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Minutes of the ERCC Committee meeting held on 19 July, 2016 in London

Present:	Mr. Godfried De Vidts	ICAP (ERCC Chairman)
	Mr. Dan Bremer	BAML
	Mr. Michael Manna	Barclays
	Mr. Andreas Biewald	Commerzbank
	Mr. Romain Dumas	Credit Suisse
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Johan Evenepoel	Euroclear Bank
	Mr. Francois-Xavier Bouillet	Goldman Sachs
	Mr. Nicola Danese	JP Morgan
	Ms. Amanda Brilliant	Nomura
	Mr. Michel Semaan	Crédit Agricole
	Mr. Sylvain Bojic	Société Générale
	Mr. Gareth Allen	UBS Limited
On the phone:	Mr. Eugene McGrory	BNP Paribas
	Mr. Andrea Masciovecchio	Intesa SanPaolo
	Mr. Harald Bänsch	UniCredit Bank
	Mr. Nicholas Hamilton	JP Morgan (ERCC Ops Group Co-chair)
	Mr. Richard Comotto	ICMA Centre
Also Present:	Mr. David Hiscock	ICMA
	Mr. Alexander Westphal	ICMA
	Ms. Lisa Cleary	ICMA
	Ms. Lalitha Colaco Henry	ICMA (Secretary)
Apologies:	Mr. Grigorios Markouizos	Citigroup (ERCC Vice Chair)
	Mr. Jean-Michel Meyer	HSBC
	Mr. Eduard Cia	UniCredit Bank (ERCC Vice Chair)
	Mr. Richard Hochreutiner	Swiss Reinsurance
	Mr. Ed Donald	Standard Chartered (ASIFMA)

Welcome

The Chairman welcomed those in the room and on the phone and thanked ICMA for hosting the meeting.

1. Minutes from the last meetings

The minutes of the last two Committee meetings, which took place on 20 May 2016 in Dublin and 21 June 2016 in Vienna were unanimously approved. The minutes of the joint ISLA-ERCC Committee meeting, which took place on 21 June, were also approved, subject to a minor clarification in agenda item 6 (ECB's CSPP programme). The ISLA Board has also approved the minutes of the joint ISLA-ERCC Committee meeting.

2. Intraday liquidity and ERCC Operations Group update

Mr. Dumas said that there were three issues to consider. First, intraday credit lines are mainly driven by a time gap between settlements, where you have to pay for a reverse repo ahead of when you receive the cash from an equivalent repo. This time gap is driven by the current cross-border settlement infrastructure where firms are required to pre-position. One solution to this issue may be the development of better sequencing of settlements (rather than individual actors all carrying out their own optimisation). Mr. Dumas asked whether it would be worth discussing this issue with the infrastructure providers to see if they can optimise sequencing and shaping. The longer the time gap the more credit lines grow.

Second, Mr. Dumas questioned whether increasing intraday credit lines could be reduced in the Euro market with the full implementation of T2S? Lastly, Mr. Dumas noted that in times of systemic nervousness (such as the aftermath of the Brexit decision) there appear to be different consequences depending on whether a firm's credit line is provided in central bank money or commercial bank money, which in turn depends on whether the firm is a direct or indirect participant of T2S. The intraday credit line depends on the credit appetite of the counterparty's infrastructure provider and also on how much collateral you have to secure it. In a systemic situation, the risk appetite of the central bank will stay the same or will increase but the appetite of private agents will likely decrease. Regarding the collateral securing the transaction, in a systemic situation the central bank tendency will be to widen eligibility and keep the haircut unchanged while a private agent is more likely to widen the haircut and tighten eligibility. Therefore, the type of access that a firm has will be important.

Mr. Biewald said that compliance with BCBS 248, Monitoring Tools for Intraday Liquidity Management, requires the treasury department within each bank to monitor its intraday liquidity profile. The monitoring of the intraday liquidity profile BCBS 248 will make the users and mis-users of intraday liquidity more visible. Sources of intraday liquidity include (a) reserve balances at the central bank i.e. cash and collateral, (b) collateral pledged with the central bank or with ancillary systems that can be freely converted into intraday liquidity, (c) unencumbered assets on a bank's balance sheet that can be freely converted into intraday liquidity, (d) secured and unsecured, committed and uncommitted credit lines available intraday and (e) balances with other banks that can be used for intraday settlement. Previously, the ICSDs used to provide intraday liquidity free of charge versus pledged collateral but this is now more restricted, due to more stringent regulatory requirements on their side. Due to the many and rich sources of intraday liquidity, continental European banks were not particularly concerned with intraday collateral use. Bank surplus liquidity was recycled and collateral left in the source account was a huge resource that was not ring-fenced and was always available as the oil for the settlement engine. Therefore, continental European banks were not particularly concerned with intraday collateral use.

