

INTERNATIONAL SECURITIES MARKET ASSOCIATION

Minutes of the European repo council's general meeting held on October 21, 2004 in London

Location: Bloomberg L.P.
Auditorium
City Gate House
50 Finsbury Square
GB-London EC2A 1PQ

Time: 14.30 - 17.30

The following members of the European repo committee were present:

Mr. Ulf Bacher, Dresdner Bank AG, Frankfurt
Mr. Jean Begonin, Credit Suisse First Boston (Europe) Limited, London
Mr. Stefano Bellani, J. P. Morgan Securities Ltd., London
Mr. Francesco Cafagna, Goldman Sachs International, London
Mr. Cameron Dunn, Merrill Lynch International (MLI), London
Mr. Godfried De Vidts (Chairman), Fortis Bank, Brussels
Ms. Bassma El-Amir, Deutsche Bank AG, London branch
Mr. Grigorios Markouzos, Citigroup Global Markets Ltd., London
Mr. Andrea Masciovecchio, Banca Intesa S.p.A., Milan
Mr. Edward McAleer, Morgan Stanley & Co. International Ltd., London
Mr. David McClean, Nomura International plc, London
Mr. Ashraf Rizvi, UBS AG, London branch
Mr. Nicolas Truong, Société Générale S.A., Paris

Apologies:

Ms. Clarice Calderoni, UniCredit Banca Mobiliare S.p.A., Milan
Mr. Eduard Cia, Bayerische Hypo- und Vereinsbank AG, Munich
Mr. Johan Evenepoel, Dexia Bank Belgium NV/AS, Brussels
Mr. Oscar Huettner, Barclays Capital Securities Limited, London
Mr. Michael Murray, Confederación Española de Cajas de Ahorros (CECA),
Madrid
Mr. Simon Parkins, BNP Paribas, London

Also present:

Mr. Adrian Tgetgel, Associate Counsel, ISMA, Zurich

The following member firms were represented at the meeting:

ABN AMRO Bank N.V., Amsterdam
Banca Caboto S.p.A., Milan
Banca Intesa S.p.A., Milan
Banca d'Intermediazione Mobiliare IMI S.p.A., Milan
Banco Bilbao Vizcaya Argentaria S.A., Madrid
Banco Santander Central Hispano S.A., Madrid
Bank Austria Creditanstalt AG, Vienna
Banque et Caisse d'Epargne de l'Etat, Luxembourg
Barclays Capital Securities Limited, London
Caja de Madrid, Madrid
CALYON, Paris
CCF, Paris
Confederación Española de Cajas de Ahorros (CECA), Madrid
Citigroup Global Markets Limited, London
Credit Suisse First Boston (Europe) Limited, London
Daiwa Securities SMBC Europe Limited, London
Danske Bank AG, Copenhagen
Deutsche Bank AG, London branch
Dexia Bank Belgium NV/SA, Brussels
Dresdner Bank AG, Frankfurt
DZ Bank AG Deutsche Zentral-Genossenschaftsbank, Frankfurt
Fortis Bank, Brussels
Goldman Sachs International, London
HBOS Treasury Services plc, London
ING Bank N.V., Amsterdam
J.P. Morgan Securities Ltd., London
KBC Bank N.V., Brussels
Landesbank Baden-Württemberg, Stuttgart
Lehman Brothers International (Europe), London
Lloyds TSB Bank plc, London
Merrill Lynch International, London
Mizuho International PLC, London
Morgan Stanley & Co. International Ltd., London
Nomura International plc, London
Société Générale S.A., Paris
The Royal Bank of Scotland plc, London
UBS AG, London Branch, London
UniCredit Banca Mobiliare S.p.A., Milan

The following member firms were not represented at the meeting:

Aurel Leven Securities, Paris
Banca Monte dei Paschi di Siena S.p.A., Milan
Banca Nazionale del Lavoro S.p.A., Rome
Bank Julius Bär & Co. AG, Zurich

Bayerische Landesbank Girozentrale, Munich
Bayerische Hypo- und Vereinsbank AG, Munich
BNP Paribas, Paris
Bear, Stearns International Limited, London
CDC IXIS Capital Markets, Paris
Commerzbank AG, Frankfurt
Canadian Imperial Bank of Commerce (CIBC), London Branch
HSBC Bank plc, London
ING Belgium SA/NV, Brussels
NIB Capital Bank N.V., The Hague
Kredietbank S.A. Luxembourgeoise, Luxembourg
Man Financial Limited, London
Mitsubishi Securities International plc, London
MPS Finance Banca Mobiliare S.p.A., Siena
NIB Capital Bank N.V., The Hague
Raiffeisen Zentralbank Oesterreich AG, Vienna
Royal Bank of Canada Europe Limited, London
WestLB AG, Dusseldorf

1. Opening of the meeting by the chairman of the European repo committee (ERC committee)

The chairman first welcomes the council member delegates, observers and the guests and thanks Bloomberg L.P., London for hosting today's meeting.

Thereafter, he gives a slide presentation on a number of issues in which the ERC committee has been actively involved during the past months (attachment 1).

2. Approval of the minutes of the ERC annual general meeting held on March 16, 2004 and dated April 1, 2004

The minutes of the European repo council's annual general meeting held on March 16, 2004 and dated April 1, 2004 are unanimously approved.

3. Update on GMRA related matters

Mr. Tgetgel provides the council with an update report in relation to the following matters:

3.1 Legal opinions

3.1.1 2004 and 2005 update exercise (attachment 2: slide presentation/ slide 1: List of update legal opinions)

On April 2, 2004 ISMA completed this year's annual opinions updating exercise and published update opinions for 34 jurisdictions. In 16 of these jurisdictions the exercise was conducted jointly with TBMA

Recently, ISMA started with the preparation of the 2004/5 opinions updating exercise. In this context, ISMA appointed its member representatives on the ISMA/TBMA joint opinion committee (JOC) and also defined the time table for the 2004/5 updating exercise. The number of JOC members has been extended from ten to 12 to reflect the JOC's additional workload resulting from a number of new countries in which ISMA and TBMA recently agreed to obtain opinions. TBMA has yet to appoint its representatives on the JOC. As in previous years, ISMA intends to publish the update opinions again by the end of March (2005).

3.1.2 New opinions for Poland, Greece, Hungary, Norway and Cyprus (attachment 2/ slide 2: List of new legal opinions ordered)

The relevant JOC working group has recently signed off on the final version of the **Polish** opinion, which is now ready for publication. Following receipt of the final version of the **Greek** opinion from counsel and endorsement by the relevant JOC working group, ISMA will make both the Greek and the Polish opinions available to its members.

Hungarian counsel is currently further amending their draft opinion, which will be submitted again to the relevant JOC working group for review in due course. **Norwegian** counsel recently submitted a revised draft opinion, which is currently under review by the relevant JOC working group.

Very recently, ISMA received an initial draft of the **Cypriote** opinion, which will now be submitted to the relevant JOC working group for review.

3.1.3 New opinions for Brazil, the People's Republic of China, Estonia, Latvia, Lithuania, Malta, the Philippines, South Korea and Taiwan (attachment 2/ slide 2: List of new legal opinions ordered published on April 2, 2004)

Since it should be possible to obtain satisfactory opinions for **Brazil, the People's Republic of China, Estonia, Latvia, Lithuania, Malta, the Philippines, South Korea and Taiwan**, ISMA recently instructed local counsel for the above jurisdictions to prepare a draft opinion for ISMA's review.

TBMA confirmed that they will join ISMA in seeking the opinion for the People's Republic of China. In relation to Brazil, Estonia, Latvia, Lithuania, Malta, the Philippines, South Korea and Taiwan, TBMA has yet to confirm whether they will join ISMA in seeking opinions for these jurisdictions.

3.1.4 New opinions for Croatia, the Czech Republic, Slovakia, Slovenia, Mexico, Scotland and Malaysia?
(attachment 2/ slide 3: List of jurisdictions where the enforceability of the GMRA is currently being reviewed)

In relation to **Croatia, the Czech Republic, Slovakia and Slovenia**, ISMA is currently monitoring the respective legal developments with a view to ascertain at what stage a clean opinion can reasonably be expected for these jurisdictions.

At the ERC committee's request, ISMA is currently clarifying whether clean opinions on the enforceability of the GMRA under the laws of **Mexico** and **Scotland** could be obtained. In the affirmative, and subject to acceptable cost caps, ISMA will consider seeking opinions for these two jurisdictions.

In relation to **Malaysia**, ISMA will establish with the ERC committee whether there is sufficient market demand for a Malaysian opinion. In the affirmative, and subject to a clean opinion being available at acceptable costs, ISMA will consider seeking a Malaysian legal opinion.

3.2 Promotion of the GMRA in Romania and Russia
(attachment 2/ slide 3: List of jurisdictions where the enforceability of the GMRA is currently being reviewed)

Through a contact identified by the chairman of the ERC committee, ISMA is trying to establish whether the GMRA could be adopted as the standard document for cross-border repo transactions in **Romania**.

