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ICMA

EUROPEAN REPO COUNCIL

Minutes of the Annual General Meeting of the ICMA European Repo Council held on September 14, 2011, in Paris

Location: The InterContinental Hotel – Le Grand Paris, 2 rue Scribe hosted by BNY Mellon in the context of their *"Thought Leadership discussion on the future of Central Counterparties and the increasing demand for collateral"*.

Time: 10:00 am – 12:30 pm

Presenting:

Mr. Godfried De Vidts (ERC Chairman), ICAP Securities Limited, London
Mrs. Gertrude Tumpel-Gugerell, Former member of the Executive Board of the European Central Bank
Mr. Tony Platt (ERC Operations Group Chairman), Morgan Stanley & Co. International PLC.
Mr. Andreas Biewald, Commerzbank Aktiengesellschaft
Mr. Richard Comotto, ICMA Centre
Mr. David Hiscock, ICMA, London
Ms. Lisa Cleary, ICMA, Zurich

Member firms represented at the meeting:

Please see Annex A

1. Opening of the meeting by the Chairman of the European Repo Council and 2. Approval of the minutes of the ERC Meeting held on Thursday, 10 March 2011 in London

The Chairman gave the following speech.[1]

Good morning ladies and gentlemen. Welcome to this semi-annual repo Council meeting with my special thanks to BNYMellon for being our host today. Before I make my opening address I would like to ask if anybody has any remarks on the minutes of our last meeting held on 10 March, 2011 in London. That not being the case let me start this meeting.

Our crucial wholesale financial markets are the backbone of modern finance. The repo market has been developed and now acts as a transmitter of liquidity from the lender of last resort to the real economy to ensure that liquidity is transferred to where it is most needed. The well being of our market is hugely important to the real economy but unfortunately the merits of our efforts often go unrecognized.

After the turbulent summer of 2008 I mentioned that attention to the repo desk increased dramatically as Presidents and CEOs of banks suddenly realized liquidity was probably the most important aspect of our banking métier. Unsecured lending was discouraged through the Basle 2

[1] Reproduced in full.

capital agreement while secured lending was chosen by the central bank community as the prime vehicle to provide the necessary oxygen to the financial markets.

As the European Repo Council we have not ignored this responsibility. Hence this meeting, as with our previous gatherings, will continue to focus on the delivery of a professional and robust financial market infrastructure that can deliver what is needed for our markets.

It comes as no surprise that our group, managed by the elected ERC Committee has given considerable attention to the work of the Giovannini group, the European Commission working groups named CESAME 1 & 2 and the recent EGMI Working group. Our attention goes further and also includes participation with the BIS, IOSCO, IMF, and World Bank as well as many private initiatives. A second pillar of our co-operation with the authorities is through our contacts with both the ECB /Eurosystem and the Bank of England. And as repo markets are increasingly identified as the home of collateral management for a wide range of functions we obviously keep in touch with work the of other trade associations.

The current regulatory focus is on increased central clearing of OTC derivatives. However, despite the work and expertise of our community in the development of central clearing for repo, this valuable initiative has unfortunately not received the attention it deserves. We have always encouraged central clearing and today 20% of our activities have already been transferred for settlement through CCPs. The ERC, as witnessed in today's agenda, covers many areas of work that contribute to the current regulatory requirements. In that context, the work of our recently reinvigorated ERC Operations Group under the chairmanship of Tony Platt has looked at margin calls procedures, trade matching and other post trade functionalities that need to be improved. Here, as elsewhere, senior market practitioners are setting standards and leading by example.

The release, in July last year, of the ERC White Paper regarding short selling and market infrastructures has been helpful in bringing expertise to the debate on the post trade environment. This post trade environment will be the focus of a new round of regulatory initiatives that will be covered at the forthcoming conference hosted by the European Commission on October 24th. Today's release of our new academic research regarding the use of commercial and central bank money is yet another example of the need for more educational material so that well balanced and constructive reforms of the financial market infrastructure can be progressed.

Regretfully, our efforts have not been given adequate follow up by our politicians. In response to this the ERC Committee has therefore decided to take steps to further raise the visibility of our work to outside decision-makers and although I don't expect our heads of state to read the minutes of our regular meetings you as stakeholders will receive even more information about the many good initiatives we are taking forward. Your feedback becomes even more important so we can together work and educate those that are given the task of regulating the financial markets.

It is therefore with great honour and pleasure that I introduce to you our keynote speaker of today. Mrs. Gertrude Tumpel-Gugerell was until recently a member of the ECB's governing council. During her 8 year term as the head of the post trade section at the ECB I had the pleasure of meeting Mrs. Tumpel in numerous meetings all over Europe but in particular in Brussels. I will always treasure the meeting of the CESAME group where the frustration about the lack of progress to harmonise Europe's post trade infrastructure into something that could work cross border without frictions came to a head. Those of you who had the pleasure of working with Mrs. Tumpel know that she is a pillar of stability when tensions rise. As Mr. Jean-Claude Trichet said at the symposium in Frankfurt in honour of Mrs. Tumpel – Gertrude was always able to analyse, listen and bring focus back to the discussion. So at this particular CESAME group meeting I witnessed Mrs. Tumpel with a firm and raised voice announcing that enough was enough. Years of talks had not progressed the issues and so the announcement of the T2S initiative was made. From the early days of T2S the ERC Committee has supported the ECB in its push ahead with this initiative. In the following years our calls for even further integration materialized with the agreement to reform the internal Eurosystem framework with the announcement of the CCBM2 initiative.

Mrs. Tumpel, on behalf of the ERC, I would like to thank you for your contribution to the development of the repo market and your willingness to meet and listen to us. Your acceptance to address our gathering today delights me as I am sure that the few months since your departure at the ECB has given you time to reflect on the theme of your address: 8 years of support to integrate Europe's post trading. May I ask you to the podium for your speech. Many thanks

3. Keynote speech

Ms. Tumpel-Gugerell gave the following speech.[2]

1. Introduction

The ERC deserves some special praise, because of its efforts over the past years to provide education and information to the market on often complex issues emerging in the money market. Let me share with you a quote of about 100 years ago, which is still very much valid:

> "A notion prevails that the Money Market is something so *impalpable* that it can only be spoken of in very *abstract* words, and that therefore books on it must always be exceedingly difficult. But I maintain that the Money Market is as concrete and real as anything else; that it can be described in as plain words; (that it is the writer's fault if what he says is not clear)"[3]

What I would like to do today is to start by looking back at my 8 years when I was working at the European Central Bank and discuss with you the evolution I witnessed in the area of securities settlement and collateral management. The experiences made in those years, help me formulating three suggestions of what I could see as priorities in this field to continue with the integration.