For money market transactions the European Banking Federation recommends that Euro payments related to interbank transactions, which are traded on the value date on or before 10:00 CET should be sent on the value date, with sufficient liquidity coverage as soon as possible and, at the latest, before 12:00 CET (Source: European Interbank Liquidity Management Guidelines, Revision 29015 by EBF a.o.) This ensures that no-one is utilising other people's liquidity due to late settlement or postponing settlement up to the cash deadline set by the ICSDs.

Certain tri-party trades are an example for a potential inefficient use of intraday liquidity. Some firms may have open tri-party repos in Euros until late in the day. The tri-party providers do not have any intraday deadlines requiring tri-party counterparties to settle before a certain time except for the cash deadline and the collateral deadline. If the collateral deadline is after the cash deadline then if the tri-party dead fails, then the bank might have problems with their central bank balances overnight. Therefore, the tri-party issue needs to be solved as well.

T2S will reshape the way banks manage their intraday liquidity. Theoretically, all trades could settle overnight, but that is a utopia. Instructing and settling are two separate actions. One party may send instructions early but settlement will depend on both counterparties sending instructions so that settlement can take place. Some banks have very effective intraday liquidity cash managers who work efficiently with the cash and collateral that is available to them. For those banks who invest in this functionality, the efficiencies to be made are significant, saving those banks millions in intraday liquidity. Repo could be settled in daytime processing cycles which would enable net settlement with a low intraday liquidity requirement. For example: Clearstream Frankfurt currently offers batch processing at a pre-defined point in time which allows settlement with minimum cash injection.

It was noted that the more counterparties delay settlement the more that risk builds up in the system. There may be merit in considering whether to develop recommendations that parties should instruct early. It was noted that while all market participants should be encouraged to adopt good settlement discipline practices, banks could lead the way, given the savings that they would make by having effective intraday liquidity management practices. However, settlement infrastructure also needs to improve. For example, in relation to net settlement for cash payments pair-offs take a long time to arrange. There needs to be better systems that facilitate net settlement and better interoperability. It was agreed that the Committee should work closely with the ERCC Operations Group to understand how to standardise certain settlements.

Mr. Hamilton said that the ERCC Operations Group is contributing to a COGESI review focused on improving and harmonising collateral management arrangements within the Euro area. While the T2S model has started to mature there are still concerns around certain functionality relating to the movement of collateral post T2S. Three work-streams are looking at the frictional issues around interoperability at a market level in terms of products, agents and firm processing. Work-stream one is looking at collateral mobility. Work-stream two is looking at collateral holding and segregation while work-stream three (WS3), which is the work-stream that the ERCC Operations Group is leading, is looking at collateral messaging. In particular, WS3 is looking to improve messaging in the market and highlighting issues regarding the movement of collateral both regionally and globally.

WS3 is looking at repo, securities lending and the more vanilla pledge instruments. The work is focused on messaging events across the eco-system – i.e. the movement of information from point of execution (i.e. venue) through the institutional layers and then to the agents, custodians and CSDs to understand how those processes interact with each other. WS3 has started to survey the different participants in terms of how they interact from a messaging perspective. It is clear that trade information is re-shaped significantly across the layers and this causes re-processing and potentially delays in how trades are eventually transferred between the layers. It is also clear that when a trade starts at the top level in terms of venue and execution and is then translated through the banks' processing, it ends up as a very simplified event in the market infrastructure. To most FMIs and agents repo looks like a simple cash message, either on the inventory side or on the cash side; and hence it is very difficult to differentiate between repo and cash market processes. Therefore, the next part of the exercise, to be completed by the end of November, is to fully map out this ecosystem and highlight key areas for standardisation, focusing heavily on the product definition to ease some of the issues relating to the segregation of repo and other collateral products from the cash businesses. This will be critical in preparing for the CSDR settlement discipline regime in 2018 and the transmission of messages into trade repositories under the SFTR.

The key reference point is the ISO 20022 standard but little work has been done to link (i) trade execution from a venue perspective; (ii) firms; and (iii) the wider environment. All environments need to use the same messaging model. This will also help to achieve fully interoperable tri-party models between the ICSDs and any other tri-party agents. Currently, there are clear differences between how the tri-party models work in Clearstream and Euroclear Bank. Looking at CCP interoperability, there are opportunities to achieve standardisation across the regional and global tri-party models. However, to achieve this, WS3 needs to take a back-to-basics view about how those data-points are transmitted across the eco-system. There is also an opportunity to automate certain elements of asset servicing.

