International
Capital
Market
Association

ICMA

Minutes of the ERCC Committee meeting held on 20 May, 2016 in Dublin

Present:	Mr. Godfried De Vidts	ICAP (Chairman)
	Mr. Daniel Bremer	Bank of America Merrill Lynch
	Mr. Michael Manna	Barclays
	Mr. Eugene McGrory	BNP Paribas
	Mr. Grigorios Markouizos	Citigroup (Vice Chair)
	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	J.P. Morgan
	Mr. Sylvain Bojic	Société Générale
	Mr. Richard Hochreutiner	Swiss Re
	Mr. Eduard Cia	UniCredit Bank (Vice Chair)
On the phone:	Ms. Amanda Brilliant	Nomura International
	Mr. Gareth Allen	UBS Limited
Also Present:	Mr. Andy Jobst	IMF
	Mr. Graham Frier	Citadel Securities
	Ms. Klaudia Mach	Simmons & Simmons LLP
	Mr. Francesco Lago	Banca IMI
	Mr. David Hiscock	ICMA
	Mr. Andy Hill	ICMA
	Mr. Alexander Westphal	ICMA
	Ms. Lisa Cleary	ICMA
	Ms. Lalitha Colaco Henry	ICMA (Secretary)
	Mr. John Burke	
Apologies:	Mr. Andrea Masciovecchio	Intesa San Paolo
	Mr. Michel Semaan	Crédit Agricole
	Mr. Jean-Michel Meyer	HSBC
	Mr. Nicholas Hamilton	J.P. Morgan (ERCC Ops Group Chair)
	Mr. Richard Comotto	ICMA Centre
	Mr. Ed Donald	Standard Chartered (ASIFMA)
	Dr. Nathalie Aubry-Stacey	ICMA

1. Welcome

The Chairman welcomed those participating and thanked ICMA for hosting the meeting. He extended a warm welcome to Mr. Jobst, Mr. Frier, and Mr. Burke. He also welcomed Ms. Mach and Mr. Lago who were attending in their capacity as representatives of ICMA's Future Leaders Committee. The Future Leaders Committee is comprised of individuals in the early stages of their career who can provide ICMA with guidance on how to improve its engagement with the younger generation among its members. ICMA places great importance on reaching out to younger finance professionals in its member firms not only to raise awareness of ICMA's work and the benefits they could read from its services but also to foster a sense of community.

2. Minutes from the last meeting

The minutes of the last meeting, which took place on 13 April 2016 in London were unanimously approved.

The Chairman noted that on Thursday, 19 May he had attended a meeting of the European Commission's European Post Trade Forum (EPTF) where he had presented the ERCC's vision on collateral management. The presentation that he gave had previously been used at the e-MID event in Italy and would also be used at the meeting with the ECB on 31 May. The presentation will be published on the Commission's website in due course. The associations in attendance at the EPTF meeting had appreciated the presentation and helpful feedback was received. It is now becoming clearer to all that regulation cannot be assessed or developed in silos and that instead a "helicopter view" must be adopted to look holistically at all the elements that impact the markets. Post-trade processes should work in such a way as to facilitate the wider repo and collateral management business. However, the Commission had stressed at the meeting that their focus would be on post-trade issues, rather than taking a broader view. The Chairman also noted that COGESI has now set up three working groups. The ERCC Operations Group is leading one of these working groups. There is now a strong link between T2S and the ECB's desire to create a common collateral management system between the National Central Banks (NCBs) and additionally, future work which could be called CCBM3 which is the idea of creating a system to mobilise collateral anywhere in the world - i.e. a global collateral management system linking cash and securities. The development of such a system will be challenging and will take considerable time and effort. The Chairman's presentation was followed by Mr. Dyson's (ISLA) presentation, and the two presentations had complemented each other very well to set out the issues facing the markets. The Chairman will continue to attend EPTF meetings on an ad hoc basis.