The legal situation in **Russia** remains unclear. ISMA and TBMA are currently examining the possibility to support new legislation that would allow the adoption of the GMRA as the standard document for cross-border transactions with Russian counterparties.

3.3 Core provision opinions (CPOs) required by the German Financial Supervisory Authority (BaFin)

Similar to the Financial Services Authority in the UK, the BaFin recognises the effect of netting provisions for regulatory capital and large exposure requirements and like the FSA, the BaFin also requires the provision of netting opinions for the GMRA.

In addition to the netting opinions for the GMRA, the BaFin has since 1997 required a confirmation for each netting opinion that the conclusions reached in the netting opinion for the relevant jurisdiction would not be affected by the *inclusion of alterations to the provisions of the GMRA*. For this purpose, the BaFin requires the provision of a core provision opinion together with each netting opinion, which should:

- (i) identify any provisions of the GMRA (the core provisions) that are so essential to the GMRA under the relevant jurisdiction that a material alteration thereof could affect the conclusions reached in the relevant netting opinion;
- (ii) contain a confirmation that any modification to any provision of the GMRA under the relevant jurisdiction that has not been identified as a core provision, would not affect the conclusions reached in the relevant netting opinion;
- (iii) contain a confirmation that certain alterations, listed in a separate annex, typically agreed between the parties to a GMRA under the relevant jurisdiction, would not affect the conclusions reached in the relevant netting opinion.

To date, CPOs have been obtained and updated on an annual basis by the Association of German Banks for Belgium, Canada, Cayman Islands, France, Germany, England, Ireland, Japan, Luxembourg, the Netherlands, Singapore, Switzerland and the United States.

With a view to supporting its German members to enable them to comply with the BaFin's requirements, ISMA is currently clarifying in collaboration with the Association of German Banks whether the existing and future CPOs could be integrated in ISMA's opinions on the GMRA.

3.4 Annexes to the GMRA

A few days ago, the Australian Financial Markets Association (AFMA) informed ISMA that it recently incorporated into its "Guide to OTC Documents" an AFMA annex 1 in relation to both the 1995 and 2000 versions of the GMRA. AFMA also informed ISMA that the Reserve Bank of Australia plans to issue an updated RITS annex to make it compatible with the GMRA 2000 in the near future.

In relation to the Japanese Securities annex, Japanese counsel recently responded to a query raised on the precise scope of application of the annex. ISMA will shortly update its members on this issue by means of a circular.

4. Fails in negative interest rate repos

Mr. Bacher, Dresdner Kleinwort Wasserstein, Frankfurt gives a slide presentation on fails in negative interest rate repos. A copy of the presentation is attached to these minutes (attachment 3).

He reports that, on August 25, 2004, a meeting between ISMA's market practices committee (MPC) and a delegation of the ERC committee took place where this issue was discussed and where ISMA's secretariat was requested to produce draft wording addressing fails in negative interest rate repos for incorporation in the GMRA or ISMA's rule book.

A further ad-hoc meeting between the MPC and delegates of the ERC committee will be held on November 16, 2004 to follow up on the issue.

At this stage of the meeting, Mr. Davies, chairman of the Securities Operations Committee within the Association of Foreign Banks, London gives a slide presentation on the reduction of operational risk in the repo market. A copy of the presentation is attached to these minutes (attachment 4).

Mr. Davies encourages the council member representatives to discuss possible ways and means on how to reduce operational risk for their firms' repo desks and to provide him with input by e-mail (<mailto:philip.davies@gs.com>).

5. Meeting of representatives of various trade associations sponsoring standard market documentation with representatives of the ECB held on July 29, 2004 to explore the differences between the various standard agreements and the ways and means to further reduce basis risk resulting from the co-existence of different agreements

Mr. Raffan reports that ISMA's chief executive, ISMA's general counsel, the chairman of the ERC committee and himself attended a meeting held at the invitation and under the auspices of the ECB in Frankfurt on July 29, 2004 with other market associations sponsoring standard agreements used in the European financial markets.

When inviting the various associations, the ECB had stated that is wished to act as a facilitator to allow market associations to enter into a dialogue on how the different standard agreements could be further harmonized with a view to contributing to enhancing financial integration and stability, both on a European and a global level.

During the meeting, ISMA reiterated its principal position as stated publicly beforehand on numerous occasions, i.e. that international, cross-border repo transactions (including those between counterparties

based in two different countries within the Euro zone) should be documented by the GMRA. In this respect, ISMA pointed out that for these transactions the GMRA currently provides the desired uniformity since it is subject to English law, the jurisdiction of the courts of England and is worded in English, irrespective of where the counterparties are based. By contrast, the EMA allows counterparties to choose the applicable law, the forum in which disputes are to be litigated and the language in which the agreement is issued. In other words, EMA's architecture does *not* achieve the same level of uniformity for repo transactions documented by it as the GMRA. ISMA also pointed out that, due to the global nature of the international repo market, the objective of harmonising documentation should not be looked at from a European, but rather a global perspective, and that there is no need to promote documentation competing with the GMRA in this area in light of the longstanding acceptance of the GMRA. At the end of the meeting, it was agreed that it would be desirable to continue discussions among the various trade associations. While ISMA will continue to participate in these discussions, it will not deviate from its current position promoting *exclusively* the GMRA for use in the international cross-border repo markets.

6. Clearing and settlement in the European Union

Due to absence of Mr. Lo-Giudice, European Commission, the chairman gives a slide presentation on clearing and settlement within the European Union. A copy of the presentation is attached to these minutes (attachment 5).

7. Collateral framework of the European Central Bank

Mr. Mastroeni from the European Central Bank in Frankfurt, gives a slide presentation on the collateral framework of the European Central Bank. A copy of the presentation is attached to these minutes (attachment 6).

8. Results of ISMA's seventh semi-annual European repo market survey of June 9, 2004

Mr. Comotto, ISMA Centre, University of Reading gives a slide presentation of the results of ISMA's 7th semi-annual European repo market survey of June 9, 2004 (attachment 7).

The results of the 7th semi-annual European repo market survey can be downloaded from ISMA's web site at www.isma.org.

All firms active in the European repo market are invited to participate in ISMA's 8th semi-annual European repo market survey, which will provide a "snapshot" of the market at close of business on Wednesday, December 8, 2004. Firms interested in participating in the 8th semi-annual European repo market survey are requested register by completing and submitting the registration form which can be downloaded from ISMA's webpage by clicking [here](#).

9. Any other business

No comments.

10. Next meeting

The next general meeting of the European repo council will be held on March 17, 2005 at 14.30 in Zurich. The meeting will be hosted by the Swiss National Bank.

The exact venue will be confirmed in due course.

11. Eurex's Euro General Collateral pooling project

Mr. Naas, Deutsche Börse Group, Frankfurt gives a slide presentation on Eurex's Euro-General Collateral pooling project. A copy of the presentation is attached to these minutes (attachment 8).

12. Bloomberg's repo electronic trading project

Due to absence of Mr. Cohen, Mr. Meboroh-Collinson, Head of Fixed Income Transaction Products Europe & Asia, Bloomberg L.P., London gives a presentation on Bloomberg's repo electronic trading project.

