

Minutes of the Joint Meeting of the ERCC Committee and ISLA Board held on 21 June, 2016 in Vienna

Present:	Mr. Andy Krangel	Citigroup (ISLA Chairman)
	Mr. Godfried De Vidts	ICAP (ERCC Chairman)
	Mr. Mohamed Moursy	ABN Amro (ISLA Treasurer)
	Mr. Mick Chadwick	Aviva Investors
	Mr. Mark Newton	Barclays
	Mr. Michael Manna	Barclays
	Mr. Rob Lees	Brown Brothers Harriman & Co
	Mr. Stefan Kaiser	BlackRock
	Mr. David Raccat	BNP Paribas
	Mr. Eugene McGrory	BNP Paribas
	Mr. Grigorios Markouizos	Citigroup (ERCC Vice Chair)
	Mr. Andreas Biewald	Commerzbank
	Mr. Jonathan Lombardo	Eurex
	Mr. Mathew McDermott	Goldman Sachs
	Mr. Roy Zimmerhansl	HSBC (ISLA Vice Chair)
	Mr. Andrea Masciovecchio	Intesa SanPaolo
	Mr. Duncan Wilson	JP Morgan
	Mr. Nicola Danese	JP Morgan
	Ms. Amanda Brilliant	Nomura
	Mr. Michel Semaan	Crédit Agricole
	Mr. Roelof Van der Struik	PGGM Vermogenbeheer
	Mr. James Treseler	Société Générale
	Mr. Sylvain Bojic	Société Générale
	Mr. Alex Lawton	State Street
	Mr. Richard Hochreutiner	Swiss Reinsurance
	Mr. Casey Whymark	UBS
	Mr. Eduard Cia	UniCredit Bank (ERCC Vice Chair)
	Mr. Arne Theia	UniCredit Bank
Also Present:	Mr. Kevin McNulty	ISLA
	Mr. Andy Dyson	ISLA
	Ms. Claire Davis	ISLA
	Mr. David Hiscock	ICMA
	Mr. Alexander Westphal	ICMA
	Ms. Lisa Cleary	ICMA
	Ms. Lalitha Colaco Henry	ICMA (Secretary)
Apologies:	Mr. Dan Bremer	BAML
	Mr. Romain Dumas	Credit Suisse
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Johan Evenepoel	Euroclear Bank
	Mr. Francois-Xavier Bouillet	Goldman Sachs

Mr. Jean-Michel Meyer	HSBC
Ms. Martina Szameitat	Morgan Stanley
Mr. Gareth Allen	UBS
Mr. Ed Donald	Standard Chartered (ASIFMA)
Mr. Richard Comotto	ICMA Centre

1. Welcome

Mr. Krangel warmly welcomed all the attendees to Vienna for the second joint meeting of the ERCC Committee and the ISLA Board.

2. ESMA's work on segregation of accounts for UCITS

ESMA has set up a working group to look at the segregation of accounts. The working group has proposed that alternative asset fund managers should ensure that they use a single depository which should hold all of a firm's financial instruments in a segregated account and clearly identify the beneficial owners of financial assets at all times. However, segregation at the sub-custodian level in the custodian chain will effectively mean that affected counterparties will no longer be able to be served efficiently by a tri-party collateral manager as the collateral would have to be held in segregated accounts at the sub-custodian. Collateral substitution and optimisation would therefore become subject to market settlement timings rather than intraday movements in the tri-party agents' books and records. This makes those counterparties unattractive and would therefore remove a significant pool of essential liquidity and funding from the market, at a time when funding and collateral is increasingly in demand. This would severely damage the tri-party market. BNY Mellon has circulated a letter on this issue which has been shared with the other triparty agents. Mr. De Vidts said that ERCC has been asked whether it can help to highlight the issues

Mr. Dyson said that this is a significant issue from a securities lending perspective. If there were to be full asset segregation at the custodian level, the lending and management of collateral would become highly problematic. This is an issue not only for tri-party collateral management but for individual clients as well. This is a particularly serious issue for UCITS and could result in them not being able to lend securities. There is anecdotal evidence to suggest that where segregation has taken place, typically in the French custody system, clients no longer lend out their securities.

