

**Minutes of the European Repo Committee meeting held on June 30, 2011 in Sintra, Portugal**

Present:	Mr. Godfried De Vidts	ICAP (Chairman)
	Mr. Eduard Cia	UniCredit (Vice Chairman)
	Mr. Edward McAleer	Morgan Stanley (Vice Chairman)
	Mr. Andreas Biewald	Commerzbank AG
	Mr. Eugene McGrory	BNP Paribas
	Mr. Herminio Crespo Urena	Caja de Madrid
	Mr. Grigorios Markouizos	Citigroup
	Mr. Tony Baldwin	Daiwa Capital Markets Europe
	Mr. Olly Benkert	Goldman Sachs International
	Mr. Sylvain Bojic	Société Générale
	Mr. Jean-Michel Meyer	HSBC Bank
	Mr. Mats Muri	Barclays Capital
On the phone:	Mr. Stefano Bellani	J.P. Morgan
	Mr. Romain Dumas	Credit Suisse Securities
	Mr. Johan Evenepoel	Dexia Group
	Mr. Michel Semaan	Nomura
	Mr. Simon Tims	UBS AG
	Mr. Tony Platt	Morgan Stanley (Chair, ERC Ops)
	Mr. Richard Comotto	ICMA Centre
	Mr. John Serocold	ICMA Ltd
Also Present:	Ms. Lalitha Colaco-Henry	ICMA Ltd (Secretary)
	Mr. David Hiscock	ICMA Ltd
	Mr. Jean-Robert Wilkin	Clearstream
	Mr. Frank Reiss	Euroclear
	Mr. Cedric Gillerot	Euroclear
Absent:	Mr. Andrea Masciovecchio	Intesa Sanpaolo
	Mr. David Nicholls	Deutsche Bank
	Ms. Lisa Cleary	ICMA

**Welcome by the Chairman**

The Chairman thanked everyone for attending and asked whether Committee members felt it was helpful for the meeting to be hosted in the margins of the ISLA Annual Conference. It was noted that the timing of the meeting was not ideal as it coincided with quarter-end financial reporting and market uncertainty over Greece meant it was a busy time. Nevertheless, the Committee felt there was value in continuing to have a Committee meeting in the margins of the ISLA annual conference.

The Chairman also noted the recent change in the composition of the Committee. Ms. Jessica McDermott had left the committee. The Chair expressed gratitude for the contribution made by Ms. McDermott and wished her all the best for the future. As per the ICMA rules, Mr. Sylvain Bojic of Société Générale was welcomed as a new Committee member.

## **1. Minutes of previous meeting**

The draft minutes of the last ERC Meeting, held on 10<sup>th</sup> May 2011 in London, were sent to the ERC Committee on 9<sup>th</sup> June 2011. The draft minutes were unanimously approved without comment.

## **2. Repo Cash Settlement Study**

Mr. Richard Comotto noted that the handout of the diagrams had been discussed at length at the ERC Ops meeting the previous week. The aim of the study is to examine where central bank money (CEBM) and commercial bank money (COBM) are used in CCP-cleared repo settlement flows. The basic argument is the perceived trade-off between risk and efficiency/effectiveness. In theory, CEBM poses minimum risk whereas COBM offers gains in efficiency and effectiveness. However, in reality, CEBM may not be completely riskless and COBM is not always much riskier but is essential for international, cross-border settlement.