November 10, 2004

AT/ys

The Chairman



Godfried De Vidts

The Secretary



Adrian Tgetgel

Attachments



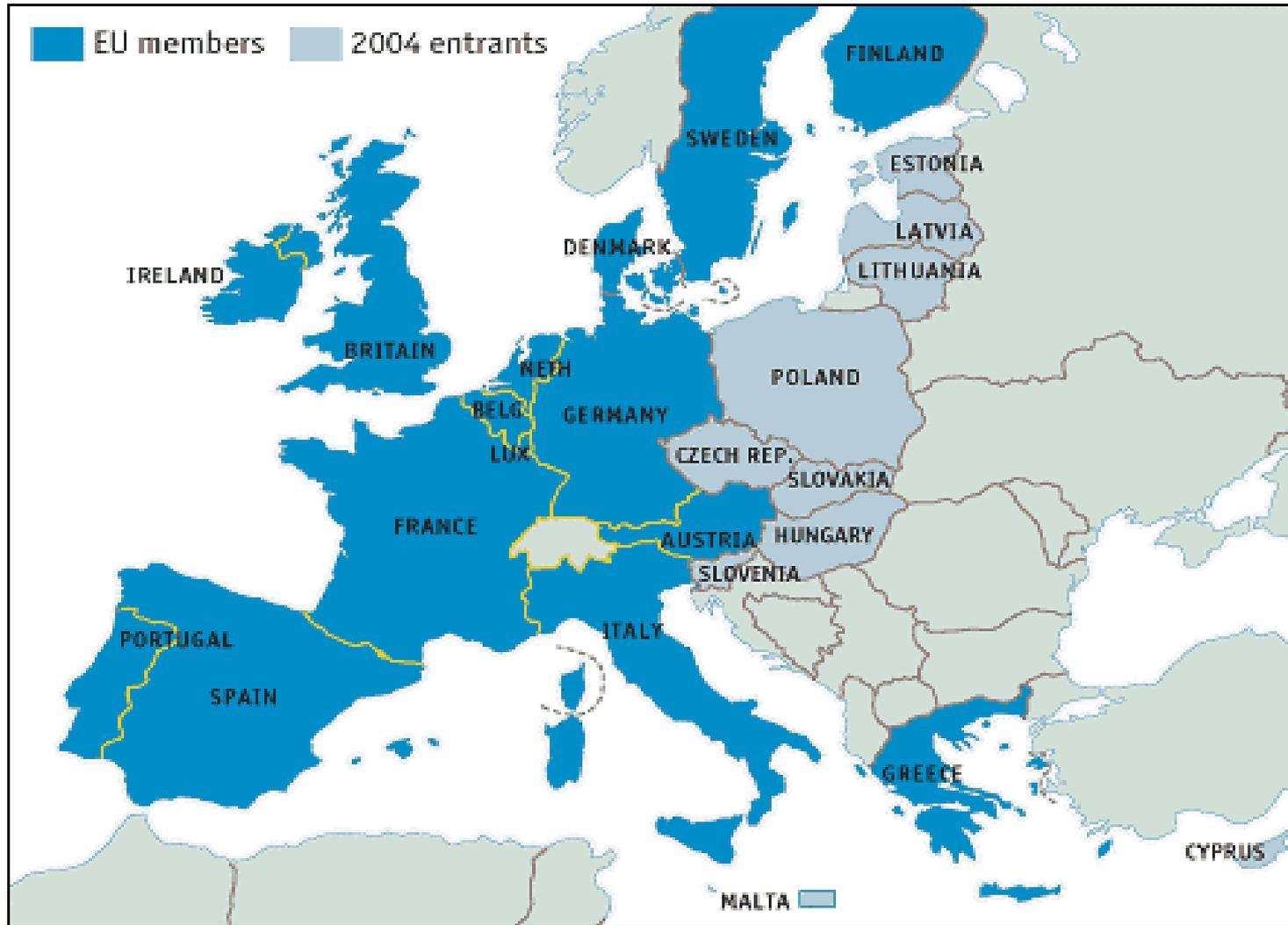
I S M A

European Repo Council

October 21 st , 2004

London

Repo Area: from 3.2m km² to 3.8m km²

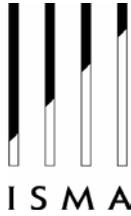


Recent market events/issues

- ACI presidency
- Collateral management - ABS/MBS
- 3th Professional Repo Market Course Nov
- IAS 39
- Basle 2
- Bank of Japan
- Fails Italy/France

Recent market events/issues

- Data explorer
- CPSS/IOSCO re Central Counterparties
- Eonia repo
- ECSDA
- Bank of England
- Repricing



European Repo Council General Meeting, October 21, 2004

GMRA

1. List of update legal opinions published on April 2, 2004

Joint ISMA/TBMA update legal opinions

<ol style="list-style-type: none">1. Austria2. Belgium3. Canada4. England5. Finland6. France7. Germany8. Ireland	<ol style="list-style-type: none">9. Italy10. Japan11. Luxembourg12. Netherlands13. Portugal14. Spain15. Switzerland16. USA
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ISMA alone update legal opinions

<ol style="list-style-type: none">1. Abu Dhabi2. Australia3. Bahamas4. Bahrain5. Bermuda6. British Virgin Islands7. Cayman Islands8. Denmark9. Hong Kong	<ol style="list-style-type: none">10. Kuwait11. Netherlands Antilles12. New Zealand13. Saudi Arabia14. Singapore15. South Africa16. Sweden17. Thailand18. Turkey
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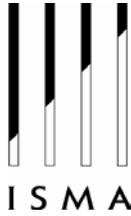
I S M A

European Repo Council General Meeting, October 21, 2004

GMRA

2. List of new legal opinions ordered

<ol style="list-style-type: none">1. Poland2. Greece3. Hungary4. Norway5. Cyprus6. Brazil7. The People's Republic of China	<ol style="list-style-type: none">8. Estonia9. Latvia10. Lithuania11. Malta12. The Philippines13. South Korea14. Taiwan
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European Repo Council General Meeting, October 21, 2004

GMRA

3. List of jurisdictions where the enforceability of the GMRA is currently being reviewed

<ol style="list-style-type: none">1. Croatia2. The Czech Republic3. Slovakia4. Slovenia5. Mexico	<ol style="list-style-type: none">6. Scotland7. Malaysia8. Romania9. Russia
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Management of fails in negative interest rate repos

Ulf Bacher

Global Head of STP/T Principal Trading

ERC General meeting

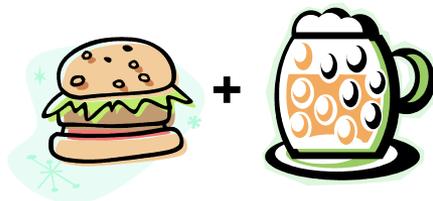
21st October 2004

Free Lunches in Repo Markets?

A Repo with a negative Interest Rate ...



... can be a free lunch and a beer...

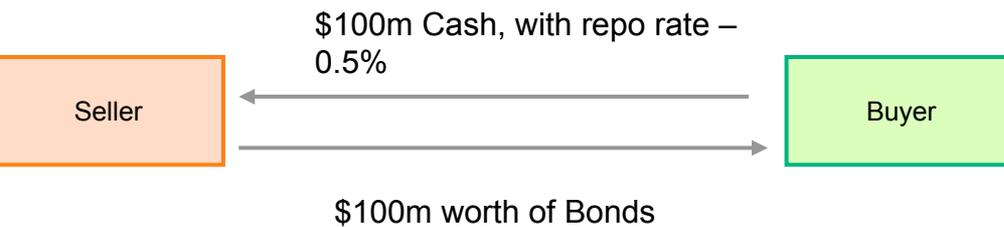


... for an opportunistic market player

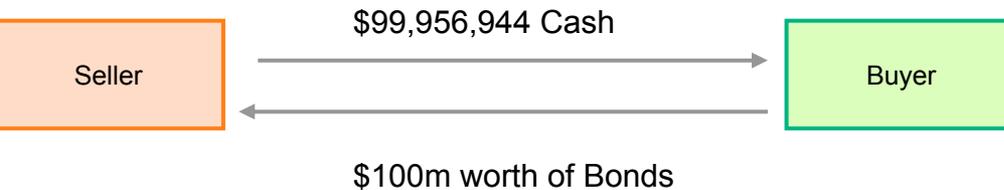


An Example - Why do negative interest rates differ?

Trade inception – August 25th



Trade maturity – September 25th



At termination, under negative interest rate repo, less cash will be paid back by the 'seller' than the 'buyer' originally paid at trade inception

➤ Positive Repo Rate:

- As cash and repo leg are paired-off at the end-leg of the repo, *the seller will have to pay the positive interest rate – even if he fails to deliver.*
- This poses an *in-built incentive* to deliver in the repo and *behave accordingly.*

➤ Negative Repo Rate:

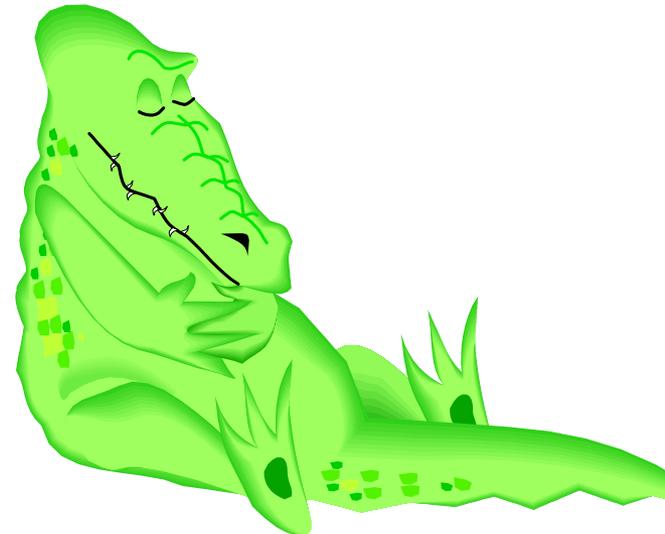
- However, if the repo rate is negative, *the seller will receive interest rate – even without the intention to deliver the bonds.*

➤ Consequences:

- **Adverse market behaviour** and wrong incentivization for market participants.
- Opportunistic market participants **arbitrage the regulatory/contractual gap.**
- Creation of **market uncertainty** in negative repo rates environments. **Adverse selection. Liquidity drain.**

The Party is over - We need to act

- The ERC cannot support a market standard that actually encourages a fail-friendly or even fail-supportive market environment.
- Incentives of the market participants have to be aligned with a proper market behaviour.
- The ERC has to define a rule-set that will support a “regular market” and discourage actively the opportunistic market participant



Possible solutions

- 1) **Penalties:** The imposition of a financial penalty against the seller of the bonds in the case that the trade fails because the seller is short or has made an operational error.

