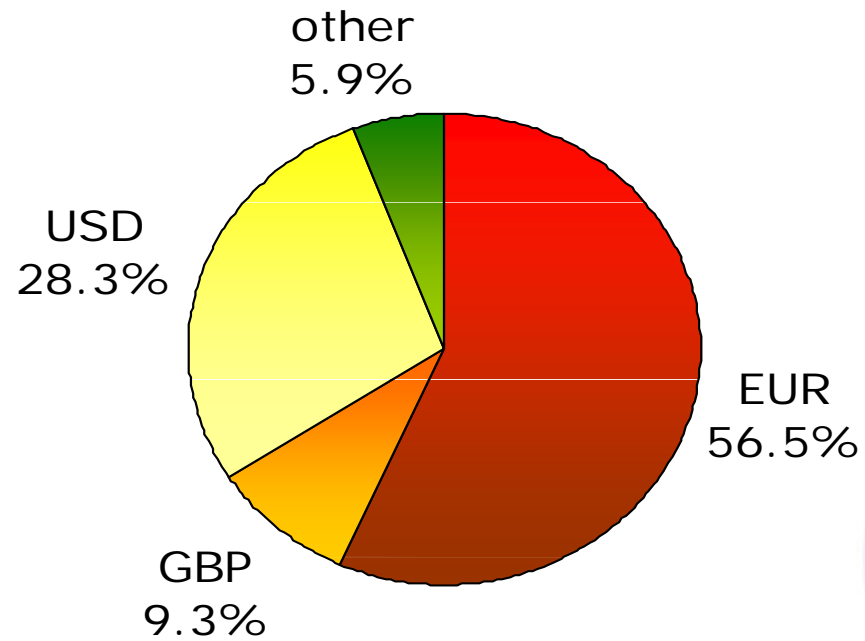


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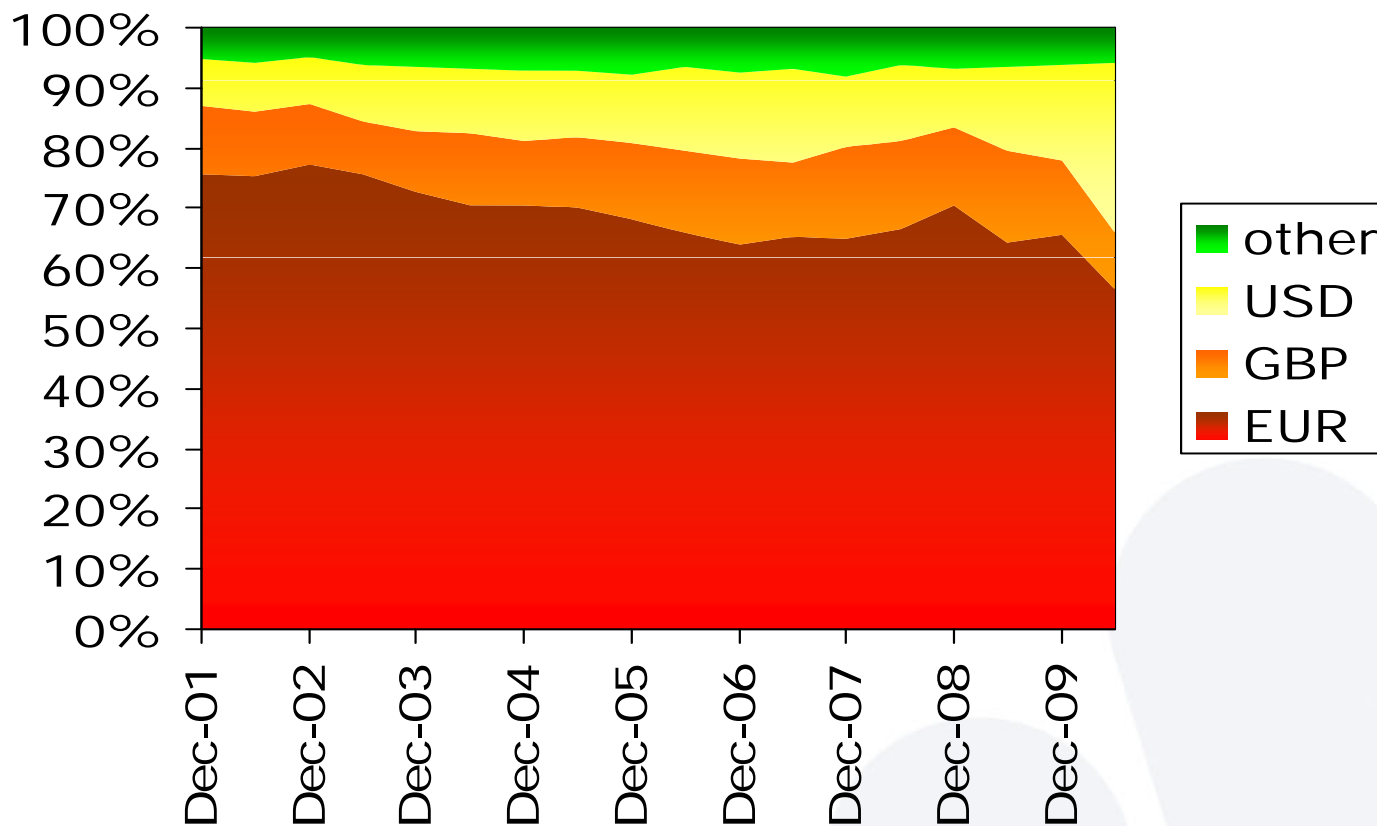
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Currency analysis