2. Achievements in Europe's post trade and collateral management.

So, where were we eight years ago? Well, in 2003, Europe looked quite different. Systems were mainly national and dispersed. And also central banks were focussing on their own national responsibilities. Over the years, I have seen a growing awareness for the importance of integrated infrastructures, not only to maximise efficiency, but also as a factor to stabilise the whole financial system. The transformation concentrated on 4 main threads of activities, with both central banks and the industry playing key roles in the process.

First, central banks have been improving their own services and infrastructures. We all have in front of our eyes the development of TARGET2, the second generation of the large value payment system, as an example that set a kind of benchmark, with its single price for domestic and cross-border payments, and the possibilities it offers for pooling intraday liquidity throughout Europe.

Second, substantial efforts have been made (by central banks) to set the standards for strengthening financial market infrastructures. In particular, central banks developed standards for large value payment and settlement systems, and published recommendations for central counterparties (CCPs)

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[2] Reproduced in full.

[3] Walter Bagehot. Lombard Street: A description of the money market. Henry S. King and Co., 1873

and retail payment systems. The promotion and control of the implementation of standards for infrastructures then became later known under the name of 'oversight'. Today, eight years later, it can be said that financial market infrastructures continued to function well during the financial crisis. So, efforts made by the industry to mitigate risks inherent in payment and settlement systems paid off. In a few minutes, I will come back to the current regulatory initiatives, which aim at further reducing systemic risk.

As a third strand of activity, central banks and the industry have been improving their analytical work related to market structures and their performance. For example, eight years ago, central banks analysed the role of central bank money in payment systems, highlighting the symbiotic relationship between central banks and commercial banks. Indeed, while central bank money plays a pivotal role in modern infrastructures, we also underlined that both forms of money are used interchangeably by the public when making payments, because they are convertible at par[4]. We also tackled concrete questions related to access to central bank money; in particular which institutions may have accounts at the central bank.

Such analytical exercises help taking sound policy decisions. In this case for example, the work contributed to the Eurosystem's recent decision to implement (in March 2011) an emergency overnight euro credit facility within TARGET2, specifically designed for CCPs located in the euro area. I welcome that also the industry contributes with analytical work. The ERC will present today their new study on the complementary role of central bank and commercial bank money, and this is indeed a good example to foster public debate on important settlement issues.

In a fourth field of activity, central banks and the industry have been improving their monitoring of recent developments in payment and settlement systems. Attention has also been increasingly paid to market developments, the use of collateral and in particular to the increasing use of cross-border collateral arrangements. The ERC's European repo market survey is very interesting in this respect and seems to indicate a recovery in the repo market (there was a decrease in 2008 due to the financial crisis, and since then a recovery). I want to pause here for a moment and show some interesting figures over the past eight years, on the use of collateral to mitigate counterparty risks in financial market transactions:

- Central bank credit collateralisation has increased significantly, including the pre-depositing of collateral with the central bank.
- Other market segments are also increasingly using collateral. In particular, there was a growth in collateral for exposures in OTC derivatives and collateralised instruments.
- Finally, also regulatory initiatives (such as Dodd Frank in the US and EMIR in the EU) and market preferences are driving up the use of collateral, which can be seen in the expansion of services of CCPs.

My personal assessment is that, overall, over the past eight years, many achievements have been made. Our regulatory framework and our understanding of market structure and performance have improved. And, thanks to efforts in the industry, many barriers identified in the Giovannini reports have been addressed. So, I can also welcome that Europe is gradually growing closer together and market integration has increased. However, market integration increased at a pace that was slower than some had originally hoped for. Why is this so? One important element has been the financial crisis, which started in 2007, and attracted much attention and resources to cope with the crisis, to

[4] See CPSS report on "The role of central bank money in payment systems", August 2003. It is explained that central banks issue their own liabilities for use as money ("central bank money") and commercial banks issue their liabilities ("commercial bank money). Confidence in commercial bank money lies in the fact that commercial banks can honour their sight liabilities by converting them into central bank money if their clients demand it.

consider the lessons learned, and to implement regulatory reform to ensure a more stable financial system. That said, one should not lose track on the need to pursue a more integrated capital and securities market, and post-trade sector, as this would make markets in Europe more efficient and liquid. [It is time for a re-focus on financial integration].

I see in particular three main priorities for Europe to address the challenges we have witnessed and give further impetus to the integration of the post-trade sector. The first priority is related to obtaining a proper legal and regulatory framework. The second priority is related to the implementation of CCBM2 and T2S, the central bank services for (pan-European) collateral management and securities. The third priority is related to measures for collateral optimisation, due to the increasing demands on collateral.

3. Current issues and way forward.

3.1. Regulatory initiatives
Let me now come to the first priority for Europe namely creating a sound financial system through strengthening the regulatory framework for post trading infrastructures. Some legislative instruments have already been implemented but further progress is needed. The vision should be to remove all barriers in the post-trading market. To achieve this, we still have some key challenges ahead. Currently legislative initiatives such as the European Market Infrastructure Regulation ("EMIR"), Central Securities Depositories ("CSD") Regulation and measures on Close-out netting are under discussion.

One lesson of the recent financial crisis was that insufficient transparency on the OTC derivatives may endanger financial stability. The G20 therefore stressed *"All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end 2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."*

As a consequence the EC adopted in 2010 a Regulation on OTC derivatives, central counterparties and trade repositories. In order to reduce systemic risk the Regulation proposes a reporting obligation for OTC derivatives, a clearing obligation for so-called “standardized” OTC derivatives through CCPs, measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives and strict rules in particular for CCPs (e.g. organizational rules, prudential rules) and also for trade repositories. It is of utmost importance that the on-going negotiations come to an end in order to meet the G20 deadline in 2012 and leave enough time for the development of the technical standards by the European Securities Markets Authority.

