International
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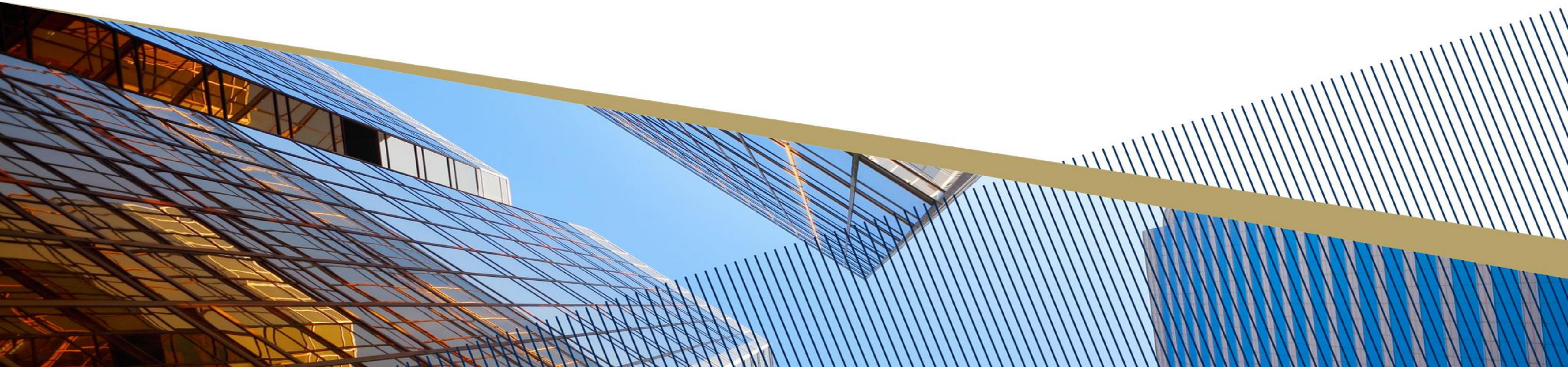
ICMA European Repo and Collateral Council General Meeting

15 November 2019, Brussels



Welcome Remarks

Godfried De Vidts
Senior Advisor
ICMA ERCC

ERCC Initiatives 2019: Helping to foster a robust and orderly repo and collateral market

Moderator: **Godfried De Vidts**, Senior Advisor, ICMA ERCC

Panellists:

Lisa Cleary, Senior Director, ICMA

Richard Comotto, Senior Fellow, ICMA Centre

Nicholas Hamilton, Executive Director, Digital & Platform Services, J.P. Morgan; ERCC Ops chair

Andy Hill, Senior Director, ICMA

Alexander Westphal, Director, ICMA

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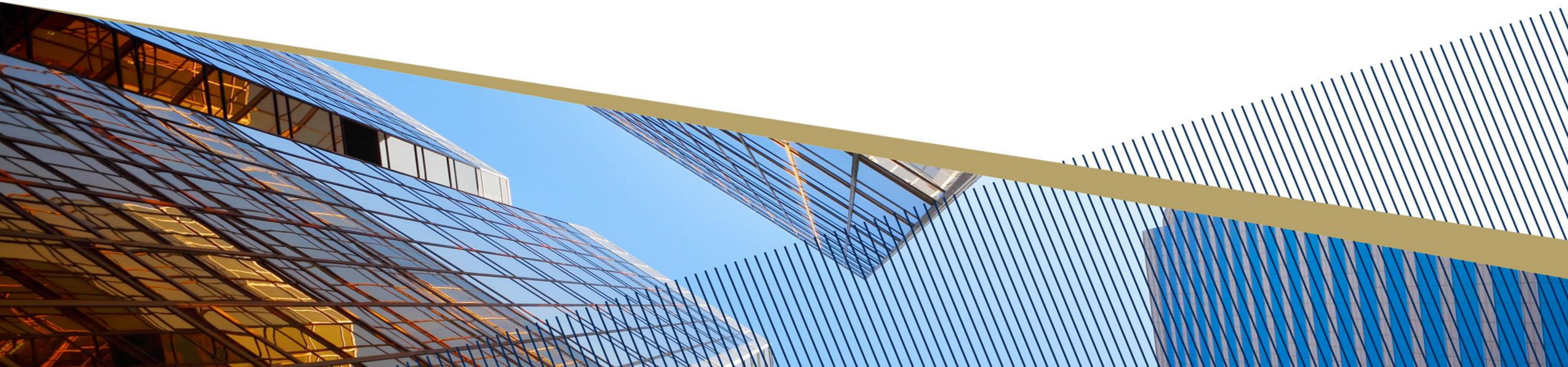
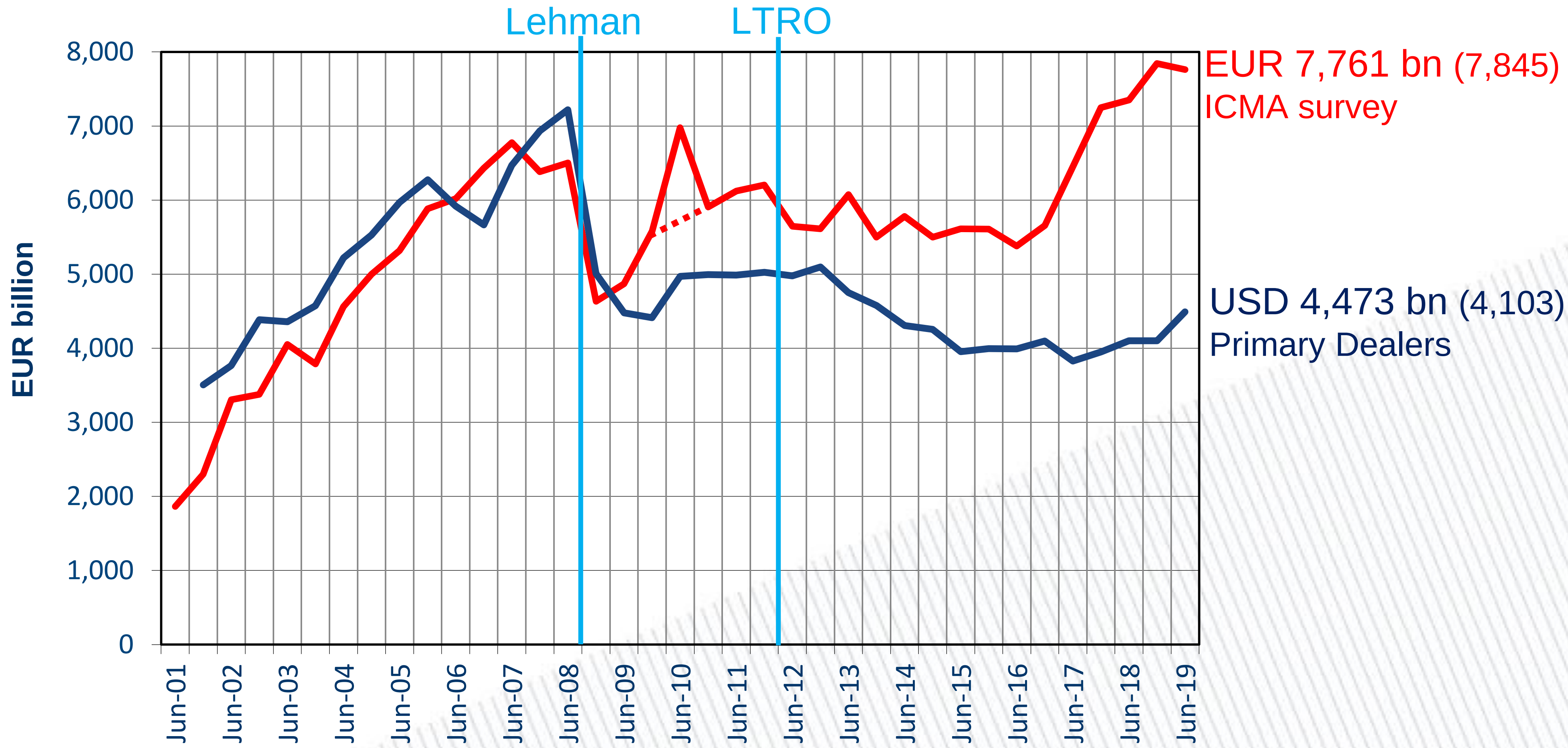
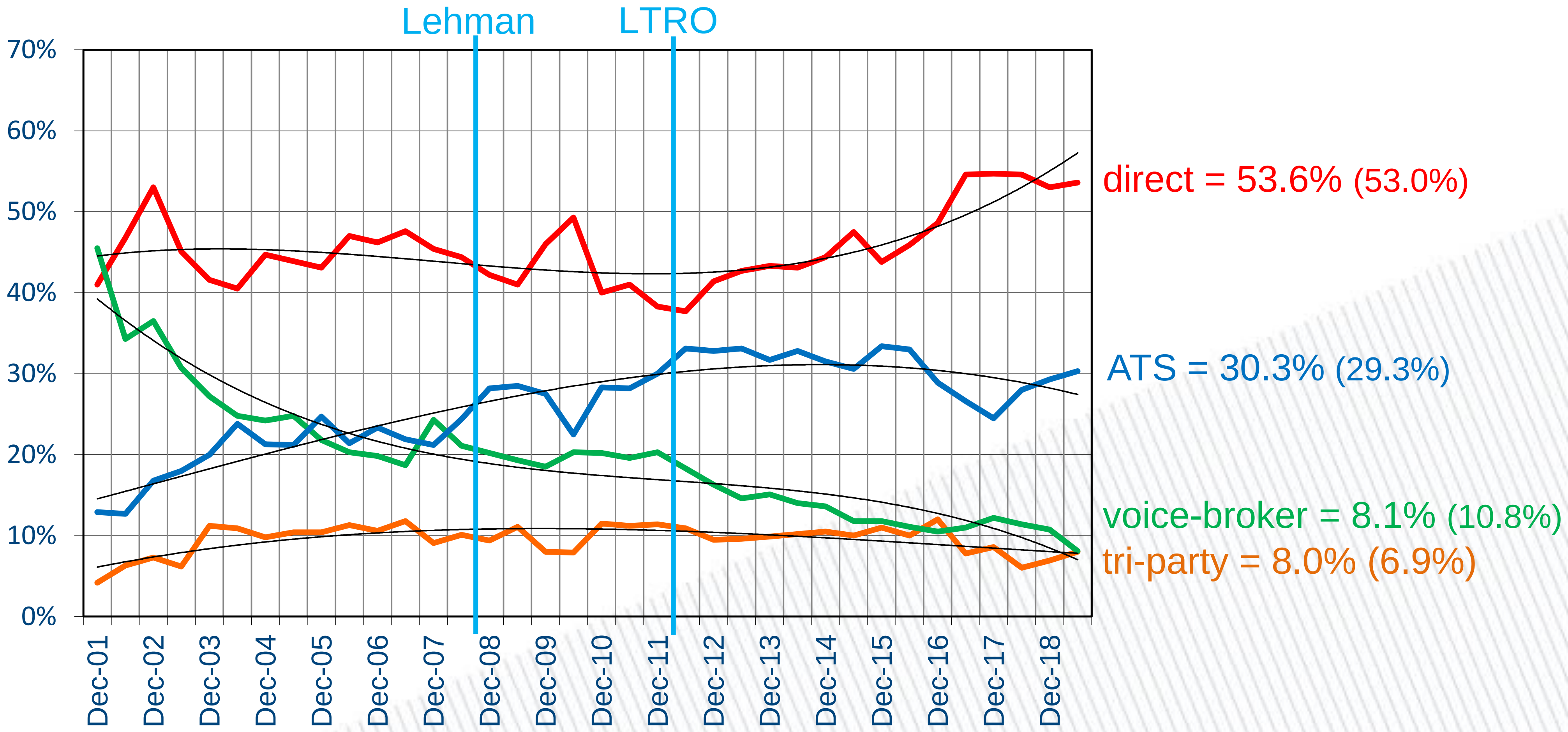
37th European Repo Market Survey