This work will be on-going for the next six months. The ERCC Operations Group will be drafting position papers for review by the ERCC Committee. The ERCC Operations Group has already had discussions about some of the frictional issues regarding pair-offs and timeliness and delivery to market but more empirical work needs to be carried out to prioritise the work.

The Chairman referred to a potential fixed income study that some Committee members have discussed. He will be discussing this paper with ICMA to see if funding can be obtained for further work. A key issue to consider is the way in which this would fit alongside the work already being carried out by the ERCC Operations Group. The Committee agreed that any new work should complement the ERCC Operations Group work and that further work is needed. Mr. Hiscock said that ICMA would carefully explore the business case for this project and would need to consider whether the various pieces of work currently being done are sufficient or whether there are gaps that would need to be addressed in order for members to develop greater market efficiency and satisfy forthcoming regulatory requirements. It was noted that if you can standardise messaging and have the whole industry use the same system then interoperability will follow. Accordingly, the work being done by the ERCC Operations Group is crucial. Mr. Hamilton noted that the COGESI work is a very significant work programme which will take time to complete. In the meantime, the ERCC Committee and ERCC Operations Group need to come to some agreement on the direction they wish the work to take, which in itself, is a significant undertaking. It was agreed that further discussions should be held. The Chairman also said that he would discuss the on-going work with the Commission and the ECB.

Mr. Evenepoel said that prior to 2015 credit usage and liquidity usage were not a problem but now CSDR is posing a number of problems for Euroclear. Euroclear has been told by its regulator that the credit it provides to clients must be reduced substantially. Euroclear also has to consider stress testing which envisages the default of the two most important clients. If this should happen, Euroclear could use pledged securities as collateral, but it poses a liquidity issue rather than a credit issue. Another problem is the day to day business. Previously, liquidity was not a problem because Euroclear could rely on cash correspondents for each currency. Accordingly, Euroclear was able to offer a liquidity service – with clients offering securities in return for credit/cash. However, Euroclear recently undertook an intraday liquidity monitoring exercise which showed important peaks in some currencies. Some clients are using Euroclear's liquidity with cash correspondents quite early in the morning. Pre-CSDR, Euroclear could use uncommitted cash correspondent lines as liquidity sources. However, post-CSDR, these peaks have to be covered by qualified liquidity sources. Euroclear has also been asked by its regulator to monitor more closely the quality of the securities that clients are providing to secure their cash correspondent lines. This means that if

Euroclear allows clients to use lower quality securities to secure their cash correspondent lines, then Euroclear is required to back those securities with liquidity sources. For all these reasons it is important that Euroclear seeks to reduce both credit and liquidity usage.

Mr. Evenepoel went on to say that there are a number of quick wins which are outlined in the slides, such as the three way substitutions in the overnight batch, which was improved in January 2016. At the request of clients, Euroclear has also tried to postpone settlement positioning. Previously, everything was positioned on credit on S-1. Now, for the French, Spanish and Italian markets Euroclear is positioning after the Euroclear overnight (without disrupting the settlement cycles). This is a recent change which helps to substantially reduce credit usage overnight. It also means that settlement is aligned more closely with the local markets. Liquidity and credit usage will change further when Euroclear is fully integrated with T2S.

Euroclear also offers a service whereby on behalf of clients it will postpone settlement positioning to reduce credit usage. However, it was noted that postponing settlement to as close to the settlement deadlines as possible does not solve the underlying issues that were discussed earlier and could be seen as a race to the bottom. While it helps the individual client, it does not benefit the market, especially when clients of one ICSD are trading with clients of the other ICSD. Postponing settlement has to be suitably calibrated to meet the needs of all market users. This is made more difficult by the fact that the cash deadlines are different from the settlement deadlines. An emerging trend is to allow settlement to be instructed 10 minutes before Target closing with commercial settlement for cash taking place between 16:00 and 17:00 CET. This results in a period of one and a half hours during which time there is uncertainty about whether the transaction will settle. In a negative rate environment, this leads to increased costs and risk. However, Mr. Evenepoel noted that Euroclear will offer this service to clients that have a history of settlement fails and as such avoid impact on actual settlement time (i.e. not disruptive). In addition, costs will be imposed on clients who do not comply with the deadlines, which should help to enforce market discipline. The Committee agreed that it was necessary to find the right timing for settlement in order to develop a more streamlined settlement system.