In the field of CSDs the EC published a consultation which outlines two key aspects: (1) a common regulatory framework for CSDs and (2) the harmonisation of the securities settlement process. CSDs are essential market infrastructures and should therefore be subject to common rules on authorisation and supervision and to strict prudential requirements. In this context I also welcome all measures which intend to improve settlement discipline i.e. that a transaction is settled on the intended settlement date.

In view of legal certainty and financial stability the harmonization of close-out netting arrangements is another issue which will be tackled by the EC in the near future. I look forward to the proposal of the EC.

3.2. Central bank services for securities and collateral management
Let me now come to the second priority I see for Europe, namely the timely implementation of T2S and CCBM2. As you know, T2S will be the single technical platform for the settlement of securities in

central bank money in Europe. And with CCBM2, the Eurosystem will further integrate its collateral management system. So, in the case of Eurosystem credit operations, counterparties will be able to use a common instruction to initiate a collateral mobilisation in CCBM2 which is settled in T2S.
Let's focus on T2S first. T2S is on track and is half way through its development phase. The technical development has progressed well and negotiations on the contract with CSDs and central banks outside the euro area are close to finalisation. T2S will generate significant benefits for its participants; it will reduce settlement cost, decrease liquidity needs and lower back office costs due to the harmonisation of operational procedures that T2S will require. Market participants have strongly requested that T2S becomes even more involved in European post-trade harmonisation related to T2S. The T2S Advisory Group and its new T2S Harmonisation Steering Group will make sure that harmonisation initiatives are fully in line with market needs and the close co-operation with other harmonisation bodies and in particular the EU Commission ensures that there is no duplication of effort but consistency in the approaches taken. This is a very important endeavour and I am convinced that it will bring us closer to the completion of a true Single Market.

With CCBM2, it is the intention to come to a more efficient and more harmonised management of domestic and cross-border collateral at Eurosystem level. The Eurosystem will in particular implement two enhancements requested by the industry (and the ERC in particular). The first enhancement will be the removal of the "repatriation requirement". The "repatriation requirement" was introduced by the Eurosystem in the current CCBM (in 1999), and requires that eligible assets that are not held in the respective issuer CSD are repatriated to the issuer CSD before being mobilised with the Eurosystem when using the CCBM. This repatriation requirement will be removed (with the launch of CCBM2) and will allow counterparties to consolidate their collateral holdings in particular ICSDs or CSDs that have a number of eligible links.

The second important enhancement is related to the introduction of cross-border triparty collateral management services with Eurosystem operations. The triparty services involve a third party, acting as an agent for the collateral taker (in this case the Eurosystem) and the collateral provider (the counterparty). The Eurosystem has agreed to support triparty services into its framework for credit operations at a cross-border level. This would mean for example that Dutch banks (in their Eurosystem operations) would be able to use triparty collateral management services offered in Frankfurt or Paris.

3.3. Use of collateral

Let me say a few words on the third priority for Europe: "optimise further the use of collateral". In general, we see that there is a shift to secure trading, while the unsecured market has contracted over the past years. When looking at the usage patterns of collateral mobilisation with the Eurosystem, we can also observe that the cross-border use of collateral via CCBM has increased substantially since 2003. In fact, the CCBM services of the Eurosystem were initially only considered as a temporary solution of the Eurosystem to transfer the eligible assets in Europe until the market would come up with its own solutions. What is especially noticeable is that in the past, counterparties were using only a few of the locations covered by the CCBM to mobilise their collateral with the Eurosystem, while now, all locations covered by the CCBM are being used, be it to varying degrees. Also, counterparties are slowly increasing their use of links to mobilise collateral with the Eurosystem. This shows that the market is increasingly managing their collateral at a European level.

The greater demand for collateral has put greater emphasis on the flexible use of collateral and collateral optimisation techniques. This creates a growing interlinking of segments of the securities market, which in turn could imply greater spill-over effects. Indeed, with the progress in the development of links, and the mobilisation of scarce collateral as efficiently and safely as possible, also the interdependencies between market infrastructures increase. For example, securities issued in Germany, could be mobilised via links with the Eurosystem in, say, France; any disruption in Germany could therefore also have an impact in France.

With the rising reliance on the use of collateral, it could be challenging for market participants to have adequate, quality collateral for their different commitments. This is in particular related to the new supervisory and regulatory requirements, which are being set up to strengthen the capital requirements for counterparty credit exposures. For example, banks will be required to hold capital against their exposures to CCPs. And those OTC derivatives that could not be cleared centrally will be subject to higher capital requirements. Close attention should also be paid to infrastructures used by market participants, and in particular the adequate quality collateral accepted by infrastructures, because it is in all our interest to keep infrastructures a source of stability.

Looking forward on the use of collateral, I expect that market participants will continue to search for solutions to further optimise the use of their collateral. In Europe, I also expect that innovative and competitive solutions will emerge. It could be that we are moving to interconnected markets, where the processing of collateral will be done with infrastructures that provide additional services (such as triparty services). There could also be an increase in interoperability agreements or other partnerships. Ultimately, I would hope that we come to solutions where participants have the free choice to decide where their securities are handled.

4. Conclusion

Let me now conclude. Over the past eight years, Europe has come a long way. Financial integration has been a gradual but irreversible process. With the joint efforts of central banks and the industry, it will lead us to a financial market, which is large and liquid, and which is both resilient and efficient. Being part of a global market, Europe can however not take too long to make further improvements in the use of collateral. Continued and bold efforts are needed on three priorities: to come to a solid regulatory framework, to ensure a timely implementation of Eurosystem projects, and to optimise further the use of collateral.

3. The use of central bank money and commercial bank money in repo

The Chairman noted that one of the key frustrations for the members of the ERC Committee and the ERC Operations Group was the difficulty they faced moving collateral through the EU network of CSDs and the ICSDs. Accordingly, there is a need for products that can be used by all market participants irrespective of their location. There is a need for technological improvements in the post-trade area as the distribution of liquidity remains sub-optimal. There is also a need for more centralised clearing. To highlight the issues, and as a follow-up to last year's White Paper on short selling and settlement failures, Mr. Richard Comotto was asked to carry out a further study.