Currency analysis



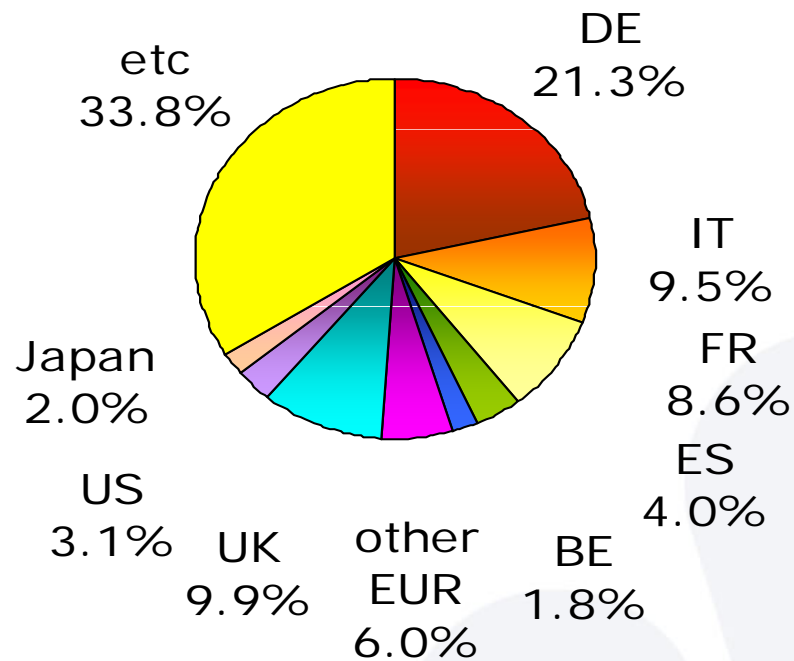


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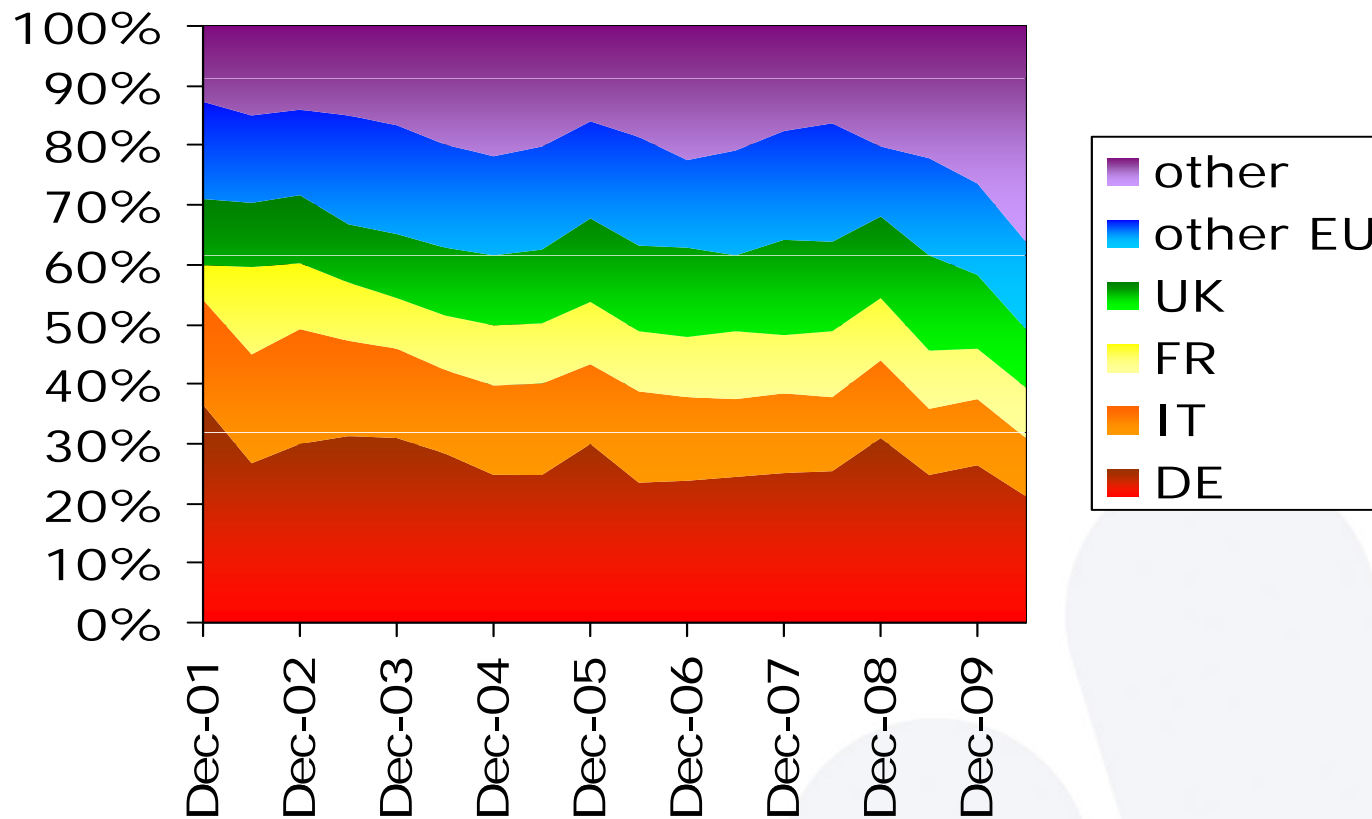
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Collateral analysis