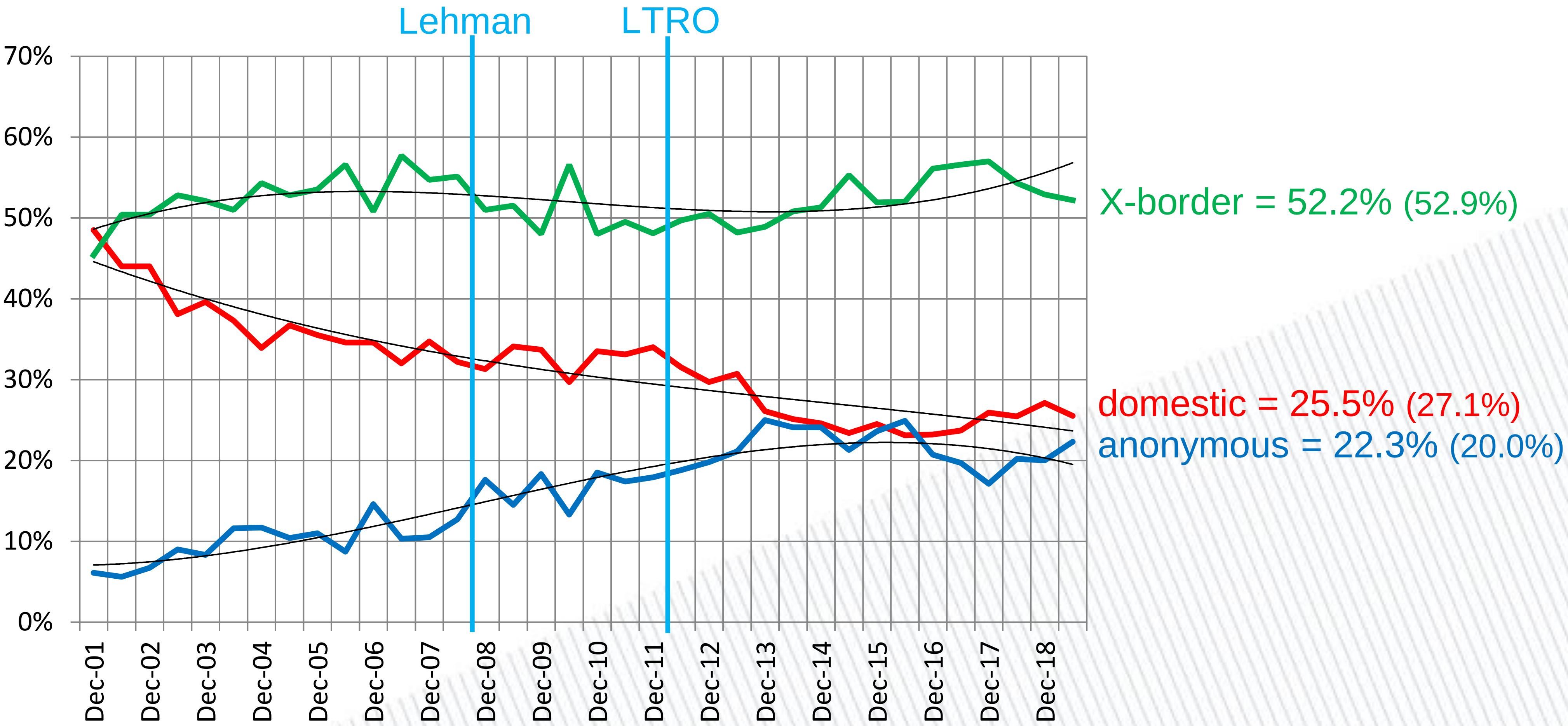
Headline numbers: ICMA & FRBNY surveys



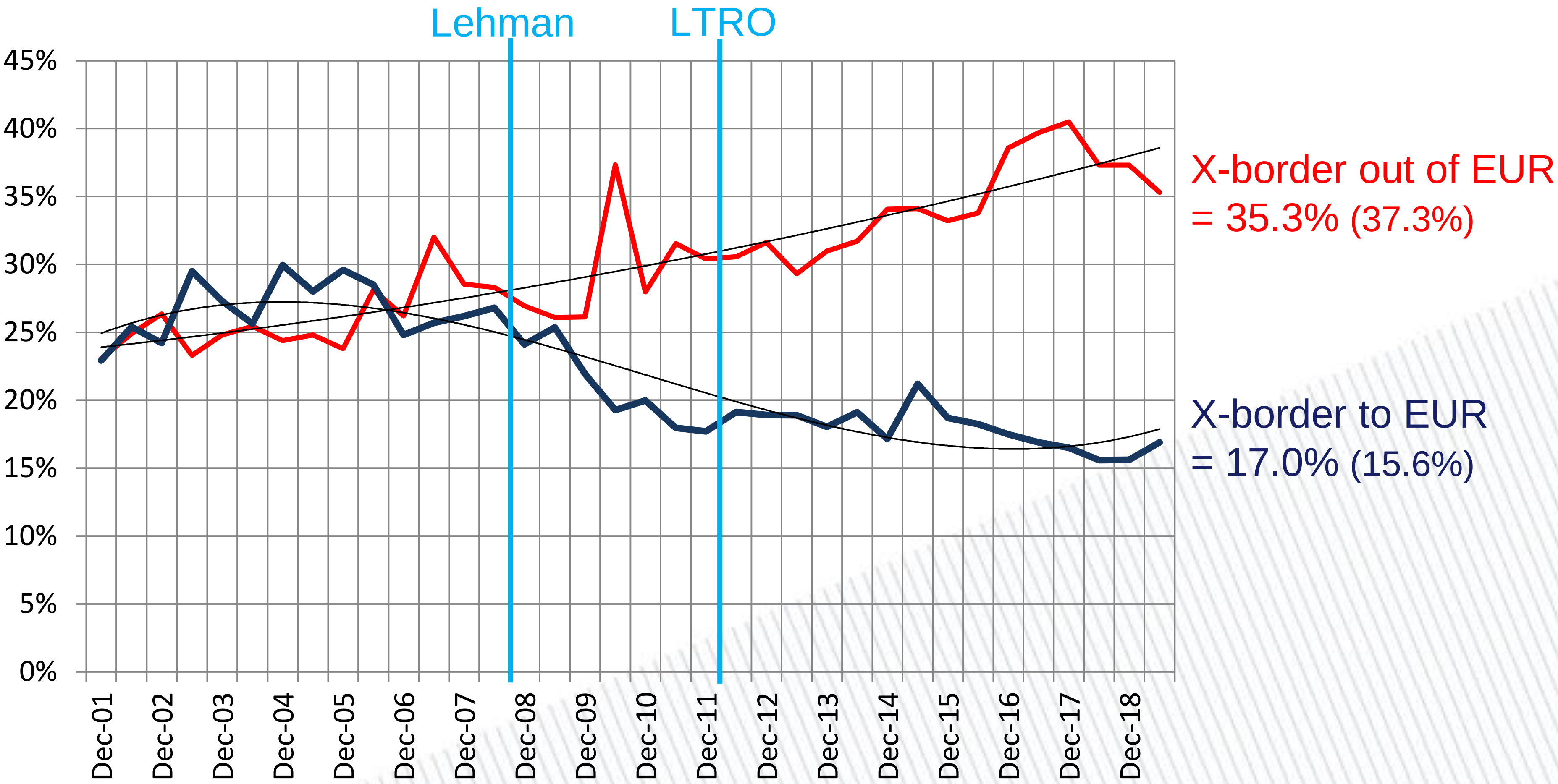
Trading Analysis



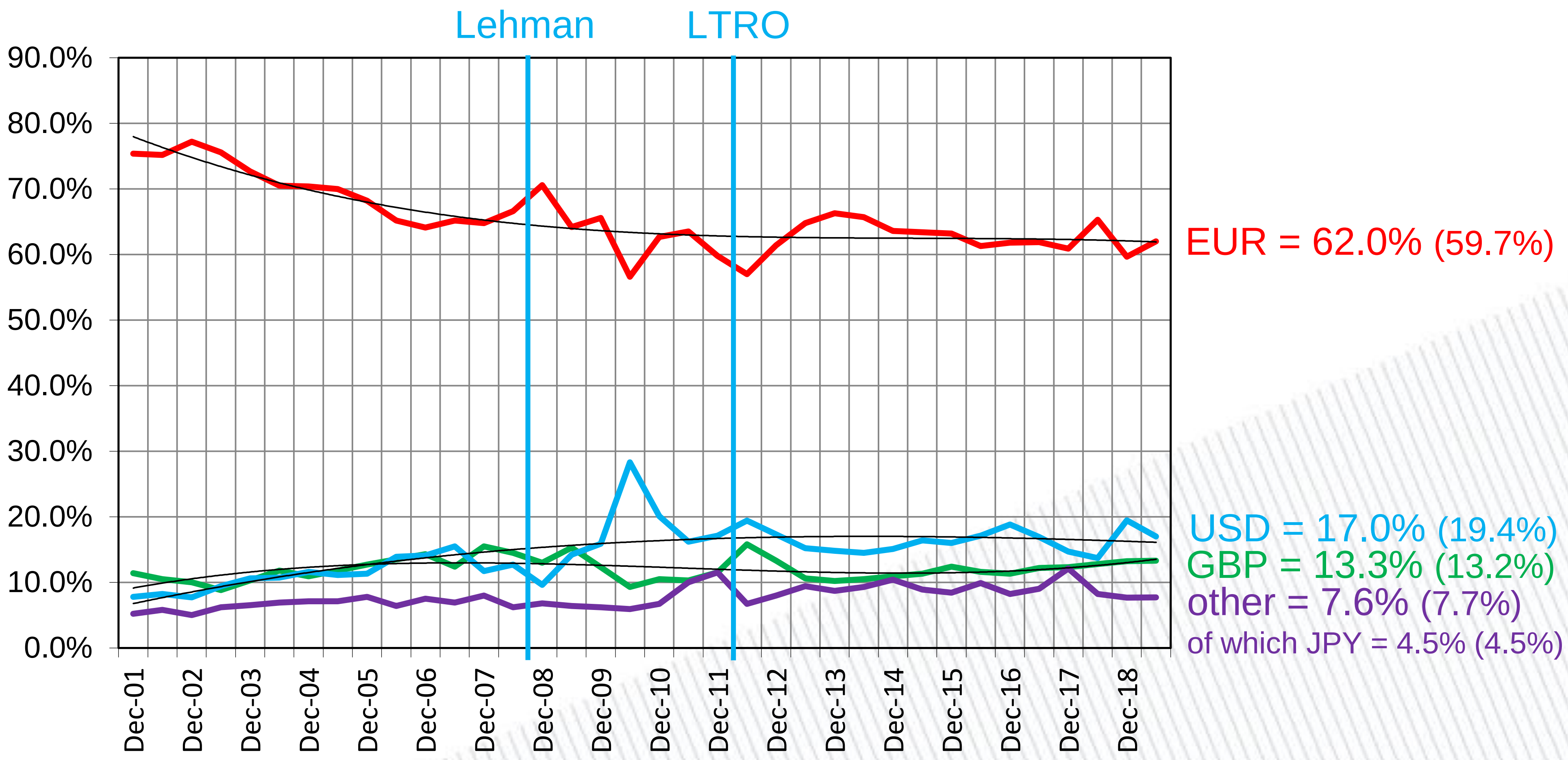
Geographical Analysis



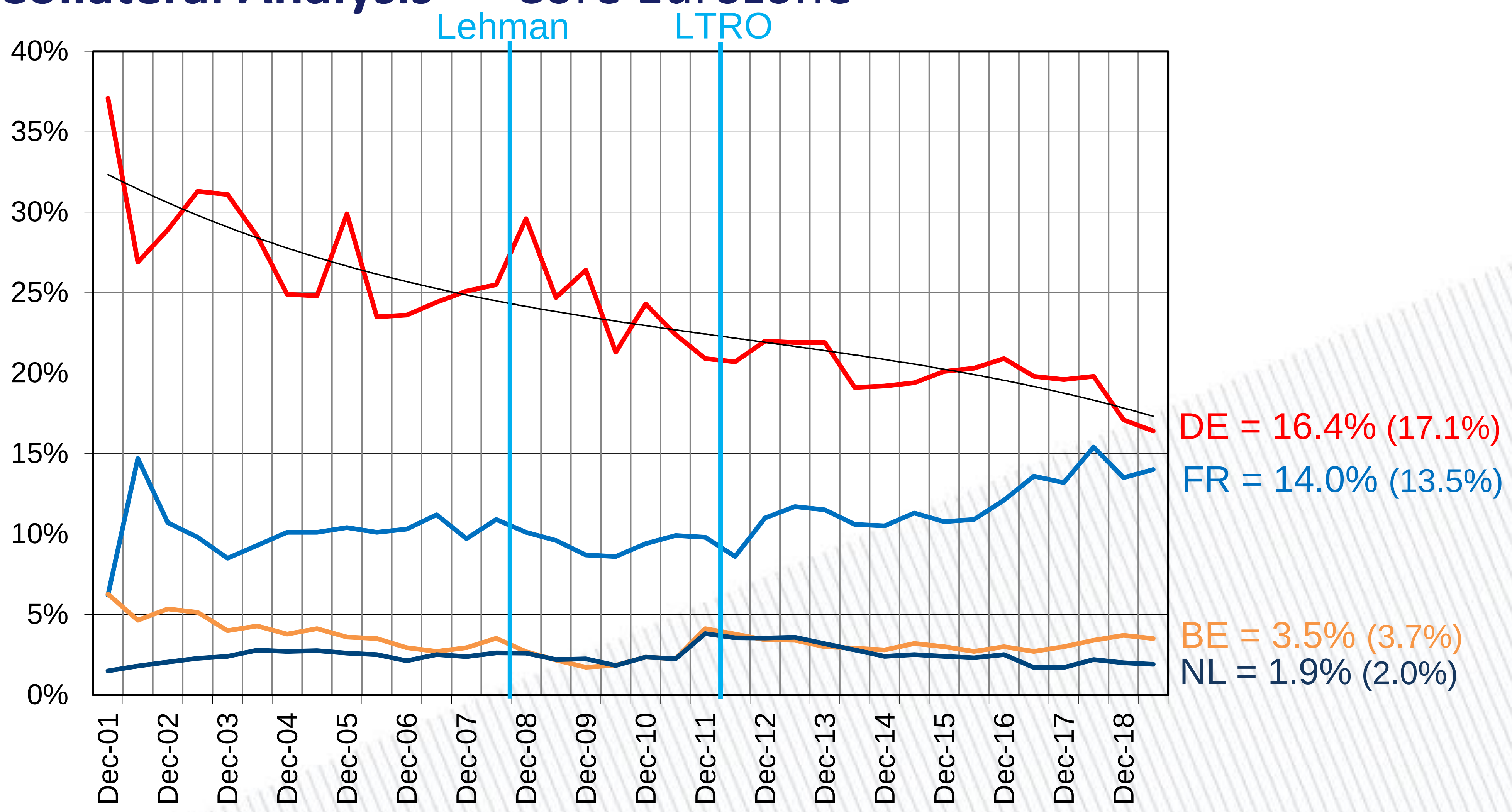