Mr. Comotto said that the report "The use of central bank money and commercial bank money in repo was commissioned by the ERC to inform the various discussions that are currently taking place about the role of central or commercial bank money in the clearing and settlement of European fixed-income securities. These discussions are a subset of the consultations on a regulatory framework for CSDs in Europe and aspects of the harmonisation of securities settlement, as well as attempts by the ERC to achieve interoperability between tri-party services. The specific trigger for the report is the proposal in the draft CPSS/IOSCO paper on *Principles for Financial Market Infrastructures* that "an FMI should conduct its money settlements in central bank money where practical and available". Some have argued that FMI should in principle not be allowed to settle in commercial bank money at all. However, such a complete switch would be a major reversal of regulatory policy. To date, the interconnected use of central and commercial bank money has been seen by central banks as an essential feature of the current monetary system. Indeed, the CPSS paper on *The Role of Central Bank Money in Payments Systems (2003)* stated that "the composite of central and commercial bank money…is essential to the safety and efficiency of the financial system".

This report is intended to describe the current situation and examine whether or not a switch out of commercial bank money is necessary, desirable or feasible. To begin, the report looks at the question of what is central and commercial bank money. On the surface, this is a simple question, but it is very easy to become confused. Accordingly, the report maps the flows of central and commercial bank money, specifically, in the context of fixed-income clearing and settlement in Europe. Central bank money is a deposit held at a central bank. It can be used as a "settlement asset" to make payments in settlement of debts or loans with other institutions that also hold central bank accounts. The central bank provides the "payment system" for such transfers, i.e., the technology and the rules. Because it is believed a central bank cannot fail, central bank money is seen as a risk-free settlement asset. If you are holding money in a central bank account during a crisis, that money should therefore be safe - central bank money has no credit risk. And because no one will refuse to accept a central bank deposit in settlement of a payment because there will never be doubts about the creditworthiness or liquidity of the central bank in its own currency, there is no liquidity risk. So, for example, if an account-holder fails on the central bank, the latter can keep itself liquid by printing money, and users can have confidence that a central bank payment system will continue to operate throughout a crisis. In this way, central bank payment systems help to contain systemic risk. This means that, in a crisis, the market can be certain that payments across the central bank payment system will take place. The problem is that, most institutions wishing to make payments do not have access to central bank accounts, as most central banks limit access to commercial banks or other institutions that are systemically important. And many of the institutions that are able to open central bank accounts do not necessarily think it is economically justifiable to do so. Nor do central banks usually offer cross-border access (a major exception being the ECB within the eurozone) and none offer foreign currency payments. Multi-currency cross-border payments are of course essential for a market like European repo. If you do not have access to a central bank account, or you prefer not to use such an account, or you wish to make payments in foreign currency or in another country, then you will have to use the services of a commercial bank to make payments at the relevant central bank on your behalf. The result is that payments architecture is tiered.

In the top tier, within the central bank payment system, are the clearing or settlement banks which make payments for themselves or as agents for customers, including smaller banks, who inhabit the lower tiers. These payments are made by transferring deposits between accounts at the central bank, so represent central bank money. As payments are concentrated in this tier, this is where systemic risk is most potent. If you are a member of the lower tiers and you wish to make a payment to another member of the lower tiers, you ask your agent bank to transfer money on your behalf. If the payee is a customer of the same agent bank, all that happens is that there is an internal payment across the books of the agent bank. Nothing moves across the central bank payment system. Legally-speaking, the payment is a matter between you and your agent bank and no one else. It is therefore in commercial bank money. The same principle holds if you wish to make a payment to a customer of another agent bank. You instruct your agent bank and they pay the other agent bank across the central bank payment system, in central bank money. However, <u>you</u> have not made a payment in central bank money. Your payment instruction is a transfer across the books of your agent bank out of your account, so your payment has been in commercial bank money, even though the payment has ultimately been in the central bank payment system. If you wish to make or receive payments in foreign currency or cross-border, you will use a correspondent bank which holds a central bank account in the relevant currency and country, but you will be paying or receiving commercial bank money.

Mr. Comotto went on to say that payments activity could be seen as a series of pyramids in different currencies, with payment in the top tier within each pyramid in central bank money, where systemic risk is concentrated, but payments reaching down into each economy and payments between pyramids in commercial bank money. Central bank money provides the safe hinge on which the system swings but commercial bank money extends the reach and integrates all the economic agents. The vast bulk of payments are in commercial bank money.

The particular concern of the European repo and cash markets in fixed-income securities is how payments are made in settlement of securities transactions. Many of these payments are made across FMIs, which include CSDs, ICSDs and CCPs. Most CSDs and CCPs settle in central bank money but the ICSDs and the largest CCP settle in commercial bank money.

Is commercial bank money a safe settlement asset? In the CPSS *Core principles for systemically important payment systems (2001),* the CPSS/IOSCO *Recommendations for securities settlement systems (2001)* and the CPSS/IOSCO *Recommendations for central counterparties* (2004), central banks have always accepted that safety is not the sole prerogative of central bank money and envisaged the possible use of commercial bank money, where steps are taken to protect members of a depository or CCP from potential losses and liquidity pressures arising from the failure of the settlement institution whose assets are used. That protection comes from prudential supervision; a strict risk management framework, which requires, among other things, adequate collateralisation; use of more than one cash settlement agency bank; FMI delivering clearing services (CCP) or securities settlement services (CSD and ICSD) not engaging in unrelated commercial business; and access to central bank liquidity (which, it is important to note, is not dependent on having a central bank account). So there has never been any doubt that commercial bank money can be a safe settlement asset.

Is it feasible to extend the use of central bank money? Without the access to the multi-currency and cross-border settlement services in commercial bank money provided by agents and FMI, international financial institutions would be forced to establish a commercial bank in every currency zone and open an account at the central securities depository (CSD) of almost every market in which they wished to participate. This is simply impracticable. Nor could eurobonds (i.e. offshore bonds) be settled. The integrated global financial system, in which borrowers can access the cheapest capital and investors can achieve the maximum diversification of their risk, is built on flows of commercial bank money, albeit anchored against the risk of systemic instability by access to central bank money.

