International
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ICMA

Minutes of the ERCC Committee meeting held on 30 September, 2016 in Munich

Present:	Mr. Godfried De Vidts	ICAP (ERCC Chairman)
	Mr. Dan Bremer	BAML
	Mr. Michael Manna	Barclays
	Mr. Andreas Biewald	Commerzbank
	Mr. Johan Evenepoel	Euroclear Bank
	Mr. Francois-Xavier Bouillet	Goldman Sachs
	Mr. Jean-Michel Meyer	HSBC
	Mr. Andrea Masciovecchio	Intesa SanPaolo
	Ms. Amanda Brilliant	Nomura
	Mr. Richard Hochreutiner	Swiss Reinsurance
	Mr. Sylvain Bojic	Société Générale
	Mr. Gareth Allen	UBS Limited
	Mr. Eduard Cia	UniCredit Bank (ERCC Vice Chair)
On the phone:	Mr. Eugene McGrory	BNP Paribas
	Mr. Grigorios Markouizos	Citigroup (ERCC Vice Chair)
	Mr. Romain Dumas	Credit Suisse
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Nicola Danese	JP Morgan
	Mr. Nicholas Hamilton	JP Morgan (ERCC Ops Group Co-chair)
	Ms. Rebecca Carey	Euroclear (for item 3 only)
	Mr. Alexander Westphal	ICMA
Also Present:	Mr. Martin Scheck	ICMA
	Mr. Jean-Robert Wilkin	Clearstream (for item 3 only)
	Mr. Arnaud Delestienne	Clearstream (for item 3 only)
	Mr. Edwin De Pauw	Euroclear (for item 3 only)
	Mr. Staffan Ahlner	BNY Mellon (for item 3 only)
	Mr. David Hiscock	ICMA
	Ms. Lalitha Colaco Henry	ICMA (ERCC Secretary)
	Mr. Richard Comotto	ICMA Centre
Apologies:	Mr. Michel Semaan	Crédit Agricole
	Mr. Ed Donald	Standard Chartered (ASIFMA)

Welcome

The Chairman welcomed those in the room and on the phone and thanked Mr. Eduard Cia and UniCredit for hosting the meeting and for their hospitality.

1. Minutes from the last meeting

The minutes of the last ERCC Committee meeting, which took place on 19 July 2016 in London, were unanimously approved.

2. ERCC and the buy-side

Mr. Scheck discussed ICMA's approach which covers all aspects of the debt securities markets from issuance onwards. In line with this, ICMA's membership includes issuers, intermediaries, investors, market infrastructure providers and other entities with a substantive stake in the debt securities markets. Wherever possible ICMA's councils and committees represent the entire value chain and their membership composition reflects this. The membership of the ERCC already includes nine stand-alone asset managers and eight market infrastructure firms. The rest of the council can loosely be classified as sell-side. Hence, at present standalone buy-side firms account for around 12 percent of the members of the ERCC.

An active discussion followed that focused on how the Committee should develop in order to be reflective of the changing composition of the Council. This is in the context of ensuring that the Committee continues to reflect the whole repo market which is of critical importance in the Committee's interactions with regulatory authorities and also when setting standards of best market practice.

All members agreed that the Committee is currently highly effective, well respected, focused, relevant and knowledgeable. It is important that Committee members are able to devote sufficient amounts of time to working actively on various Committee initiatives and also have the requisite technical knowledge to make a positive contribution. All agreed that they do not wish to see the effectiveness of the Committee diluted. There is also a feeling that the voting arrangements (where Council members vote-in the Committee on an annual basis) are democratic, generally work well and should not be compromised. Nevertheless, it was agreed that there could be instances where the voting mechanics may result in an under-representation of key emerging groups of repo participants such as the buy-side.

The Committee concluded that:

- Greater buy-side participation in the ERCC Committee is welcomed, including more interaction with ICMA's Asset Managers and Investors Council (AMIC).
- ICMA will encourage more buy-side firms to join the ERCC Council ahead of the electronic elections in January 2017 and more generally;
- The number of seats on the ERCC Committee will remain at 19 with the understanding that it is a working committee and that all members must contribute actively and attend on the current terms.
- Failing to better balance the spread of active market participants from both sectors, the ERCC Committee will seek to include buy-side observers as a short-term measure.

The ERCC Secretariat will prepare a paper setting out a range of initiatives to encourage greater buy-side participation in the ERCC in advance of the next committee meeting.

3. Intraday liquidity

The Chairman said that when looking at the development of a new secured benchmark, it had become apparent that there was little understanding of how repo transactions are routed through to CCPs when they are traded electronically and anonymously or bilaterally. As a result, Mr. Burke looked into the trade registration models used by the various CCPs and his report[1] was published on 27 September. It has now become apparent that banks are being charged for intraday liquidity and this is changing market behaviour. Given the issues surrounding mandatory buy-ins under the CSDR there is a growing need to look at intraday liquidity in greater detail, especially from a front-office perspective.