Geographical Analysis



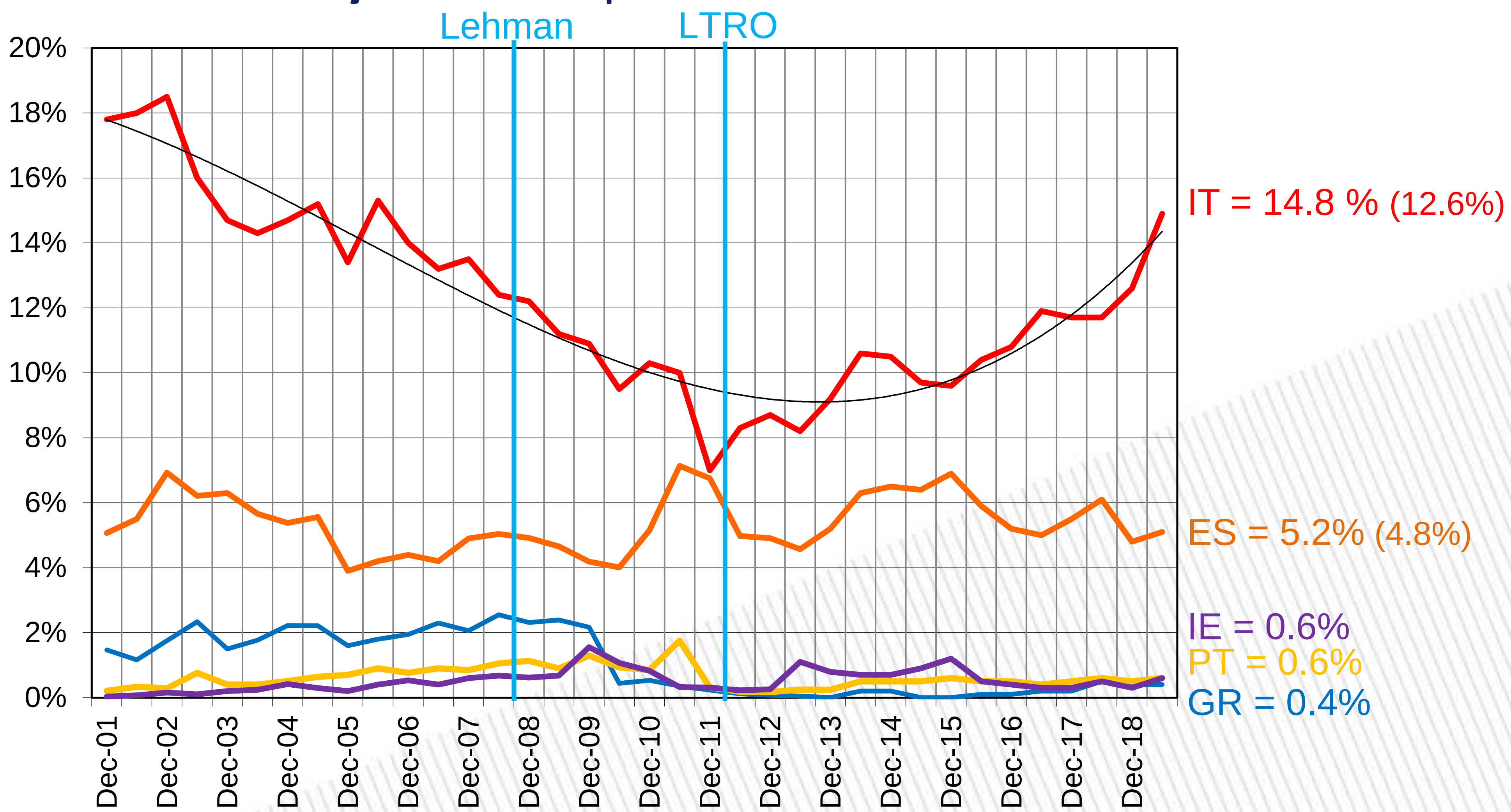
Currency Analysis



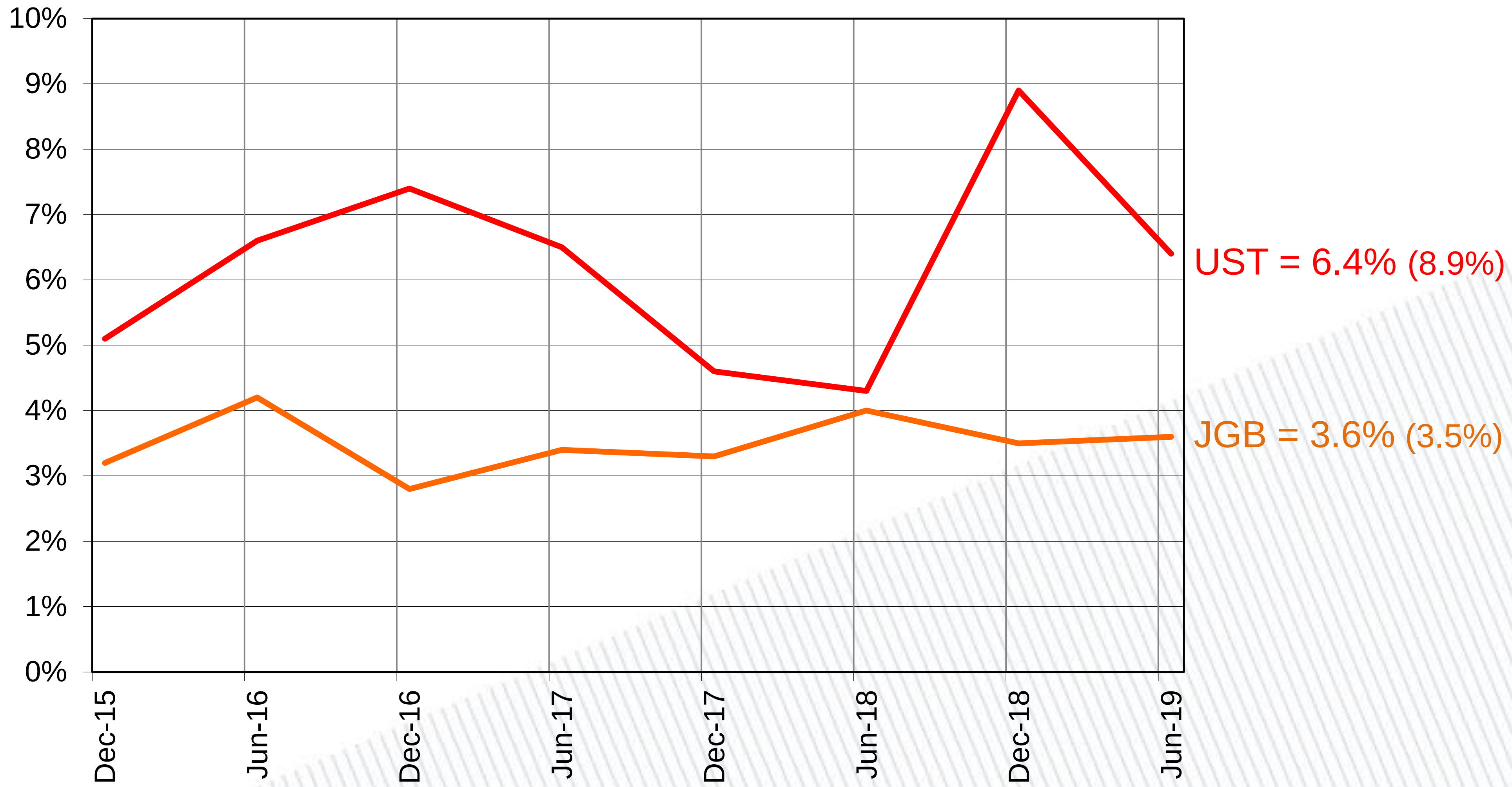
Collateral Analysis --- Core Eurozone



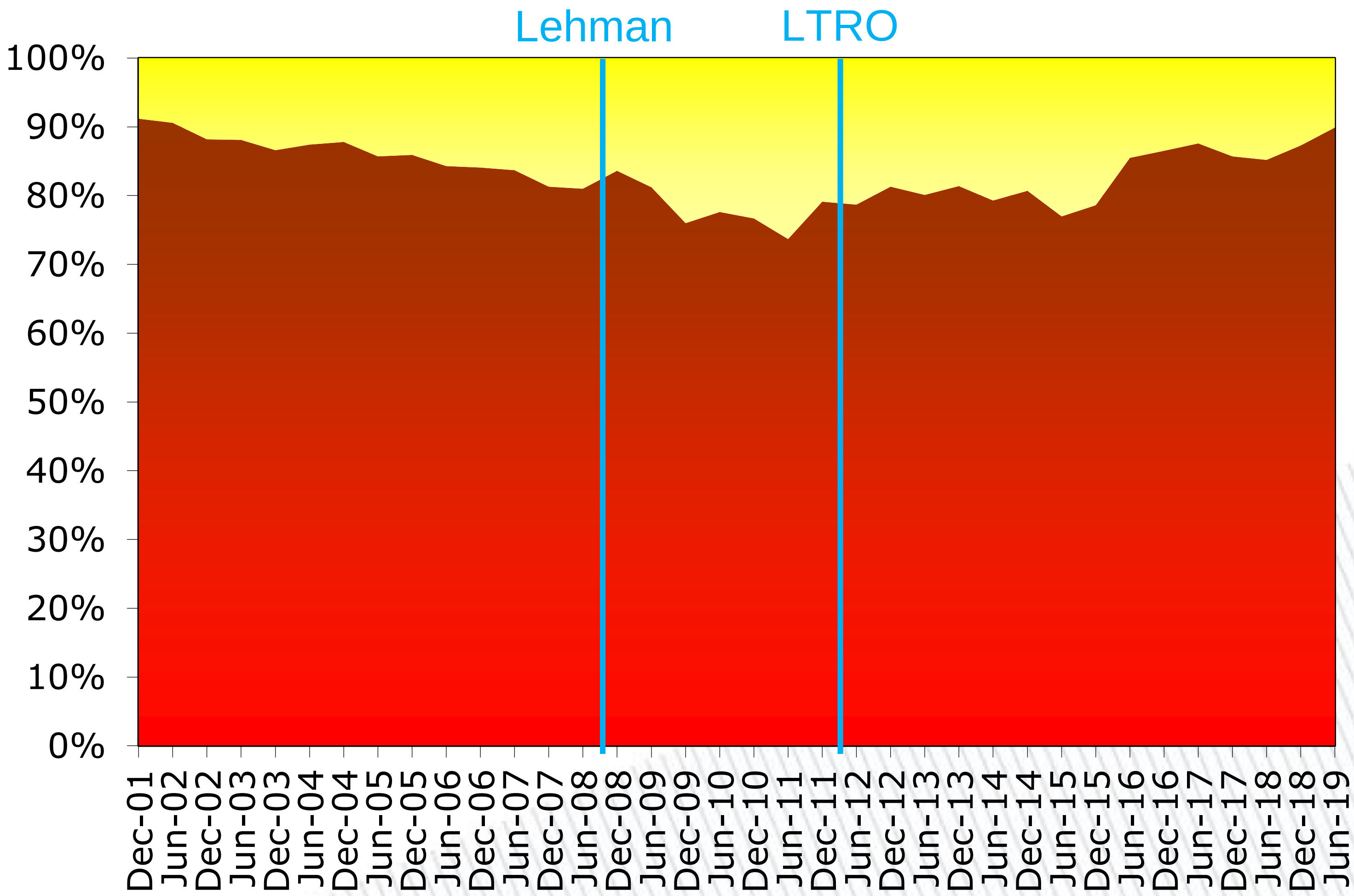
Collateral Analysis --- Peripheral Eurozone