The diagrams show the four possible constellations – covering the different variations for clearing, settlement and payment flows. Diagrams 1.1b and 1.1c reflect the fact that some participants prefer to use custodians and/or settlement banks. These diagrams show that COBM allows banks to use correspondent banking services and custodian securities settlement services. However, it was noted that missing from diagrams 1.1b and c is the distinction as to whether a bank would have a visible account through a global custodian or not. Some banks will have a direct account but may still prefer to use an agent. The diagrams on page 3 represent the integrated version of the first model. In the integrated model, the central bank grants a mandate to the CSD to operate a securities settlement cash account in CEBM so the payments shown within the CSD are true CEBM. The CSD also handles intraday credit. The integrated model operates in Euroclear Belgium, Netherlands, France, and is used by the National Bank of Belgium. The diagrams on page 4 represent pure COBM – they show settlement within the same ICSD directly or through agents. On page 5, the diagrams show settlement between two ICSDs, which is also entirely COBM. Only direct settlement is shown but settlement can also be through an agent. The diagrams on page 6 show settlement between a CSD and an ICSD, using cross-border settlement links between the ICSD and the CSD. It was noted that Euroclear has access to CEBM but this is not widely used.

The ICSDs allow settlement in many more currencies than just the euro and also allow cross-border settlement. It was noted that even if banks have direct central bank access, certain flows would still settle in COBM. The current system carefully balances risk and efficiency, which is recognised by CPSS/IOSCO whereby the standards<sup>1</sup> advocate that COBM mechanisms are adequately supported and regulated.

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<sup>1</sup> See the CPSS [Core Principles for systemically important payment systems \(2001\)](#) and the CPSS/IOSCO [Recommendations for securities settlement systems \(2001\)](#).

The Chairman asked Committee members to provide any comments on the paper before July 11<sup>th</sup> in advance of a meeting with the ECB. It is expected that Mr. Comotto's paper will be discussed further at the next ERC Committee meeting in August before publication at the next ERC Council meeting on September 14<sup>th</sup>.

### **3. Update on Interoperability between the ICSDs**

The Chairman noted that the next step is to take forward interoperability over the bridge in triparty. If there is interoperability between the two ICSDs, then it would be possible to access Eurex Clearing or any other CCP in Europe. One member expressed the view that if the CPSS/IOSCO model becomes required CEBM settlement, then potentially a large pool of liquidity is excluded – i.e. those who cannot settle in CEBM. It was important to keep as many options open as possible. However, it was also recognised that market efficiency may eventually force streamlining though it now appears that there are more CCPs and tri-party agents operating in the market. It will be important to maintain a multi-nodal system to avoid fragmenting liquidity. This means that triparty agents must be interoperable and the ECB should be asked to support this aim. However, it was also stressed that efficiency is an admirable goal but not if achieving it means an increase in risk.

Mr. Reiss noted that Euroclear will launch in November its new triparty offering for ESES (Euroclear Settlement of Euronext-zone Securities) markets, with DvP settlement in CEBM in ESES. Euroclear will then implement triparty interoperability between the ICSD (Euroclear Bank) and ESES CSDs in line with the model approved by the ERC.

Following on from the previous ERC Committee meeting, when the LCH.Clearnet's collateral basket with pledge proposal had been discussed, the Chairman noted that there was a need for a small working group to consider what the composition of the European collateral pool baskets should be, especially given the Basle III liquidity framework. It was agreed that the working group would be made up of Messrs. Meyer, Benkert, and Biewald with Mr. McAleer chairing the group. The working group undertook to report back at the next Committee meeting in August.

### **4. Use of loans as collateral**

The Chairman noted that there were three parties interested in building the loan repo database. There was some discussion among members about the merits of the various options. The Committee agreed that until firms recognise the value of making loans repo-able then there is little point in expending a lot of additional resource. It was agreed that this matter should remain on the agenda as a way of monitoring market sentiment regarding the use of loans as collateral. The Chairman of the ERC Ops Group also noted that the operational work on credit claims would be significant.

### **5. Repo margin guidelines**

The Committee discussed the draft Repo Margin Best Practices paper that had been prepared by the ERC Ops Group. The Chairman of the ERC Ops Group said that under the GMRA 2011, two different

calculations are provided for the calculation of Transaction Exposure and that it is up to the parties to contractually agree which method they will adopt. A provision has been included in the Best Practices paper that “best practice is to agree a methodology on a portfolio basis, not on a transaction level” (point 2). However, it was noted that parties may wish to use one or other methodology depending on the nature of a particular repo trade, instead of adopting a methodology on a portfolio basis. The Chairman of the ERC Ops Group said he would circulate this issue back to the sub-group.