Mr. Evenepoel also noted that T2S will solve liquidity and credit issues, especially its auto-collateralisation function. When the auto-collateralisation function is in place in 2017 clients will be able to substantially reduce their credit usage and Euroclear's liquidity usage. However, it was noted that such functionality will be expensive to use and as such relevant only to major credit users. Mr. Biewald said that Clearstream had indicated that the technical ability to input instructions earlier is the best way to settle all trades in the night. The Clearstream system was designed to achieve a high degree of finality very early during the business day and intraday cash was not required in any of their cycles.

The Chairman suggested that Clearstream should be invited to discuss this issue and also the impact that T2S will have on intraday liquidity.

3. Liquidity assessment

Mr. Dumas said that in relation to capital requirements for the risk of close-out positions, i.e. the need to liquidate collateral, an important question to consider is how long it will take to close out the position. The length of time the liquidation is anticipated to take will feed into a firm's RWA calculation, which in turn has a capital impact. Underlying the calculation is the intraday volatility of each of the ISINs constituting the collateral and the number of assumed days it will take to liquidate. If you are considered to have, against a certain netting set (i.e. collateral with a given counterparty under a repo or CSA etc.) too great a concentration of a certain type of collateral (e.g.

German government bonds), then in line with the daily liquidity for that market it is considered that your period of risk increases. Therefore, there is an incentive to diversify your collateral holdings. But, from a risk department's point of view it may well be less desirable to have 5 billion of German government bonds and 2 billion of Italian government bonds rather than 7 billion of German government bonds, because the diversification involves accepting lower quality collateral. Returning to the RWA calculation, it may be safer to have 50 million of a 5-year Spanish government bonds rather than 50 million of 30-year German government bonds, because daily volatility on the 30-year bond will be much higher than on the 5-year bond. In a close-out situation one does not just sit on the collateral and wait to liquidate it. Instead, the portfolio is neutralised first. Therefore, one wants to be incentivised not to just diversify into lower quality collateral, but rather to be able to use the collateral that can be considered to be the safest. When considering what is the safest, the most important element is the credit aspect as the interest rate aspect is something that can be neutralised with swaps and futures. So for an essentially interest rate product, such as German government bonds, what one does in practice when liquidating a portfolio is firstly to neutralise the interest rate and curve risk with liquid instruments (i.e. futures and swaps) and then the portfolio can be liquidated over time. This means that the risk one is left with during the 10 or 20 days liquidity exposure calculation period is an asset swap type of risk rather than full duration risk. It was agreed that Mr. Dumas, Mr. Manna and Mr. Bouillet would look to further develop this idea, considering whether the aspect of "hedgeability" might better be reflected in assessing capital requirements for close-out risk.

4. Netting of cash in a T2S or CSDR environment

This agenda item was postponed till the next meeting.

5. AOB and further dates

German netting issue - Ms. Cleary said that a call with German council had been held recently to discuss a German supreme court decision relating to the German master agreement (that appeared to undermine close out valuation methodology). An update to the legal opinion will be published shortly, which should provide the market with sufficient comfort until legislative amendments can be made in Germany. Members should ensure that the opinions on which they seek to rely extend to their particular circumstances and satisfy themselves as to the strength of the opinions and the effect of the assumptions and qualifications contained therein.

Buy-side annex – Ms. Cleary said that work on the buy-side annex is progressing, however, only a few Committee member firms are taking part in the working group, which is suffering from a lack of engagement. Additionally, some firms are expressing concerns and doubts about whether it will be possible to develop a standardised form of GMRA Annex given the number of additional bespoke provisions required for credit, tax and other purposes.

It was noted that while not all Committee members see the need to be involved in the working group, the business case for developing an annex may nevertheless continue to exist. Ms. Cleary agreed to circulate a summary of the project so that Committee members could consider this with their firms and provide a definitive decision as to whether a business case can be made to continue with the project and if so whether they would be willing to allocate resource to it.

SLRC update – Mr. Hiscock said that the meeting had first discussed current market conditions with a focus on the sterling market post-Brexit. Concerns were expressed about the impact of the Brexit vote on the sterling market, the initial effects of which have been a drying out of the term market and that spreads have widened quite markedly – both of which are unhelpful for the market.