Collateral Analysis --- non-EU collateral

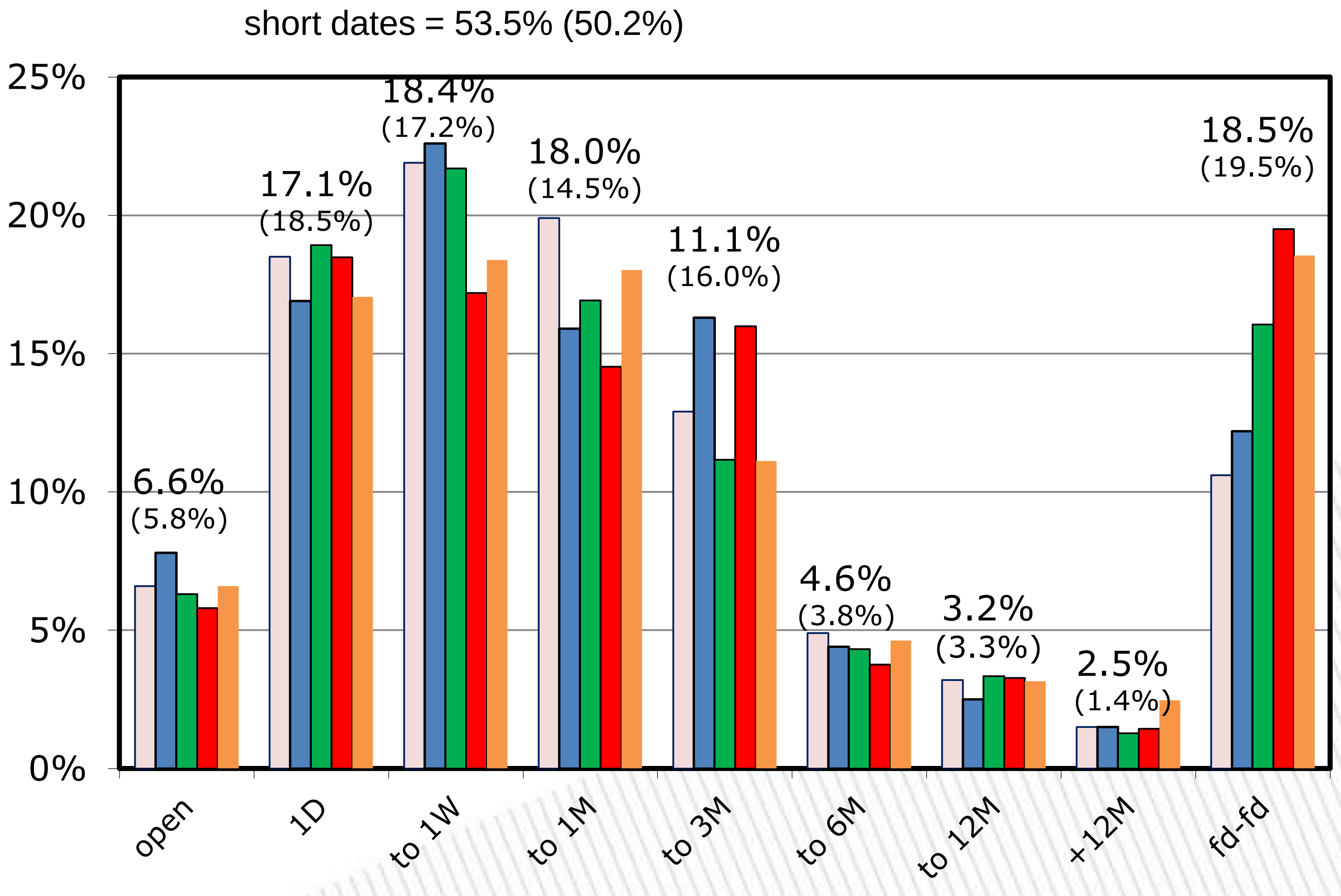


Collateral Analysis

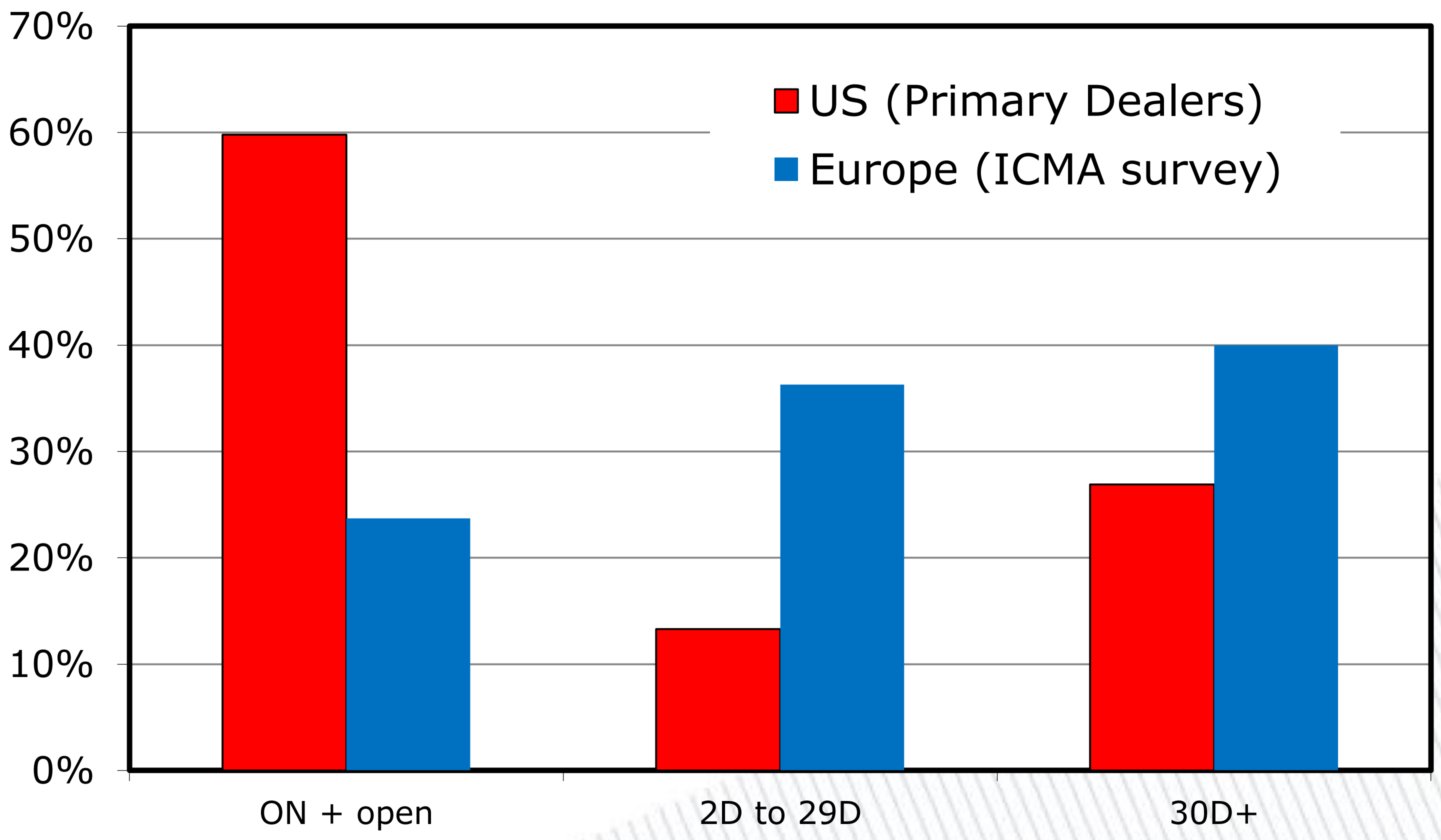


EU govis = 89.9% (87.3%)

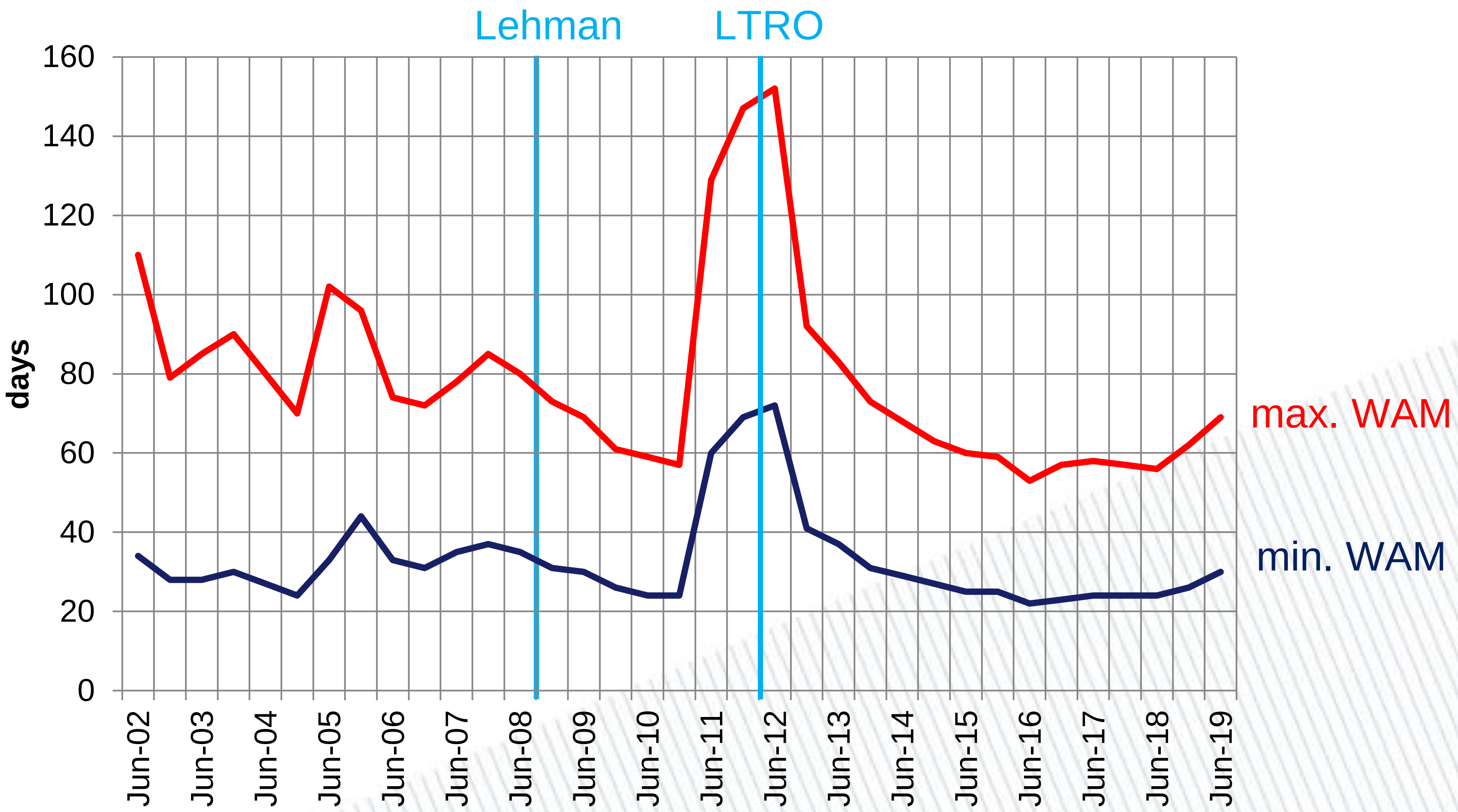
Maturity Analysis



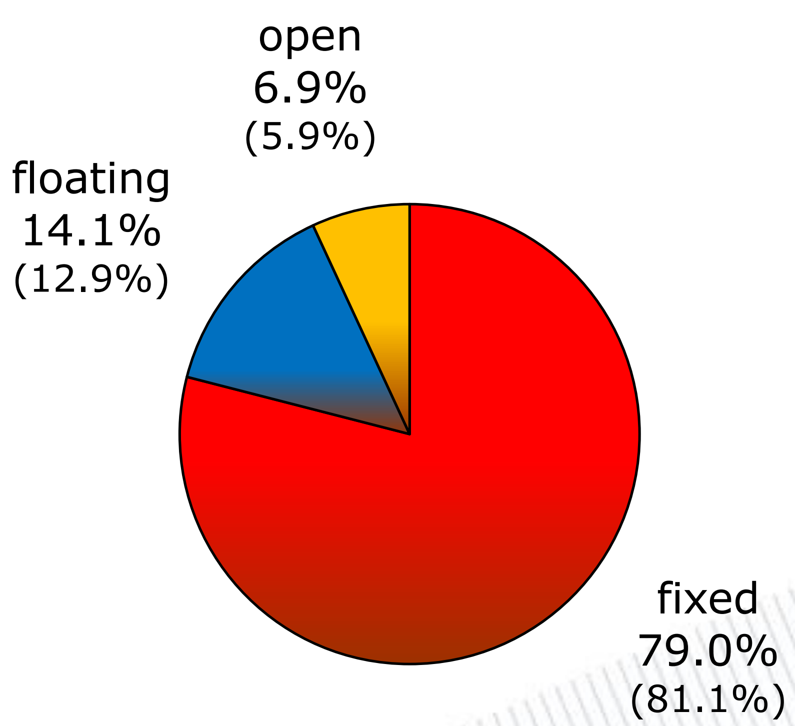
Maturity Analysis --- US v Europe



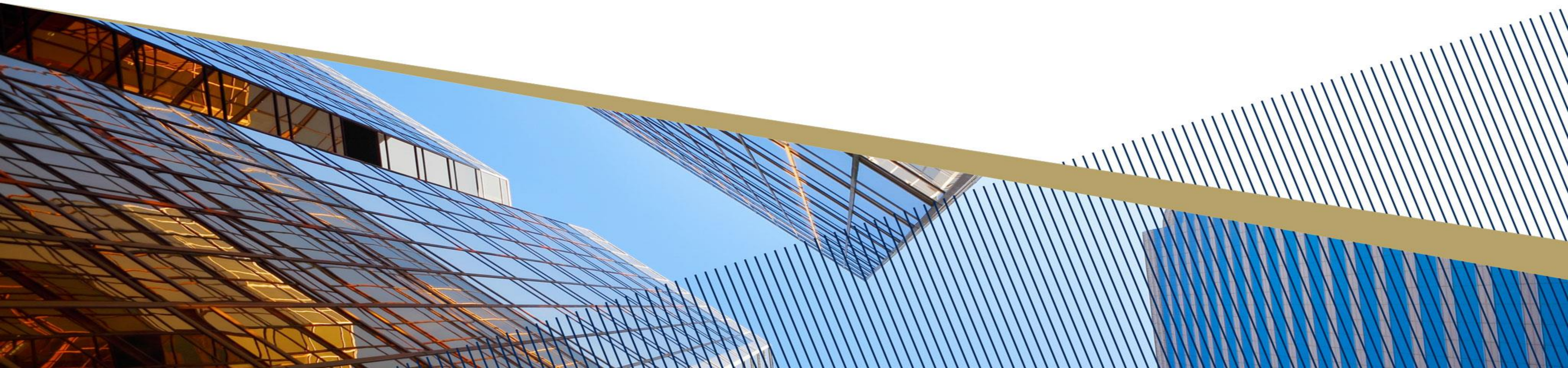
Maturity Analysis



Rate Analysis



Transition from EONIA to €STR

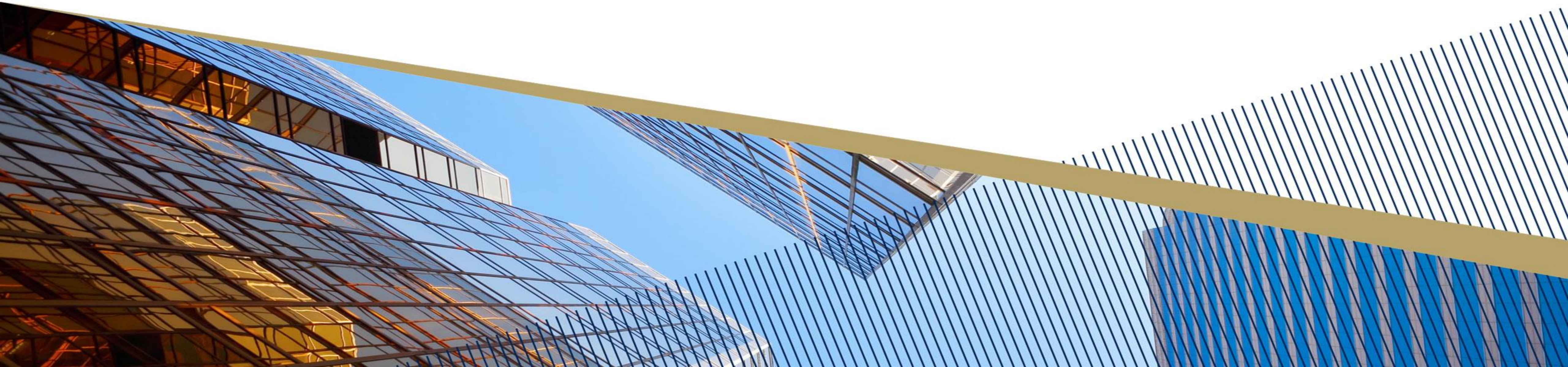


Transition from EONIA to €STR : recommended best practice for repo (from Oct 1, 2019)

- The Interbank market should transact purely on a fixed-rate basis ("classic repo") and should no longer use floating rate repo.
- In the case of non-interbank transactions (such as dealer-to-client), where firms agree to transact on a floating-rate basis (using EONIA or €STR), best practice will be to apply the fixing of the penultimate accrual date of the transaction to the final (repurchase) date (i.e. "crystalizing" the penultimate fixing into a fixed rate for the final business day). This will allow for parties to send timely settlement instructions for the repurchase leg of the transaction.
- Where the Repurchase Price of a floating-rate repo indexed to an overnight index has to be calculated and instructed before the fixing and publication of the final rate and the parties decide to make retrospective reimbursements for any difference between the actual and correct Repurchase Prices, it is best practice to document this agreement and the deadline for reimbursement, if necessary in the Confirmation of the transaction, and for any reimbursement to be made immediately following the Repurchase Date, but no later than 30 days afterwards. Where several reimbursements are to be claimed on the same day, a single net amount should be claimed from a counterparty, rather than separate claims for each transaction. **The net claim per day per counterparty should not be for less than EUR 500 or the approximate equivalent in other currencies**.