It was also noted that regarding the margin securities to be accepted (point 5), the Best Practices paper sets out that margin securities should have characteristics similar to or better than the securities being repoed. Should parties to a GMRA specify margin eligibility criteria, this will prevail. Regarding how interest is paid on cash-margin (point 6), it is proposed that the Best Practices paper set out that best practice is for cash margin interest to be settled on a monthly basis by the fifth business day. It was agreed that it would be better to provide for the use of RONIA as an alternative to SONIA.

On the issue of the minimum transfer amount (MTA), it is proposed that the Best Practices paper provide for the MTA to be agreed bilaterally and if not that the MTA be unilaterally cancellable at any time without notice (point 7). Regarding point 8 of the Best Practices paper (is substitution of margin securities possible), it was noted that where margin securities have been posted, parties may agree to substitute such securities with other securities. There was also discussion about the market practice of returning margin two days prior to settlement. There was agreement for the idea that there should be a move to a same-day margin settlement assumption. Participants should not assume settlement for either the on-side or off-side of portfolio trades.

Regarding what happens if margin is not delivered (point 15) if the receiving party chooses not to invoke their default rights then for relationships with a T0 settlement period the margin call should be recalculated and reissued. For relationships with a T+1 or T+2 period of settlement, the delivering party should endeavour to deliver at the soonest possible time. However, it was noted that this formulation could incentivise bad behaviour – i.e. waiting for a lower margin call. The Chairman of the ERC Ops Group noted that he would adjust the Best Practices paper and re-circulate. He also indicated that he would consider the approach to margining best practices taken in the US MRA when finalising the ERC’s Best Practices document.

## **6. Interest Calculation for floating-rate repos**

Discussion of this item was postponed.

## **7. Coupon re-investment on buy/sell-backs**

Discussion of this item was postponed.

## **8. Repo Code of Conduct**

Discussion of this item was postponed.

## **9. ERC Operations**

The Chairman of the ERC Ops Group noted that he had circulated a close to final version of the ERC Recommendation on Bilateral Repo matching as a driver for risk reduction. He advised the Committee of the spirit of the document – i.e. that it was not a prescription or a mandate but that it should instead be viewed as evidence of self-regulation by the ERC and that participants would be able to reference this document to encourage adoption of best practice by themselves and their clients, with particular emphasis on operational risk reduction in forward starting and term dated bilateral transactions. The Chairman of the ERC Ops Group commented that clearly the idea would be for electronic platform adoption for deal matching but that it was not the role of the ERC to sponsor such solutions, but instead to lay out the best practice guidelines to enable the market to move in the right direction with a common understanding of standards. The Chairman of the ERC Ops Group noted that he had received no further suggestions for revisions and if no revisions were requested post the Committee meeting, the document would subsequently be published on the ICMA website.

The Recommendation has subsequently been published on the ICMA website and can be accessed [here](#).<sup>2</sup>

## **10. Legal update**

A note will be circulated to the Committee given Ms. Cleary's absence. However, it was noted that the GMRA 2011, the associated update protocol and the 2011 update of the ICMA GMRA legal opinions are now available on the ICMA website.

The GMRA review working group continues to work on GMRA related initiatives. Of particular note are the discussions regarding clause 6(j) of the GMRA, which is a condition precedent clause. There has been various litigation focusing on the equivalent condition precedent clause 2(a)(iii) of the ISDA Master Agreement. The GMRA review working group has discussed amendments to clause 6(j) and is considering the position in the context of the ongoing litigation, the work of ISDA working group on this issue and market developments.