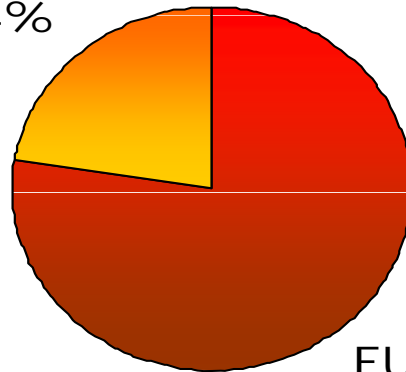


Collateral analysis



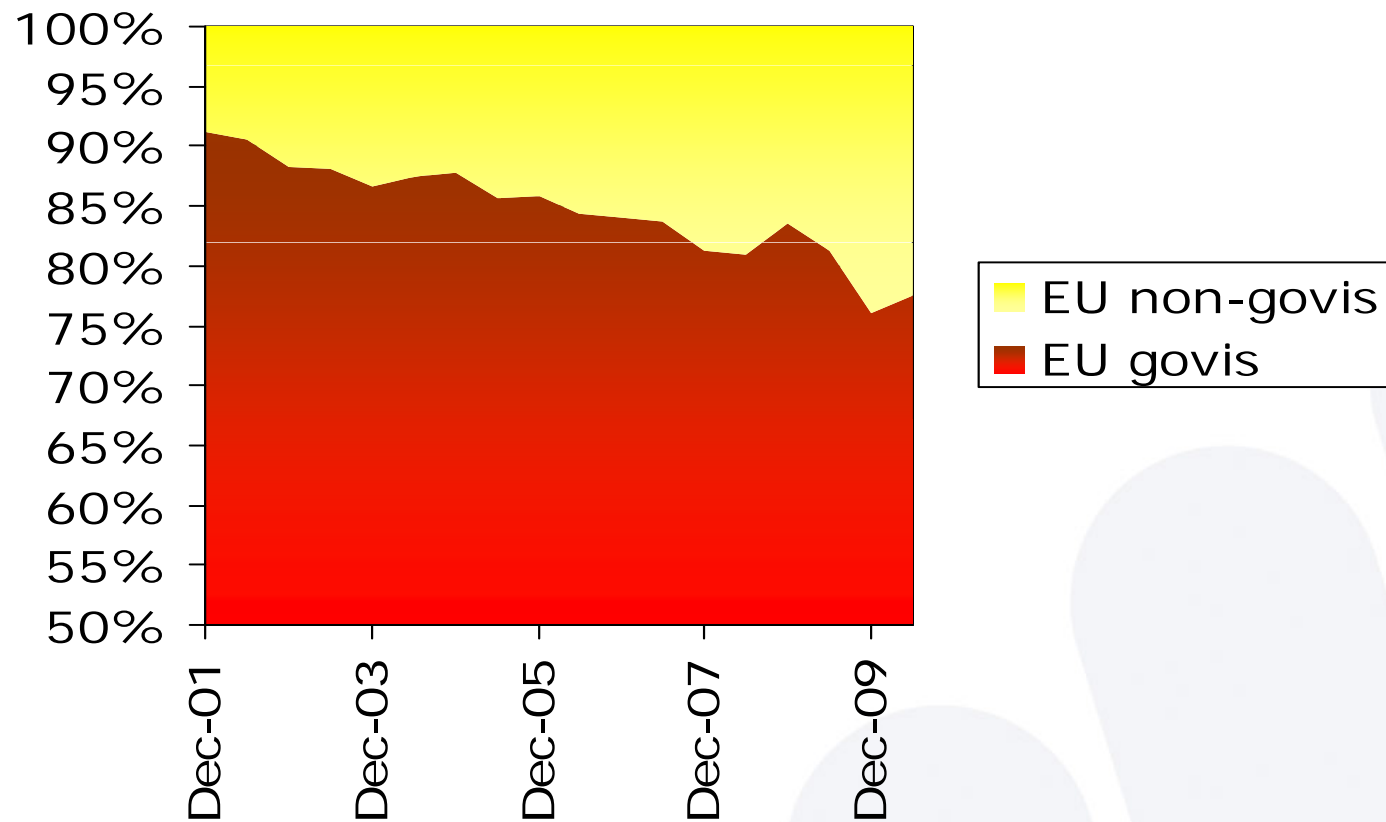
Collateral analysis

EU non-
govis
22.4%



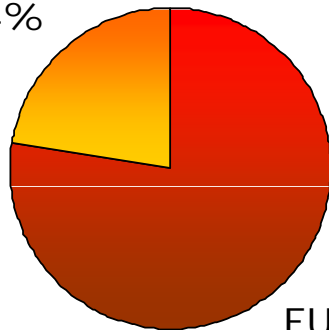
EU govis
77.6%

Collateral analysis



Collateral comparison

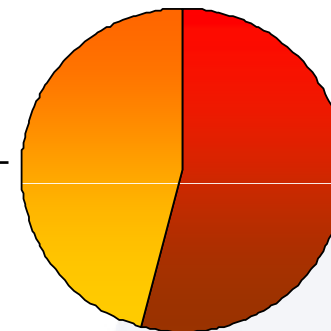
EU non-
govis
22.4%



EU govis
77.6%

banks

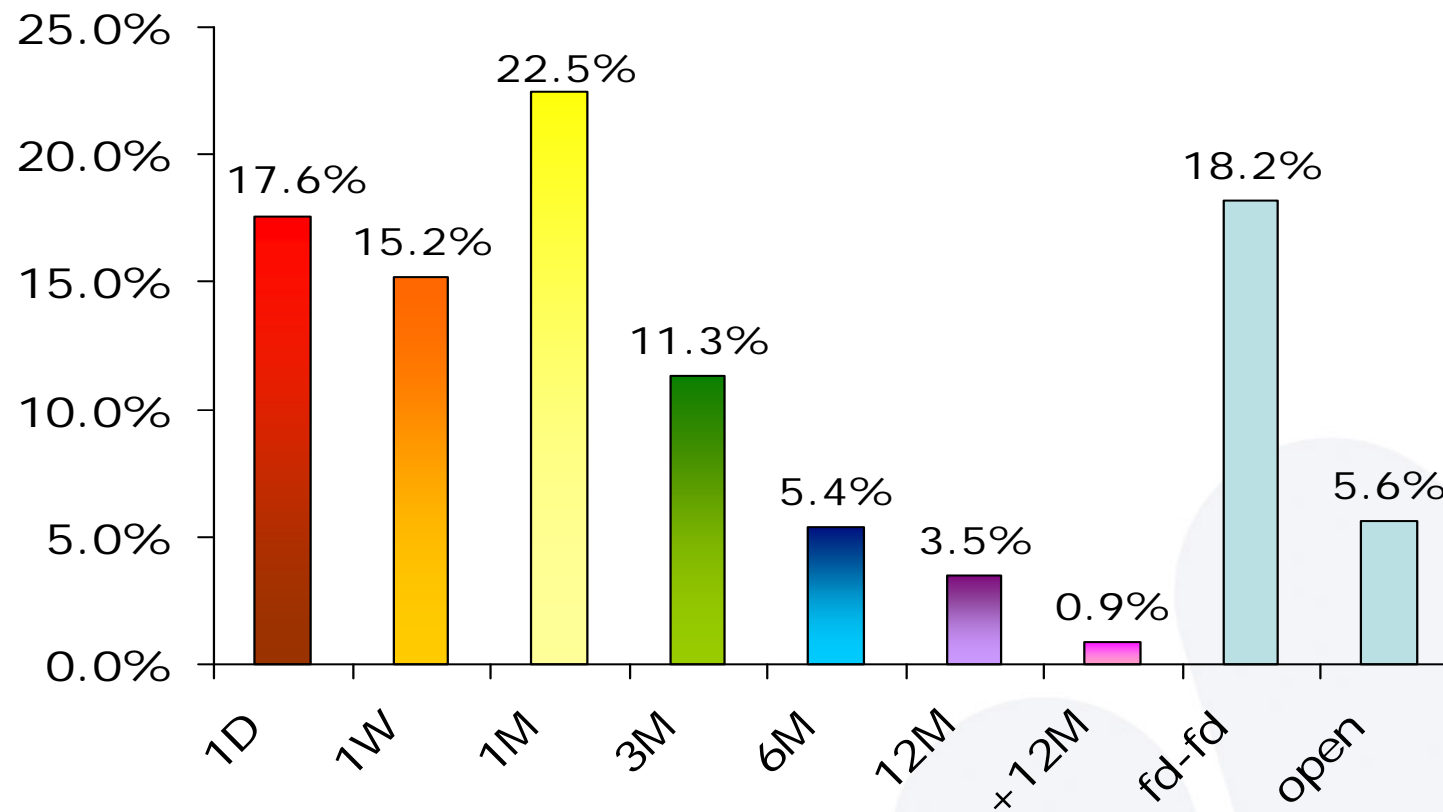
EU non-
govis