ICMA ERCC memorandum outlining recommendations for repo market best practice to address the transition from EONIA to €STR

FinTech and the Common Domain Model (CDM)



ISDA Common Domain Model (CDM) and repo

- The ISDA CDM has been designed as an industry solution to tackle the lack of standard conventions in how derivatives trade events and processes are represented. Developed in response to regulatory changes, high costs associated with current manual processes, and a demand for greater automation across the industry, the ISDA CDM establishes a common blueprint for events that occur throughout the derivatives lifecycle, paving the way for greater automation.
- Essentially the CDM creates common building blocks in machine readable format that can be used by all businesses and processes within a firm, or across the entire industry. The benefit is to recreate and represent any individual securities transaction or lifecycle event in an entirely consistent and replicable way, deriving exactly the same cashflow outputs.
- ICMA has embraced the opportunity to partner with ISDA in developing the CDM to encompass bond and repo markets. As with derivatives, the expected benefits to the bond and repo markets will be:
  - Greater internal efficiencies for firms' various processes and IT applications: e.g. trade execution, risk management, regulatory reporting, trade confirmation, reconciliations and settlement.
  - Enhanced interoperability between market infrastructures, including trading venues, order/execution management systems, CSDs, CCPs, and trade repositories.
  - Consistency of regulatory transaction and trade reporting (MiFIR / SFTR).
  - A common foundation for developing new technologies such as distributed ledger and cloud services.

ICMA CDM and repo & bond markets

Benefits of CDM

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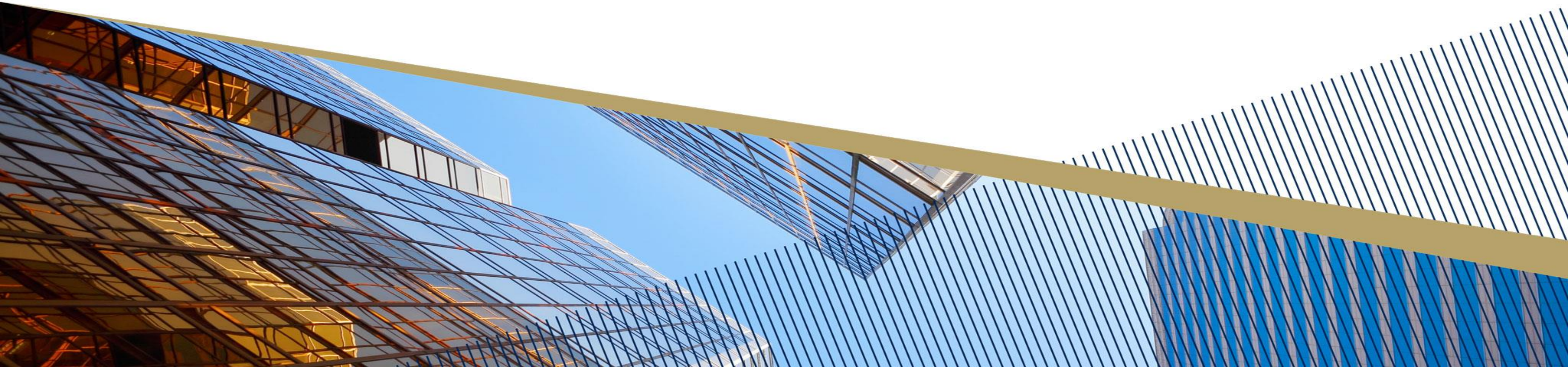
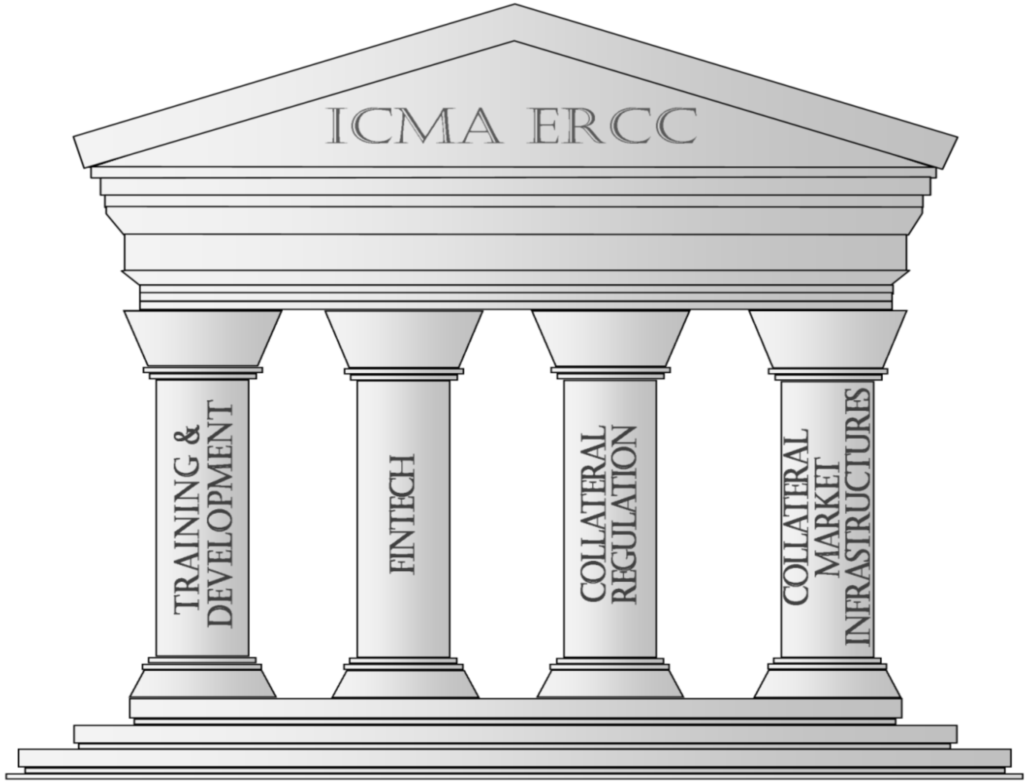
ERCC Ops initiatives



ERCC Operations Group – 4 pillars



Pillar 1: Best Practice & Training

- Repo Guide to Best Practice
- EONIA to €STR transition
- ICMA events, courses and workshops

Pillar 2: Technology

- FinTech mapping directory
- ECB FinTech WG
- Common Domain Model (CDM)

Pillar 3: Collateral Regulation

- EU SFT Regulation
- MiFIR reporting (ESCB repo)
- CSD Regulation
- UK Money Markets Code

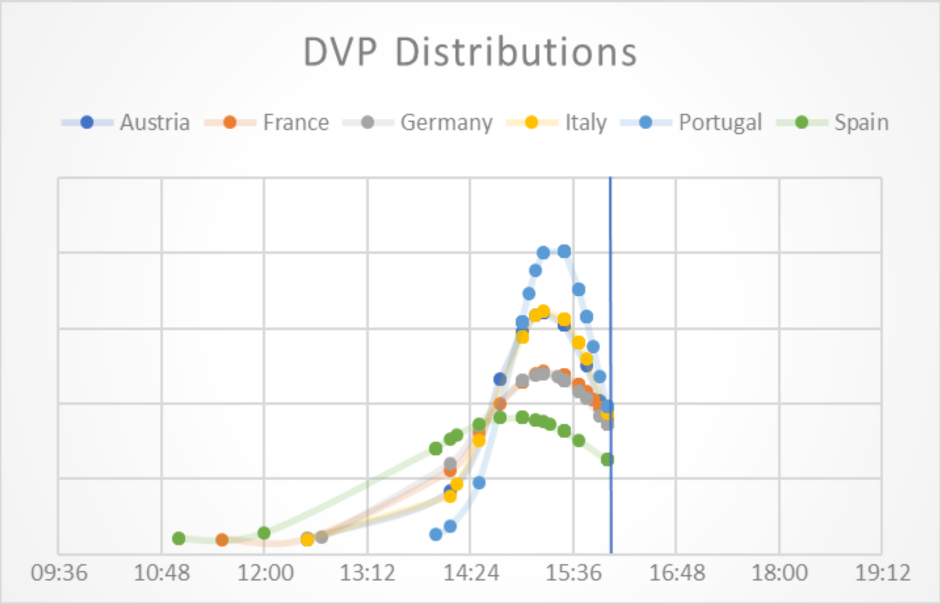
Pillar 4: Collateral Market Infrastructures

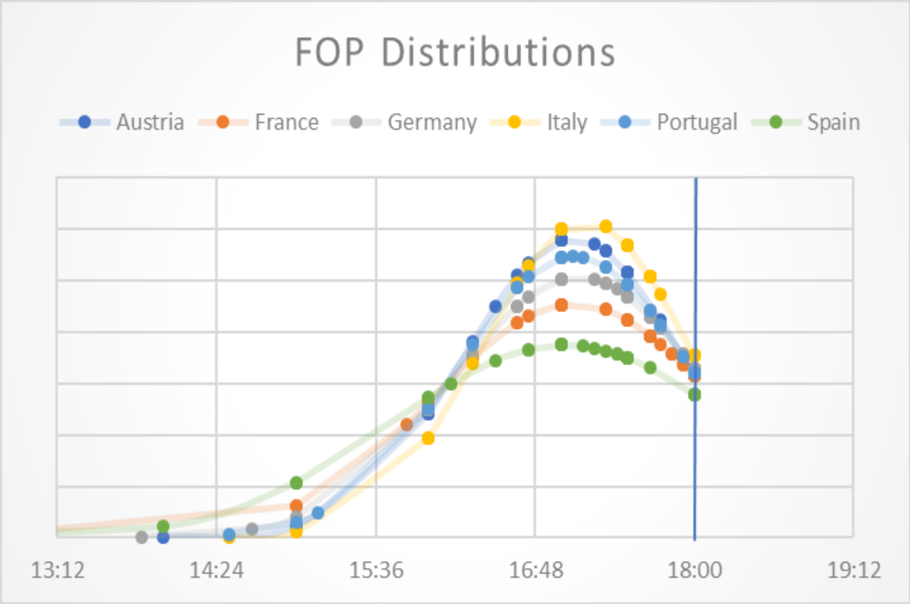
- ECB's AMI-SeCo & T2S
- Collateral management harmonisation (CMH-TF)
- Intraday liquidity
- Other FMI developments

Background and key findings

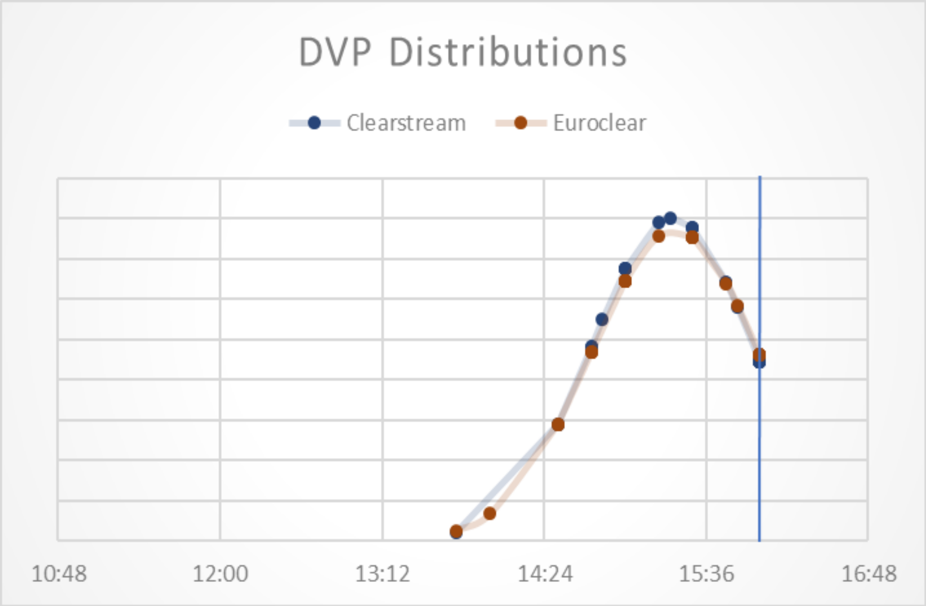
- In the context of the CMH-TF work, ECB asked the ERCC to provide an updated view on settlement cut-off times and need for harmonisation – ERCC and ISLA launched a joint survey in July (updating a previous version undertaken in 2014) covering 6 domestic (T2S) markets & the two ICSDs (including Bridge)
- Around **40 responses received** across ISLA and ERCC membership (mostly larger sell-side firms, but also some smaller institutions and buy-sides)
- Responses show **significant improvements since the previous survey** (although comparison is difficult due to differences in approach) and notable consistency across the different markets considered
- Average internal cut-off time **generally within 1 hour** from the applicable market cut-off for both DvP and FoP and across all markets (with some exceptions)
- As expected, internal cut-off times generally **around 30 minutes earlier where custodians are involved** as compared to ICSD/investor CSD scenarios across all markets – some outliers for direct participants but probably due to limited number of entries
- As the infrastructure setup has improved over the past years, the focus is shifting to underlying frictions and behavioural issues that may impact firms’ settlement efficiency and limit firms’ ability to manage and optimise intraday liquidity management