Mr. De Pauw said that influencing forces which impact on settlement liquidity include the timing of settlement and the availability of resources, in respect of both securities and cash liquidity. Additionally, if both parties to the transaction are not using the same settlement system the level of interoperability between the two systems may further impact on settlement efficiency. There are currently two settlement worlds in Europe - settlement in central bank money (CeBM) and settlement in commercial bank money (CoBM). The lack of interoperability between CoBM and CeBM was identified as one of the barriers to efficient settlement in Europe by the Giovannini Group fifteen years ago. To achieve an efficient capital market in Europe, it is necessary to consider how best to maximise interoperability between the CoBM and CeBM liquidity pools, not only in terms of cross border settlement but also for collateral management flows. By the end of 2017, 23 CSDs will have outsourced their settlement systems to T2S and settlement in those CSDs will happen in CeBM with participants using a single cash account at a central bank of their choosing. From a cash perspective, T2S is also interoperable with Target 2 with liquidity moving seamlessly between the two systems. CoBM is the other side of Europe's settlement infrastructure which entails settlement interoperability between the two ICSDs over their settlement bridge (Bridge) and also settlement interoperability between the ICSDs and T2S. In order to settle in CeBM, a firm must have an account with one of the 23 central banks connected to T2S. As most, if not all, non-banks do not have accounts with any of the central banks they must therefore settle in CoBM.

The T2S operational day starts with an overnight batch cycle that runs from 20:00 until just before midnight. This is followed by real-time settlement that runs until 2:00 and it re-opens again from 5:00 till 16:00. Significant progress has been made in aligning the Clearstream Bank Luxembourg (CBL) and Euroclear Bank (EB) settlement windows with those of T2S. Mr. De Pauw said that the ICSDs are continuing to invest in improving interoperability between themselves and with T2S but that it will take time to achieve full interoperability between the three systems. The Committee noted that if CBL and EB were to settle using the same settlement windows as T2S then the intraday liquidity gap would be lessened. As T2S is the main system which sets the standard, CBL and EB should try to match the T2S settlement windows. However, it was noted that the ICSDs also operate/service non-EU and non-EUR markets and therefore require an operating timeline that optimises interoperability with these different liquidity pools.

Interoperability is greatest when the three systems (i.e. CBL, EB and T2S) operate real-time settlement windows simultaneously. The benefit of real-time settlement is that you can quickly move back and forth between environments. However, the three systems also use batch processing. A batch is a closed process where all instructions within the batch are settled to the extent possible. It is very liquidity-efficient with the object being to achieve as much netting

[1] Alternatively, see: http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/ercc-publications/icma-ercc-reports/icma-ercc-report-on-the-trade-registration-models-used-by-european-ccps-for-repo-transactions/

within the batch as possible with participants being able to optimise their liquidity needs within a single environment. T2S operates a batch that finishes before midnight. CBL starts its operating day around 9:30 with a first batch that finishes at approximately 22:00 CET and then it runs in real-time mode. T2S is the first system to provide feedback to the other two systems at 20:00. EB operates only one cycle within its batch while T2S operates three cycles within its night-time batch – which amounts to three attempts at settlement within the batch. After each cycle, T2S provides feedback to the other systems to try to obtain any missing information about the trades that have yet to settle so that they will hopefully settle in the next cycle. The aim is to settle as many trades as possible by the end of the third cycle of the batch. Unfortunately, there is currently no interoperability between the EB and T2S batches because the EB batch starts later than the T2S batch. However, the timing of the T2S batch is likely to change once the last of the CSDs have migrated to T2S in 2017.

During the day-time, the T2S settlement window for delivery versus payment (DvP) instructions currently closes at 16:00. The ICSDs DvP settlement window also closes at 16:00 with input deadlines for cross-border settlement (between the ICSDs and T2S) being close to 16:00. The input deadline for DvP for the ICSDs Bridge is 15:00. However, in 2017 the input deadline for the ICSDs Bridge will close 20 minutes later at 15:20. There are also some free-of-payment windows in both T2S and the ICSDs which continue after 16:00. Finally, T2S and the ICSDs have some optional settlement payment windows which are for those instructions that specifically request settlement later than the 16:00 EUR cash deadline. The T2S window is called a “bilaterally agreed treasury management” (BATM) window. At the end of the CoBM settlement day, treasury departments in some banks look to square their EB and CBL accounts by accessing the overnight money markets. For this reason, T2S set up the BATM function as a special ring-fenced time for treasury departments to manage the liquidity of their banks. It was noted that every settlement instructed after 16:00 poses a certain liquidity risk - settlements being instructed without the knowledge of the bank's treasury department may not be properly funded.