45.7%



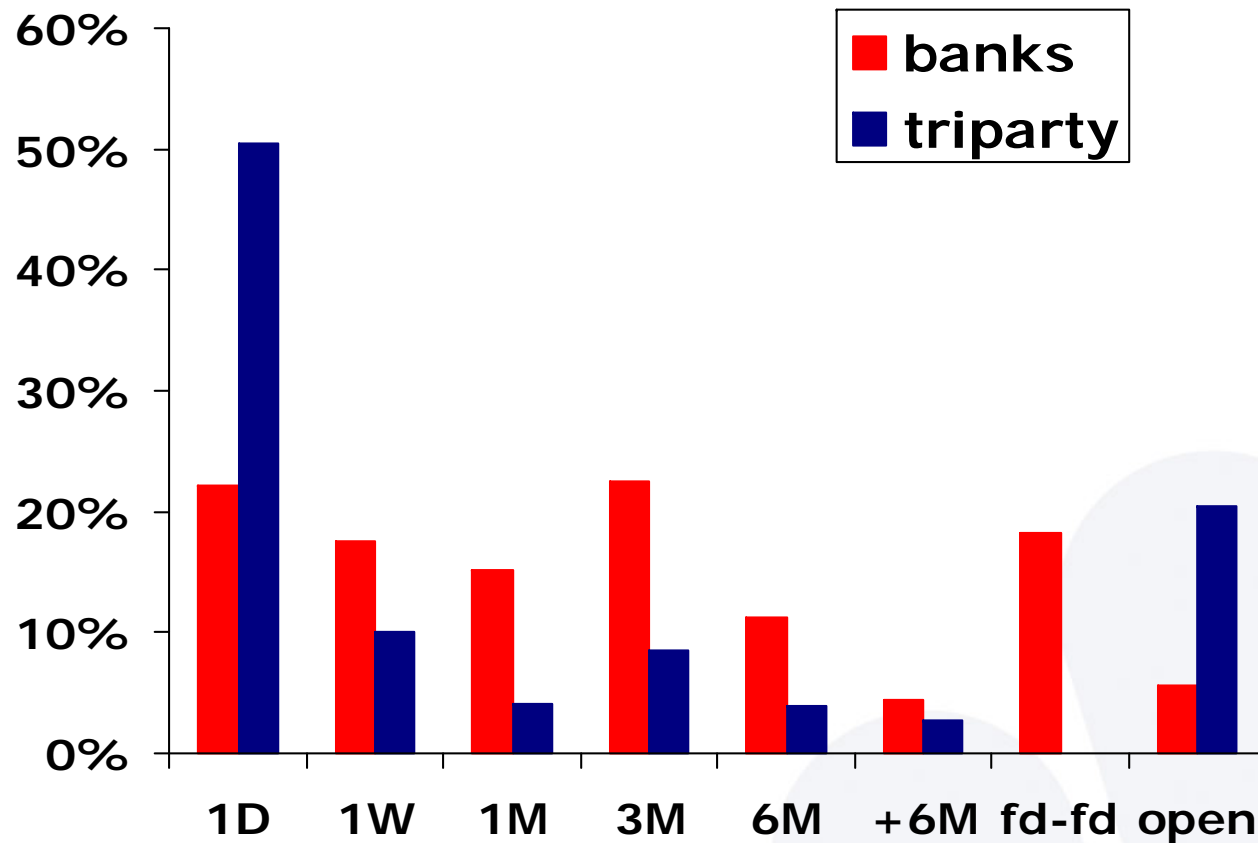
EU govis
54.3%

triparty

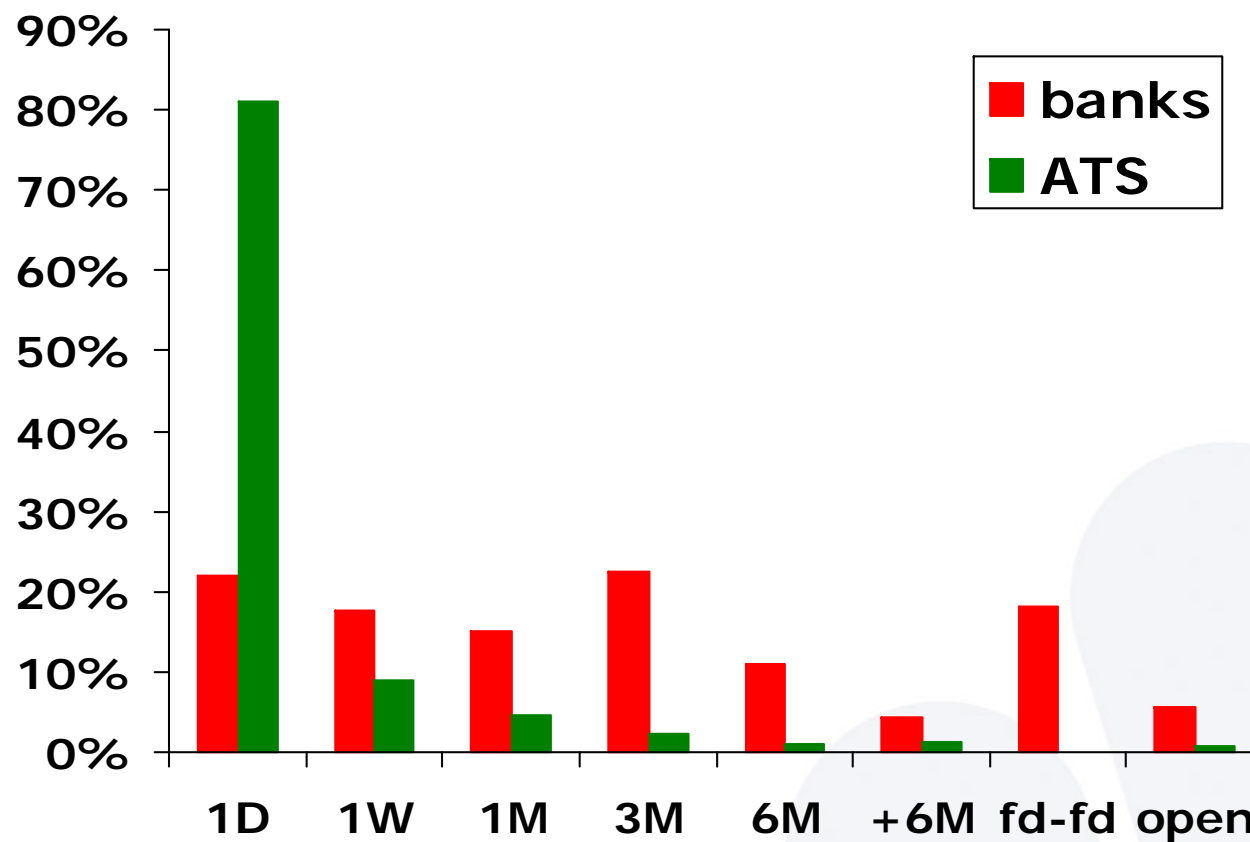
Maturity analysis



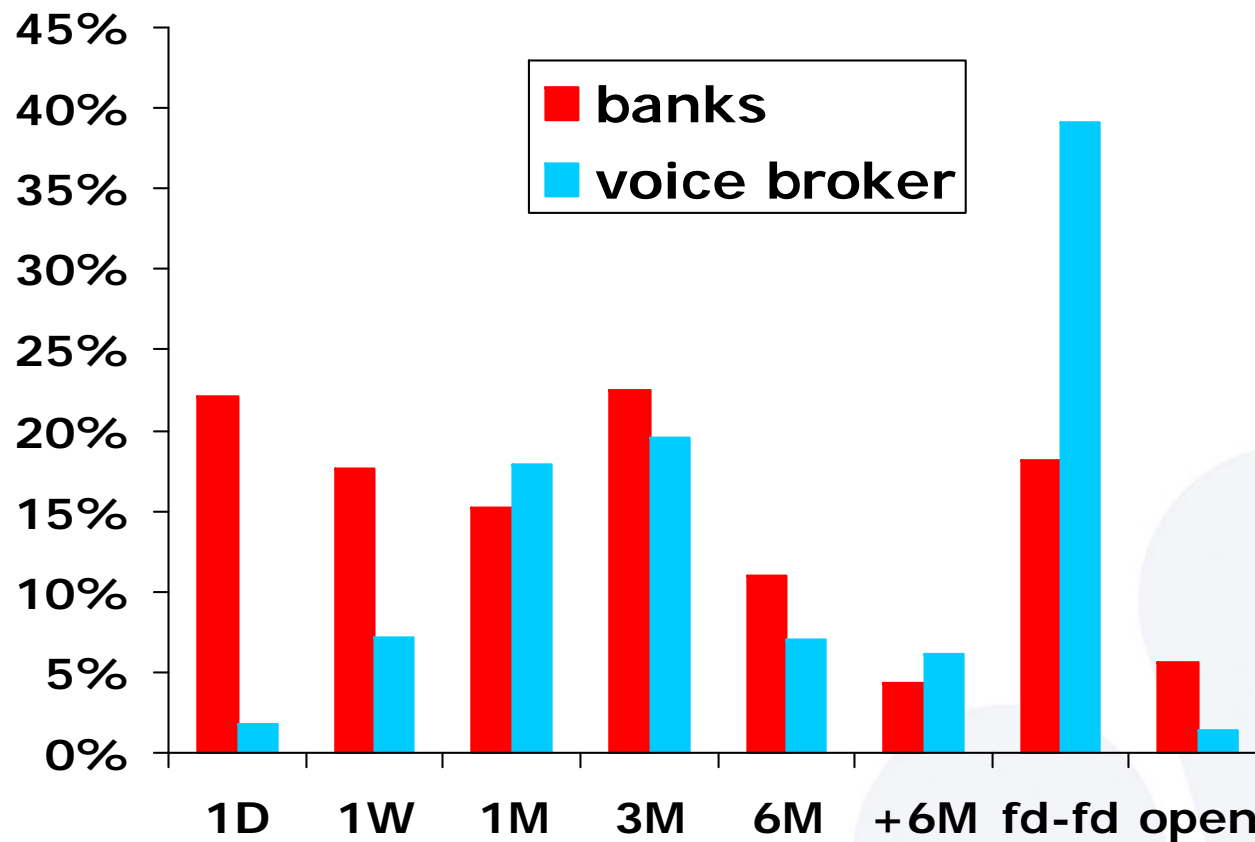
Maturity comparison



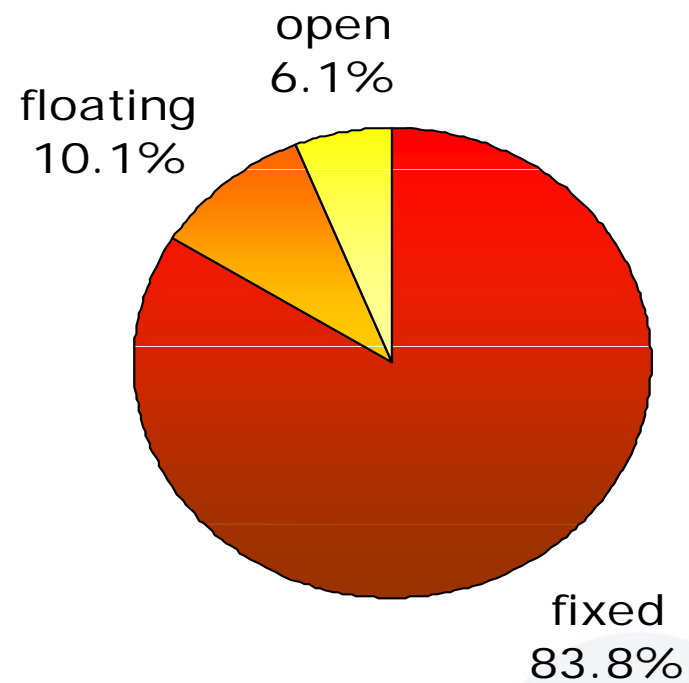
Maturity comparison



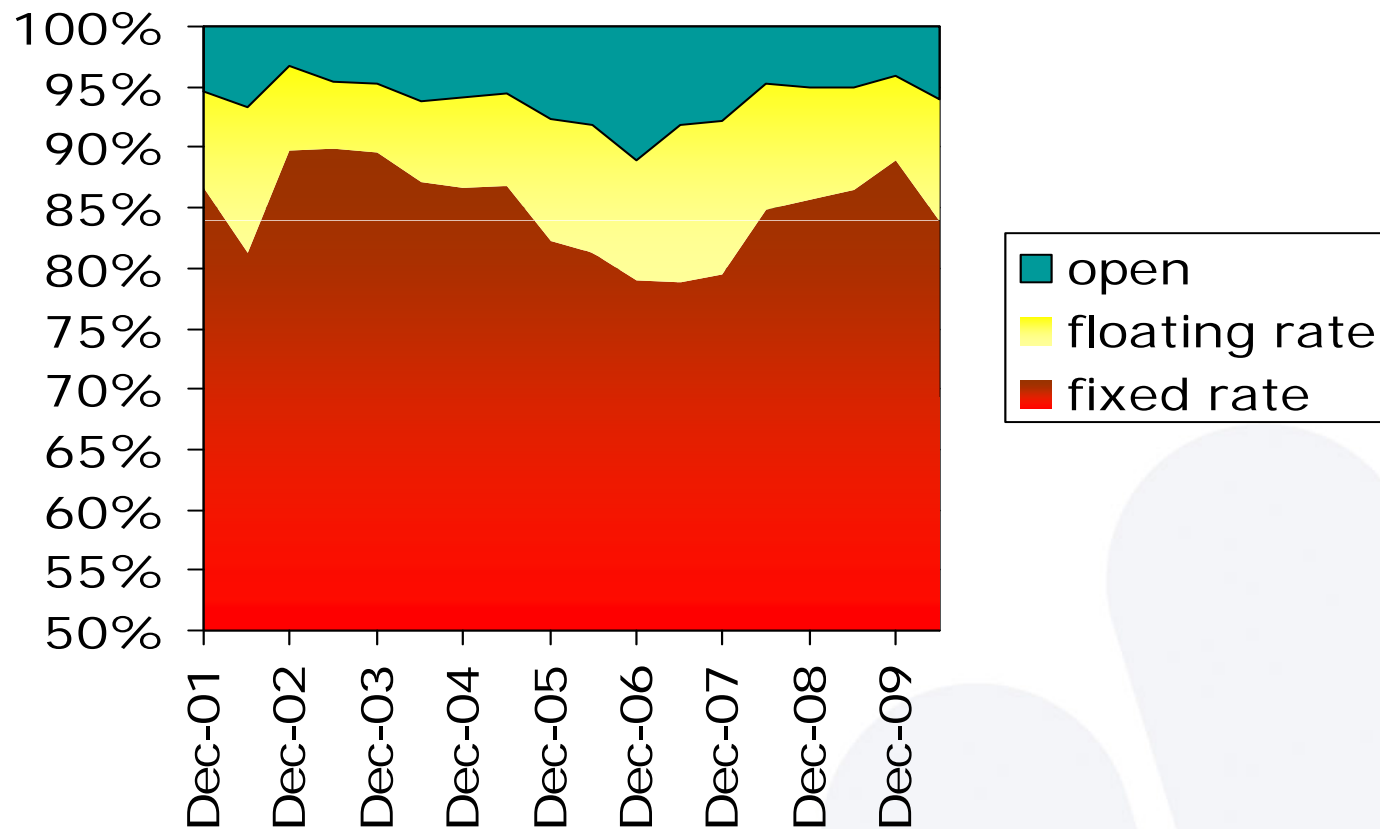
Maturity comparison



Rate analysis



Rate analysis



Next survey