It was also noted that there has been interest for some time in developing an annex to the agreement to cater for longer term transactions. A sub-group of the GMRA review working group has been formed to discuss the development of a term repo annex.

## **11. Regulatory Update**

It was noted that existing Commission work, such as the MiFID review has slowed slightly. However, progress is being made in other regulatory fora such as the FSB, which is working on shadow banking. The definition of shadow banking may include securities lending, repo and any OTC business. AIG is used as an example of a non-bank that had a large securities lending business. Regulatory focus is on

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<sup>2</sup> Alternatively, see <http://www.icmagroup.org/ICMAGroup/files/2e/2eba29d5-2084-4c77-97d4-a4d7e1192fe8.pdf>

how to get greater transparency in these areas. The relationship between securities lending/repo and pro-cyclicality and systemic risk is being examined in some detail.

It was noted that Mr. Kevin McNulty of ISLA does not attend ERC Committee meetings even though he is routinely invited. Mr. McAleer will speak with Mr. McNulty to press him to attend meetings given that many of the regulatory issues facing repo markets similarly affect securities lending markets. It would be advantageous for repo and securities lending associations to lobby and respond to regulatory proposals in a consistent manner.

It was noted that new to the regulatory agenda is a focus on ETFs, particular where these involve synthetic and leveraged structures.

A draft response to the CPSS/IOSCO paper on principles for Financial Market Infrastructures (FMIs) will be circulated to the Committee shortly for comment.

## **12. Upcoming meeting dates and Any Other Business**

A query had been received regarding the limits set out in UCITS governing the ability of funds to invest in repo. The Committee felt that it was not for the ERC to be lobbying for amendments to UCITS investment restrictions.

The ICMA website needs to be updated to reflect the fact that the ERC acceptable general collateral (GC) list should include government and government guaranteed bonds and bills from Slovakia and Estonia; and bonds being issued collectively by Euro sovereigns, such as in the case of the European Financial Stability Facility (EFSF) issues. The ERC Secretariat will look into making this amendment.

Mr. McAleer will provide an update to the Committee on agency lending disclosures.

The Committee agreed that starting with this meeting the ERC Committee minutes should be published on the ICMA website once they have been approved by the Committee.

### **Further dates:**

The ICMA ERC Secretariat will be in touch regarding availability for a Committee meeting to be held at the end of August.

The ERC Council general meeting is being held on September 14<sup>th</sup>.

A further ERC Committee meeting will be held at the beginning of November in Copenhagen, at the invitation of Danske Bank.

BondLend are hosting the Professional Repo Course in London from November 21 – 22.

### **Action points:**

1. Committee members are asked to provide any comments on the Repo Cash Settlement Study to Mr. Comotto before July 11<sup>th</sup>.

2. The working group looking at the composition of the Euro GC pooling baskets in the light of the Basle III liquidity framework will report to the Committee at the next ERC Committee meeting in August.
3. The Chairman of the ERC Ops Group will amend the Repo Margin Best Practices paper and re-circulate a draft to the Committee.
4. The Chairman of the ERC Ops Group will publish the document “Recommendation on Bilateral Repo Matching as a driver for risk reduction” on the ICMA website if no further comments are received.
5. The ICMA ERC Secretariat will circulate Ms. Cleary’s legal update note to the Committee.
6. Mr. McAleer will speak with Mr. McNulty about attending ERC Committee meetings given that many of the regulatory issues facing repo markets similarly affect securities lending markets.
7. A draft response to the CPSS/IOSCO paper on principles for FMIs will be circulated to the Committee shortly for comment.
8. The ERC list of acceptable general collateral (GC) will be amended.
9. Mr. McAleer will provide an update to the Committee on agency lending disclosures.
10. The ICMA ERC Secretariat will organise a further Committee meeting to be held at the end of August in London.

The Chairman:

The Secretary:



Godfried De Vidts



Lalitha Colaco-Henry