The integral role of commercial bank money can be appreciated by looking at the flows of central and commercial bank money. The report examined four basic configurations of CCP, CSD and payment system. These configurations are set out in a series of diagrams which Mr. Comotto explained with the assistance of his slide presentation. The diagrams, with full explanation are set out fully in the report which can be accessed here.[5]

The Chairman noted that the three priorities of the ERC are: (a) development of interoperability for tri-party between both ICSDs; (b) unfettered access by all types of trading venues, be it electronic or voice, to all CCPs irrespective of the location of the collateral; and (c) improved European-wide access to liquidity, fully respecting the level playing field for all users. The Chairman went on to note that with regard to the first priority, meetings were being scheduled with both ICSDs to see how best to take this forward. With regard to the third priority, the five CCPs had been invited to a meeting with another meeting scheduled for October 25th in London with the two ICSDs.

The Chairman also said that Mr. Comotto's study had been presented to Mr. Patrick Pearson, of the European Commission, who had welcomed it as a helpful addition to the regulatory debate. The

[5] Alternatively, see: http://www.icmagroup.org/getdoc/9cf5a44b-cd7b-403d-9d0f-baac95acad25/European-repo-market-report.aspx

Commission is focusing on CSD legislation. Europe needs to be better in developing a framework where collateral can be used irrespective of its locations.

5. ERC Operations Group update

Mr. Tony Platt, Chairman of the ERC Operations Group said that the work load of the ERC Operations Group was being driven by market participant conventions, infrastructure conventions and regulatory developments.

In terms of tri-party settlement interoperability, Mr. Platt clarified that the real issue is settlement interoperability between tri-party agents. A revised full DvP model has been proposed by the tri-party agents, but this has resulted in discussions regarding settlement in central bank money and commercial bank money. It is hoped that Mr. Comotto's study will help discussions with the tri-party agents to progress. Mr. Platt also commented that the ICSD bridge would need to be extended to maximise the basket trading opportunities that the settlement interoperability would provide. Discussions are in progress.

The ERC Operations Group had also recently published the ERC Recommendation on repo matching as a driver for risk reduction. This Recommendation can be accessed from the ICMA website.[6] Some market participants are still resisting same-day affirmation and instead may wait up to two days. However, the Group considers that this is not good practice and could result in an increased number of trade fails. Moreover, by not moving to same-day affirmation, risk management and funding transparency is lost. Mr. Platt commented that focus should be given to term dated or forward starting trades where the time value of operational risk is greatest. Now that the ERC Recommendation has been published, and while the spirit of the document is a best practice recommendation, the ERC Operations Group will look at how market practice in this area can be improved. One possibility would be to seek a technological solution, but any improvements would also need to accommodate voice and non-automated trades. It is also recognised that given the scale of mandatory, regulatory driven systems upgrades that firms are having to put into place, it is perhaps understandable that the market may be reluctant to implement non-mandatory systems upgrades.

The ERC Operations Group has also set up a sub-group to revise the ERC's Best Practice Guide to Repo Margining of 2005. One of the findings of the sub-group is that some market participants work on the principal of assumed settlement. This means that some market participants return collateral two days prior to settlement. This practice needs to change so that margin is based on actual rather than assumed settlement - the portfolio value must be based on T–1. Margin must be retained until the exposure has been removed through settlement. However, in order to shift market practice to actual settlement, there must be an agreed and coordinated approach for adoption. This issue becomes less relevant on a same-day margin call settlement basis, but allowance for fails would be best practice. Feedback from the market was requested.

Mr. Platt also noted that the GMRA 2011 sets out two margin calculation methods. The sub-group have set out draft guidelines that parties should agree which method they will use. Additionally, the revised guidelines will set out that different transactions may require different methodologies, which may result in having to manage a combination of the two margin calculation methods within one portfolio. It was noted that the sub-group are aiming to publish the finalised guidelines in January 2012 with full ERC adoption by the end of June 2012.

[6] Alternatively, see: http://www.icmagroup.org/ICMAGroup/files/2e/2eba29d5-2084-4c77-97d4-a4d7e1192fe8.pdf

On regulatory consultation, Mr. Platt said that the ERC Operations Group had considered a variety of regulatory consultations and initiatives including the proposals related to the Securities Law Directive and the work of the settlement date harmonisation group. Consideration of the CPSS-IOSCO consultations on the Principles for Financial Market Infrastructures had also taken a considerable amount of time.

The ERC Operations Group is now composed of 16 members and the frequency of meetings had increased as had turnout at meetings. Members of the Group were increasingly attending key industry meetings in support of the ERC agenda. Going forward, it would be important to leverage the expertise of every member of the Group to ensure that the Group was adding value.

In the next 12 months, the Group expects to finalise the repo margin guidelines in advance of their publication in January. The Group will also continue to promote the ERC Recommendation on repo trade matching and act as an industry escalation point regarding non-adherence. The Group will continue to engage with the ICSDs on interoperability. Further, the Group anticipates continuing to support the White paper recommendations and observations. On the development of T2S and CCBM2, there is clearly a need to consider how these systems will work in an operational environment and so the Group will be engaging in these areas as well. The Group will also liaise with ICMA's Secondary Market Practices Committee to review the validity of current terminations and the buy-in rules set out in ICMA's Secondary Market Rules and Recommendations. Finally, the Group will continue to review and scrutinise regulatory consultations and submit input into ICMA responses as required.

6. Update on the European repo market White Paper on short selling and settlement failures

Mr. Richard Comotto said that there was no progress to report regarding Greece. In Spain, there had been progress on two issues. The first concerned the finality of the overnight cycle. The White Paper had reported that the finality of the overnight batch-processing cycle, which ends at 20:00 CET on S-1, was delayed until 07:00 CET on the settlement date. This was seen as very late and representing a constraint on the re-use of securities. The CSD announced in October 2009 that finality was to be advanced to 00:00 CET on the settlement date. The Settlement Finality Act has been amended, with effect from 1 July 2011, to this effect. The second issue concerns cut-off deadlines. The White Paper had reported that between 15:30 and 16:00 CET, entry of new instructions to the CSD was restricted to users with their own accounts at the CSD settling their own transactions and excluded third-party users. It was argued that the issue was significant because a large volume of transactions remained after this period. In November 2009, the CSD extended the deadline for third-party instructions to 16:00 and own-account members to 16:15. Iberclear announced in July that the government has approved a reform of the Securities Market Act 1988 to eliminate the remaining difference in cut-off deadlines.