Advantages:

- Enforces good delivery
- Creates market discipline
- Aligned to the wishes of some market authorities
- Leverages the precedent observed in other markets such as the Futures market

Disadvantages:

- Has the potential to massively increase market illiquidity
- Will result in increased costs of financing transactions
- Will interfere in the orderly running of the repo market

- 2) **Early termination:** Trade will be automatically terminated at the first fail date, where the seller is at fault.

Advantages:

- Allows the counterparty which requires use of the bonds to source from elsewhere without continuing to pay a negative interest rate
- Prevents abuse of the system and aids the operation of an orderly market

Disadvantages:

- Settlement can only be confirmed on the next business day after contractual settlement – as a minimum this will leave a negative interest cost to the buyer for 1 day
- May generate a decrease in market liquidity as a result of the fail being part of a 'chain'

Possible solutions

- 3) Revert to zero rate from negative rate: If the seller is at fault the repo rate is zero for the period of the failure. Once the opening leg is settled the negative rate becomes effective for the remaining period of the trade.

Advantages:

- Negates economic impact of failure to non defaulting counterparty.
- Actually encourages liquidity, those with liquidity are encouraged to trade.

Disadvantages:

- May not be a strong enough penalty to enforce market discipline on its own.
- Requires amendment of closing leg cash (although floating rate repo requires amendment already).

Recommendation

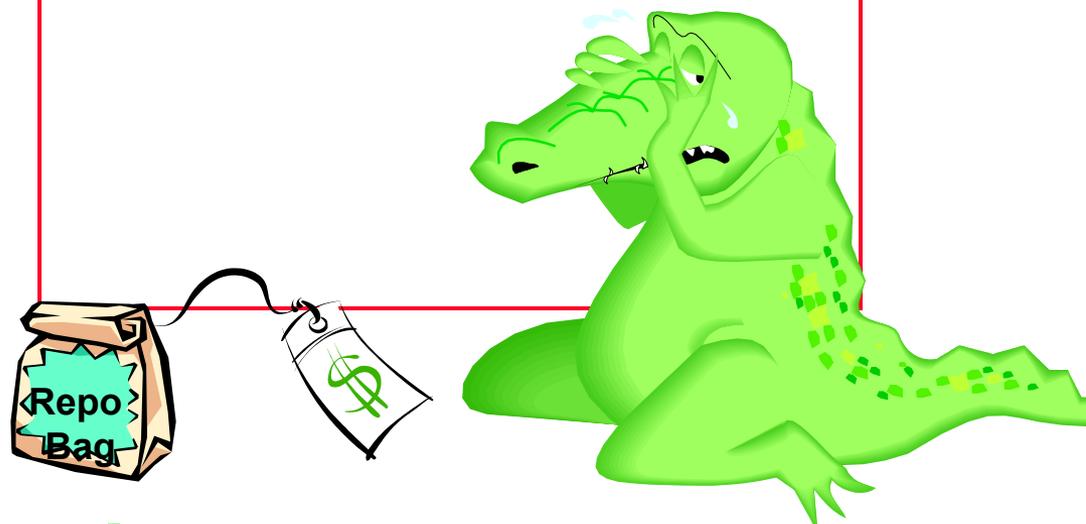
If the seller fails to deliver then the buyer has the option to early terminate the transaction and this option continues for every day that the trade fails and the seller is at fault. In addition, for every day that the trade fails the repo rate is zero.

Advantages:

- Negates economic impact of failure to non defaulting counterparty
- Actually encourages liquidity, those with liquidity are encouraged to trade
- Allows the negative interest rate repo market to continue
- Allows the counterparty which requires use of the bonds to source from elsewhere without continuing to pay a negative interest rate
- Prevents abuse of the system and aids the operation of an orderly market
- Avoids cancelling transaction

Disadvantages:

- May generate a decrease in market liquidity as a result of the fail being part of a 'chain'
- Requires amendment of the closing leg of the repo trade (although floating rate repo trades require same amendment)



Implementing Repo Trade Matching

Association of Foreign Banks – work in progress

**Presentation to ISMA European Repo Council –
General Meeting**

Phil Davies

Thursday 21st October 2004

Current Process

Dealer to Dealer:

- Some firms match trades in ISMA TRAX (trade date)
- Start leg is matched in depositories for settlement purposes (start date - 1)
- End leg is matched in depositories for settlement purposes (end date - 1)
- Booking errors often identified 1 day prior to end date

Dealer to Client:

- Trade is confirmed verbally and by fax on trade date
- Start leg is matched in depositories for settlement purposes (start date - 1)
- End leg is matched in depositories for settlement purposes (end date - 1)
- Booking errors sometimes identified on trade date, or prior to end date

Future Process – Goals

Dealer to Dealer:

- Match all trade details on trade date (no need for subsequent corrections)
- Match most post-trade actions (e.g. rate rolls) on date agreed
- Instructions at depository level submitted as ‘matched’ by matching utility to reduce manual effort
- Make use of automatic coupon compensation at depositories where this is available
- Booking errors identified on trade date

Dealer to Client:

- Trade is confirmed and matched electronically on trade date
- Both legs will still have to be matched at depository
- Discuss with wider community whether coupon compensation functionality can be used
- Booking errors identified on trade date

Next Steps

- Inclusion of some firms based outside London and UK to ensure any proposed solution has no geographical barriers to adoption
- Collaboration with ISMA to define workflow proposal for dealer to dealer matching (TRAX re-write budgeted for 2005)
- Work with SWIFT to standardise client affirmation/allocation message formats
- Develop cost/benefit business case to justify development and implementation of improved processes

If interested in understanding more please contact:

Phil Davies

Goldman Sachs International

+44 (0)20 7774 2921

philip.davies@gs.com

Financial Markets Integration: The security side

Financial Markets Infrastructure
European Commission

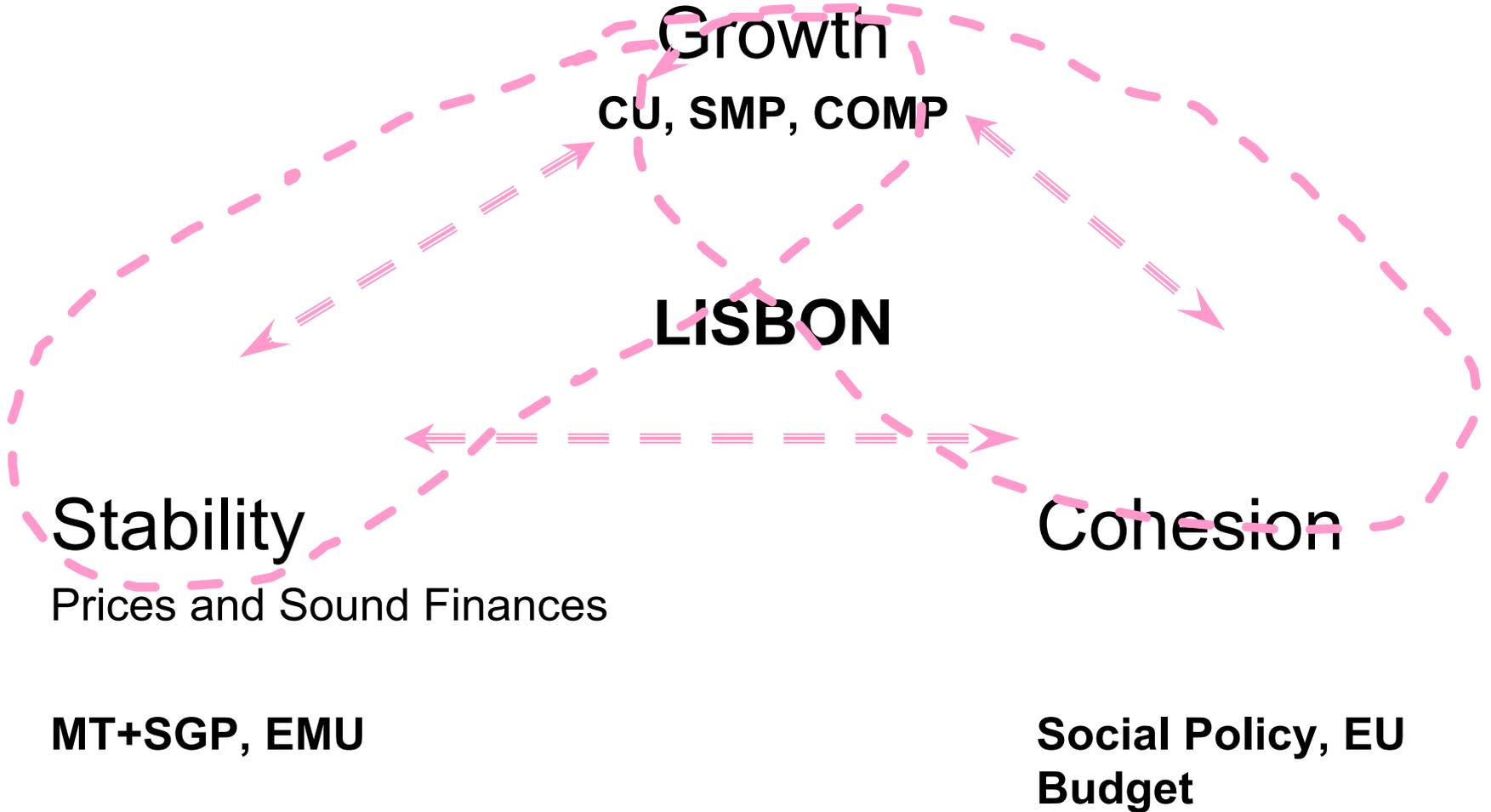
Meeting of the European Repo Council
London 21 st October 2004

Plan of the Presentation

- Why securities post-trading (C&S) matters?
- Background and issues
- The Commission point of view:
 - the approach to C&S
 - the objectives of the Communication
 - the actions to be taken forward.
- After the Communication
 - The consultative process
 - The CESAME group
 - The Impact Assessment
 - The Directive
- Next steps

Why C&S Matters?