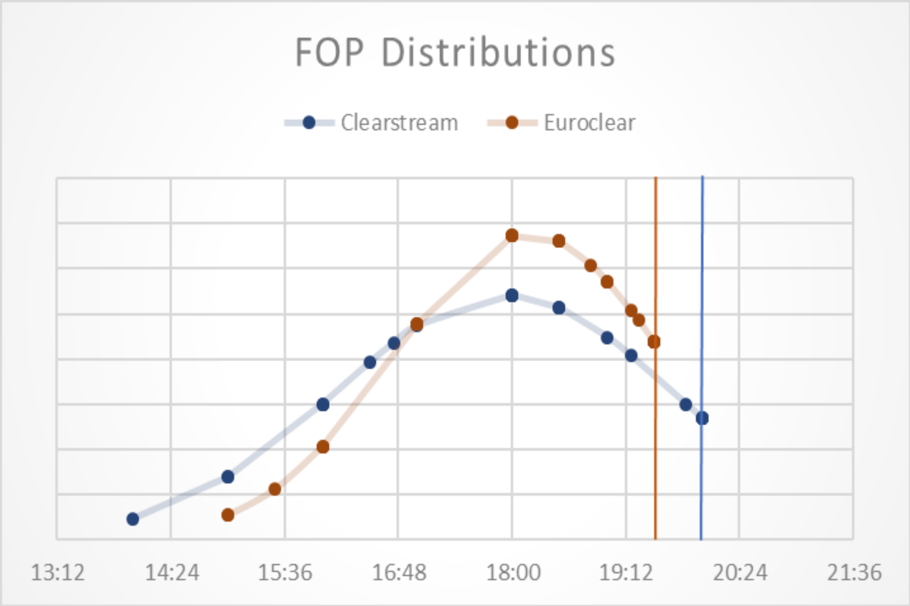
Overview of survey results: Domestic T2S markets





Overview of survey results: ICSDs





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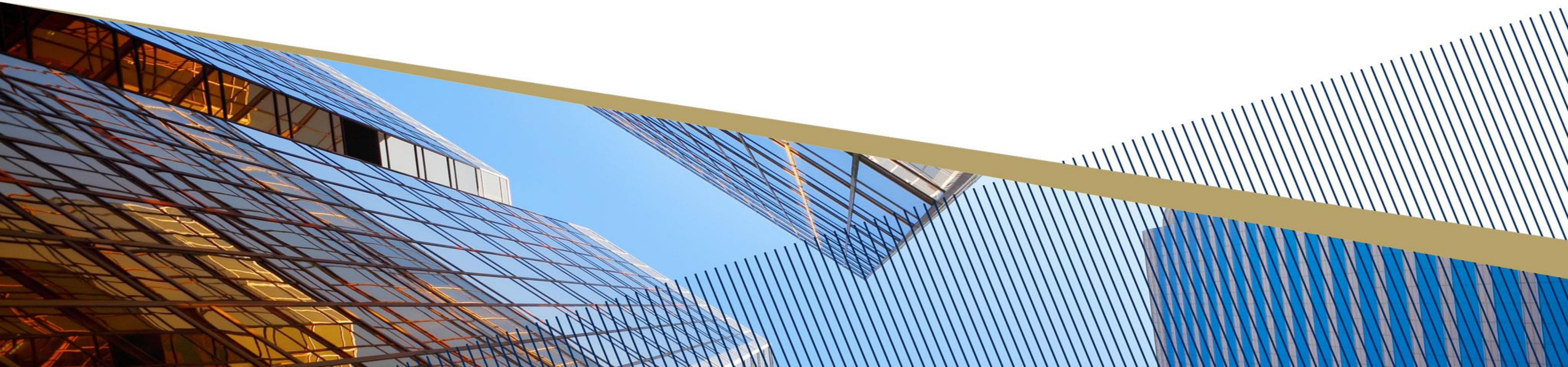
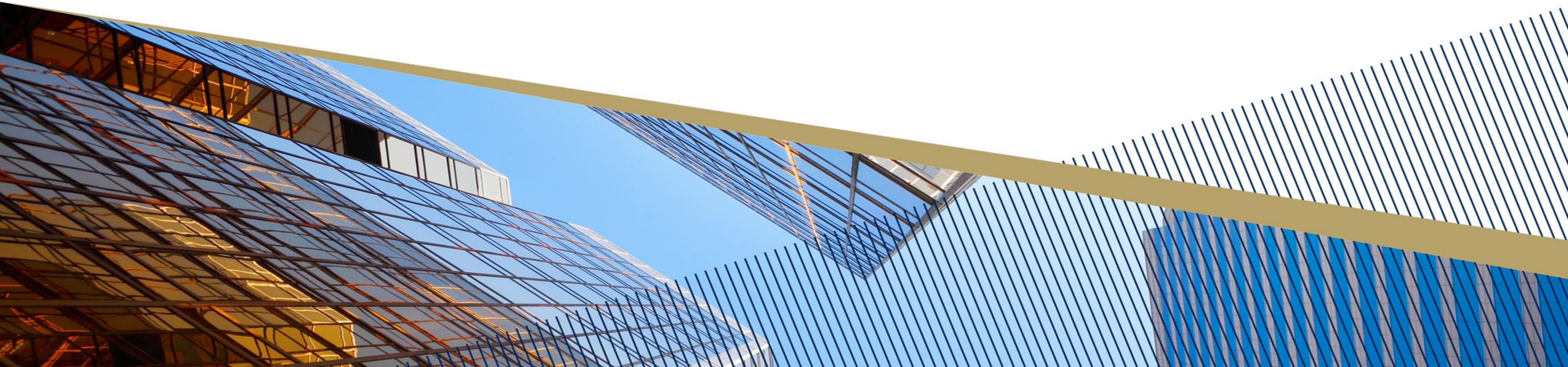
T2S and balance sheet netting



Balance sheet netting in T2S

- **According to International Accounting Standard (IAS) 32 a financial asset and a financial liability can be offset and presented as a net amount on the balance sheet, if they are:**
  - between the same counterparties;
  - in the same currency;
  - for the same explicit final settlement date;
  - subject to a currently legally-enforceable right of set-off;
  - intended to settle on a net basis or simultaneously.
  - In addition to intention to settle net or settlement simultaneously, there is also settling on an RTGS that is functionally equivalent to net settlement.
- **In the context of T2S, it is not clear if the criteria for "intended net settlement" are fulfilled when settling across T2S CSDs**
  - Initial ERCC letter sent to the ECB in November 2017 to ask for clarification
  - Ultimately up to external accountants to reach a conclusion on the question
  - In order to facilitate the discussion, ICMA hosted a meeting between ECB experts, accountants and ERCC members in September 2019 – follow-up discussions ongoing
- **Similar concerns existed for regulatory netting under the Capital Requirements Regulation (CRR), but have been resolved as the final version of the CRR review published on 7 June 2019 explicitly recognises T2S (article 429b(5)(a))**

Basel requirements & minimum haircut floors



Basel requirements & minimum haircut floors

- **FSB adjusts implementation timelines for its policy recommendations to address financial stability risks in securities financing transactions**
  - On 19 July 2019, the Financial Stability Board (FSB) announced adjustments to the implementation timelines for its recommendations on securities financing transactions (SFTs), specifically those related to minimum haircut standards for non-centrally cleared SFTs
  - The framework of numerical haircut floors will be extended to January 2022 (instead of end-2018) for bank-to-non-bank transactions and to January 2024 (instead of end-2019) for non-bank-to-non-bank transaction

- **EBA advises the European Commission on the implementation of the final Basel III framework**
  - As part of its advice to the Commission, the EBA also published *Policy Advice on the Basel III Reforms on Securities Financing Transactions*. The EBA makes two specific recommendations with respect to SFTs:
  - *Recommendation SFTs 1: Basel III post-crisis reforms on the calculation of the exposure values of SFTs except the minimum haircut floors framework*
  - *Recommendation SFTs 2: Introduction of the minimum haircut floors framework for SFTs:*

“only after further analyses and recommendations are provided by market authorities and systemic risk authorities”

Basel requirements & minimum haircut floors

- **EBA: Minimum haircut floors and non-cash-collateral**
  - In line with a longstanding advocacy point of the ERCC, the EBA also offers an interpretation of the provision in the December 2017 Basel III Revisions that would provide an exemption to the haircut floors in the case where banks borrow securities against non-cash collateral, provided the collateral cannot be re-used, and which would be consistent with the 2015 FSB framework.

- **Revised BCBS leverage ratio reporting requirements to prevent "window dressing"**
  - On 26 June 2019, the BCBS published the finalised revisions to leverage ratio disclosure requirements, setting out additional requirements for banks to disclose their leverage ratios based on quarter-end and on daily average values of securities financing transactions. A comparison of the two sets of values will allow market participants to assess better banks' actual leverage throughout the reporting period.
  - These revisions are applicable to the Pillar 3 disclosure requirements associated with the version of the leverage ratio standard that serves as the Pillar 1 minimum capital requirement as of 1 January 2022.
  - In the EU, the agreed text of CRR II (published in the *Official Journal* on 7 June 2019)already anticipates this.

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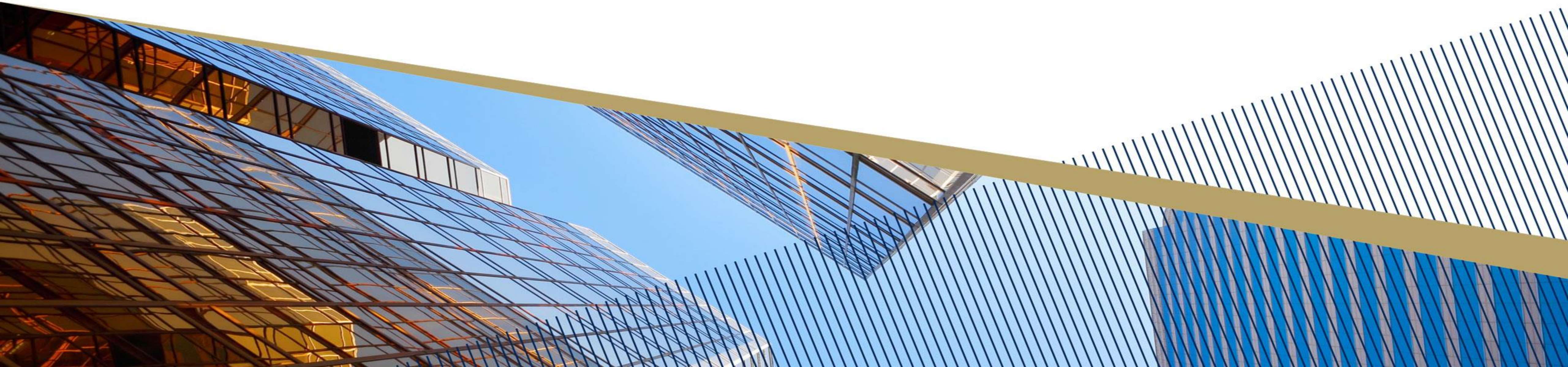
CSDR settlement discipline



CSDR mandatory buy-ins

Due to come into force in November 2020

What is ICMA doing about CSDR buy-ins? Implementation

- Updating the **ICMA buy-in rules** to be CSDR compliant:
  - Providing a contractual framework and market best practice to support implementation
  - Providing contractual solutions to some of the regulation’s more problematic challenges

- **Addressing the asymmetric payment provisions** for buy-in and cash compensation
  - Working with ESMA to provide Q&A that allows for symmetrical payments through contractual agreements (such as the ICMA buy-in rules)

- Working with the broader industry to design and propose a workable **pass-on mechanism**

- Working with ISLA to establish **best practice for SFTs** in the case of fails
  - Exploring possibility of updating the **GMRA** to include buy-in provisions

- Working with ISLA to propose appropriate **exemptions for certain SFTs**:
  - Open trades (including once they have reached 30 business days)
  - Basket trades (including triparty and DBV)