3. Regulatory treatment of sovereign exposures

Mr. Jobst said that one topic on the IMFs' radar screen is market liquidity. In the next few months the IMF wants to increase its market surveillance as it believes that market liquidity is very important and is a key issue going forward, especially in the medium term when authorities will be looking to monetary normalisation. Mr. Jobst noted that the Euro Area: Interest Rate Expectations chart on slide 3 was remarkable in that it showed how the ECB's pursuit of negative rates, which has been very powerful, has led to a tremendous yield curve flattening. The forward curve of EONIA has been remarkably low and if you take forward expectations on the 1-month, it is back to zero percent in 6 years, which is far beyond the ECB's QE horizon which will mean a long period of very low interest rates. The equivalency of govies and marginal policy rate chart shows data for the Euro area, Japan and Switzerland expressed in terms of maturity and you can see, especially for the Euro area, that we are at six years of having to hold overnight policy rate levels given current yield curve flattening, similar to Japan and Switzerland. The IMF has never seen such a level of term-spread compression and low interest rates. Mr. Jobst said that another important element was fragmentation. By this he did not mean fragmentation of prices but fragmentation of allocation of excess liquidity, which is driven by the sourcing channel of QE. Even adjusting for that sourcing channel, slide 4 shows the cross-border spillovers from assets purchasers. In the wake of QE Target 2 imbalances may have amplified which could complicate the sourcing of collateral putting a premium on financial plumbing to help reduce fragmentation by reversing cross-border flows of excess liquidity. The blue bar shows the sourcing of assets while the red bar shows what ends up in excess liquidity – the deposits placed with the central banks. The data shows that there is a problem in Europe, and it calls for action to redistribute excess liquidity, which should be channelled into the real economy. This means that the repo market should be used to channel excess liquidity from the surplus countries to where it can be deployed more readily into lending and productive investments.

Slide 5 looks at market liquidity. Asset purchases have not resulted in collateral scarcity but if you look at the financing needs of governments, markets will shrink. This has implications for the availability of collateral and particularly central bank money. Market functioning in govies as collateral has deteriorated sharply and is potentially an indication that things are going less well. As far as market liquidity is concerned, the IMF is seeking input from the Committee on a range of questions. What do ERCC Committee members feel about the strengthening of the "transmission role" of SFT markets regarding collateral management? This question covers topics such as securities lending by NCBs, collateral procedures for commercial bank (bank-to-bank) and central bank (NCB-to bank) practices, non-marketable assets and foreign collateral and interoperability of (triparty) collateral management services. A second question concerns the review of the impact of various regulatory initiatives on repo trading such as the liquidity coverage ratio (LCR), the net stable funding ratio (NSFR), mandatory buy-in provisions under the CSDR and financial stays/creditor hierarchy under the BRRD. The IMF is seeing a reality-check and the "view from the ground". Finally, input is sought on the progress that has been made to remove the Giovannini barriers. What is most pressing? The IMF engages with a variety of authorities and feedback from the Committee would help to inform the IMF's views in those discussions. At the moment, the IMF's research on market liquidity indicates that alarm bells are not ringing constantly but there is cause to be concerned.

Referring to slide 8, Mr. Jobst said that a pressing topic concerned to the prudential treatment of sovereign risk aimed at enhancing banks ex ante resilience to sovereign risk in order to facilitate the introduction of the proposed European Deposit Insurance Scheme. Work on the prudential treatment of sovereign risk had been delayed because of opposition from some member countries. Nevertheless, there are various Pillar 1 options being discussed by both the Basel Committee and the Directorate-General for Economic and Financial Affairs (ECFIN), and all three options would have an impact on collateral markets which would vary depending on how each option was calibrated. Option one involves the use of positive risk weights where credit risk weights for all sovereign exposures would be applied under the standardised approach, subject to a certain floor. Option two involves the use of exposure limits up to a certain threshold while option three adopts a hybrid approach of using both positive risk weights and exposure limits.

The Committee broadly expressed two differing opinions. On the one hand, it was felt that the new proposals would be counterproductive and that the European Union should be discussing how to move away from national issuance towards pan-European issuance. Some Committee members felt strongly that the debate was circular - the sovereign risk exposure proposal was being suggested in order to achieve banking union and reduce risk, but in fact the proposal, if implemented, would only serve to increase risk. If you know that there will be a massive supply shock to the market in the future, you will front-load now and re-balance the portfolio now. It was also noted that current market conditions mean that implementing such a proposal now would have little effect, given benign interest rates and QE bringing down the spread. Instead, this discussion of sovereign risk exposure should be had in five years' time after five years of QE. On the other hand, however, some European countries believe that there is a very strong nexus between sovereign and bank risk, which needs to be addressed and that nexus needs to be severed and that there needs to be a re-distribution of risk. This could lead to a truly European banking model with true risk sharing. It was noted that the Greek banks had become insolvent because they had held such large amounts of Greek government debt. Such a scheme could help to reduce the knock-on effects of sovereign risk exposure to the banks. However, it was also noted that, for example, Italian banks would lend to Italian firms and that it was harder to see German banks lending to fewer German firms and instead lending outside of Germany to Italian firms etc. which would be the point of a banking union. Finally, it was questioned whether the solution is a bigger issue than the problem that this proposal is trying to fix. Committee members were urged to send further thoughts to Mr. Jobst.