The EU Economic System

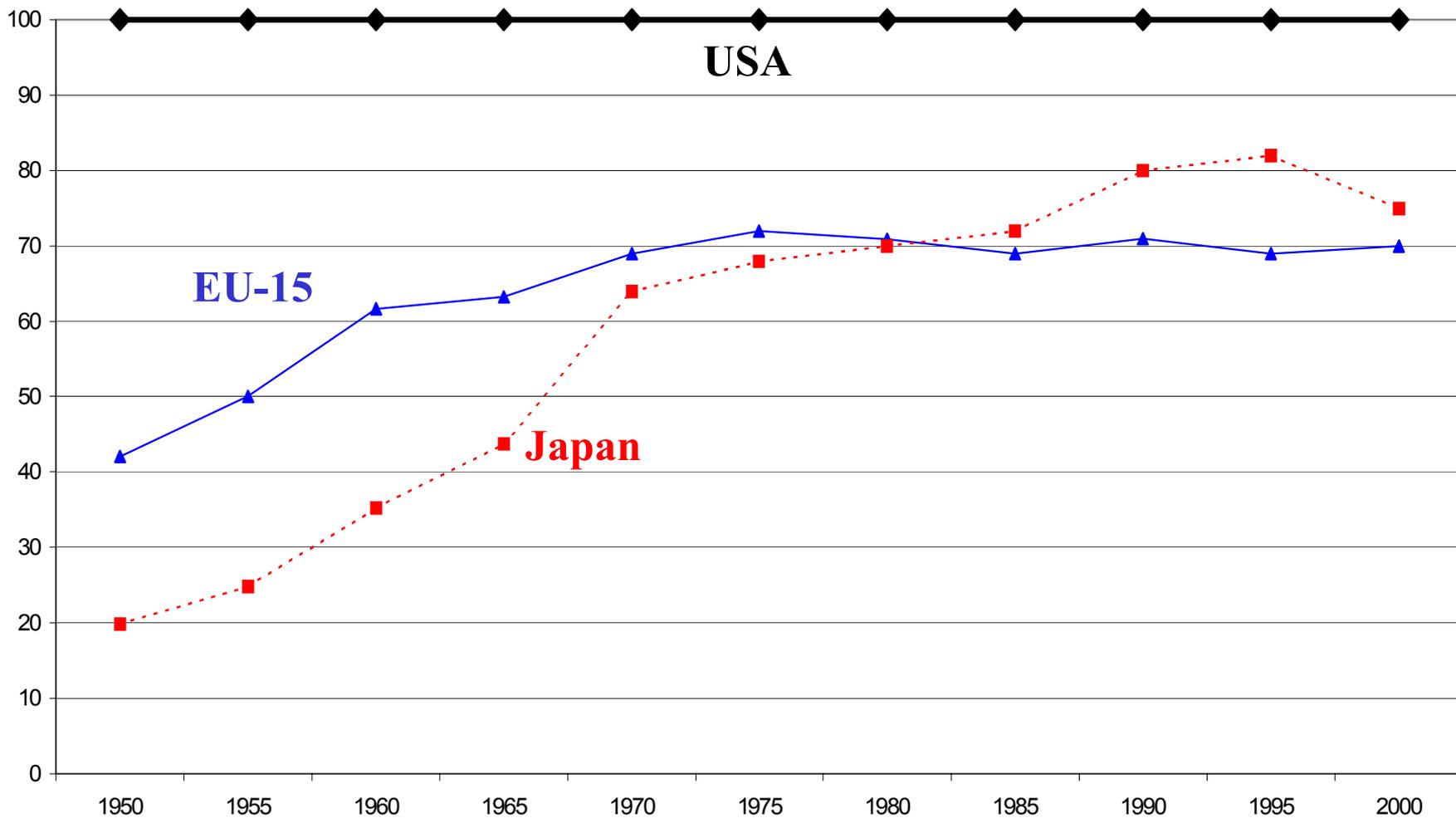


Lisbon Agenda

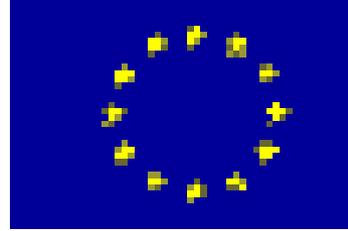
- Lisbon set ambitious objectives
 - Europe is to become “the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.”
The Heads of State, in Lisbon 2000
- To be reached with a new instrument: the OMC

Levels

Per capita GDP at PPP



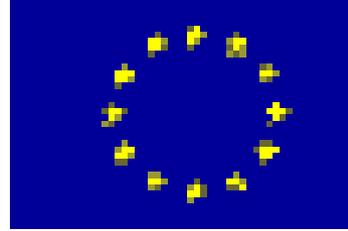
Growth: the situation



Post-war structure

- large industries, exploiting economies of scale
- EU catch-up with US
- assimilation of developed technologies
- innovation to improve known technologies

Growth: the situation



Structural change

- EU stopped catch-up with US
- innovation at the frontier matters
- “radical” innovation
- higher education needed when at frontier

Low growth = symptom



- Failure to adapt the economic system based on
 - Assimilation of existing technologies
 - Mass production
 - Large firms with stable markets & labour relations
- Failure to become an innovation-based economy
 - Entry
 - Labour mobility within & across firms
 - Retraining
 - Difficult external financing
 - Investment in R&D and higher education

Lisbon's Core Message

- Growth is achieved with greater employment and greater productivity (which in turn is the product of investment and total factor productivity)
- Financial markets integration plays an important role in facilitating capital investment and enhancing overall productivity

...in formulae

$$Y = L * (Y / L)$$

$$\frac{DY}{dt} = \frac{DL}{dt} * Y/L + \frac{D(Y/L)}{dt} * L$$

$$Y = L * (K/L) * (Y/K)$$

$$\frac{DY}{dt} = \frac{DL}{dt} * Y/L + \frac{D(K/L)}{dt} * L * \frac{Y}{K} + \frac{D(Y/K)}{dt} * K$$

Background and issues: 1

- Cross-border Clearing and Settlement in the European Union is generally considered less efficient, more expensive and potentially less safe, than domestic Clearing and Settlement.

Background and issues: 2

- Fragmentation of Clearing and Settlement arrangements along national lines as a consequence of a number of barriers to cross-border activity
- Giovannini barriers:
 - Technical or market barriers
 - Tax barriers
 - Legal barriers

Background and issues: 3

- Settlement for a cross-border operation within the EU costs as much as a cross-border operation between the EU and US
- Average cost of domestic settlement in the EU equivalent to the cost of domestic settlement in the US (Financial Integration Monitor, 2004)
- Recent study by NERA challenges the latter finding but confirms that:
 - Cross-border clearing and settlement in the EU is much more expensive than domestic clearing and settlement

Background and issues: 4

- High costs for cross-border Clearing and Settlement in the EU hinder the development of integrated capital markets and therefore the Lisbon Agenda
- This implies:
 - Reduced scope for diversification of investor portfolios
 - Reduced market liquidity, therefore...
 - Higher cost of capital for issuers
 - Lower competitiveness of the EU system

Background and issues: 5

- Absence of a common regulatory framework
- Absence of a level playing field (banks vs. non-banks)
 - Access rights
 - Capital adequacy requirements

The Commission approach: 1

28/4/2004 Communication on C&S

Previous work taken into account in the Communication:

- Commission **first Communication** on Clearing and Settlement (2002)
- Endorsement of the approach taken in the **GIOVANNINI REPORTS (2001 and 2003)**
 - Elimination of barriers necessary to achieve integration and efficiency
 - combined private/public sector efforts
 - wide consultation
- **CESR-ESCB STANDARDS:**
 - Represent the securities regulators' and central banks' view on the appropriate framework for the regulation / supervision / oversight of Clearing and Settlement Systems in the European Union

The Commission approach: 2

- The field is not empty!
- Market participants and market forces will determine the “final” structure of the Clearing and Settlement sector and the mix of integration and consolidation of existing systems
- No structural intervention in the form of:
 - Consolidation of existing systems
 - Segregation of Intermediary/Banking activities
 - The choice of the governance structure – user-owned/governed or for-profit