Mr. Comotto noted that in Italy, there had been no further progress and instead more problems had arisen. In May and again in August, there had been system outages at Monte Titoli which were believed to have been caused by technical problems. On 31 August, the Chairman of the ERC and the Chairman of the ERC Operations Group had written to the CSD to express the concern of members about the resilience and recovery capacity of the settlement system and the failure of the CSD to communicate with members as to the nature and seriousness of the problem or to provide status updates. The letter called upon the CSD to remedy the underlying problems and verify the remedies in order to restore confidence to members. The ERC Chairman had recently met a senior manager of the CSD group and had been assured that urgent action was being taken. It is understood that an independent audit has been undertaken of the IT provider and the report would be published shortly.

7. Market practice issue

Mr. Richard Comotto said that a disagreement between an ATS and a CCP had been reported to the ERC Committee by a member about the reinvestment period to be used in the calculation of the repurchase price of a buy/sell-back where a coupon on the collateral was due on a Saturday (in a buy/sell-back, the manufactured payment triggered by a coupon payment is not paid on the coupon date but is deferred to the repurchase date and accordingly the repurchase price is net of the manufactured payment plus the reinvestment income on the payment over the period between the coupon date and repurchase date). The problem had been rapidly resolved but the ERC felt it was important to promulgate the correct practice. This is that the reinvestment period should start on the Monday when the coupon was actually paid. One of the principles underlying repo is that, other than a borrowing fee, collateral repoed out should not yield more or less to the seller than if that collateral had not been repoed out. As an investor holding the collateral in question, and not repoing it out, would only have been able to reinvest the coupon from the Monday, when it was paid, this was the appropriate treatment under repo.

8. The GMRA 2011 and related initiatives

Ms. Lisa Cleary said that the GMRA 2011 had been published in May 2011. The GMRA 2011 was the result of a market-driven process including input from ERC Committee members. It introduced a number of key amendments.

A GMRA 2011 protocol has been developed as an efficient and cost-effective method for firms to upgrade their documentation. Early feedback indicated that the protocol needed a few amendments, which are currently being incorporated into the document. Once this process has been completed the ERC Committee will advocate adoption of the protocol by the industry.

Work is on-going to review the annexes to the GMRA 2011. The annexes being reviewed are the buy/sell-back annex, the equities annex, the agency annex and the bills annex. Additionally, a term repo annex working group had been put together. Term repo is an increasingly important area.

Finally, Ms. Cleary noted that in 2011 ICMA had obtained legal opinions on the GMRA 1995, 2000 and 2011 for 62 jurisdictions. A further opinion for Russia was still being finalised and would hopefully be published shortly.

9. Eurepo®

Mr. Andreas Biewald said that Eurepo® is the benchmark for secured money market transactions. Earlier in the year, the Eurepo® Steering Committee had decided to amend the Eurepo® definition to provide additional clarity regarding the way the rate is calculated. The old definition provided:

> “Eurepo® is the rate at which one prime bank offers funds in euro to another prime bank if in exchange the former receives from the latter the best collateral in terms of rating and liquidity within the Eurepo® GC basket.”

The definition has now been amended to:

> “Eurepo® is the rate at which, at 11.00 a.m. Brussels time, one bank offers, in the euro-zone and worldwide, funds in euro to another bank if in exchange the former receives from the latter the best collateral within the most actively traded European repo market.”

The key amendments relate to the removal of the concept of prime bank and the Eurepo® GC basket. It will be important for every panel bank to take the new definition into account.

At the same time, the Eurepo® Steering Committee also decided to make other amendments to the Eurepo® Code of Conduct, which is published on the EBF website.[7] In particular, the changes to the Code concern the elimination of the rotation system and the specification of the Steering Committee. The amendments to the Code were seen as necessary to better reflect current market conditions. The changes will also help explain the practices that underlie Eurepo®, providing greater transparency.

The Code requires the 36 Panel Banks to quote Eurepo® daily except weekends and statutory holidays for the complete range of maturities as indicated by the Steering Committee. Thomson Reuters collate the data received from the Panel Banks to produce the Eurepo® rate. Every Panel Bank is required to directly input its data onto a Thomson Reuters system by 10:45 a.m. (CET). When calculating the benchmarks, Thomson Reuters eliminates the highest and lowest 15% of all the quotes collected. Thomson Reuters have provided data about the extent to which panel banks provide timely and reliable data. This shows that there is room for improvement and the ERC urges all Panel Banks to provide their data on a timely basis. The ERC also urges participating banks to quote according to the new Eurepo® definition.

The Eurepo® Steering Committee has set up a task force to consider a new Euro secured benchmark. Members of the task force include Unicredit, Calyon, Commerzbank and Dexia, though the group has not yet held a meeting.

Mr. Biewald said that his personal view is that there is demand for a new Euro secured benchmark taking into consideration the shrinking volume of the unsecured EONIA fixing. The decline in EONIA is due to a variety of factors. A new Euro secured benchmark would include collateral traded overnight in CCP eligible collateral. The benchmark would represent a weighted average and be managed under the authority of the Euribor-EBF. Potential data providers could be central counterparties providing data from the ECNs. This would avoid discussions about the data to be sent by banks in order for the benchmark to be calculated. The ideal would be to keep the instrument as simple as possible. Current data shows that the volume in GC Pooling overnight per day averages around €9 billion. MTS data shows an average volume of around €8 billion. If it were possible to obtain BrokerTec data it would be fairly simple to switch on a secured benchmark that is of a similar volume to EONIA.

The Chairman noted that there has been increased cooperation with the EBF. It has now been agreed that minutes of ERC Committee meetings will be shared with the EBF as soon as they are drafted while minutes of EBF meetings with be shared with the ERC.