4. <u>Impact of monetary policy</u>

Turning to slide 10 Mr. Jobst said that there is increasing thought being given to preserving banks absorptive capacity in adverse macro situations, so that the banking sector can act as a rebalancing mechanism. This would encourage greater diversification of sovereign risks in the euro area. It would also allow safer jurisdictions to move into peripheral debt. Thought should also be given to designing measures that are consistent with liquidity requirements while also allowing for a smooth conduct of monetary policy. LCR already imposes a risk weight on sovereign exposures. Conduct of monetary policy is a topic where Mr. Jobst is seeking views. What in your view would be the impact of Pilar 1 options on SFTs and market structure? How would it influence counterparty risk management? Could SFTs facilitate the implementation of Pilar 1 options?

The Committee noted that there is a real fear regarding collateral scarcity, given that the banks will be required to post more collateral in September and the ECB is taking collateral out of the market. If you are short of collateral, where will you get it from? The role of the NCBs are also crucial in this regard. NCBs should offer the option of accepting both cash and collateral, which would be very helpful for banks. However, it was noted that current rules prohibit the using of cash as collateral. The Committee agreed that the ECB has not always been receptive to industry concerns regarding the ASPP in the past. It was suggested that the IMF, being an international organisation could argue for greater consistency between the ECB, the US Fed, the Bank of England etc. i.e. amongst global central banks. Mr. Jobst noted the concerns expressed.

5. <u>Repo CCP operating models</u>

The Chairman said that in looking to advance the EMMI's work to develop a secured overnight benchmark the ERCC had decided that a new euro secured index should include all CCP cleared trades – i.e. not just electronic traded transactions but also voice brokered and any other OTC bilateral trades, which are submitted to the CCPs by the trading parties. However, it had become apparent in taking this decision forward that there are significant differences in the way that CCPs manage the risk provided by different trading sources. Additionally, the BRRD grants an exemption to CCPs from the 48 hour stay provisions. This exemption raises the question of the stay protocol implications for a trade in the period up to the CCP registering the trade and becoming counterparty. Accordingly, a decision had been taken to commission Mr. Burke to carry out a study on CCPs

Mr. Burke said that he was carrying out an analysis of CCP Trade Registration Models for the purpose of informing the Committee about the business models operated by the major European CCPs and how they differ from each other in relation to their repo clearing services. The report is narrow in focus and seeks to review the operation, risk and legal aspects of the trade registration process at the six European CCPs' that have established a significant repo clearing service: BME Clearing, CC&G, Eurex Clearing, LCH Ltd, LCH SA and Nasdaq Clearing. Mr. Burke said that the goal has been to work with the CCPs in a collaborative way to ensure that information about the trade registration process is captured and reported correctly and that the methods for doing so are transparent. An introductory letter has been sent to the CEO of each CCP which provides the background and rationale for the analysis. A questionnaire has also been sent to the CCPs, which asks 22 questions about the business model, operational model and risk and legal model used by each CCP. Responses have been received from five of the six CCPs while follow-up calls have been held with four CCPs and calls with the remaining two CCPs are scheduled shortly. There has been constructive engagement from all the CCPs. The Committee agreed to discuss Mr. Burkes' findings further at the next Committee meeting in June.

6. Impact of current/forthcoming regulations

The Chairman said that a small group of Committee members would be meeting with the Belgian DMO shortly to discuss NSFR. Mr. Hiscock said that ICMA had also written to the EBA who had declined to meet with the ERCC at this time as this issue is not currently on their agenda, but they may still be interested to meet with ICMA at a later date. Mr. Hiscock suggested that the Committee consider accepting Ms. Kay Swinburne's offer of providing her with advance briefing on market issues. The Committee agreed that the NSFR paper, which had been shared with the Commission, should be published on the ICMA website.

On LCR, the Chairman said that there was nothing further to report. On BRRD, the ERCC's position is still that the treatment of CCPs regarding the 48 hour stay provisions should be symmetric with that of other market participants.