The Commission objective: 1

- To ensure that EU securities Clearing and Settlement systems are efficient, safe and enjoy a level playing field (that is more cost-effective, more competitive and safer).
- In order to achieve these objectives a number of measures and policies need to be pursued:

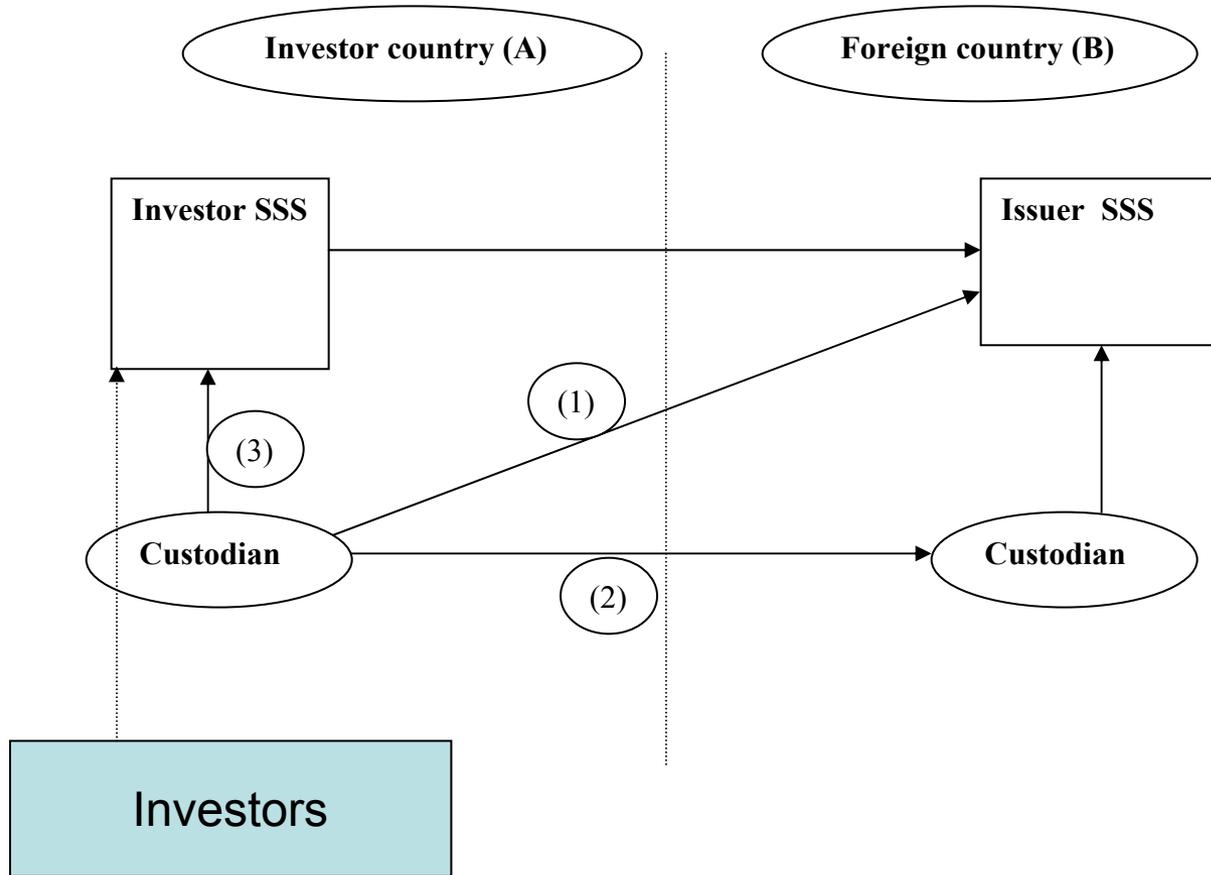
The Commission objectives: 2

- **Liberalisation and integration** (ensuring comprehensive access rights and removal of existing barriers)
- **Continued application of competition policy**
- **common regulatory and supervisory** framework (including definitions) to ensure:
 - Financial stability
 - Investor protection
- Appropriate **governance arrangements** to supplement the previous measures and policies with two aims in mind:
 - avoid anti-competitive practices
 - safeguard against risk

Liberalisation and integration

- Integration means a situation where all obstacles to the use of the different cross-border channels are eliminated. Wider users choice
- Choice will increase competition in the “distribution” of cross-border settlement services and will reduce prices of such services

Integration: 1



Application of competition policy: 1

- Integration is only an intermediate objective to achieve efficiency
- In fact, SSSs enjoy a very high degree of market power in the “production” of settlement services
 - Regardless of the degree of competition in the “distribution” of cross-border settlement services...
 - ...there is only one Issuer – SSS (in few cases two)

Application of competition policy: 2

- Competition policy is then necessary to deliver efficiency gains and increase consumers and/or investors welfare
- The Communication calls for an appropriate balance between ex ante legislation and ex post implementation of competition policy (see governance measures)

Regulatory/supervisory framework

- To ensure:
 - Financial stability
 - Investor protection
 - A level playing field
- To avoid that national authorities hinder the integration of systems

Governance

- Governance arrangements are meant to supplement the other measures and policies with two aims in mind:
 - avoid anti-competitive practices
 - safeguard against risk
- While integration is intended to increase competition in the distribution of cross-border settlement, some governance measures are meant to minimise the possibilities for unfair competition by SSSs

The Commission actions

- **Setting** up a Clearing and Settlement Advisory and Monitoring Expert Group
- **Analyse** the responses to the April Communication
- **Prepare** the impact assessment for the possible directive
- **Possible proposition of** a framework (Lamfalussy) Directive to secure a legal framework throughout the EU (late 2005)
- **Setting** up expert groups to address legal and tax issues
- Ensure effective **implementation of competition law**

Clearing and Settlement Advisory and Monitoring Expert Group (CESAME)

- In order to overcome barriers to integration, coordination between private and public sector bodies is necessary
- Priority action by the Commission
 - A first introductory meeting was held on **July 16th**, before the end of the consultation period

CESAME/3

- **Composition**

- Commission chairs
- AG as **Principal Policy Adviser**:
- 21 private sector participants
- 4 public sector observers
 - CESR
 - ECB, BoE and NBP

CESAME/4

- 21 private sector participants
 - 11 banks*, including:
 - The 2 leading custodian banks
 - 3 investment banks
 - 1 Silo
 - 5 CSDs*
 - 1 Exchange*
 - 2 CCPs
 - 1 Issuer*

* including associations

CESAME/4

- relevant organisations that are not participants will be nevertheless invited to provide progress reports on their work
- Open to any external contribution

Specific tasks: external dimension

- Supporting the C&S integration project and ensuring transparency:
 - wide dissemination to the public of all necessary information, explanations and reports on the state of reform
 - Specific web-page with agenda, attendance and synthesis report of every meeting
 - http://europa.eu.int/comm/internal_market/financial-markets/clearing/cesame_en.htm
 - Transparency towards respective stakeholders (e.g. Commission informs/discusses with ESC, FSC, etc)

Specific tasks: internal dimension

- Ensuring coherent action :
 - Informally assist the Commission
 - Interface between the private and public sector bodies.
 - Liaise with other bodies

Informally assist the Commission

- ✓ Provision, on request, of advice on specific technical issues
 - ✓ The Group will not assist the Commission with the drafting of any future Directive
 - ✓ The aim is for the Commission to get a better understanding of the issues
 - ✓ In the first meeting, it was agreed that the Group could provide input on the **cost-benefit analysis**

Interface between the private and public sector bodies

- Monitoring progress:
 - relevant organisations to provide progress reports on their work
- Defining interdependences among barriers:
 - Strong consensus that the barriers as defined in the two Giovannini reports should remain the focus of the private and public sector efforts
 - Progress on barriers 1, 3, 4, 6 and 7 was discussed
 - the Commission was requested to keep the pressure high on MSs (for the public side of the barriers) via the ESC or the FSC

Liaise with other bodies

- The legal and tax expert groups
 - First meeting: The CESAME Group stressed the importance of addressing both the legal and the tax barriers
- Link with international bodies, such as the G-30 and UNIDROIT (in the Legal Group)

Consultation process/1

- 79 responses:
 - Country authorities: 4
 - Governments: 7
 - Central banks: 5
 - Securities regulators: 3
 - Silos: 4
 - CSDs: 4
 - CCPs: 2
 - Exchanges: 6

Consultation process/2

- Issuers: 3
- Banks: 24
- Securities firms: 3
- Inv. Man. Companies: 4
- Other associations: 4
- Law firms/institutes: 3
- Matching serv. Prov's: 1
- Other serv. Prov's: 1
- Private: 1

Consultation process/3

- Most respondents so far have agreed to the publication on Commission web site:
 - YES: three quarters
 - NO: 2

Consultation process/4

Complete summary will be provided; main issues being

- Most respondents agree with the general approach
- Preference for a directive (main argument is legal certainty)
- Issue of definitions (functions and market) is at the center of the debate
- Issue of supervision (nome/host country; lead supervision; cooperation) divide between authorities and market operators
- Governance issues divide between banks and non banks
- Unanimous support for the three groups (for the tax group: unanimity minus 2!)