10. Regulatory Issues

[7] Alternatively, see: http://www.euribor-ebf.eu/assets/files/New%20Eurepo%20Code%20of%20Conduct%20March%202011.pdf

Mr. Hiscock said that on March 10th (the same day as the last ERC Council meeting) the CPSS and IOSCO had issued a joint consultation paper regarding Principles for Financial Market Infrastructures (FMIs). The consultation had proposed to establish 24 principles applicable to all FMIs including payment systems, CSDs, SSSs, CCPs and trade repositories. The principles cover such areas as default, risk management, access and efficiency, etc. The ERC Committee and ERC Operations Group had reviewed that paper and submitted a response in time for the July 29th deadline. The response supported the idea that sound, efficient market practices should be introduced and commented on the 24 proposed principles. The response also commented on some more general considerations which in the ERC's view form an important part of the background against which the establishment of the principles should be considered. These included points regarding counterparty credit risk, the usage of CCPs, the adequacy of available collateral to meet the demands being established and the definition of FMIs. Additionally, the response commented on the preference, set out in principle 9 for "money settlements in central bank money" versus settlement in commercial bank money, and advocated that both settlement practices be allowed to continue. CPSS/IOSCO received well over 100 responses to the consultation which have now been published.

The Financial Stability Board issued a consultation on July 19th regarding effective resolution measures for Systemically Important Financial Institutions (SIFIs). In particular, the proposal includes a suggested temporary stay on rights to close out netting, akin to that previously proposed as part of the EU's framework for bank recovery and resolution. The ERC response therefore reiterated comments that had been made to the European Commission in March. In particular, the response noted that arrangements need to be carefully developed to take account of repo. Moreover, the aim of allowing for the orderly resolution of a failing institution must be balanced with the market need for prompt close out so as to mitigate the risk of loss. Finally, the response emphasised that established, sound and efficient market practices for repo should not be impeded.

The Commission consulted in February on EU financial sector taxation. Taxation is not normally a topic that ICMA would consider, but this consultation raised a specific question regarding the potential treatment of overnight secured credit, mainly through repos. Notably, the wording of this question suggested that repos are a cheap, unstable and systemically risky source of funding. We responded by refuting this wording and highlighting the importance of repo as a source of funding. We asserted that measures that could harm the repo market would therefore be problematic. There are some in the EU sphere now demanding a financial transaction tax. It is unclear how these proposals will proceed as the UK has stated categorically that it will oppose such proposals. In order for the proposals to proceed as an EU Directive, there must be unanimous support. Accordingly, consideration is being given by some as to how the proposals could go forward in a way that would be limited to the Euro area.

Mr. Hiscock turned to an update on other regulatory developments, starting with the proposed new regulatory capital standards. The Basle III rules text covering capital and liquidity had been issued on December 12th 2010. This was followed by the European Commission publishing its related proposals for the EU in July, which involve both a Directive and a Regulation. As expected, items of note from the ERC's perspective include a liquidity coverage requirement, to be introduced by 2015. There will also be a new leverage ratio, which will include repos taking account of master netting (though not cross-product netting). Firms will have to publish data by 2015 with the potential for this becoming a binding limit by 2018. The other notable element of the proposals relate to CCP exposures where it is proposed that a 2% risk weight be applied in respect of trade exposures. In this regard, the EU is in lock-step with the international community. Regarding the extra capital charges for SIFIs (which, as proposed, could impact the largest 28 institutions on a sliding scale) it remains to be seen what the extent of the changes will be, including whether there will be any extra liquidity requirements for SIFIs. The Commission has indicated that it will await the outcome of discussions at the Financial Stability Board and the Basle Committee on Banking Supervision. A detailed framework will be submitted to the Cannes meeting of G-20 leaders on 3 – 4 November 2011.

The review of the Markets in Financial Instruments Directive (MiFID) is on-going and the European Commission expects to publish draft proposals in mid-October. These will change the rules related to trading, both fixing issues perceived in the current equity focussed provisions of MiFID and extending MiFID to fully encompass non-equities' markets. Considering earlier consultations we can expect that these will have an effect on market structure, through rules on trading venues, and on market practices, through rules on pre- and post-trade transparency.

In respect of the post-trading framework, the Commission continues to advance a series of measures including the European Market Infrastructure Regulation (EMIR), the Securities Law Directive (SLD) the Central Securities Depositories Regulation and close out netting. Additionally, there are two expert working groups that have been considering what further actions may need to be taken – these are the Expert Group on Market Infrastructures (EGMI) and the Tax barriers Business Advisory Group (T-BAG). The Commission is holding a conference on October 24th in Brussels to discuss the road ahead for the European post-trading landscape. Further details can be found here.[8]

Mr. Hiscock also noted that in July the FSB issued a press release regarding recommendations for strengthening the oversight and regulation of the shadow banking system. The shadow banking system has been broadly defined as credit intermediation involving entities and activities outside the regular banking system. This is an extremely broad definition. Four key risk factors have been identified – maturity transformation, liquidity transformation, imperfect credit risk transfer and leverage. The FSB has now identified five areas of further work, one of which is particularly relevant – the regulation of activities related to securities lending/repos, including possible measures on margins and haircuts. The reason they are concerned with repo, whether rightly or wrongly, is that there is a perception that repo was one of the sources of, unstable, funding to shadow banks. There is a belief that rehypothecation of securities was a way in which leverage was built into the system. In the US a report was published entitled "The run on repo and the panic of 2007 – 2008" which theorises that the crisis was caused by repo. This thesis is being considered by the authorities. The FSB has set up a working group to advance its work, in particular looking at potential regulation of cash reinvestment from securities lending and repo; and the possibility of setting minimum haircut levels for securities financing transactions, to try to limit the potential for procyclical variation.

The Chairman noted that the European Commission, the FSB, the ECB and other regulators are all examining repo. ICMA are considering what more can be done to further clarify the way the market works, focusing especially on rebutting some of the US academic articles that argue that repo contributed significantly to the financial crisis.