There was also a discussion of the Bank's July 2016 Financial Stability Report, and its focus on market liquidity. The FPC's review of the leverage regime highlighted that the regulation has been a positive step that has made markets more stable but there are refinements that could improve market effectiveness without compromising the resilience of the markets. Specifically, there are certain elements of the leverage ratio regime that might be amended such as allowing the netting of cash receivables and payables from unsettled sales of securities and allowing initial margin posted by clients to reduce dealers' potential future exposures to default of those clients in CCP derivative transactions. The Bank is also calling for further examination of the leverage ratio and consideration of other measures such as potentially taking holdings of central bank reserves out of the measure of exposure for leverage purposes. The Bank also emphasised that the ratio is intended to be applied only at a consolidated level. These amendments are expected to be discussed by the BCBS, but it is anticipated that the US Fed may try to push back against reducing the regulatory burdens on the repo market. The Chairman noted that the Federal Reserve Bank of New York had recently published a paper looking at the prolonged dislocation between the cash bond and CDS markets. The Chairman agreed to circulate the paper to the Committee.

There was some discussion at the SLRC meeting about these proposed amendments to the leverage ratio regime. In particular, SLRC members noted that simply saying that the ratio is intended to be applied at a consolidated level does not take away from the fact that it still brings pressure to bear on the underlying business because the balance sheet has to be allocated and charged in order that a firm can manage to a consolidated target number. If there is a problem with hitting that number the firm needs to be aware of where it can most quickly adjust the ratio, which is likely to be in a business such as repo and therefore there are inevitably going to be pressures that feed into the market. The ERCC has had a similar discussion with the Bank about the NSFR. It was noted that the Bank's Financial Stability Report also makes clear that repo supports the cash markets. The Bank is setting up a central bank working group to look specifically at repo and its relationship with the cash markets, the liquidity in such markets being important to financial stability.

There were a few updates at the SLRC meeting on other matters including the Code of Conduct work in which Mr. Bouillet is involved. The Bank is aiming to have a reasonably well-developed draft by the end of Q3 with the new Code being introduced in the middle of next year alongside f the introduction of the new global FX Code. It remains very important from an ERCC perspective to look carefully at the evolution of this work because of how it could interact with the ERC Guide to best practice in the European repo market.

Brexit – The Chairman said that this discussion would be postponed until the UK invokes Article 50. Mr. Hiscock said that ICMA are not planning to form a Brexit Committee that would cut across all of ICMA's activities, but rather it will be for each of the existing market practice committees to discuss Brexit and if it becomes clear that there are issues that should be considered further, then these should be brought to ICMA's attention so that ICMA can consider to what extent it needs to react on behalf of members.

NSFR – Mr. Bojic noted that Mr. Masciovecchio had recently forwarded to the Committee the FAQ's published by the BCBS on the NSFR. There is a question mark about the treatment of open repo transactions. How does a firm prove that it can close such transactions at any time, for NSFR purposes? One way would be to re-price any open trade (i.e. close and re-open) after three months, thus demonstrating an end-date to the trade.

Asset segregation – Mr. Hiscock said that ESMA published a call for evidence on 15 July relating to asset segregation and custody services under AIFMA and the UCITS Directive. The deadline for responses is 23 September. Mr. Hiscock will be in touch with ISLA and, potentially, EFAMA to understand what positions they are taking and see if there are any positions that the ERCC should be supporting to try and ensure that asset segregation rules do not unnecessarily disrupt liquidity in the market. There is an open hearing taking place on 20 July which should provide more clarity on the issue and help decide whether the ERCC should respond.

European Money Market Fund Regulation - Mr. Hiscock said that trilogues are now starting on the European Money Market Fund Regulation proposed by the Commission in 2013. The European Council has now reached its view on the proposed Regulation. The proposed Regulation includes specific language about the extent to which money market funds can engage in reverse repo and repo-type transactions including limits on how much of those types of transactions they can engage in. There are also differences between the three different texts – i.e. the original Commission proposal, the Parliament's view and the Council's view. Mr. Hiscock asked Committee members to get in touch directly if there are any strong views on this topic, as there is an opportunity to input views into the trilogue debates.

Future **ERCC Committee meetings** have been scheduled as follows:

1. **30 September 11:30 – 14:30 CET**, kindly hosted by UniCredit;

2. **26 October**, meeting of the ERCC Committee with the ECB in Frankfurt; and

3. **14 November 10:15 – 13:15 CET** - ERCC Committee meeting in the margins of the Euroclear Collateral Conference in Brussels.

Other Repo dates:

- **ICMA European Repo and Collateral Council General Meeting – 27 September 2016, 2:00 – 5:00 BST**, kindly hosted by BondLend at Level 39, One Canada Square, Canary Wharf, London, E14 5AB, in the margins of the BondLend conference on "The changing landscape of fixed income finance". Mr. Mark Yallop will provide the keynote address.

The ERC Chairman: The ERC Secretary:

Godfried De Vidts Lalitha Colaco-Henry
30 September 2016