On CSDR, a small delegation had met with the Commission to discuss the asymmetry of the payment differential between the buy-in price and the original transaction price that results from the mandatory buy-in regime. Mr. Hill said that the Commission was sympathetic and had implied that the asymmetry is due to an alternative interpretation of the buy-in process which is embedded in the Level 1 text. The Commission is concerned about the potential for market abuse and also about the impact on market liquidity. The Commission suggested that the ERCC keep the Commission informed about these two themes and also feed into the CMU work stream. The Chairman noted that it would make sense to link any potential concerns about market abuse in this regard to the Market Abuse Regulation as part of the CMU. Mr. Hill emphasised that the Commission is trying to work with the ERCC to find constructive ways of addressing the issues. The Chairman noted that the most likely way that this could be done would be in the Level 3 Q&A. Mr. Hill added that he is also optimistic that the deadline by which firms will have to comply with the provisions will continue to be extended. Additionally, a review of Level 1 of the CSDR will take place in 2019, which could be a further opportunity to find a workable solution if one has not been found by then.

In the context of the Maple Bank moratorium, the Committee discussed whether it would be possible to develop a document which sets out the default procedures in each jurisdiction across Europe, especially in relation to local banks that would not fall within the scope of the BRRD. This would help the market to better understand whether a default announcement had been made by regulators and what the default procedures are in each jurisdiction. Such a document would set out the strongest tool of each national regulator to shut down a bank short of using resolution powers and the process for announcing the use of the power to the market. The Chairman said that at the last COGESI meeting BNY Mellon Frankfurt had been asked to produce a paper describing the Maple Bank moratorium for the ECB. This paper could potentially be used as the basis for developing a document as requested by the Committee.

7. FSB/ESMA work on the imposition of minimum mandatory haircuts

Mr. Hill said that Mr. Comotto, with the assistance of various Committee members, had put together a survey template for haircut data as requested by ESMA. Some Committee members had provided data which had been collated and aggregated on an anonymized basis and sent to ESMA. On 12 May a few Committee members met with ESMA to discuss repo market haircut policies. The meeting had been constructive and they found the data which had been provided useful. ESMA has asked whether they can publish the data in their October report. Accordingly, are those Committee members who provided data willing for the aggregated and anonymised data to be published? ESMA also asked whether ICMA could provide haircut data on a six-monthly basis. Mr. Hill said that it would be necessary to refine the template for both quantitative and qualitative data. It was also noted that providing haircut data would assist central banks to take a more flexible approach in times of crisis as they would have reference data about how liquidity has evolved over time and what the market thinks about specific collateral.

Mr. Hiscock noted that the FSB has made its recommendations on haircuts. ESMA has now been tasked by the Commission to bring the FSB’s framework to the EU. Broadly speaking, the ERCC is recommending that ESMA adopt the position already taken by the FSB. However, at the same time the Vice President of the ECB has stated that macroprudential authorities such as the European Systemic Risk Board should be given the power to set floors on haircuts and margins of derivative and SFTs at the transaction level and should also be able to change these in a time variant manner, by which he means countercyclicaly.

8. ECB's Occasional paper "Basel III and recourse to Eurosystem monetary policy operations"

The Chairman requested that those Committee members attending the ECB meeting be prepared to discuss the paper at the meeting on 31 May.

9. Administrative issues

The Committee recommended that Canadian Imperial Bank of Commerce, London Branch (trading as CIBC World Markets plc) should become a member of the International Repo and Collateral Council (IRCC) and the European Repo and Collateral Council. Mr. De Vidts and Mr. Cia of the IRCC Committee approved the recommendation. The Secretary agreed to inform the firm accordingly.

10. AOB and further meetings

Mr. Frier suggested that he could return to a further Committee meeting to discuss the idea of a buy-side clearing model.

Messrs. Dumas, Biewald and Evenepoel agreed that they would return to the June Committee meeting to discuss the extent to which the ERCC Committee can and should work with infrastructure providers to minimise intraday credit line usage. Additionally, Mr. Dumas will return to the June Committee meeting to discuss whether the liquidity of a collateral portfolio should capture a "hedgeability" aspect. For example, interest rate risk can be hedged with very liquid instruments to neutralize price volatility and this could be included in the liquidity assessment methodology in order to incentivise the best use of collateral.