11. Repo Survey

Mr. Richard Comotto said that the 21st semi-annual survey of the European repo market, which was carried out on June 8th showed a modest increase in the headline figure to EUR 6,178 billion from EUR 5,908 billion in the previous survey. It was worth noting that, after the Lehman collapse the survey shrank to EUR 4,633 billion in December 2008, having reached EUR 6,775 billion. The market has continued to follow a steady growth trend, and the exceptional transactions which caused a spike in activity in June 2010 would seem to have been more or less completely unwound. Using constant samples, growth over the last six months was 3.6%, while year-on-year growth was 10.2%.

[8] Alternatively, see: http://ec.europa.eu/internal_market/financial-markets/clearing/postradingconference_en.htm

The share of electronic trading accounted for 28.2%, little changed from the last survey, while voice-brokered business was down to 19.6% from 20.3%. There was also a slight drop in tri-party repo to 11.2%. Anonymous electronic trading had declined from 18.5% to 17.4% due to an increase in direct cross-border business

The data also shows that a significant proportion of voice-brokered trades and direct trades are cleared through a CCP. Overall, CCP-cleared transactions accounted for 30.5% of outstanding repo business.

US Dollar trading was down to 16.2%, possibly representing the unwinding of the remainder of the exceptional transactions recorded in June 2010. There was a jump in the share of the Japanese yen to a record 6.4% from 3.6% for reasons that are not clear. In electronic trading, there was a sharp increase in the share of the euro, at the expense of the Swiss franc and pound sterling.

The share of German government bonds fell back but that of German covered bonds (pfandbriefe) increased. German government bonds have become scarcer as their role as a 'safe haven' has reduced secondary market supply. Spanish collateral (particularly government securities) continued to gain share, demonstrating the success of CCP clearing in securing market access for Spanish banks. Japanese collateral also expanded. The reduction in the share of German government securities was largely responsible for the continued reduction in the share of all government bonds within the pool of EU-originated collateral to a record low of 73.7% from 76.7%. But this change masked an expansion in the share of Spanish government securities. There was a significant shift in tri-party collateral into higher-rated non-government bonds (notably pfandbriefe). The percentage of government bonds in tri-party is starting to fall.

Short dates fell back sharply to a record low of 50.9% from 62.5%. On the other hand, repos with remaining terms of between six months and a year increased to 6.9% from 3.6%, and transactions with more than a year remaining to maturity jumped to 8.7% from 1.0%.

Floating rate repo rebounded. Open rate repo increased slightly. Securities lending on repo desks declined to 17.5% from 18.8%. The next survey will be conducted on December 7th.

12. Any other business

The Chairman noted that no further business was raised. He thanked BNY Mellon, Mr. Richard Comotto and the ICMA staff.

13. Next meetings

The Chairman said that there would be a GMRA/GMSLA Workshop being held in Zurich from September 21 – 23rd. Additionally, the next ICMA Professional Repo and Collateral Management Course was being hosted by BondLend on November 21 – 22 at the Grange Tower Bridge Hotel in London. Further details can be found here.[9] Finally, the next general meeting of the European Repo Council would be held in the afternoon on January 18th in Luxembourg, hosted by Clearstream.

[9] Alternatively, see: http://www.icmagroup.org/Events/ICMA-Professional-Repo-and-Collateral-Manageme-(1).aspx

Annex A

The following member firms were represented at the meeting:

Aurel BGC, Paris
Banco de Sabadell, SA
BNP Paribas, Paris
Banco Santander, S.A., Madrid
Caja de Ahorros y Pensiones de Barcelona (La Caixa), Barcelona
Caja de Madrid, Madrid
Citigroup Global Markets Limited, London
Confederación Española de Cajas de Ahorros (CECA), Madrid
Crédit Agricole Corporate and Investment Bank, Paris
Danske Bank A/S, Copenhagen
Dexia Bank Belgium NV/SA, Brussels
DZ Bank AG Deutsche Zentral-Genossenschaftsbank, Frankfurt
Eurex Repo GmbH, Frankfurt
EuroMTS Limited, London
Goldman Sachs International, London
HSBC Bank plc, London
HSBC France, Paris
ICAP Securities Limited, London
ING Bank N.V., Amsterdam
J.P. Morgan Securities Limited, London
Kredietbank SA LuxembourgeoiseKBL European Private Bankers S.A., Luxembourg
Landesbank Baden-Württemberg, Stuttgart
Macquarie Bank Limited, London
Morgan Stanley & Co. International PLC, London
NATIXIS, Paris
Nomura International plc, London
Nordea Bank Danmark A/S, Copenhagen
Société Générale S.A., Paris

The following member firms were not represented at the meeting:

ABN AMRO N.V., Amsterdam
Banca IMI S.p.A., Milan
Banco Bilbao Vizcaya Argentaria, S.A., Madrid
Bank Julius Bär & Co. AG, Zurich
Bank of Scotland plc, London
Banque et Caisse d'Epargne de l'Etat, Luxembourg
Barclays Capital Securities Limited, London
Bayerische Landesbank, Munich
Commerzbank Aktiengesellschaft, Frankfurt
Commonwealth Bank of Australia, Sydney
Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (trading as Rabobank International), London branch
Credit Suisse Securities (Europe) Limited, London
Daiwa Capital Markets Europe Limited, London
Deutsche Bank AG, Frankfurt
Fortis Bank, Brussels

GESMOSA-GBI, Agencia de Valores, S.A., Madrid
ING Belgium SA/NV, Brussels
IntesaSanpaolo S.p.A, Milan
Jefferies International Limited, London
KBC Bank N.V., Brussels
Lloyds TSB Bank plc, London
Merrill Lynch International (trading as Bank of America Merrill Lynch), London
MF Global UK Limited, London
Mitsubishi UFJ Securities International plc, London
Mizuho International plc, London
Monte dei Paschi di Siena Capital Services Banca per le Imprese S.p.A., Siena
National Australia Bank, London
National Bank of Greece S.A., Athens
NIBC Bank N.V., The Hague
Norddeutsche Landesbank Luxembourg SA, Luxembourg
Raiffeisen Zentralbank Österreich AG, Vienna
Royal Bank of Canada Europe Limited, London
The Royal Bank of Scotland plc, London
Tradeweb Europe Limited
UBS AG, London Branch, London
UniCredit Bank AG, Munich
UniCredit Bank Austria AG, Vienna
WestLB AG, Düsseldorf