International
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Association

ICMA

Minutes of the European Repo Committee meeting held on 16 September, 2015 in Frankfurt

Present:	Mr. Godfried De Vidts	ICAP (Chairman)
	Mr. Daniel Bremer	Bank of America Merrill Lynch
	Mr. Michael Manna	Barclays
	Mr. Grigorios Markouizos	Citigroup
	Mr. Andreas Biewald	Commerzbank
	Mr. Romain Dumas	Credit Suisse
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Tony Baldwin	Daiwa Capital Markets
	Mr. Francois-Xavier Bouillet	Goldman Sachs
	Mr. Jean-Michel Meyer	HSBC
	Mr. Nicola Danese	J.P. Morgan
	Mr. Andy Wise	Morgan Stanley
	Mr. Sylvain Bojic	Société Générale
	Mr. Richard Hochreutiner	Swiss Re
	Mr. Gareth Allen	UBS Limited
	Mr. Eduard Cia	UniCredit Bank
On the phone:	Mr. Michel Semaan	
Also Present:	Mr. David Hiscock	ICMA
	Ms. Lisa Cleary	ICMA
	Mr. Andy Hill	ICMA
	Ms. Lalitha Colaco Henry	ICMA (Secretary)
Apologies:	Mr. Eugene McGrory	BNP Paribas
	Mr. Andrea Masciovecchio	Intesa SanPaolo
	Mr. John Edwards	BrokerTech
	Mr. Oliver Clark	MTS Markets
	Mr. Kevin McNulty	ISLA
	Mr. Richard Comotto	ICMA Centre

Welcome by the Chairman

The Chairman warmly welcomed the Committee to ICAP's office in Frankfurt. He noted that the first item on the agenda (update on RFR) had to be postponed as neither Mr. Edwards nor Mr. Clark had been able to travel to Frankfurt. Instead, they would attend the 2 December meeting of the ERC Committee in London.

The Chairman also noted that Mr. Ed McAleer had retired from Morgan Stanley. He had been the Vice-Chairman of the International Repo Committee (IRC Committee) and accordingly, it had been decided to appoint Mr. Andy Wise as his interim replacement on the IRC Committee. The appointment of the IRC Committee Vice-Chair has been tabled on the Agenda of the European

Repo Council meeting on 14 October. Additionally, Mr. Michel Semaan had recently been made redundant from Nomura. Under the rules of Section 1000, he has three months within which to find a new role with another European Repo Council firm. During those three months, Mr. Semaan will remain a Committee member.

Lastly, European Repo Committee elections, using the new electronic voting process, will take place in January 2016. ICMA will call for nominations in December and the results of the election will be announced in February.

1. Minutes of the previous meeting

The draft minutes of the last ERC Committee meeting, held jointly with the ISLA Board on 23 June 2015 in Lisbon, were unanimously approved. They will now be published on the ICMA website.

2. Draft 29th semi-annual repo survey conclusions

In Mr. Comotto's absence, the Chairman said that there had been a 2% increase in the headline number to EUR 5,612 billion which was an increase in a constant sample of 4.6% since December 2014. The increase over the last six months had not been expected and the Committee was asked to consider why the headline figure had increased when it was felt that trading volumes were declining. While it was accepted that the survey is based on a snapshot, which makes the survey sensitive to blips, it was suggested that moving the date of the survey from the 15th to the 30th might more accurately reflect the state of the repo market. There was also speculation that the effect of the slowdown is not yet evident because there are a couple of banks that have not started to take into account some of the regulatory ratios, and so the figures are slightly skewed. Once these banks start accounting for the regulatory ratios, the figures will drop. The Committee also noted that when TLAC and NSFR are finalised, there will be a further drop in the less liquid space.

The Chairman also noted that the survey showed that there had been a decrease of government bond collateral within the pool of EU collateral from 81.5% to 77%. Also of interest was the increase in short-dates which had risen again to over 60%. Additionally, the Committee took note of the fact that a recent analysis of a data sample of global bank SFT reporting showed that for the period from 2012 to 2014, while gross reporting is only down 6%, on a net basis it is down 12%, which shows that global banks are becoming more efficient to survive.