Wednesday, 9th December 2010



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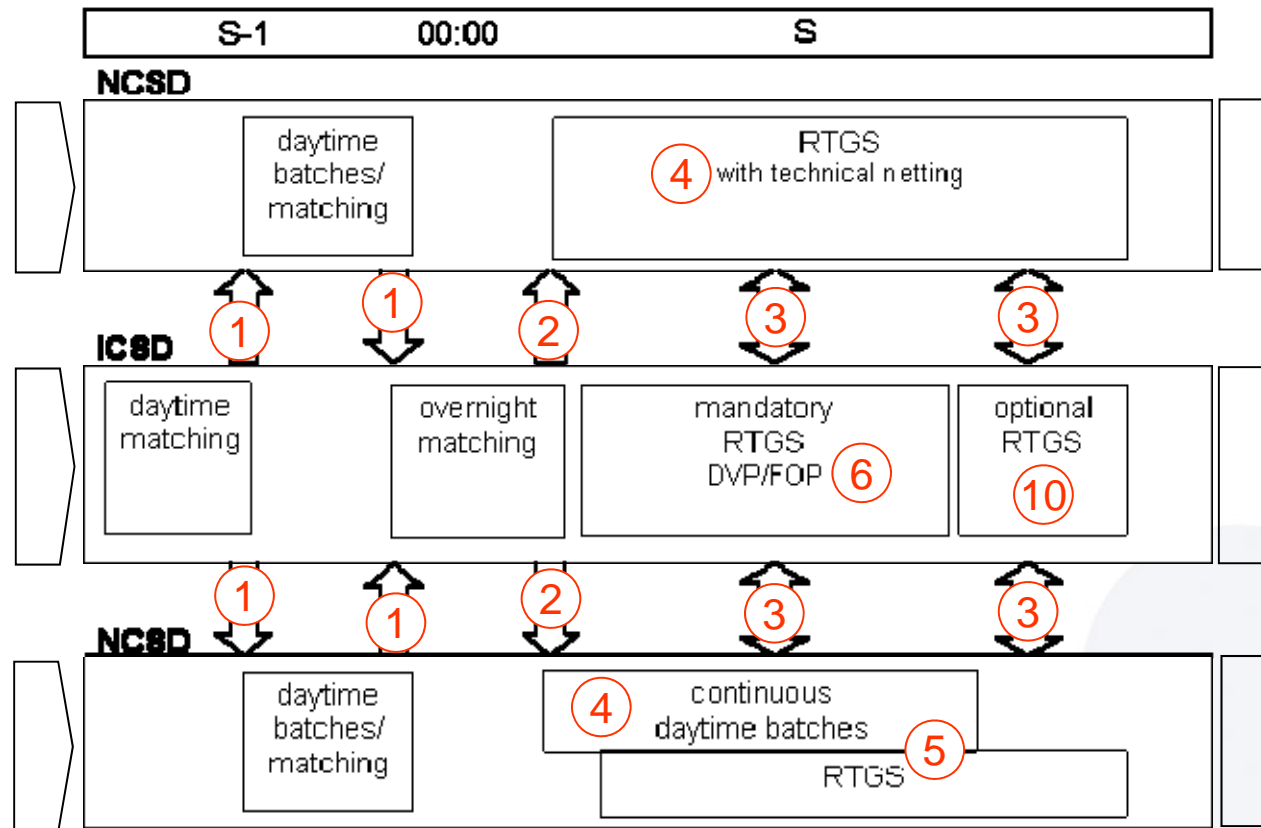
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The White Paper

- The role and importance of the repo market
- The special repo market
- The role of short-selling
- Uncovered short-selling
- Failure to deliver in the repo market
- Infrastructural inefficiencies contributing to settlement failure
- **Major barriers to interconnectivity in Europe**

Infrastructural inefficiencies contributing to settlement failures (2)



Major barriers to interconnectivity in Europe --- Italy

- rise in fails at LCH.Clearnet --- market or infrastructure problem?
- barriers to interconnectivity
 - parallel RTGS and daytime batch-processing are only linked one way --- no recycling of unsettled instructions from RTGS
 - difficult for users to access the CSD to fix settlement problems
 - concentration of settlement in the overnight batch-processing --- settlement efficiency or problem with RTGS?
 - telephone pre-matching of non-electronic repos
 - access at the end of the day is restricted to custodians
 - late settlement finality
- confusion between CCP and CSD roles