ISLA and the ERCC are working with BNY Mellon to examine the issues. BNY Mellon is producing a short briefing note to be shared with regulators. ISLA has also discussed this issue with its asset managers and beneficial owners sub-group. The sub-group will discuss this issue with trade associations on the fund management side such as EFAMA.

It is likely that ESMA will release further proposals on this issue before the end of the year. Therefore, there is an opportunity to seek to educate regulators about this issue and it will be important to provide more detail and data to further those discussions. It would be important to explain to regulators about why this issue is important to liquidity in the repo, securities lending and collateral markets. However, because this proposal will not impact the repo and collateral markets directly (except to the extent that it would exacerbate collateral scarcity) a more persuasive argument would need to be made by asset-owners themselves. Mr. De Vidts proposed writing a letter to the authorities setting out industry concerns. A joint ERCC-ISLA approach to EFAMA should be the first step, with Mr. Dyson taking the lead, to determine if EFAMA are interested in writing a joint letter to ESMA.

3. Re-use

Mr. De Vidts said that the Vice-President of the ECB, Mr. Vítor Constâncio had recently given a speech about repo, quoting the academic study by Gorton and Metrick and arguing that collateral should not be re-used. It was agreed that this is a worrying development.

Mr. De Vidts noted that the ECB will be hosting a joint IMF-ECB workshop on 24 – 25 October on money markets, monetary policy implementation and market infrastructures. To this end, the ECB has issued a call for academic papers to form the basis of the discussion. Attendance at the workshop will be by invitation only and the ECB will select the papers for discussion. This is a good opportunity to highlight the importance of re-use to money markets and to produce an academic counter-argument to the Gorton and Metrick paper. Mr. De Vidts undertook to contact various academics about drafting a suitable paper.

4. Bank of England work to replace the Repo, SL and NIPs Codes

Mr. Dyson said that the three industry codes governing short-dated markets (non-investment products, securities lending and repo) had been removed from the Bank of England's website as they were out-of-date. Given the development of the global FX Code, the Bank of England is working with market participants to consolidate and update the old industry codes into a single code covering securities lending, repo and short-end money market transactions. There are three separate technical work-streams which are reviewing each of the three markets. Mr. Dyson sits on the securities lending working group while Mr. Bouillet sits on the repo working group.

The securities lending working group has reviewed about 80 percent of the old securities lending code and is now giving thought to the language to be used in the new code. Once this has been completed, the next step will be for the new code to be reviewed by an over-arching group that is co-chaired by Mr. Paul Wilson of JP Morgan. The role of the over-arching group is to bring the three separate work-streams together and put around it some language on topics such as ethics and codes of behaviour. This work is ongoing and is due to be completed by the middle of next year. It is hoped that a first draft could be shared with the ISLA Board and the ERCC for review towards the end of this year. Notably, the new code will not be prescriptive but instead will set broad principles around the way in which people should conduct their repo, securities lending and money market business, with the emphasis being on conduct rather than on regulation. The Code will nevertheless bind individuals through the UK's Senior Managers Regime. Mr. Hiscock said that the new global FX code of conduct had been published earlier in the year and that there will be an expectation for a degree of harmonisation between the global FX code and the new Bank of England code. In particular, the language related to ethics and conduct will be important.

Mr. De Vidts noted that the next general meeting of the European Repo and Collateral Council will take place on 27 September in London and Mr. Mark Yallop, the new chair of the FICC Market Standards Board, has been invited to provide the keynote speech.

5. Minimum margins and Haircut floors

Mr. De Vidts said that the idea of pro-cyclical haircuts, whereby haircuts are increased in good times and decreased in stressed times, is being driven by academics who do not understand how markets work. In reality, banks will not decrease haircuts in stressed times but instead will look to cut credit

lines. Pro-cyclical haircuts would also take liquidity out of the market in good times while in stressed times liquidity would dry up even further. These proposals go far beyond the recommendations made by the FSB. European regulators could implement legislation that is more stringent than the FSB recommendations.