3. Repo market study

Mr. Hill said that, to date, he had conducted 36 interviews with a wide range of repo market participants, but still had more to do, including interviews with buy-side participants. The key findings will be presented at the 14 October European Repo Council general meeting. However, he will circulate a draft to the Committee for comment in early October.

Key themes emerging from the interviews so far are the impacts of Basle III and the leverage ratio in particular. The changing regulatory environment is altering the business models of the banks and buy-side relationships are evolving such that repo is becoming less commoditised and more negotiable. Banks and clients are working together to find tailored financing solutions to suit both their liquidity and financing needs. Bank balance sheets are becoming more negotiated with the view that high quality liquid assets and collateral are "king" while "cash is trash". Netting is of critical importance with increased focus on netting optimisation solutions (e.g. standardised "break-dates" on term trades). There are significant regulatory concerns, especially regarding NFSR, CSDR mandatory buy-ins, SFTR, and BRRD.

A key focus in drafting the report is that it should be a fair snapshot of the market and should also be forward-looking. In this regard, market participants have said that they expect further consolidation in the market and lower volumes, with the interbank market continuing to contract. There is also an expectation that some banks will remain active market-makers but others will retrench to minimum liquidity and collateral management levels. Bid-ask spreads will inevitably widen. Central clearing for larger buy-side clients is also seen as inevitable. There is also concern over repo and bond market functioning after QE is unwound. The Committee noted that NSFR incentivises banks to trade among themselves rather than with customers. Additionally, as BRRD is being implemented individually in each of the Member States, there are concerns that firms will encounter a patchwork of regulatory provisions which will increase the cost of doing business in different member states. It may also force the market to move to CCP trading.

4. Meeting with the ECB - current market conditions

The Chairman noted that the Bank of France's credit claims initiative had recently received a boost from the ECB's Governing Council which, at the end of August, had modified the Eurosystem legal framework to allow for the mobilisation of Euro Secured Notes as eligible collateral for its refinancing operations. This is an important step for the use of credit claims as collateral but is only available for French banks as they are the only banks with access to the Banque de France's ESNI system. The Chairman stressed to the Committee that it would be worthwhile for ICMA to develop the GMRA Credit Claims annex, but he recognises that there is little market appetite at this time. The Committee also noted that the ECB has said that there is currently a sufficient amount of collateral and that additional collateral in the form of credit claims is not immediately needed. It was also noted that at the recent Bank of England SLRC meeting concerns were expressed about the general impact of regulation and the generally negative outlook for repo markets in the light of QE.

Where will bonds come from if the current source of bonds (based in Asia) decides to stop providing supply and how will this affect markets? Where is your backstop? Data shows that pools of collateral are shifting due to QE. A large proportion of European debt is not held in Europe but is held in Asia and the Middle East. Accordingly, the behaviour of non-domiciled holders of bonds is very important to supply.

Data shows that Worldwide International Reserve Assets, excluding gold, (WIRA) may explain changes in the GC-Eonia spread. Assets held by non-leveraged accounts, even if available in a lending programme, will suppress availability and affect the cost of bonds. If collateral is then transferred to leveraged holders, such as a bank balance sheet or hedge fund, it will need to be funded which increases availability and could force a re-price. There is speculation that recent moves in the GC-Eonia spread illustrate this.

The Committee also noted that the ECB has no choice but to continue with QE. The markets seem to be surviving for now. However, it is recognised that the markets would be far more fragile and volatile without lending in place.

It was also noted that there are documentation issues that directly impact netting (and thus the balance sheet) if banks borrow bonds from the Banque de France and the Bank of England. It was agreed that this should be raised with the ECB.

5. BRRD

Ms. Cleary referred to a paper that had been put together by Daniel Bremer and herself, which had been circulated to the Committee ahead of the meeting. The paper sets out some background regarding the legal framework that has been established by global resolution regimes as well as the practical impact of such resolution powers and related industry initiatives on the repo and securities lending markets. It was stressed that the BRRD, which establishes a framework for the recovery and resolution of credit institutions and investment firms in the EU, is in the process of being implemented across the EU. The BRRD enables resolution authorities to temporarily suspend termination rights, imposing stays which would override certain provisions of relevant financial contracts, including repo and securities lending master agreements. There was some discussion about the practical implications of a stay. The objective of the BRRD is to ensure that failing entities can be resolved. Ms. Cleary reiterated that in the event of a stay payment and delivery obligations under the transaction (i.e. margin payment) should continue.