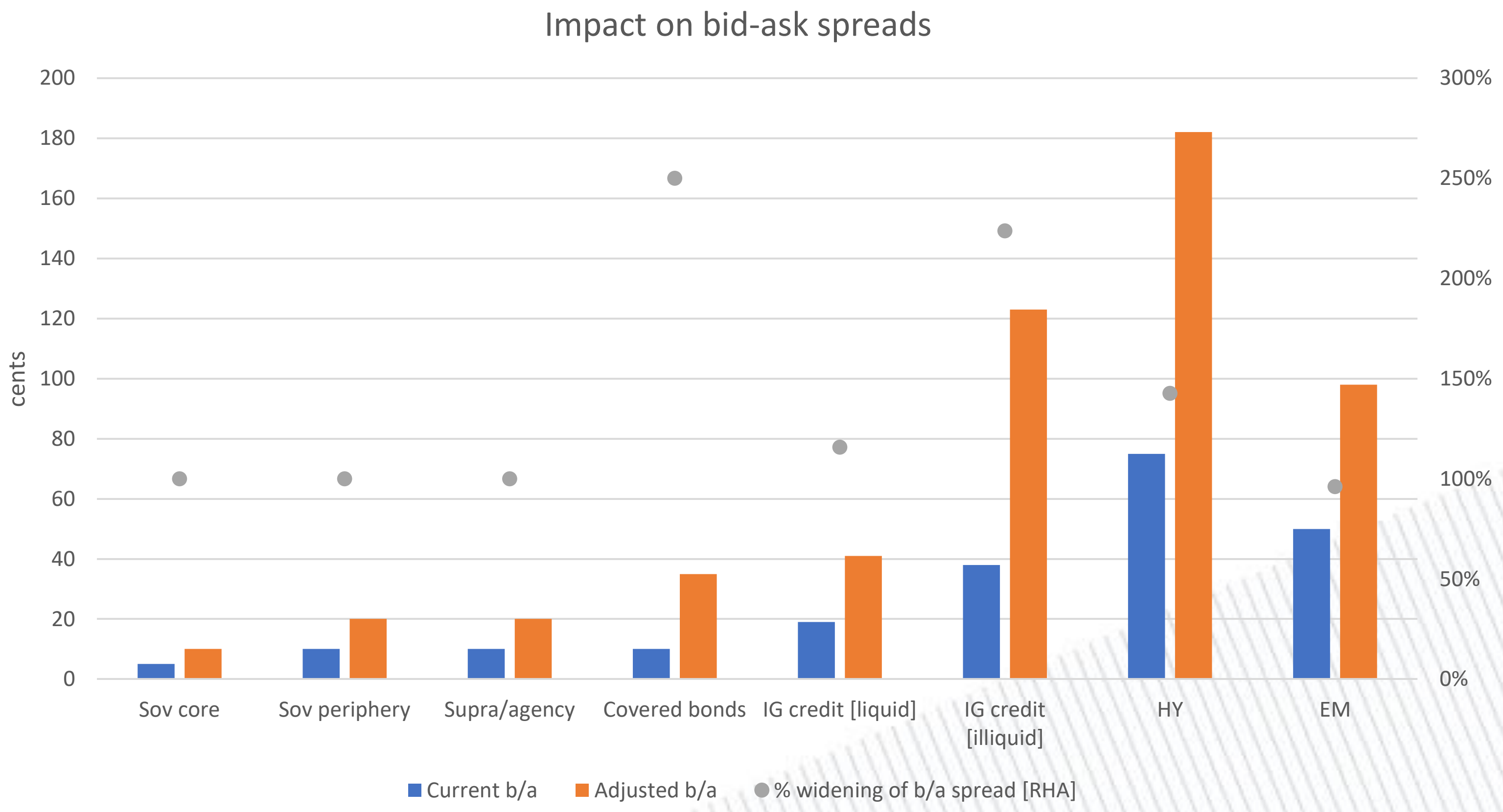
What is ICMA doing about CSDR buy-ins? Implementation

- Raising awareness of scope, details, and potential implications.
  - In particular non-EU entities and smaller buy-sides

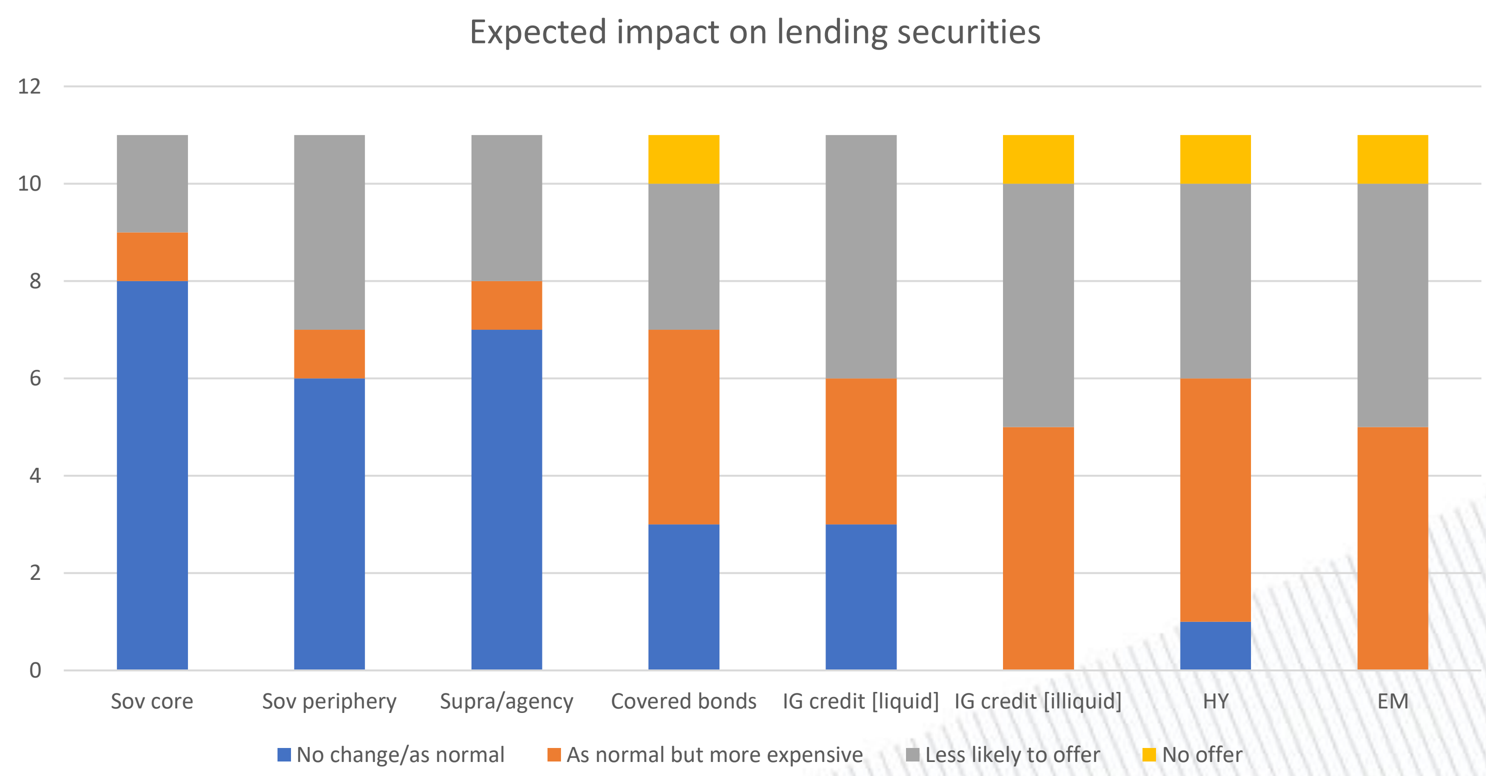
- Continuing advocacy with regulators and policy makers with a view to delaying/amending the CSDR mandatory buy-in provisions.
  - ICMA's position is that cash penalties should be made more punitive as a less disruptive alternative to applying the mandatory buy-in regime
  - ICMA has undertaken a 2^{nd} Bond Market Impact Study in fall 2019 to coincide with the CSDR 5 year review (following the previous study of 2015)

Details and initiatives of the ICMA CSDR-SD Working Group can be found here:
https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/secondary-market-practices-committee-smpc-and-related-working-groups/csdr-sd-working-group/

Mandatory buy-in impact study



Mandatory buy-in impact study



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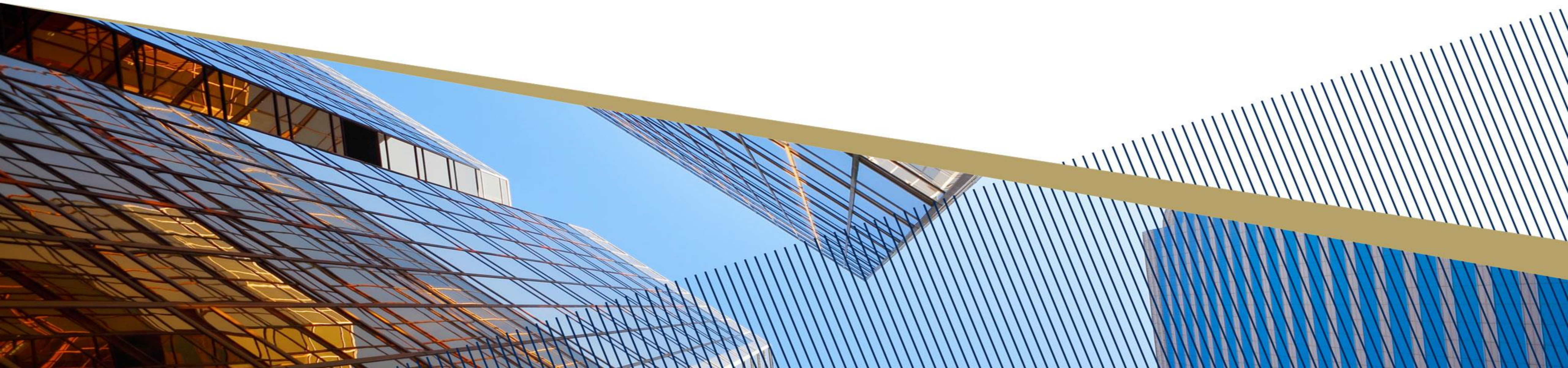
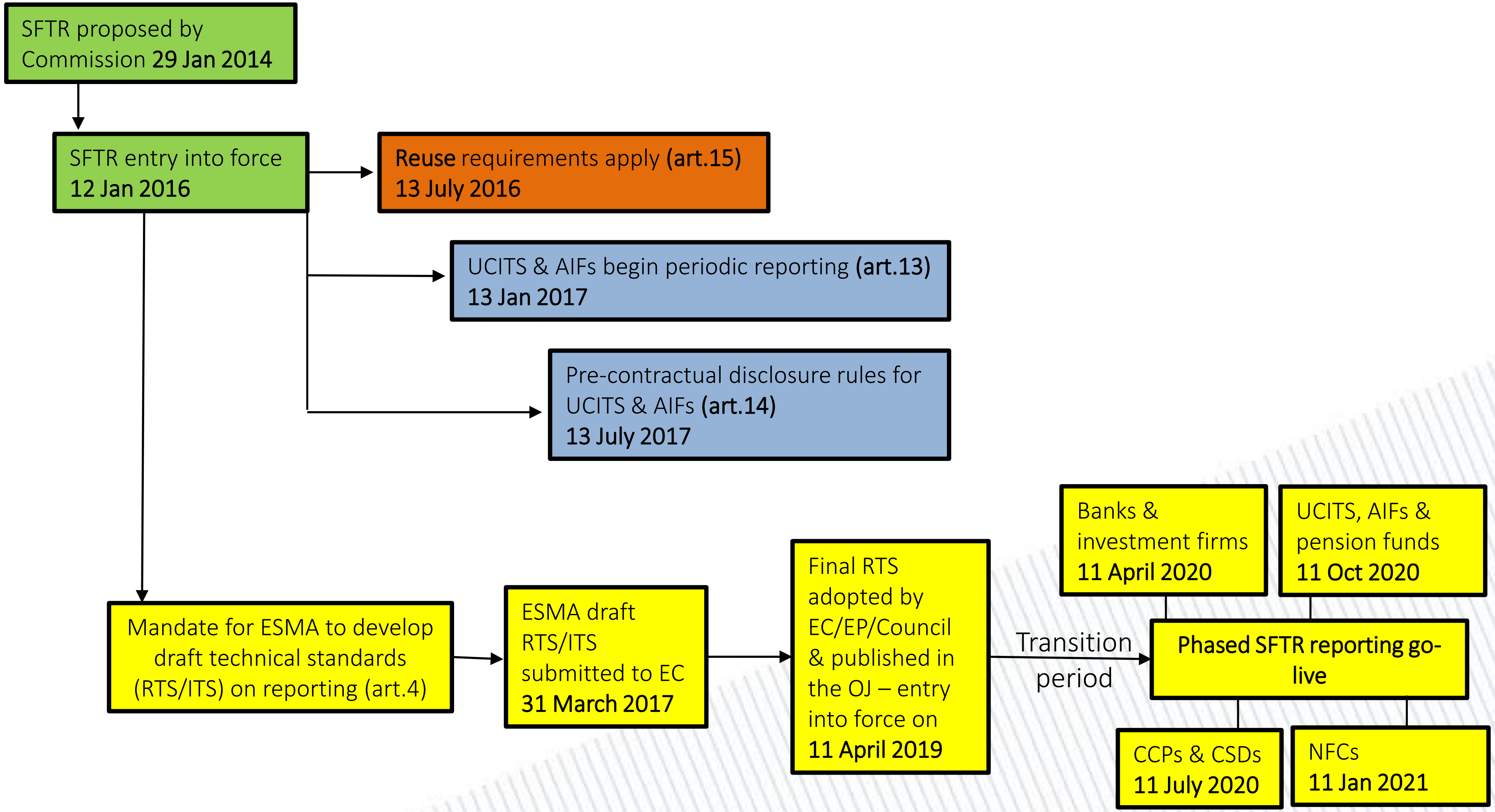
SFTR implementation



SFTR: Key elements and timeline



Finalising the regulatory framework

- **Technical standards on SFTR reporting published in March 2019 (Level 2)**
  - Including RTS, ITS and reporting tables
  - Publication determined the SFTR reporting go-live dates
- **Ongoing ESMA work on important additional implementation guidance (Level 3)**
  - Including Reporting Guidelines, Validation Rules and Q&As
  - Draft Guidelines published in May for public consultation – ERCC submitted a detailed consultation response
  - Updated validation rules published on 31 October, but final Guidelines still pending (expected publication in mid-December 2019)
- **Continued ERCC dialogue with ESMA and NCAs on implementation**
  - Including with the FCA on SFTR implementation in the UK post-Brexit

What is ICMA doing to help members implement SFTR reporting?

