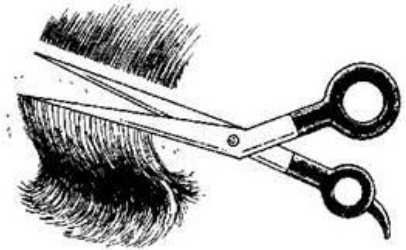
# Perspectives from the eye of the storm

- ICMA report published 18 November 2015
- Reviews the **European repo market's current state and future evolution**
- Reports broad concern as to the extent to which the repo market can continue to perform its various roles, efficiently and effectively
- Basel III, incorporating Risk Capital Requirements, Leverage Ratio, LCR and NSFR, is the single greatest regulatory driver of change
- **Structure and dynamics of the repo market are being transformed**

## Commission's call for evidence on the EU regulatory framework for financial services

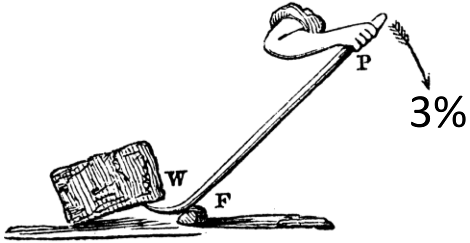
- Examination of the cumulative impact of regulation, in context of the Capital Markets Union (CMU) project
- ICMA responded on 20 January 2016
  - Focussed primarily on the issue of market liquidity, citing published ICMA studies in evidence & detailing concerns in respect of three specific elements:
    - European corporate bond secondary market liquidity
    - **Repo market liquidity and collateral fluidity**
    - CSDR mandatory buy-ins and fixed income liquidity

- Concerns regarding repo market liquidity and collateral fluidity lie at the heart of much of ICMA ERCC's work relating to the impact of regulation on repo and collateral markets



## Haircuts

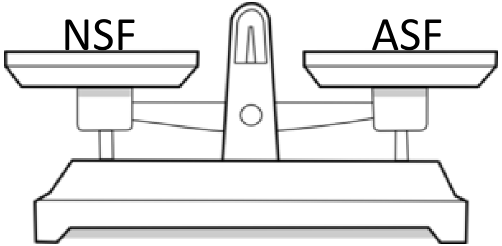
- In October 2014, the FSB published its regulatory framework for haircuts on non-CCP cleared SFTs
  - Aims to limit excessive leverage build-up outside the banking system & to reduce its procyclicality
  - Consists of:
    - Qualitative standards for methodologies used by SFT market participants to calculate haircuts on the collateral received; and
    - **Numerical haircut floors** that will apply to non-CCP cleared SFTs in which financing against collateral other than government securities is provided to entities other than banks and broker-dealers (referred to for simplicity as “non-banks”)
  - Expanded framework in November 2015 also out numerical haircut floors to apply to non-bank-to-non-bank SFTs
- Article 29.3 in the EU SFTR anticipates possible EU introduction of specific SFT haircut rules
  - ESMA shall, by 13 October 2016, submit a report advising on certain risks in SFTs & the potential need for further rules
    - In preparation, ESMA has solicited information from ICMA ERCC on haircuts in the European repo market
  - Then, by 13 October 2017, the Commission shall submit a report and any appropriate proposals on EU haircut rules
- ESRB considers there is **a case for powers to make countercyclical changes to required haircuts**
- But remember, haircuts protect one party to a repo and create exposure for the other
- Markets could be disrupted if the EU adopts haircut rules which go beyond the FSB proposals




