

Minutes of the Joint Meeting of the ERCC Committee and ISLA Board on 20 June 2017 in Berlin

Present:	Mr. Godfried De Vidts	BrokerTec (ERCC Chairman)
	Mr. Andy Krangel	Citigroup (ISLA Chairman)
	Mr. Simon Tomlinson	BNY Mellon (ISLA Treasurer)
	Mr. Dan Bremer	BAML
	Mr. Michael Manna	Barclays
	Mr. Mark Newton	Barclays
	Ms. Emma Cooper	Blackrock
	Mr. Stefan Kaiser	Blackrock
	Mr. Grigorios Markouizos	Citigroup (ERCC Vice Chair)
	Mr. Andreas Biewald	Commerzbank
	Mr. Michel Semaan	Crédit Agricole
	Mr. Romain Dumas	Credit Suisse
	Mr. Jonathan Lombardo	Eurex (ISLA Deputy Chair)
	Mr. Mathew McDermott	Goldman Sachs
	Mr. Nicola Danese	JP Morgan
	Mr. Tom Wells	Morgan Stanley
	Mr. Paul van de Moosdijk	PGGM
	Mr. Roelof Van der Struik	PGGM
	Mr. Sylvain Bojic	Société Générale
	Mr. Arnaud Fransioli	Société Générale
	Mr. Alex Lawton	State Street
	Mr. Richard Hochreutiner	Swiss Reinsurance
	Mr. Gareth Allen	UBS Limited
	Mr. Eduard Cia	UniCredit (ERCC Vice Chair)
	Mr. Arne Theia	UniCredit
	Mr. Ueli von Burg	ZKB
	Mr. Richard Comotto	ICMA Centre
	Mr. David Hiscock	ICMA
	Mr. Alexander Westphal	ICMA (ERCC Secretary)
	Ms. Lisa Cleary	ICMA
	Mr. Andrew Dyson	ISLA (ISLA Chief Executive)
	Mr. Mark Hutchings	ISLA
	Mr. Roshan Adam	ISLA
On the phone:	Mr. Jonathan Lee	JP Morgan (Chair ERCC SFTR Task Force)
	Mr. Andy Hill	ICMA

Welcome

Mr. Dyson welcomed all attendees to this joint meeting of the ISLA Board and the ERCC Committee. Mr. De Vidts thanked ISLA on behalf of the ERCC for hosting the meeting.

1) SFT Regulation

Mr. Dyson provided an overview of ISLA's work in relation to the upcoming implementation of the SFTR reporting regime and some of the key challenges from a securities lending perspective. He noted that of the three markets affected by SFTR, securities lending probably faces some of the most complex challenges, mainly due to the market's high level of agency business and the large share of non-cash collateral. The agency business specifically is highly global in nature and involves a large share of non-EU counterparts who are in principle out of scope for SFTR. It is estimated that this is the case for up to 60% of all outstanding securities loans in Europe, which can go up to 80% for certain markets, particularly government bonds. This raises important questions and challenges for the implementation of the reporting regime and does not seem to be fully appreciated by regulators yet. Regarding non-cash collateral, ISLA was very pleased to see ESMA's proposal in the final draft RTS to allow reporting of collateral information up to S+1, as opposed to the general reporting deadline of T+1. Although Mr. Dyson also cautioned that this proposal might still be rolled back by the Commission if they consider it inconsistent with the Level 1 text. Mr. Dyson also reported back from a recent meeting with the European Commission, where they indicated that their ongoing review of the draft RTS is likely to take much longer than initially expected. This would result in a further delay of the implementation timeline of SFTR reporting, which is now more likely to go live around Q2 2019 (i.e. around 6 months later than initially expected). This raises some interesting questions in the context of Brexit, although other members commented that they expect the requirements to apply in the UK notwithstanding Brexit. ISLA and the ERCC also recently met DTCC to discuss their plans to provide trade repository (TR) services under SFTR. An important aspect for ISLA members is TR pricing, given that there is a real risk that an inappropriate pricing structure might drive some lenders out of the market.