In relation to (a) internal settlement within the ICSDs and (b) Bridge settlement, credit usage starts from the moment of settlement unless a participant has pre-funded the transaction. The Committee was provided with an example of a CBL client making a delivery over the daytime Bridge to an EB client. The first step is that the securities are reserved on the sellers account by CBL. CBL then sends a proposed delivery instruction to EB. EB checks the availability of cash/collateral in its client's account. If the funds are available, EB immediately debits cash from the client's account and confirms this to CBL. CBL then debits the securities and credits the cash in its client's account. In a perfect world, where there are sufficient securities and cash in the client accounts, it can take one to two hours from the time that CBL blocks the securities till EB releases the funds. Accordingly, this consumes one to two hours of intraday liquidity (or blockage) from the source account. After Phase 2 of the agreed interoperability plan has been implemented in mid-2017 the turn-around time should fall to between ten and forty minutes. However, Phase 2 enhancements are only relevant for daytime settlement.

T2S and the ICSDs support the use of intraday liquidity, one in CeBM and the others in CoBM. Both also run in real-time mode when it comes to internal settlement so credit usage will be similar in both worlds so long as both counterparts sit in the same platform. Indeed both ICSDs and T2S support auto-collateralisation mechanisms on stock and on flows. The complexity of credit usage increases when the counterparties use different systems. The major difference between CeBM and CoBM concerns the moment that intraday liquidity usage starts. For transactions where one party is in T2S and the other party is in one of the ICSDs (i.e. external transactions) credit usage starts for the party that is in the ICSDs when the instruction is sent to the T2S CSD for settlement. For the party that is in T2S credit usage would start at the moment of

settlement. In both cases, credit or liquidity usage will end upon receipt of funds which can take place in one of three ways - funding is delivered to the account, a delivery instruction is settled or funds are received from an income payment. EB and CBL impose an end of day funding deadline which requires the treasury department to send cash to the ICSD to avoid paying for an overnight credit usage. If your counterparty settles late in the day or later than expected (e.g. five minutes before the settlement deadline) then you will have a longer intraday credit or liquidity usage. It might be advisable if all banks had a direct T2S account.

It was noted that market participants are being incentivised to delay inputting settlement instructions in order to reduce their intraday liquidity costs. However, if all market participants were to do this, there would be a high risk of increased numbers of settlement fails. Therefore, there is a need to establish settlement discipline according to which market participants agree to settle trades by an agreed deadline during the day. One possibility might be to set a 12:00 deadline for instructing and funding trades – but further investigations would be needed to determine whether this would be a workable deadline for the whole market. Additionally, there is a need to improve settlement efficiency using smaller amounts of liquidity throughout the day to reduce current liquidity spikes. This could be done using settlement cycles that net transactions at a time that is convenient for the whole market.

The T2S auto-collateralisation function is open during the night and day. It solves some of the problems identified above but not all as it requires the use of HQLA. The ICSDs offer secured credit lines to their clients but because such lines are secured, the amount available is the minimum between the secured credit facility and the value of the collateral available. When looking at the value of collateral, if an ICSD client is buying securities then the value of the securities that he is buying is also taken into account in the calculation. This is the ICSDs version of the T2S auto-collateralisation feature. CSDR will not directly cause an increase in settlement costs, but some CSDR requirements imposed on CSDs (e.g. EBA technical standards on credit and liquidity) will translate into an adapted credit framework and may negatively affect collateral eligibility, usage and valuation. This will therefore result in increasing costs for participants indirectly and create further settlement frictions (see further below). With regards to the haircut on collateral the ICSDs anticipate that the collateral required to support secured lines could increase by approximately five percent. Ideally, the ICSDs want to be able to settle transactions as early as possible and have as few peaks in liquidity within the day. There is a trade-off to be considered between intraday settlement timing and intraday liquidity usage.

Mr. Delestienne said that after Wave 2 of T2S, the number of liquidity transfers between T2S and T2 increased but the overall value of those transfers decreased significantly over time (chart 8). One can conclude from the data that participants are getting better at determining how much liquidity they need in T2S and are being more efficient in how they use CeBM. However, this should be viewed in the context of the T2S auto-collateralisation feature (chart 9), the use of which has increased significantly since March 2016. Most of the auto-collateralisation figures are "on stock" rather than "on flow". The September figures will highlight the impact of the introduction of the French and Belgian markets into T2S as part of Wave 3. In the next sixteen months the rest of the EU domestic markets will migrate to T2S with Clearstream Frankfurt joining in February 2017 and the Spanish market in September 2017. This will result in a significant increase in settlement volumes and auto-collateralisation usage in T2S. Cross-CSD settlement is also expected to develop gradually over time, especially after the migration of Clearstream Frankfurt.

Phase 2 of the Bridge development plan will be delivered in the first half of 2017 and will provide improved deadlines, quicker turn-around during daytime processing and an extended timeline.