It was noted that recent visits by ISLA and the ERCC Committee to discuss haircut policies with ESMA had been useful. ESMA will be publishing their report in October, but there are concerns that it may contain scope creep. Going forward, education is key so that regulators have a good understanding of how the markets work.

It is also important to look at the development of the OTC derivatives markets and how the way OTC derivatives transactions are collateralised has fundamentally changed. The concept, in the OTC derivatives markets where initial margin goes both ways, is one which some regulators would like to extend to all types of collateralised transactions. However, if this were to be imposed on securities lending markets, it would fundamentally change the security lending markets in a way that would be very challenging and have a significant impact.

It was agreed that there is a need for more haircut data to be made available to regulators and ESMA in particular. It was also agreed that a call should be arranged with Mr. Jobst from the IMF to discuss this issue further.

6. ECB's CSPP programme

Mr. Dyson said that ISLA members are concerned that the ECB's CSPP programme will make the corporate bond market even less liquid. Corporate bond securities financing can be subject to a lack of liquidity from time to time as they tend to be smaller, tighter issues. So the question is whether the ECB's CSPP will change that liquidity profile. Will the CSPP make the corporate bond market even tighter and what does this mean for lenders? It was noted that the Bundesbank has indicated that it will re-lend the assets under the PSPP. However, the lending criteria that are being applied are very restrictive. The liquidity is there but there is uncertainty about whether it is being made available to the market. ISLA will try and collect data as part of its semi-annual survey to see if there are any discernible trends.

7. EPTF meeting

Mr. De Vidts said that he and Mr. Dyson had been invited to a recent meeting of the European Post Trade Forum (EPTF) as ad hoc parties. The EPTF has been set up to assist the Commission in its review of the removal of the Giovanini barriers to cross-border clearing and settlement. While it was disappointing that neither ISLA nor the ERCC were accepted as members of the EPTF, their attendance at the recent meeting was well received and they have subsequently been invited to contribute to a follow-up paper, in order to ensure that any positions taken in the post-trade area will not harm the trading side.

Mr. De Vidts also noted that COGESI has set up three working groups and that the ERCC Operations Groups is leading the working group on collateral messaging. This is an important step forward and compensates for the limited involvement in the EPTF.

8. SFTR reporting requirements

Mr. Dyson said that ESMA will shortly be sending questions to ISLA relating to ISLA's response to ESMA's SFTR consultation. ISLA has a meeting scheduled with ESMA in early July to answer those questions. Mr. Westphal said that ICMA has been similarly approached. It was agreed that ISLA and the ERCC would coordinate their responses and also try to reach out to AFME, time permitting. It is expected that ESMA will issue a consultation paper shortly after the meetings.

9. BRRD update

ISLA and ERCC members have discussed with the Bank of England their concerns about CCPs being exempted from the 48-hour stay provisions. However, nothing has been done to address this concern to date. It was also noted that the draft US regulation has now been published. Under the regulation, US regulators would have extra-territorial powers to impose a 48-hour stay. Therefore, lenders who lend to European subsidiaries of US broker dealers would have to adhere to US rules. This represents a significant change and would require a lot of communication with and understanding by clients. There is also some uncertainty about the definition of "qualifying financial contract" under the US rules which still needs to be clarified.

10. Post-trade affirmations and confirmations

Mr. Westphal said that the ERCC Operations Group started work in 2014 on developing a trade matching and affirmation (TMA) template for repo. The ERCC Operations Group worked in conjunction with vendor firms to develop the template, which was eventually published in December 2015. The ERCC Operations Group is now looking to promote greater use of the template and would like to collaborate with ISLA to potentially extend the template to include securities lending. Discussions in this regard have already started as Mr. Bate who drove the development of the TMA template sits on the ISLA post-trade board. Mr. Dyson said that ISLA is looking at this and would welcome an opportunity to work with the ERCC to use affirmations and confirmations more consistently in the securities lending market, especially in the context of SFTR reporting.

11. AOB

Mr. De Vidts said that the joint meeting has shown that ISLA and the ERCC have much in common. Mr. Dyson added that there are a number of areas where ISLA and the ERCC can work closely with each other.

The ERCC Chairman:

The ERCC Secretary:

Godfried De Vidts

Lalitha Colaco-Henry