- **Since its creation in 2015, the ERCC SFTR Task Force has grown into one of ICMA's largest active WGs…**
  - Open to a broad range of market participants, including sell-side, buy-side, market infrastructures and service providers (TRs & vendors) – in total **over 120 firms represented**
  - Working closely with regulators, in particular ESMA, and other trade associations, including ISLA
- **The key focus is on developing best practices – key deliverables include…**
  - **SFTR Guide:** Detailed best practice recommendations on SFTR reporting (over 70 issues covered so far) – publication following release of the final ESMA Guidelines
  - **Sample Reports:** Practical examples for reports under SFTR, already covering 35 repo scenarios (initial reports, lifecycle events and margining)
  - **Repo lifecycle events:** Comprehensive overview of relevant repo lifecycle events & agreed reporting approaches
- **Some related issues that we are looking at…**
  - MiFIR reporting of **SFTs with EU central banks** – proposals submitted to ESMA for further discussion
  - Cross-association work to develop a **Master Regulatory Reporting Agreement** (MRRA) – publication by 2019

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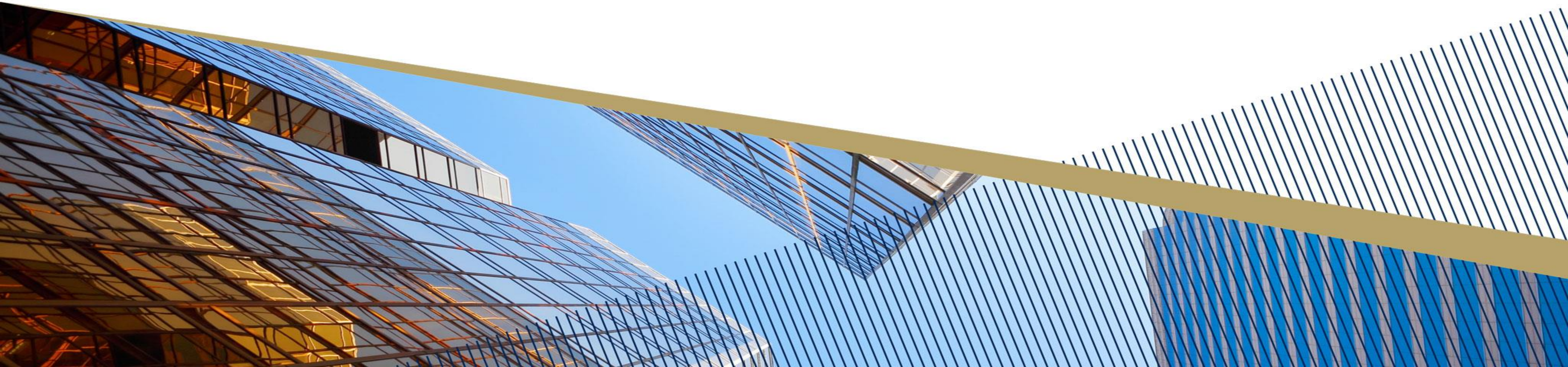
Legal Update



- 2019 Update

  - Phased approach
    - Non EU jurisdictions - April 2019
    - EU jurisdictions – by end 2019

  - Amended coverage
    - Opinions no longer cover the GMRA 1995
    - Opinions continue to cover GMRA 1995 as amended by the Amendment Agreement or GMRA 1995 as amended by the ICMA 2011 GMRA Protocol

  - Opinions address enforceability of netting provisions and recharacterisation risk.
  - Basic counterparty coverage (companies, banks and securities dealers) and extended counterparty coverage (also includes insurance companies, hedge funds and mutual funds).

  - Opinions available at: http://www.icmagroup.org/legal

✓	Common issuer
✓	Seniority
✓	One month euro t-bill
✓	RepoFunds Rate ("RFR")
✓	Futures - create one year curve
✓	Flight to quality

Panel Discussion: Creating a European Safe Asset

Moderator: **Andy Hill**, Senior Director, ICMA

Panellists:

Graham Bishop, Consultant on EU Integration, grahambishop.com

Andreas (Andy) Jobst, Senior Economist (European Department), International Monetary Fund (IMF)

George Kalogeropoulos, Adviser/DG – Market Infrastructure and Payments, European Central Bank

Jean-Louis Schirmann, Secretary General, European Money Markets Institute (EMMI)

Creating a European Safe Asset—
A Macro-Financial Perspective

ICMA European Repo and Collateral Council General Meeting

Panel Discussion

Andreas (Andy) Jobst
International Monetary Fund (IMF)

15 November 2019

Transitional Effects of "Low Forever" (1)

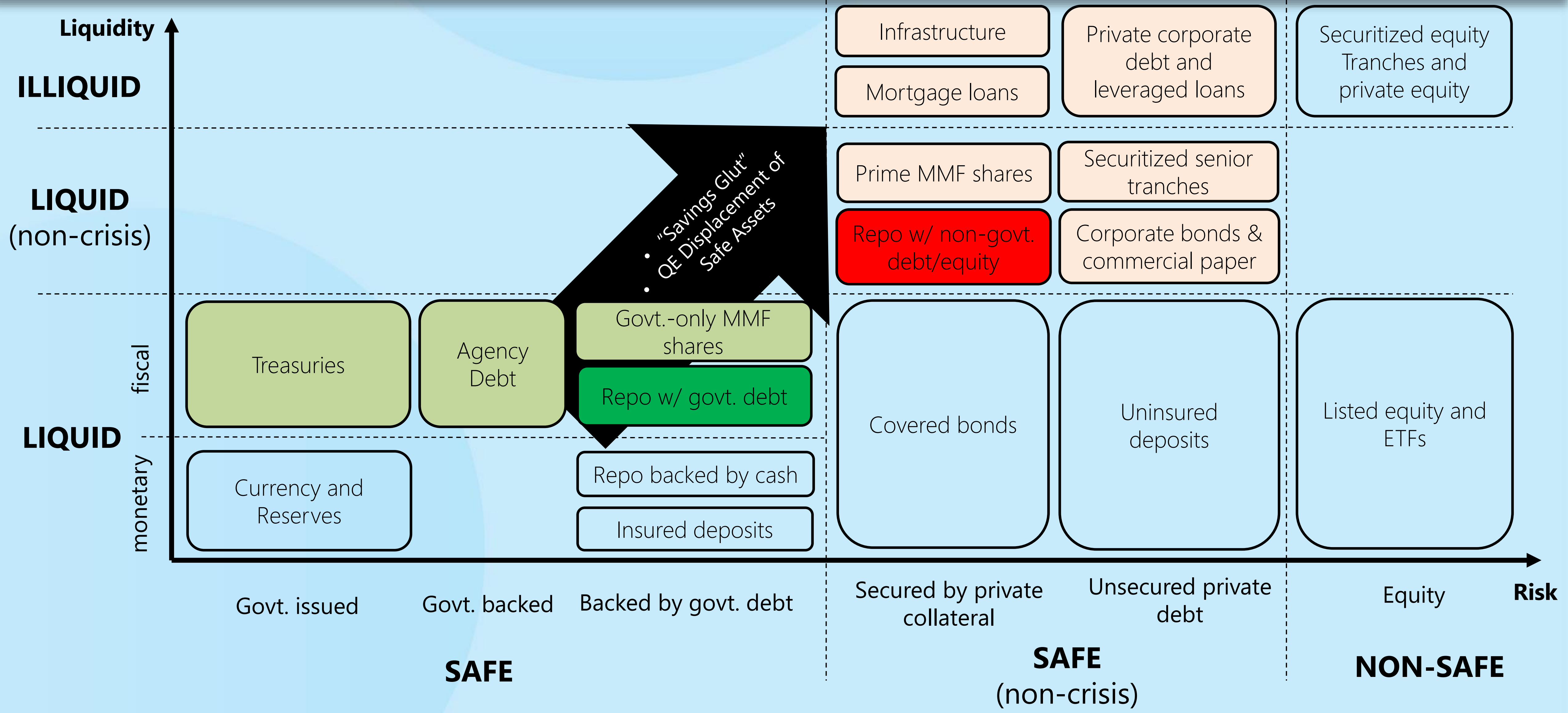
Safe assets become increasingly scarce …

- Effective portfolio rebalancing due to continued monetary easing but **financial stability risks** from negative rates and flattening yield curve
- **Increased vulnerabilities**
  - Slow adjustments to (corporate) return targets, higher indebtedness
  - Lower compensation for taking risk
- **Lower resilience**
  - Compressed interest rate margins and rising duration gaps
  - Search-for-yield

→ **Excess aggregate liquidity but scarcity of (positively-yielding) safe assets**

Transitional Effects of "Low Forever" (2)

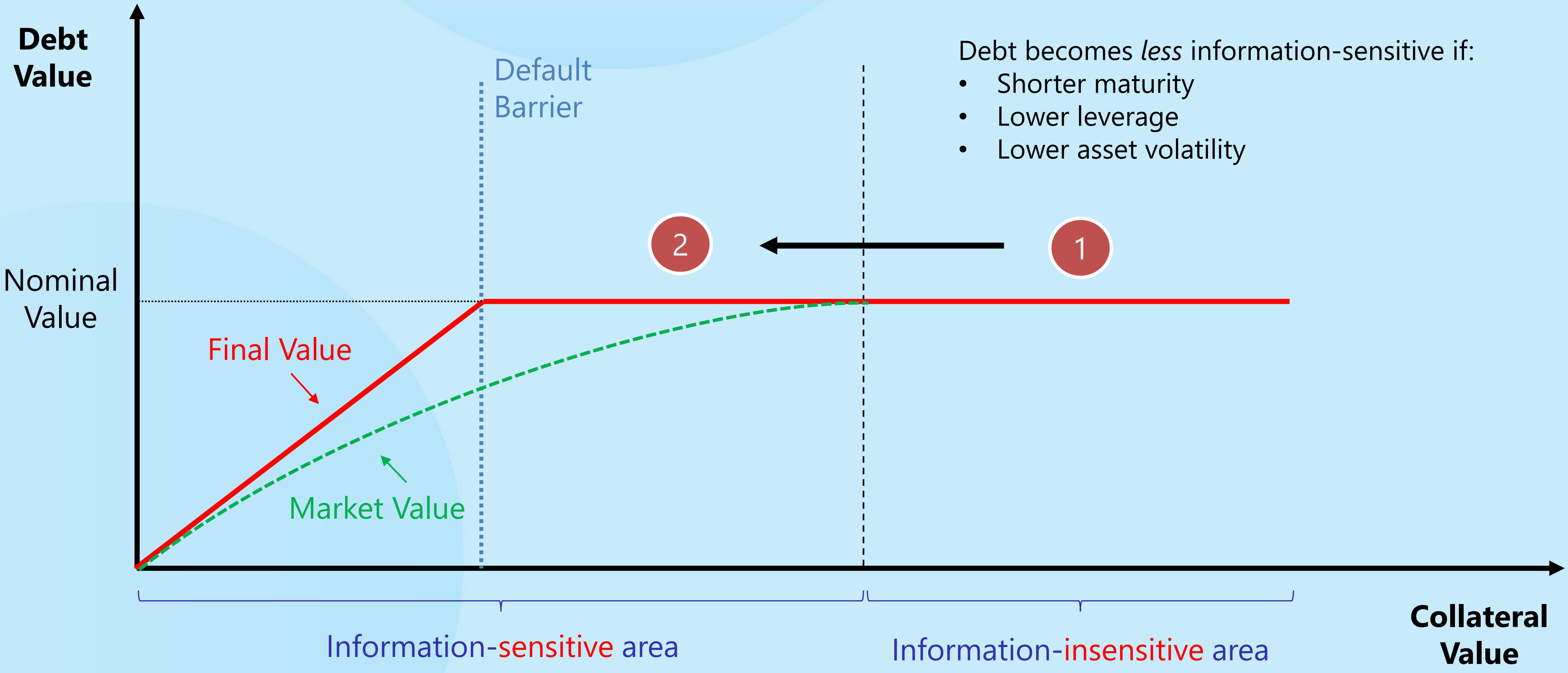
... and investors trade off greater yield against higher risk and less liquidity in new "quasi-safe assets."



Availability of safe assets is essential to efficient money markets …

- **Safe assets:** debt as minimally information-sensitive security
  - Low incentive to acquire public/private information (NQA)
  - Lower volatility that could make debt information-sensitive
- **Repo:** modern version of pawning (as information-insensitive debt)
  - Obviates price discovery → opacity can enhance liquidity
    - Money markets operate totally different from equity markets
  - Non-price adjustments to shocks maintain information-insensitivity (higher haircuts, shorter maturities)
  - But pushes risks into tail and hides systemic risk

… but more information-sensitive debt as collateral might undermine efficient access to liquidity.



“Shadow banking” creates information-sensitive debt in response to “savings glut” …

- Higher liquidity <u>without</u> changes in available collateral could increase risk and cost of potential crisis
  - More harder-to-value assets as collateral
  - Abrupt re-pricing with more bonds in passive hands (and no “bond exchange”)

Sources: New York Federal Reserve, Bloomberg L.P.

Reducing the Scarcity of Safe Assets—Supply Side

- **General Issues**
  - Should be identified by markets not by construction/label
  - For <u>euro area</u>: depends on degree of fiscal coordination and market discipline
- **Greater availability of central banks' asset holdings**
  - Expanding reverse repo and reducing current account
- **More (and/or) new public sector securities**
  - More debt issuance → but limited fiscal space/will become unsafe eventually
  - New safe assets (SDR-backed, sovereign bond-backed securities (SBBS), ECB bills)
- **More private (near-)substitutes for scarce public safe assets**
  - "Good" structured products
  - Alternative, long-term assets, e.g., infrastructure
  - Capital restructuring by corporates (debt issuance) and share buybacks

Reducing the Scarcity of Safe Assets—Demand Side

- **Reduce regulatory demands** on safe assets
- **Improve confidence**
  - Reducing inefficient hoarding of reserves (swaps)
  - Enhance social safety nets to reduce propensity to save
- **Emerging market and developing economies** (EMDE) perspective
  - FX appreciation of safe haven assets
  - Enable better cross-border capital flows (FDI)
  - Capital market development to reduce demand for USD/EUR-denominated government debt

Closing Remarks

Godfried De Vidts
Senior Advisor
ICMA ERCC

You are welcome to attend ….

Next ERCC General Meeting

Thursday 19 March 2020, 10:00 – 13:00 (UK time)

Hosted by **Equilend** in London (Level39, One Canada Square, E14 5AB)

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