However, Article 69 provides the resolution authority with a discretionary power to suspend payment and delivery obligations. The Committee expressed their concerns about this power and noted that while it might only ever be used in exceptional circumstances, it would nevertheless have to be assessed when calculating margin risk. It was also noted that CCPs, Central Banks and DMOs are exempt from the stay provisions. While the BRRD states that no creditor should be worse off than they would have been under normal insolvency proceedings, the exemption given to CCPs et al means that this will not work in practice and this will cause tremendous market uncertainty, as the CCPs could cause fire sales.

There is also an issue in Germany and Austria where there is a lack of legal certainty in relation to the enforceability of netting in these jurisdictions arising from the applicability of bail-in. Further details are contained in the ICMA GMRA German and Austrian legal opinions. National lobbying efforts are underway to encourage legislative amendments.

6. CSDR update

Mr. Hill said that ESMA had been expected to submit Regulatory Technical Standards (RTSs) at the end of September. However, over the summer ESMA had carried out a consultation on the process of buy-ins under the mandatory regime. ESMA had asked for views on three options:

(a) trading party is responsible for executing the buy-in;
(b) trading level party executing the buy-in with a fall-back option – i.e. in case the trading party does not perform the buy-in, the participant would be responsible for paying cash compensation; and
(c) CSD participant level is responsible for executing the buy-in.

The most popular response to the consultation was "none of the options provided". Respondents considered Option 1 to be the least-worst option. None of the responses favoured Option 2, which had been ESMA's preferred option. ESMA will delay submitting the draft RTSs till November.

Turning to Level 1 of the CSDR, Mr. Hill said that there were four basic problems that had been enshrined into the law. ICMA, in cooperation with some other trade associations, is drafting a letter to the Lord Hill Cabinet asking for a change to Level 1 or for a technical adjustment from ESMA. The Chairman added that he is talking with various parties about whether they will also be signatories to the letter. ESMA has indicated that it is considering a 24-month delay or a delay untill after T2S has been fully implemented.

7. <u>AOB and upcoming dates</u>

The Chairman informed the Committee of NSMA's 11th International Repo Forum being held in Moscow on 17 – 18 December. The event will highlight a variety of topics including the development of operations of the classical securities lending, bonds issuance and circulation of bonds, including serial bonds. The NSMA has asked whether there are ERC members who would be able to discuss these issues. Interested Committee members were asked to contact the Chairman directly.

Ms. Cleary asked the ERC committee for an indication of market interest in commissioning an ICMA GMRA legal opinion for Georgia. The ERC committee felt that there was insufficient interest in extending opinion coverage to Georgia.

Future **European Repo Committee meetings** have been scheduled as follows:

(1) **2 October** – 12:30 – 15:30 CET hosted by UniCredit in Munich (Room "kleiner Gartensaal", UniCredit Bank AG, Arabellastrasse 14, D-81925 Munich) followed by Oktoberfest dinner and drinks

(2) **2 December** – 15:00 – 18:00 GMT, hosted by ICAP in London (2 Broadgate, London, EC2M 7UR) followed by Christmas drinks.

In addition, Committee members were asked to take note of:

- **European Repo Council General Meeting** - **14 October 2015, 3:00 – 5:30 BST**, followed by drinks hosted by BNY Mellon at Painters' Hall, 9 Little Trinity Lane, London, EC4V 2AD. The ERC General Meeting is taking place in the margins of BNY Mellon's Thought Leadership Discussion and Panel on *"The Future of Wholesale Funding Markets: A Focus on Repo Markets Post US Tri-Party Reform"* which starts at **1:00pm BST** with registration from 12:15 onwards.

The Chairman: The Secretary:

Godfried De Vidts Lalitha Colaco-Henry
14 October 2015