International
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ICMA

Minutes of the ERCC Committee meeting held on 3 May 2017 in Luxembourg

Present:	Mr. Godfried De Vidts	BrokerTec (ERCC Chairman)
	Mr. Grigorios Markouizos	Citigroup (ERCC Vice Chair)
	Mr. Eduard Cia	UniCredit Bank (ERCC Vice Chair)
	Mr. Michael Manna	Barclays
	Mr. Andreas Biewald	Commerzbank
	Mr. Michel Semaan	Crédit Agricole
	Mr. Johan Evenepoel	Euroclear Bank
	Mr. Jean-Michel Meyer	HSBC
	Mr. Nicola Danese	JP Morgan
	Mr. Sylvain Bojic	Société Générale
	Mr. Richard Hochreutiner	Swiss Reinsurance
	Mr. Richard Comotto	ICMA Centre
	Mr. Andy Hill	ICMA
	Mr. Paul Richards	ICMA
	Mr. David Hiscock	ICMA
	Mr. Alexander Westphal	ICMA (ERCC Secretary)
Guests:	Sabrina Casagrande	EIB
	Timothy O'Connell	EIB
	Jose Maria Inesta Pena	EIB
On the phone:	Mr. Dan Bremer	BAML
	Ms. Beatrice Rodriguez	Blackrock
	Mr. Eugene McGrory	BNP Paribas
	Mr. Romain Dumas	Credit Suisse
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Nicholas Hamilton	JP Morgan (ERCC Ops Co-Chair)
	Mr. Tom Wells	Morgan Stanley
	Mr. Gareth Allen	UBS Limited
	Ms. Lisa Cleary	ICMA
Apologies:	Ms. Emma Cooper	Blackrock
	Mr. Paul van de Moosdijk	PGGM

Welcome

The Chairman opened this second meeting of the new ERCC Committee and thanked the EIB for the offer to host. Mr. O'Connell from the EIB welcomed Committee members and provided a short overview of the EIB including some of the key operational figures, highlighting the important role of the bank as largest multilateral lender in the world by volume. He commended the useful work undertaken by the ERCC to support the repo market amid difficult market conditions illustrated by the recent year-end dislocations.

1) Minutes from previous meetings

The Committee approved the draft minutes of the last Committee meeting held on 22 February in London without further comments.

2) CGFS report on repo market functioning

The final CGFS report *Global repo markets in transition post-crisis, regulatory changes and central bank stimulus* was published on 12 April 2017. The Chairman commented that the report reflects much of the feedback provided by Committee members during the different sessions held with the CGFS. The report acknowledges the problems in the repo market and includes some helpful proposals. However, unfortunately it does not set out any immediate follow-up actions to address these issues. Instead it is only suggested to reconsider the issues in 2 years. The report also still includes a number of less helpful remarks and misperceptions about repo, which only reaffirm the importance to discuss and clarify these points publicly. The upcoming ERCC General Meeting in November will be a good opportunity to do this.

On a related point, Mr. Cia reported back from a recent discussion with the German Ministry of Finance, where it was made very clear that they see any reduction in repo activity as an intended consequence of restricting short-term lending. The German authorities seem very reluctant to address any issues that cause concern for the financial sector if these are not seen to have a significant impact on the real economy. In response to this feedback, members agreed that it would be very important to set out and communicate more clearly the real economic benefits and uses of repo and to provide evidence that banks as intermediaries are responding to their clients' funding needs. The repo market simply reflects that a large portion of funding of the real economy, e.g. trade finance, is short-term. It was agreed that further evidence on this point would be extremely helpful to convince the relevant authorities that the functioning of the repo market is not a remote problem faced by financial institutions only but closely linked to the functioning of the wider economy. A good starting point is the importance of repo for pension funds, a topic already addressed by Mr. van de Moosdijk in his recent presentation to the ERCC AGM in Zurich and his article in the ICMA Quarterly Report (issue #45). More generally, input from ERCC buy-side members will be critical for this purpose. Another interesting point that arose from the discussions with German authorities and that the ERCC needs to take into account for its ongoing advocacy was their reluctance to see any changes at EU level to the rules agreed as part of the Basel framework, including on NSFR.