# Leverage Ratio

- BCBS consulted, on 6 April, on **revisions to the Basel III leverage ratio framework**
  - ICMA ERCC submitted a detailed, 6 July, response
    - Cumulative impact of the pressures being imposed on the repo market, most particularly by the leverage ratio, are such that it is already a market under significant stress
    - A number of ways in which its details could be calibrated to better smooth its effects on repo and collateral markets
    - More detailed specific treatments for special asset types such as HQLA, or in relation to desirable financing activities
    - **Suggested need to introduce specific refinements to:**
      - Exempt central bank reserves from the leverage exposure measure;
      - Exclude potential grossing up when conducting repos with central banks;
      - Eliminate double counting stemming from the required current exposure add on;
      - Reduce, or eliminate the leverage ratio impact of forward starting repos;
      - Allow for open and callable repos to be netted on the basis that they end on their earliest possible closure date
      - Ensure that detailed provisions concerning CCP activities are applied across asset classes
- EU (Capital Requirements Regulation) CRR will be updated to include applicable EU leverage ratio rules
  - Currently anticipate applicable Commission proposal in November 2016

## Net Stable Funding Ratio (NSFR)




- BCBS NSFR standard endorsed 31 October 2014, to become a minimum standard by 1 January 2018
- EU (Capital Requirements Regulation) **CRR will be updated to include applicable EU NSFR rules**
  - Currently anticipate applicable Commission proposal in November 2016
  - Official sector, as reflected in the EBA's December 2015 report to the Commission, seemingly consider that NSFR will not have significant implementation impact – as most EU banks already appear BCBS compliant
  - On 26 May, Commission published a targeted consultation to collect further perspectives on this
    - ICMA ERCC submitted a detailed, [24 June, response]
      - NSFR, if adopted exactly as per BCBS, would create significant additional stress & weaken the repo market effectiveness
      - Group level impact is very different from standalone subsidiary / business line / trading desk impacts
      - A number of ways in which its details could be calibrated to better smooth its effects on repo and collateral markets
      - Further refine the applicable ASF/RSF proportions in order to rebalance their asymmetry driven behavioural effects
      - More detailed specific treatments for special asset types such as HQLA, or in relation to desirable financing activities
      - Exempt short-term – in this context, say those of up to six months – SFTs, such as repo
      - Relax conditionality for SFT netting, and/or allowing for more offsets of "interdependent assets and liabilities"
    - **Commission will make some adaptation from Basel**, but details remain to be seen

## Revised Markets in Financial Instruments Directive (MiFID) & new Regulation (MiFIR)

- MiFID governs the provision of investment services in financial instruments by banks and investment firms and the operation of traditional stock exchanges and alternative trading venues
- MiFID was focussed on equities markets, but is now being extended to full cover non-equities markets
  - As repos are typically comprised of trades in fixed income securities, they are partially impacted by this extension of MiFID
  - In mid-2016, SFTs have been **exempted from both pre- and post-trade transparency requirements**
  - SFTs are also exempt from MiFIR transaction reporting requirements (rather being covered by SFTR reporting
    - But for now must still MiFIR transaction report repos with ESCB counterparties (as they are exempt from SFTR reporting)
  - **Best execution requirements apply**, both for execution venues and for investment firms executing client orders
  - MiFID II states that an investment firm shall not conclude TTCAs for the purpose of securing obligations of retail clients
    - GMRA repos are TTCAs – it seems these will not therefore be allowed with retail clients
    - The definition of retail clients encompasses entities such as local authorities and municipalities – but subject to applicable procedures these types of clients may be able to elect for treatment as professional clients

# Thank you, Ladies and Gentlemen

» Contacts and information:

- David Hiscock: Senior Director – Market Practice and Regulatory Policy
  - David.Hiscock@icmagroup.org
  - Tel: +44 (0)20 7213 0321 (Direct Line) / +44 (0)7827 891909 (Mobile)
- Alexander Westphal: Associate – Market Practice and Regulatory Policy
  - Alexander.Westphal@icmagroup.org
  - Tel: +44 (0)20 7213 0333 (Direct Line) / +44 (0)7469 159961 (Mobile)

ICMA Ltd, 23 College Hill, London EC4R 2RP / www.icmagroup.org

- ICMA quarterly report provides detailed updates on these matters and ICMA's broader work http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Regulatory-Policy-Newsletter