However, Phase 2 applies only to daytime processing. Night-time processing, which captures the vast majority of settlement volumes performed over the Bridge, will be untouched by Phase 2. The Bridge development plan also includes Phase 3 whereby the ICSDs will look at the feasibility of introducing a real-time Bridge with the intention of starting the work after all the CSDs have migrated to T2S. In the meantime, the ICSDs have introduced a new step between Phase 2 and Phase 3 regarding their compliance with CSDR. CSDR will fundamentally affect how the ICSDs run their business not only because of the new settlement discipline framework but also because it imposes numerous requirements on the ICSDs regarding credit and liquidity management and the management of links between CSDs, which impact the Bridge in particular. Some of these requirements will affect the clients of the ICSDs directly such as collateral eligibility rules, collateral valuation rules and concentration limits Other rules will affect ICSD clients indirectly. The ICSDs have had numerous discussions with their regulators to identify how they can satisfy the requirements but the regulators have adopted a strict interpretation of CSDR and have said that the ICSDs must eliminate all unsecured credit risk on the Bridge by mid-2017. This will have an impact on users of the Bridge. The ICSDs are trying to find ways to comply with their regulatory requirements in a way that minimises disruption to the Bridge. One measure being considered is to limit the volumes that can be settled per settlement cycle. There is currently a massive concentration of activity in the first two of the seventeen cycles on the Bridge. If a volume limit per cycle were to be imposed, the result would be to spread the remaining volumes over the cycles that follow. This could result in some transactions settling later in the night time and potentially even in the daytime, which in turn might have unintended consequences. It is important to look at the whole picture - both settlement efficiency and credit liquidity - in order to find an optimal solution. The ICSDs believe that the best way forward is to develop a real-time Bridge which would also provide the best possible infrastructure for the market while reducing regulatory concerns about systemic risk. However, one area where the ICSDs are not yet fully aligned concerns batches. The benefit of a closed batch is that the system is able to achieve a significant degree of netting within the batch which benefits market participants. However, what would the impact be on the market and on settlement efficiency if closed batches were to be phased out? CBL believe that there are no netting benefits to operating batches on the Bridge since the contents of the files are unidirectional (i.e. they contain only proposed deliveries from one ICSD to the other), so it is fundamentally different from internal settlement where batches help to net purchases and deliveries.

Going forward, the challenge for the ICSDs is to proceed with the CSDR compliance work while also trying to establish a real-time Bridge. The ICSDs see the CSDR compliance work as a mandatory step if they are to achieve their objective of real-time interoperability between the three settlement systems and also supporting previous commitments made to the ERCC regarding tri-party settlement interoperability.

Mr. Delestienne said that it would be helpful if the Committee could consider the regulatory proposals to introduce a volume limit per cycle. It would be helpful for regulators to hear objective views from market participants directly. The Chairman said that he had raised this issue with the person in charge of CMU and would also raise it in the EPTF as this issue impacts the real economy.

The ERCC Operations Group is leading the ECB's COGESI work-stream on collateral messaging. The discussion about intraday liquidity is closely aligned to this work. It was noted that the ECB is primarily concerned with CeBM and therefore is unlikely to be a significant driver for changing CoBM processes. It will be important for the Committee and the ERCC Operations Group to look into the economic case for interoperability and it was agreed that the ICSDs should be invited to the next ERCC Operations Group meeting.

The Chairman said that he felt that the discussion with the ICSDs had been productive and hoped that Mr. Scheck would agree that intraday liquidity is a topic that needs further study. Mr. Scheck indicated that ICMA would look at the scope of a possible project.

4. Development of a secured benchmark

The Chairman asked the Committee for feedback on whether the new secured benchmark being developed by the European Money Markets Institute (EMMI) will become the standard benchmark in Europe – i.e. will the market shift from using an unsecured benchmark to EMMI's new secured benchmark and to what extent should the Committee become more involved with the project. The Committee noted that the Bank of England and the Fed are both actively involved in developing UK and US secured benchmarks respectively and that those work-streams are progressing well, being underpinned with a high degree of rigour and scrutiny. The ECB is not taking an active role in the development of a European secured benchmark. The Committee concluded that it should not take a more active role in the development of the EMMI's secured benchmark, beyond its current participation in the EMMI secured benchmark steering group.

5. AOB and further dates

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

1. **26 October 12:00 – 15:00 CET** – hosted by ICAP in Frankfurt
2. **26 October 15:30 – 17:00 CET** – joint meeting of the ERCC Committee with the European Central Bank in Frankfurt
3. **14 November 11:00 – 13:15 CET** - ERCC Committee meeting in the margins of the Euroclear Collateral Conference in Brussels.

The ERCC Chairman: The ERCC Secretary:

Godfried De Vidts Lalitha Colaco-Henry