3) Regulation

a) MiFID II & repo

Mr. Hiscock and Mr. Hill updated members on the latest developments in relation to the MiFID II/R reporting requirements for repo.

Regarding transaction reporting under MiFIR (RTS 22), Mr. Hiscock explained that SFTs are generally exempt from MiFIR reporting as they are reported under SFTR. However, there is one notable exception which concerns SFTs concluded with European Central Banks (ESCB members). These trades are exempt from SFTR reporting and have to be reported under MiFIR instead. While this remains cumbersome, it has been recently clarified that the timeline of this requirement has at least been aligned with SFTR, so that the MiFIR reporting requirement for SFTs with ESCB members will only apply once SFTR reporting is itself required.

Regarding best execution reporting of SFTs (RTS 27), Mr. Hill said that there is still no clarity as to whether and how these requirements apply to SFTs. ICMA has requested urgent clarification from authorities arguing that the requirements should not apply to SFTs as they are inappropriate and would create a disproportionate burden for firms without providing any meaningful information. It seems that this question has now been pushed back by the Commission to ESMA who are working on guidance in the form of Q&As. It is expected that ESMA's draft guidance will be submitted to their Board of Supervisors in June for adoption and subsequent publication. Regarding the implementation timeline, Mr. Hill explained that while the first of the quarterly best execution reports will have to be published in April 2017 (end of Q1), firms will have to be ready in January 2018 to start collecting the relevant data.

b) CSDR

Mr. Hill provided an update on recent discussions in relation to the CSDR settlement discipline (SD) regime following the publication of the final [parameters for the calculation of late settlement penalties] on 10 March 2017. A joint ERCC/SMPC call was held on 30 March to discuss the ICMA advocacy strategy on CSDR SD going forward. A position paper setting out the ICMA proposals in more detail will be circulated next week. In short, the following line was agreed:

- ICMA broadly supports the proposed cash penalty mechanism for settlement fails, but argues for an appropriate recalibration of the penalty rates.
- ICMA retains its firm opposition to the mandatory buy-in regime, which it argues is fundamentally flawed and will be detrimental to bond market stability and liquidity.
- ICMA proposes that the cash penalty regime be implemented as scheduled, with a higher than proposed penalty rate for bonds. However, the mandatory buy-in regime should not be implemented as scheduled.
- The proposed penalty rate for bonds (except SME debt instruments) should be the equivalent of 2.50% annualized. This would broadly be in line with TMPG in the US. As CSDR doesn't allow any in-built flexibility related to interest rate changes, the rate would have to be regularly reviewed as market conditions evolve.

Members agreed with the proposal and stressed the need to build a cross-industry consensus on this question, across repo and cash traders, but also involving the buy-side. ICMA will reach out to other associations to discuss the proposals, including to the buy-side (e.g. through ICMA's AMIC).

c) CCP Recovery and Resolution

In November 2016, the Commission published an [EU Draft Regulation] on CCP Recovery and Resolution which is currently under review by Parliament and Council as part of the normal EU legislative process. Mr. Hiscock updated members on the recent developments on this file. The main concern that has been identified from a repo perspective relates to variation margin haircutting, which is not considered an appropriate recovery or resolution tool to be used for repo. An ERCC letter on this issue was sent to the relevant contacts in the European Parliament on 11 April, including a concrete drafting proposal. ISDA is supportive on this issue and has voiced similar concerns in relation to certain derivatives, but hasn't yet put forward any drafting proposal. Once they do, we can consider whether both positions can be merged.