Major barriers to interconnectivity in Europe --- Italy

- ✓ ■ harmonisation of shaping --- fails have fallen, but remain high
- improvements to interconnectivity
 - ✓ – daytime batch-processing to be abolished; only RTGS during day
 - ✓ – continuous recycling between overnight batch-processing & RTGS
 - ✓ – technical netting in RTGS
 - ✓ – bilateral cancellation facility in RTGS
 - ✓ – hold-and-release mechanism in RTGS
 - ✓ – matching at client level
 - ✓ – overnight batch-processing results by 22:00 S-1
 - ✗ – overnight CCP repos not shaped
 - ✗ – access at the end of the day is restricted to custodians
- ✓ ■ clarification of CCP and CSD roles

Major barriers to interconnectivity in Europe --- Spain

- barriers to interconnectivity
 - concentration of settlement 13:00-13:30
 - late finality of settlement
 - late afternoon access restricted to own-account members
 - prohibition on fails by members fragments the market?
 - restrictions on foreign membership of the CSD
- CCP issues
 - lack of confidence in the methodology of the domestic CCP
 - barriers to foreign CCPs

Major barriers to interconnectivity in Europe --- Spain

- barriers to interconnectivity
 - ✗ – concentration of settlement 13:00-13:30
 - ✓ – finality of settlement advanced to 00:00
 - ✓ – late afternoon restricted access limited to 15 minutes
 - ✗ – prohibition on fails by members fragments the market?
 - ✗ – restrictions on foreign membership of the CSD
- CCP issues
 - ✓ – clarification of methodology of the domestic CCP
 - ✓ – changes to the CCP
 - ✗ – barriers to foreign CCPs remain



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European Repo Council Operations Group

2010 ERC AGM Operations Update

Tony Platt 27th October 2010



- **Triparty Interoperability**
 - Reviewed the 2 models proposed by Euroclear and Clearstream
 - A revised full DvP model has been proposed and we await further details.
- **ERC White Paper**
 - ERC Operations helped to put the paper together with particular reference to understanding settlement regimes in Domestic markets.
- **Addressing settlement barriers.**
- **Greece**
 - Provided information on forced auction process and lobbied the Bank of Greece for improved operational efficiency related to matching and settlement status.
- **Italy**
 - Lobbied for improved interoperability between Express 2 and RTGS cycles
 - Lobbied for introduction of lower shaping size. Material reduction in fails in recent months.
 - Continued lobbying for shaping of start legs of same day repos
- **Spain**
 - Improved operational timings. Extended timing for non direct participants.
 - Investigation of time taken to confirm cross border settlement status.

Increase capability of the group to influence the Repo market infrastructure.

- Increase group membership and participation.
- Improve group diversity to add different perspectives to the group. (A team of just Repo specialists will offer one perspective) Include Equity Financing specialists in the forum. Ensure debate and agenda covers all asset classes.
- Include some buy side representation to help guide the best practice directives.
- Increase meeting frequency and increase face to face participation to the greatest extent possible.

Continued role in driving solutions to cross border settlement barriers. Consistent with commentary in the White Paper.

ICMA ERC White paper, extract.

The principal barriers to interconnectivity are: the shortness of the settlement day; late, infrequent or unsynchronised feedback between CSDs and ICSDs; the lack of matching within some RTGS; unsettled instructions not being recycled automatically back into the next settlement cycle; obstacles to access by users to correct errors; discrimination against cross-border users in terms of access to CSDs; the lateness of settlement finality; the lack or uncertain cost of securities lending facilities; and obstacles to competition (“interoperability”) between CCPs.

ERC Operations focus areas in respect to the above;

- Continued lobbying for development of CSD overnight batch settlement cycles.
- Continue progress in respect to extension of CSD settlement cycles.
- Continue lobbying for earlier transmission of settlement instructions to CSD’s.
- Work with ICSD’s to explore opportunities and barriers to direct CSD access.
- Continued progress in respect to shaping of settlement instruction. (Proven impact in Italy).
- Interoperability between settlement cycles/platforms at the CSD level.
- Lobby for EC/CBL bridge enhancements. Discuss ICSD connection, development and risk management requirements in a real time model.
- Keep abreast and advise in respect to settlement date harmonisation.

Continued Tri Party Interoperability development in support of basket product financing.

Objectives

- Common model. CCP agnostic as far as possible.
- Basket/tri-party dependent product liquidity to be driven by product quality, as opposed to settlement barriers.

Challenges

- Common process evolution for CCP's supporting both central and commercial bank money mechanisms.
- Full DVP flows across and within ICSD's to protect from loss of credit or liquidity.
- Implementation schedules. Priority versus competitive product development.
- Further bridge settlement enhancements required? Avoid replacing one settlement barrier with another.

Role of ERC Ops group

- Validate proposals from an Operations processing and support perspective.
- Identify any hidden settlement related product differentiators.
- Ensure participants technology requirements are known and limited.

Repo Trade matching

Drivers for trade date matching

- Convergence/harmonisation of settlement timelines (T+2 proposal) reduced pre settlement risk mitigation period.
- US market developments. Regulatory driven change and potential impact globally.
- The need for transparency on matched pending flows to aid intra day credit facility management.
- Increase in term book size. Emphasis on Bilateral term repo risk mitigation. Growth in Off-side settlement risk through increased term business.

Challenges

- Multiple potential service providers.
- Broad adoption. Buy side on boarding strategy.
- Structured financing transactions presenting new confirmation and affirmation challenges.

Role of ERC Ops

- Current state assessment.
- Monitor and discuss. Address regulatory interest.
- Issue best practice statement regarding trade matching and affirmation.



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Update on Harmonisation of Settlement Cycles Working Group





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Any other business





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Next meetings

2011 ERC Annual General Meeting to be hosted by JP Morgan