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

1. **21 June 13:00 – 14:00 CET** - joint ERCC/ISLA Board meeting in the margins of the ISLA 25th Annual Conference in Vienna;

2. **21 June 14:00 – 15:00 CET** - ERCC Committee meeting in the margins of the ISLA 25th Annual Conference in Vienna;

3. **19 July (afternoon)** – hosted by ICMA, 23 College Hill, EC4R 2RP, London;

4. **30 September 11:30 – 14:30 CET**, kindly hosted by UniCredit;

5. **30 September 14:30 – 15:30 CET**, joint ERCC/ISLA Board meeting kindly hosted by UniCredit (tbc); and

6. **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**, kindly hosted by BondLend in London.

The ERCC Chairman:	The ERCC Secretary:
Godfried De Vidts	Lalitha Colaco-Henry
21 June, 2016	

Current Issues Affecting the Repo Market

Questions and Considerations

Andreas (Andy) Jobst

European Department (Advanced Economies)
International Monetary Fund (IMF)
Email: ajobst@imf.org

European Repo and Collateral Committee
20 May 2016
Dublin

Disclaimer : This presentation should not be reported as representing the views of the IMF. The views expressed in this presentation are those of the presenter and do not necessarily represent those of the IMF or IMF policy. Any errors are those of the presenter.

Agenda

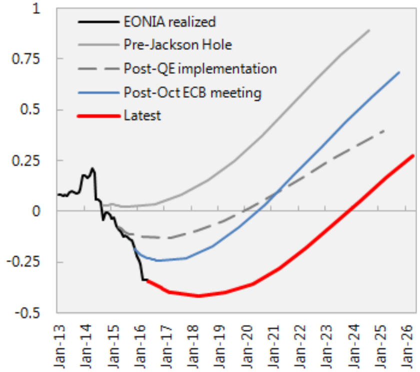
- **Market Liquidity:** Role of Repo Markets

- **Regulatory Reform:** Prudential Treatment of Sovereign Exposures

Euro Area: Risk of permanently lower equilibrium rate ...

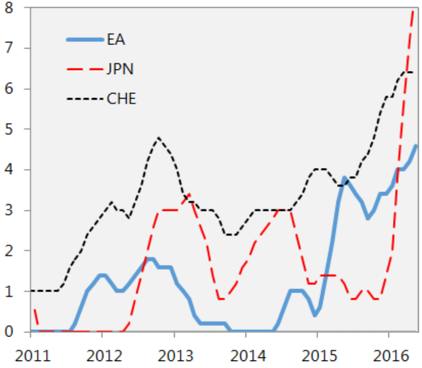
... which might mean **lower interest rates for longer**.

Euro Area: Interest Rate Expectations (EONIA)
(Percent) 1/



Source: Bloomberg LP and IMF staff calculations. Note: 1/ 1-month EONIA forwards.

Equivalency of Government Bond Yield and Marginal Policy Rate
(Years) 1/

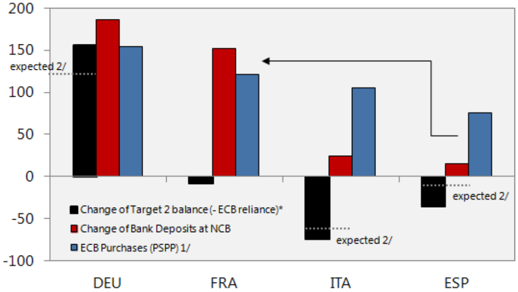


Source: Bloomberg LP and IMF staff calculations. Note: 1/ Euro area: core economies only.

Fragmentation: Cross-border spillovers from asset purchases may have amplified Target 2 imbalances ...

... which could **complicate sourcing collateral**, putting a premium on financial plumbing to help reduce fragmentation by reversing cross-border flows of (excess) liquidity.

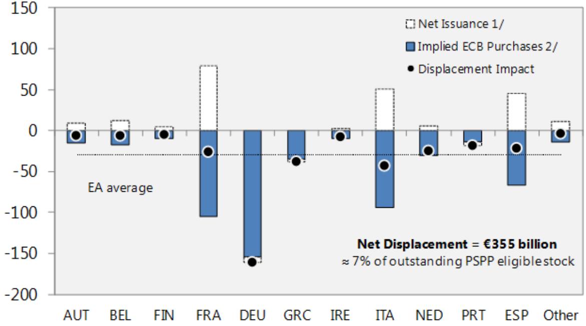
Euro Area: Rising Financial Fragmentation, January 2015-March 2016
(absolute change, EUR billion)



Source: Bloomberg L.P., ECB, Haver, NCBs, and IMF staff calculations. Note: */The use of ECB liquidity reduces the Target 2 balance and is subtracted; 1/ public sector purchase program (PSPP; 2/ expected based on changes in balance of payments after accounting for general "leakage" from Target 2 due to non-euro area trade and portfolio flows.