On a related note, the Chairman informed members that the Commission was due to publish its legislative proposal on the review of EMIR on 4 May. In June, the Commission is also expected to set out some specific views related to the controversial issue of CCP location policy. Given the political nature of this issue in the context of Brexit, it was considered helpful that this has been disentangled from the EMIR proposal itself.

d) CRD IV review

Mr. Hiscock updated members on the latest developments in relation to the ongoing review of the CRD IV package, which includes proposals on NSFR and LR. Following discussions at the previous Committee meeting the ERCC Secretariat followed up with a letter to the relevant contacts in the European Parliament, setting out our previously documented detailed proposals and requesting a meeting to discuss further. The aim is to convince MEPs to at least support the revisions of the Basel framework proposed by the Commission and ideally to go beyond these and to provide some further relief for repo. Mr. Hiscock commented that in this context it was concerning to hear that certain national authorities are not supportive of any changes at EU level to the Basel rules and recalled that the adjustments in Europe are justified by the fact that the scope of the EU rules is much broader than the Basel framework which is targeted at large cross-border banks only.
In terms of next steps, the ERCC will follow up on the letter sent to MEPs. In addition, it would be important to also raise awareness among national governments represented in the Council.
Looking beyond the ongoing review of EU rules and given the feedback received from certain Member States, members also stressed that it would be important to reach out to Basel directly.

4) ERCC Operations Group update & SFTR

Mr. Hamilton, Co-chair of the ERCC Operations Group, provided an update on ongoing ERCC Ops Group initiatives. He highlighted three key areas:

Implementation of SFTR: Most importantly, work to prepare implementation of the SFTR reporting regime is intensifying following publication of ESMA's final draft RTS on 31 March 2017. The draft RTS are still subject to review by the Commission and subsequently Parliament and Council, so this provides a short window of opportunity to raise any outstanding concerns with the proposals. A few minor issues have already been identified by the ERCC's SFTR Task Force and will be raised with legislators. However, overall the rules are not expected to change substantially. The final ESMA proposals do contain a number of useful concessions as compared to previous versions. From an operational perspective, the key issue will be reconciliation of the 60-odd data fields, which is expected to be a major challenge for the industry. There is a general feeling that vendors will have a key role to play in facilitating implementation. The Task Force is thus planning to collaborate closely with vendors. As a basis for those discussions, the group is considering to put together a list of key requirements/expectations towards vendors, including on interoperability. In addition, the group is also considering an industry-wide survey to get a better feeling for the level of readiness for SFTR and to inform the ongoing implementation work.

Complementing these remarks, Mr. Westphal went through some of the specific proposals in the final draft RTS and main positive changes from previous versions:

- **Reporting timeline:** where collateral allocations are not available on T+1, ESMA proposes that these can be reported by S+1, which is a significant improvement to previous versions.

- **Re-use reporting:** re-use will be reported based on the 'approximate measure' put forward by the FSB. While we had argued for this estimate to be reported on a monthly basis, ESMA insists on daily reporting, but clarified that this can be reported on S+1, which is understood as reporting with a 3-day lag, assuming a standard T+2 settlement cycle. From an operational perspective this is a significant relief compared to the calculation of the estimate based on premature trade date figures.
- **Collateral values:** Firms will have to report daily updates of collateral values (mark-to-market), which will be cumbersome in itself. However, on the positive side, ESMA dropped a worrying earlier proposal that this needs to be done based on the IFRS 13 accounting standard.
- **Reconciliation:** While reconciliation remains the biggest challenge within SFTR, ESMA made some positive concessions by proposing a phased approach. In a first step, there will be 63 reconcilable fields, which will be increased in a second step (within 2 years) to the full list of 97 matching fields.

Members discussed the implications of SFTR, in particular the challenges around reconciliation. While reconciliation is formally the responsibility of trade repositories, it is feared that the reconciliation requirements could imply a huge operational burden for firms as reports that do not match will have to be manually checked and corrected by counterparties. A critical aspect for firms is that this does not depend solely on their own individual compliance but importantly also on the readiness of a given counterparty. The risk is that firms might stop trading with certain counterparties if they fear that this would result in substantial operational burden due to necessary manual reconciliation. From a systemic perspective, there is thus a risk that the reporting regime could introduce major liquidity risks if certain counterparties are cut off from the market. Members discussed how to address this issue and agreed that, while asking for a longer transition period might not be very promising, it would at least be important to highlight to regulators the potential systemic risk. As a basis for this discussion, there is a need to better understand the actual rules and responsibilities for reconciliation as well as the exact scope of the reporting requirements.