Impact Assessment for the Directive:

(mid 2005)

- Evaluate Costs and Benefits of Action and Inaction
- Within Action evaluate costs and benefits of different choices
- Multidisciplinary work (several DGs in the Commission are involved).
- Discuss structure, hypothesis, figures, with both private and public bodies

Framework Directive: 1

(late 2005/early 2006)

- High level principles to be developed in conformity with the Lamfalussy approach
- CESR/ESCB standards might form the **basis** of level 2 implementing measures to be developed in accordance with the **enabling provisions** of the Directive

Framework Directive: 2

Functional approach, based on appropriate segments of the value chain

- Rights of access
- common regulatory/supervisory framework
- Governance issues

Framework Directive: 3 functional approach

- Functional approach: the same activities are subject to the same regulatory treatment, provided the risk is the same
- Two steps:
 - Definition of activities
 - Analysis of risk

Framework Directive:

4 Supervisory co-operation

- Home country principle, but need to take into account the specificities of Clearing and Settlement Systems
 - A system can be systematically important in a host country but not in the home country
 - A system may burden the resources of the home authorities

Framework Directive: 5

Governance

- Accounting separation of core activities – Issuer-SSS activities – from non-core activities to address competition issues :
 - Core activities: Custody, settlement, pre-settlement
 - Non-core activities:
 - Intermediary activity
 - Banking

Framework Directive: 6

Governance

- Unbundling of non core activities in order to avoid abuse of dominant position:
 - Participants cannot be obliged to buy non-core services when buying core services
 - Banking services: offering at least the choice to settle in central bank money

Next steps

- Next (second) meeting of CESAME on October 25th
- Setting up two expert groups (from Fall 2004) to address legal and taxation issues
- Summary of responses (Dec 04/Jan 05)
- Third meeting of CESAME expected for February 2005
- Impact Assessment by mid-2005

Addressing legal and tax law discrepancies

- The legal certainty project:
 - nature of investors' rights, transfers of rights, investors protection from intermediary insolvency etc.
- Taxation issues

The Single List

The revision of the collateral framework of the Eurosystem: the Single List

Orazio Mastroeni

European Central Bank

Directorate General Market Operations



EUROPEAN CENTRAL BANK

Euro Repo Council, London 21

October 2004

Current Eurosystem collateral framework

tier one

- marketable debt instruments
- fulfilling uniform Monetary Union-wide eligibility criteria specified by the ECB

tier two

- additional assets, marketable and non-marketable
- of particular importance for national financial markets and banking systems
- eligibility criteria established by NCBs subject to minimum eligibility criteria specified by ECB



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Why introduce the Single List?

promote:

- **harmonisation of the collateral framework**
- **level playing field**
- **phasing-out of national practices**
- **increasing availability of collateral**
- **transparency**



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The Single List

- for a smooth implementation
- without disruption of current practices

a gradual approach (first and second step)



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The Single List

first phase of the gradual approach: policy part accomplished

- public consultation ended Oct 2003
- revised frwk announced to the markets in
May 2004

implementation: May 2005



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First phase of the Single List

current tier 1 assets



no particular
problems



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First phase of the Single List

foreign debt instruments

Currency of
denomination

Only euro

Location of
establishment of
the issuer

Extension to non-
EEA G10
countries

Location of issue

Only euro area /
EEA



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First phase of the Single List

euro denominated debt instruments issued by issuers established in non EEA G10 countries

- debt instruments
- denominated in euro
- non-EEA G10 issuers (United States, Canada, Japan and Switzerland)
- assets issued in the EEA but settled (i.e. held) in the euro area;
- supported by an adequate legal assessment (“legal opinion”)



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First phase of the Single List

- **marketable tier 2**
- **debt instruments**



- **minimum common standards for markets ⁽¹⁾**
- **partial relaxation of rules for credit institutions**
- **phase-out period decided**

⁽¹⁾ affect markets where also some tier 1 debt instruments traded



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Euro Repo Council, London 21

October 2004

Second phase of the Single List

**second phase of the gradual approach:
policy aspects currently being finalised**

implementation phase: to start after mid-2005



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Second phase of the Single List

equities



- will lose eligibility
- phasing out period to be decided



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Second phase of the Single List

**non-marketable debt
instruments**



- in principle, non-marketable assets included in the single list
- exact modalities communicated in due course
- trade bills phased out



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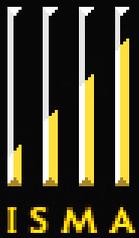
Thank you for your attention - Questions ?

Further information:

- *“The single monetary policy in Stage Three: General documentation on Eurosystem monetary policy instruments and procedures”, April 2002 (“The General Documentation”)*
- *“The collateral framework of the Eurosystem” ECB Monthly Bulletin, April 2001*
- *ECB Press Release, dated 10 May 2004 “Review of the Eurosystem’s Collateral Framework: first step towards a Single List”*
- *ECB Press Release, dated 5 August 2004 “Review of the Eurosystem’s collateral framework: second step towards a single list”*



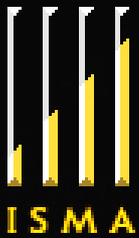
EUROPEAN CENTRAL BANK



ERC General Meeting

October 21, 2004
London

ISMA 7th Repo Survey

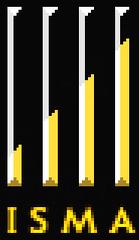


European Repo Market Survey June 2004

Conducted by the ISMA Centre

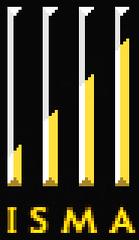


Richard Comotto



Survey overview

- Outstanding value of contracts at close on June 9, 2004
- 81 responses (from 75 groups)
- respondents headquartered in:
 - 15 European countries
 - North America
 - Japan

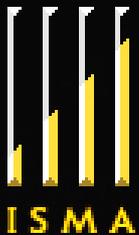


Headline figure

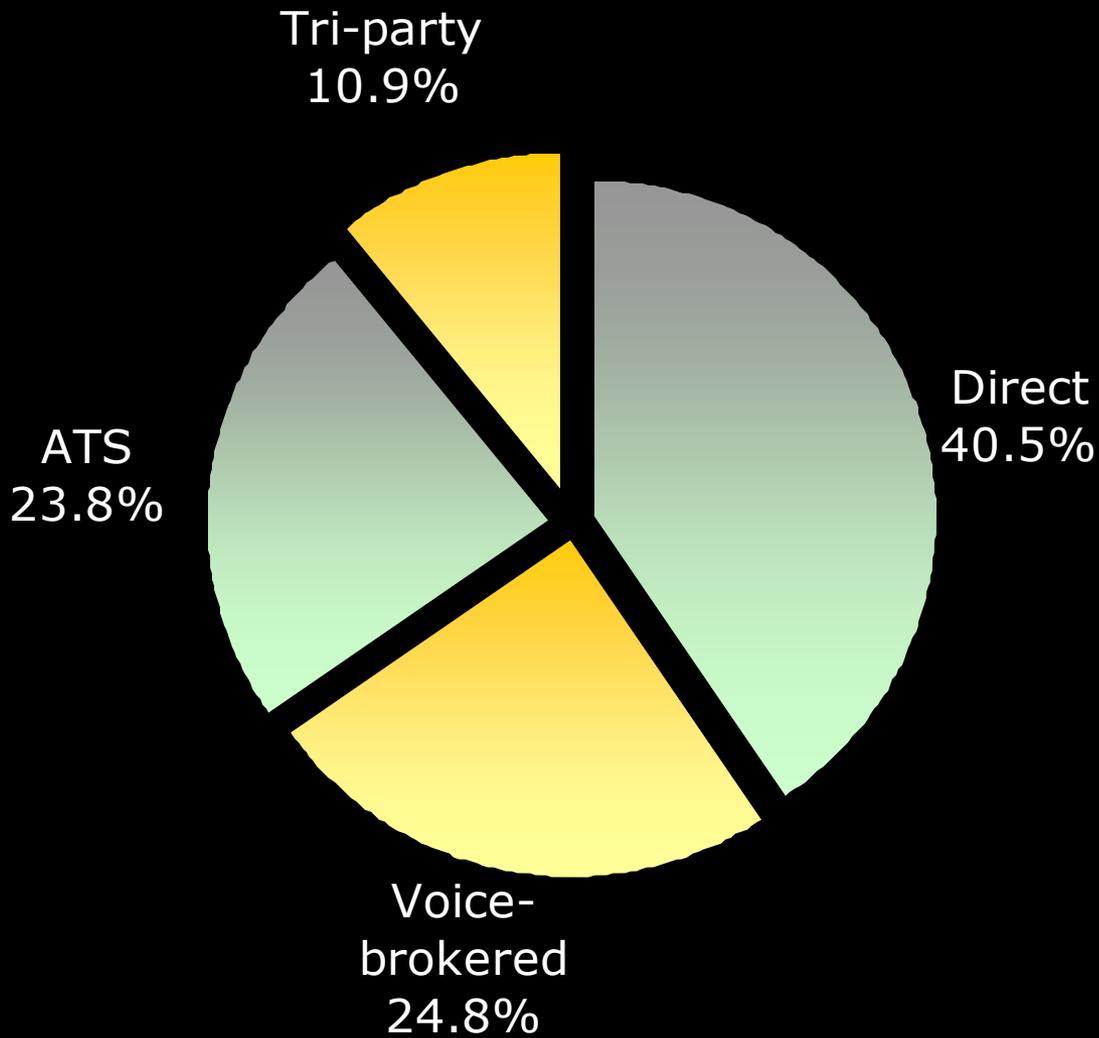
- Estimated gross total = **EUR 4,561 billion**
- December 2003 = EUR 3,788 billion
- June 2003 = EUR 4,050 billion
- December 2002 = EUR 3,377 billion
- June 2002 = EUR 3,305 billion