Mr. Lee reported back on the work of the ERCC SFTR Task Force and the main challenges with SFTR reporting for the repo market. While the SFTR taxonomy probably caters better for the repo lifecycle as compared to agency-based securities lending, one of the key challenges for repo is that the market is much less developed in terms of electronic matching, affirmation and contract compare services. The resulting lack of consistency in booking practices is likely to cause problems for the reconciliation of reports under SFTR. In order to tackle this challenge and pre-empt excessive operational burden later on, the ERCC SFTR TF has launched a bilateral reconciliation exercise to help identify the most critical transaction types and reporting fields in terms of reconciliation. A best practice document was provided to help firms participate in the exercise. The aim of the document is to standardise the exercise, guide member firms and to provide assurance for legal and compliance on confidentiality, data integrity and security. Besides reconciliation, a second important aspect of the work of the ERCC SFTR TF is the collaboration with vendors. As a basis for these discussions the reconciliation exercise is expected to be useful as it will help to firm up vendor requirements. In addition, it will also be important to seek ways to facilitate client onboarding, which is expected to be a major task for many firms, given the limited reach of service providers in repo markets today.

Finally, members also briefly discussed the significant challenge for ESMA in this respect, as they are trying to build up a sufficient capacity to manage the substantial data flows that are expected under the various reporting regimes. This is a major project for ESMA which currently binds a large part of their resources.

2) Pledge documentation progress

Mr. Hutchings provided an overview on ISLA's ongoing work to develop standard legal documentation for pledge based securities lending. This project was initiated by the ISLA Board in November 2016. The main drivers for the initiative are threefold: (i) disadvantageous capital treatment of title transfer (in terms of RWA and haircuts) in certain scenarios for both borrowers and agent lenders, (ii) impossibility of netting in some jurisdictions, and (iii) concerns from some beneficial owners about transparency and large exposures. All three issues can potentially be mitigated by a pledge structure. After the initial Board decision, ISLA undertook some further due diligence work, including a survey, to ascertain the market interest in the initiative. As soon as this was established, they reached out to Clifford Chance to do some further analysis and start working on the actual documentation. The pledge structure that is being considered would involve three separate legal documents. The actual securities lending arrangement (a modified version of the GMSLA), an accompanying securities agreement, as well as a tri-party control agreement. The latter will have to be developed for each of the tri-party agents based on a standardised template. In a first stage, they have focused on developing the modified GMSLA, which is now nearly finalised. The next step will be to develop the relevant tri-party control agreements, first for JP Morgan and BNY Mellon (under UK law), subsequently also for the two ICSDs, Clearstream and Euroclear, under Luxembourg and Belgian law respectively.

Members discussed potential reputational risks vis-à-vis regulators. ISLA members commented that there are important aspects of the pledge initiative which regulators are likely to appreciate. In particular, this will broaden the scope for CCP-clearing to include e.g. UCITS funds. It was also mentioned that the initiative is very much driven by the buy-side and thus reflects a real need from investors. Finally, it is also important to note that the pledge structure does not aim to replace existing title transfer agreements but should be considered an additional tool in the toolbox.

3) MiFID II – Best Execution

Mr. Hill updated attendees on the latest developments in relation to MiFID II best execution requirements under RTS 27. There is still an open question whether and how these requirements apply to SFTs. ICMA requested clarification from ESMA and the Commission several months ago and shared with them a position paper which describes the problems and challenges of applying RTS 27 to SFTs. While no formal clarification has been received yet, ESMA has indicated that they are looking to issue formal guidance on this question which they are currently working on and hope to have approved by their Board of Supervisors in early July. From an ISLA perspective, Mr. Krangel added that they had discussed this question a couple of years ago with the FCA who were very clear that in their view the best execution requirements would apply to SFTs. ISLA also

published a position paper on this issue. He agreed that the requirements do not make sense for securities lending either and would be very challenging to apply. It is very clear from the wording that this has not been drafted with SFTs in mind at all.

On a related issue, a question was raised about the applicability of MIFID II requirements on the disclosure of costs and charges. As for best execution, the relevant requirements do not seem to make sense in the context of SFTs and would not provide useful information. However, as the requirements do not provide for an explicit exemption for SFTs they would seem to apply in principle. Members agreed that, before raising this issue to ESMA, we should wait until we receive clarification from ESMA on the applicability of best execution to SFTs. On the back of this guidance, we can then consider whether to ask for further clarification on similar cases such as costs and charges or also record-keeping requirements, another issue that has been flagged recently.

The ERCC Chairman:

The ERCC Secretary:

Godfried De Vidts

Alexander Westphal