ERCC Ops FinTech Working Group: The ERCC Ops has established a working group which is looking at FinTech tools available for collateral operations. The aim is to prepare a comprehensive mapping on available tools in the market with a view to help achieve a more efficient post-trade process. The work is progressing well and the mapping already includes information on around 50 applications.

Broader post-trade integration initiatives: The ECB has recently revised its market infrastructure related advisory groups. The new structure is based on two groups: the AMI-SeCo, focused on securities and collateral, and AMI-Pay, looking at payments. Mr. Hamilton represents the ERCC on the AMI-SeCo which had its kick-off meeting on 6-7 March in Frankfurt. Generally, being part of this group will allow us to help shape the Eurosystem infrastructure arrangements with a specific focus on facilitating more efficient liquidity management and delivery of collateral into T2S. The AMI-SeCo will next meet on 11 May to hold a workshop specifically on collateral. At the workshop, the ECB and the ICSDs will present a joint initiative to make (euro-denominated) Eurobonds available in T2S. The Chairman raised some concerns that this initiative might lead to a fragmentation of the Eurobond market, and thus create problems for users of ICSD tri-party services, in particular those that are not direct participants in T2S. Mr. Hamilton will report back from the outcome of the discussions.

In this context, the Chairman also briefed members about recent progress in the work of the European Post-Trade Forum (EPTF), which is now almost concluded. In total, the final draft EPTF report sets out 17 barriers to an efficient and integrated post-trade space in Europe. Three of these issues have been initially raised by ICMA as a member of the group. The latest addition raised by ICMA is around national restrictions for primary dealers, as some member states still force their primary dealers to maintain an account in the domestic CSD for their primary market activity related to sovereign bond auctions. Although this had already been raised in the Giovannini reports, the issue still hasn't been addressed, running counter to the objectives and opportunities provided by T2S. In addition, ICMA has also made contributions on collateral mobility as well as intraday liquidity, which have received broad support from other EPTF members and are part of the final report. All three issues raised by ICMA have been flagged as emerging barriers in the so-called "watchlist" section of the report. In terms of next steps, once concluded the report will serve as a basis for the Commission to launch a wider public consultation on the issues, to be published probably before summer.

5) Legal update

Ms. Cleary provided an update on the latest legal developments.

The 2017 ICMA GMRA legal opinions were recently published on the ICMA website. The opinions for France, Germany and Kuwait are still pending as final comments are incorporated.

Regarding the plan to discontinue coverage of the GMRA 1995 in the 2018 legal opinions, no firm decision has been reached yet. Feedback so far indicates that firms are not yet ready for this step, although Ms. Cleary reiterated the importance for ICMA to put a flag in the sand at some point in the near future. While no decision was taken on this question at the meeting, the Chairman suggested to discuss the issue with ICMA CEO Martin Scheck and to report back to the Committee.

Ms. Cleary informed members that the recent changes to the ICMA buy-in rules had come into effect on 3 April. Although not applicable to repo, the rules are relevant for instance in the case of back-to-back transactions. In case of questions, members are invited to contact ICMA's legal helpdesk. On a related note, the ERCC's newly established legal subgroup is planning to look into the issue of settlement fail chains which involve at least one repo trade and to assess whether a more streamlined process to deal with this situation can be established.

It was agreed to discuss some of the relevant legal issues that are currently being looked at during the upcoming joint session with the ISLA Board on 20 June in Berlin. This could include ISLA's ongoing work to develop legal documentation for a pledge structure for securities lending.