Market Liquidity (1): Asset purchases have not resulted in collateral scarcity ... yet.

Euro Area: *Expected* Displacement of Oustanding Government Bond Market in 2016
(EUR billion)

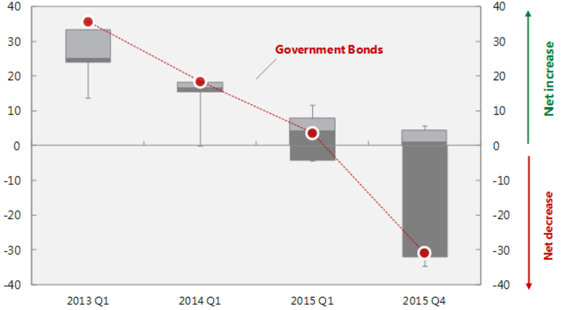


Sources: Barclays; Bloomberg, L.P.; ECB; J.P. Morgan; and IMF staff calculations.
Note: [1] Excludes coupon payments.
[2] Excludes purchases of public securities from Greece and Cyprus due to collateral restrictions and purchasing limits as well as other EA countries. Purchases based on ECB capital key in market value terms, converted into nominal amounts.

Market Liquidity (2): ... but liquidity and functioning of collateral markets seems to be declining.

ECB SESFOD Survey Results: Changes in the Liquidity and Functioning of the Collateral Market

(Percentage change over the last three months) 1/



Source: ECB Survey on credit terms and conditions in euro-denominated securities financing and over-the-counter (OTC) derivatives markets (SESFOD) and IMF staff calculations. Note: 1/ boxplots include the mean (black dot), the 25th and 75th percentiles (grey box, with the change of shade indicating the median), and the maximum and minimum (whiskers). Out of 10 collateral types included in the survey, the following are considered here: domestic government bonds, high-quality and other government/sub-national/supra-national bonds, high-quality financial corporate bonds, high-quality non-financial corporate bonds, and covered bonds.

Market Liquidity (3): Questions

- **Strengthening the "transmission role" of SFT markets regarding collateral management?**
  - Securities lending by NCBs
  - Collateral procedures for commercial bank (bank-to-bank) and central bank practices (NCB-to-bank)
  - Non-marketable assets and foreign collateral
  - Interoperability of (triparty) collateral management services
- **Review impact of various rules on repo trading?**
  - Liquidity coverage ratio (LCR)
  - Net stable funding ratio (NSFR)
  - Mandatory buy-ins (under CSDR)
  - Financial stays/creditor hierarchy (under BRRD)
- **Review progress on removing Giovannini barriers?** (cross-border clearing and settlement)

Regulatory Reform (1): Prudential Treatment of Sovereign Risk

- **Policy options aimed at enhancing banks ex ante resilience** to sovereign risk to facilitate EDIS
- **Three main Pillar I options**
  - *Positive risk weights*: Credit risk weights for all sovereign exposures applied under the standardized approach
  - *Exposure limits*: EU sovereign exemption from large exposure limits would be eliminated, imposing a ceiling on banks sovereign exposures
  - *Hybrid approach*: Risk weights gradually decrease/ increase with the size of exposures below/above a pre-defined concentration threshold

Regulatory Reform (3): Additional Considerations

- **Measures should also be designed to ...**
  - Preserve banks absorptive capacity in adverse macro situations
  - Encourage greater diversification of sovereign exposures
  - Ensure consistency with liquidity requirements (e.g., liquidity)
  - Allow smooth conduct of monetary policy (collateral market)
- **What about Pillar II/III measures?**
  - Enhanced monitoring and disclosure requirements
  - Common definition (with potential exemption for central banks)
  - Stress testing
- **Consistency with Basel process? Transition period?**

Regulatory Reform (4): Questions

- What would the **impact be of Pillar I options** on the SFTs and market structure?
- How would it influence **counterparty risk** management?
- Could SFTs **faciliate** the implementation of Pillar I options?

Thank you! Questions?