6) Preparation ERCC General Meeting in November

The Chairman reminded members that the next ERCC General Meeting will be held in the margins of the Euroclear collateral conference on 14 November in Brussels. Planning for the event is progressing well. The format will be slightly different this year, aiming to provide a solid academic perspective of the repo product to counter some of the myths about repo that have been spreading over the past years since the financial crisis. The two keynote speeches will be provided by Mr. Mahmood Pradhan (IMF) and Mr. Benoît Cœuré (ECB). In between the speeches there will be time for two panel discussions, which are currently being put together. Mr. Comotto presented a broad outline for the panels. The first one, to be moderated by Mr. Andy Jobst (Worldbank), will take a front office perspective and will address common misperceptions about re-use, leverage and the role of haircuts. The second panel will look at the challenges from a post-trade angle, covering for instance CSDR and SFTR. Mr. Comotto will moderate this second panel and Mr. Steffen Kern (ESMA) will be among the panellists. The Chairman invited ideas from Committee members regarding potential further speakers for both panels, including bank economists or suitable academics. The aim is to finalise the panel composition by the end of May.

7) <u>AOB and further dates:</u>

Mr. Westphal asked members to consider an application received from Tullet Prebon Securities to become an ERCC member. The application was unanimously approved by ERCC Committee members (as well as by the two members of the IRCC Committee).

Mr. Comotto reminded members that the annual ERCC Professional Repo and Collateral Management workshop will be held on 1-2 June in London, hosted by UBS. The event is primarily addressed at junior repo dealers but traditionally attracts a very broad range of participants. Committee members are encouraged to spread the word within their firms.

Mr. Richards mentioned that he will moderate a panel at the upcoming ICMA AGM with the Chairs of ICMA's MPRP Committees, including Mr. De Vidts as ERCC Chairman, during which some of the broad themes discussed today will be picked up again.

Mr. Hiscock informed members that the Bank of England has established a new (restructured) Money Markets Committee. Mr. Manna and Mr. Dumas are both members of the new Committee and will report back to the ERCC Committee. In addition, two sub-committees have been established, the Sub-Committee on Securities Lending on which Mr. De Vidts will represent the ERCC, and a sub-committee to monitor the implementation of the new UK Money Markets Code. Regarding the latter, Mr. Hiscock explained that while the Code is voluntary in nature there is a clear expectation from both Bank of England and FCA that all UK domiciled firms will sign a standardised Statement of Commitment to the Code. In general, ICMA is supportive of the Code and has published a related statement on its website. The high-level Code differs in nature from the ERCC Repo Guide which is a much more detailed document. However, further updates of the Guide will of course take into account the new Code where necessary.

The Chairman informed members that the anticipated EMMI consultation on the new secured benchmark has been delayed due to other priorities, but should be published in the next months. On a related note, Mr. Hiscock mentioned that the Bank of England has selected SONIA as its new £ risk-free rate. Mr. Manna remarked that he was part of the selection Committee which considered several candidate benchmarks among which a very interesting secured benchmark maintained by the LSE, called £SONET. Members agreed to invite the LSE and other providers to present their benchmarks at a future Committee meeting.

- **1 - 2 June, 9:00 – 17:00 (UK time)**: ICMA ERCC Professional Repo and Collateral Management workshop in London, hosted by UBS
- **20 June, 13:00 – 16:00 (local time):** ERCC Committee meeting in Berlin, hosted by ISLA in the margins of their 26th Annual Securities Finance and Collateral Management Conference.

This includes two separate sessions: a joint ERCC Committee – ISLA Board meeting (13:00 – 14:00), followed by a separate ERCC Committee only meeting (14:00 – 16:00)

- **12 September, 14:00 – 17:00 (UK time):** ERCC Committee meeting in London hosted by HSBC
- **14 November, 14:00 – 17:00 (local time):** ERCC General Meeting in Brussels, hosted by Euroclear in the margins of their Collateral conference

The ERCC Chairman:	The ERCC Secretary:
Godfried De Vidts	Alexander Westphal