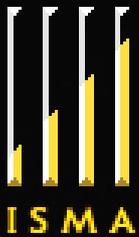
Participants in successive surveys

- 35 respondents in all surveys
June 2003-June 2004=19.0%
 - June 2003-December 2003 (H1)=2.2%
 - December 2003-June 2004 (H2)=16.4%
- 64 respondents in June 2003 & 2004 surveys
June 2003-June 2004=16.2%
 - June 2003-December 2003 (H1)=0.7%
 - December 2003-June 2004 (H2)=15.4%

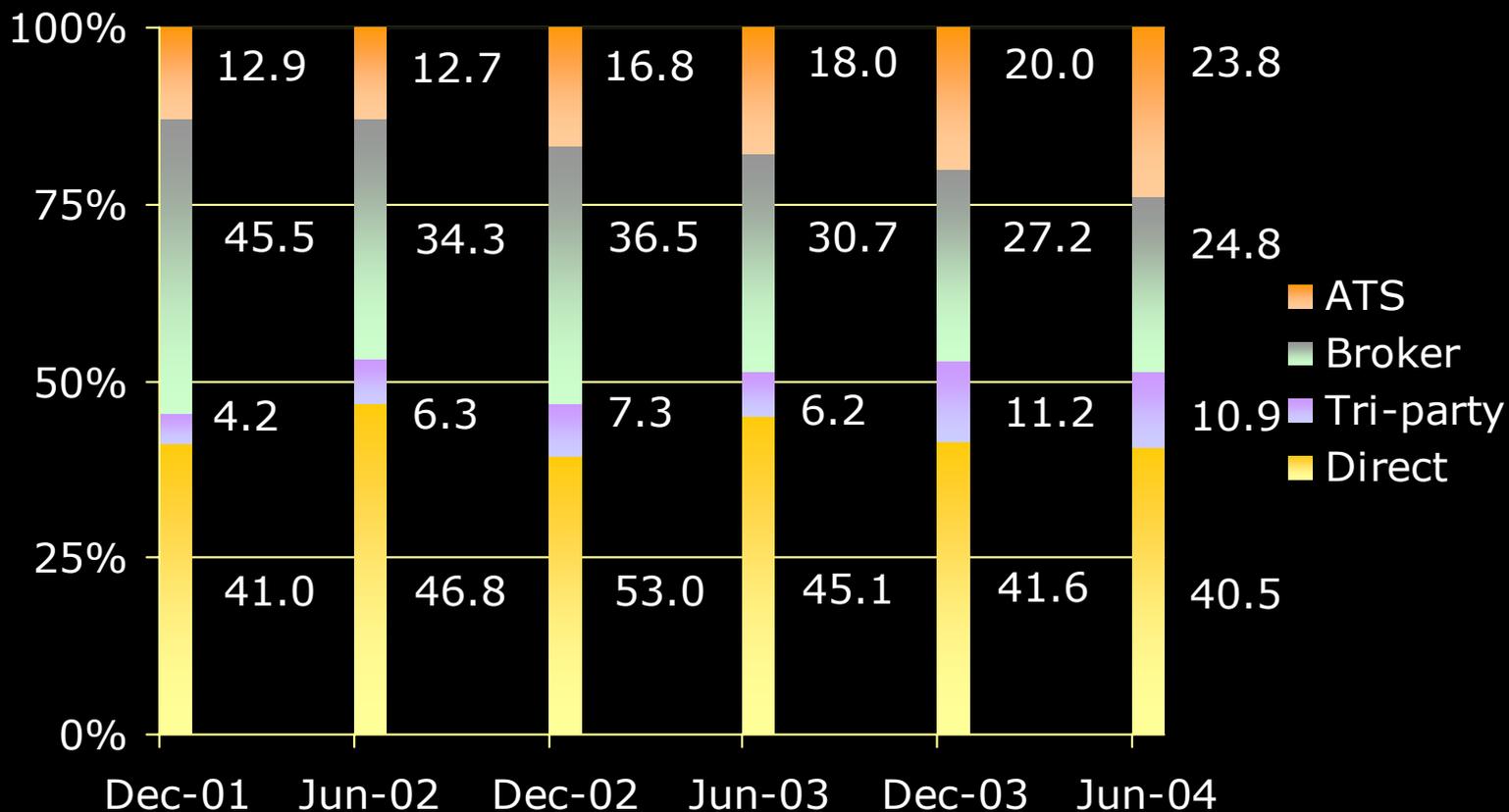


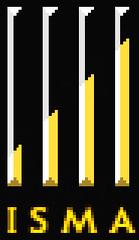
Counterparty analysis



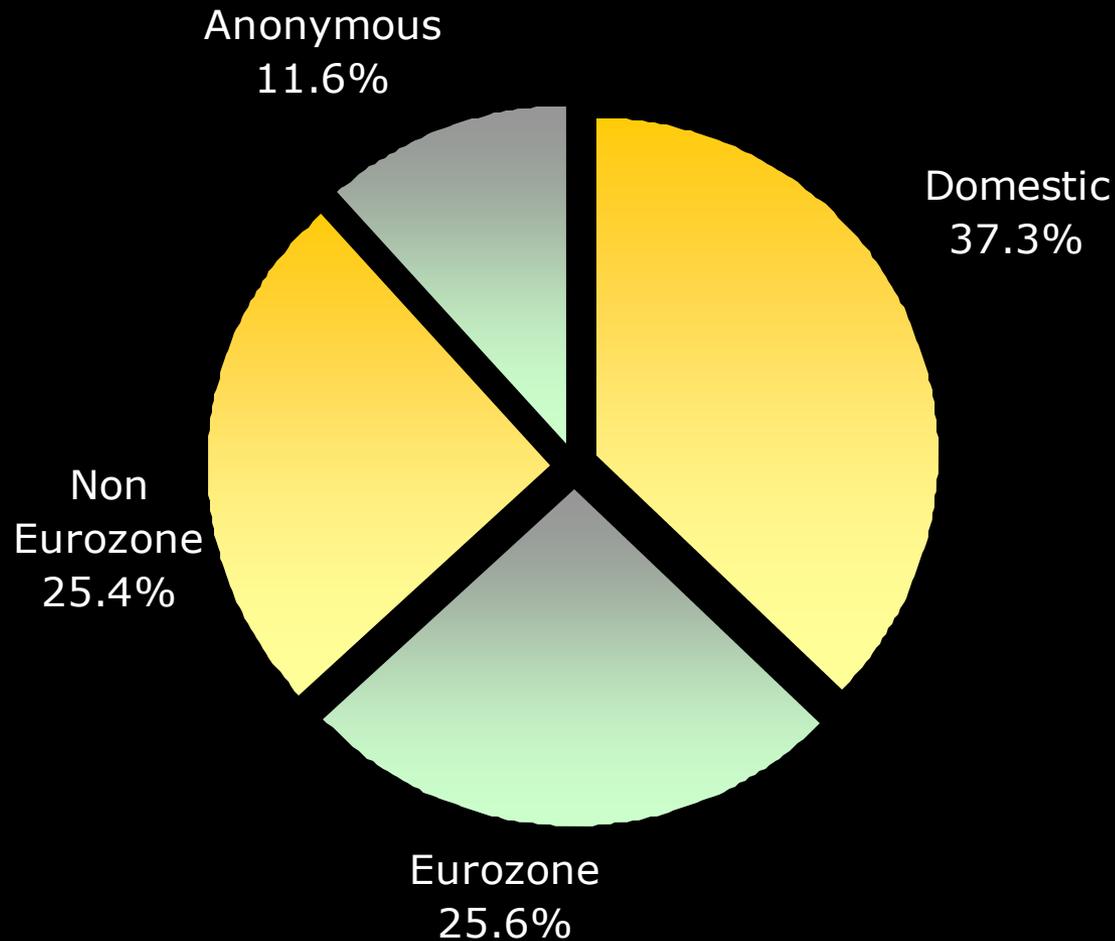


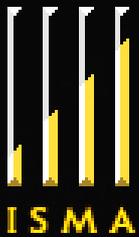
Counterparty analysis



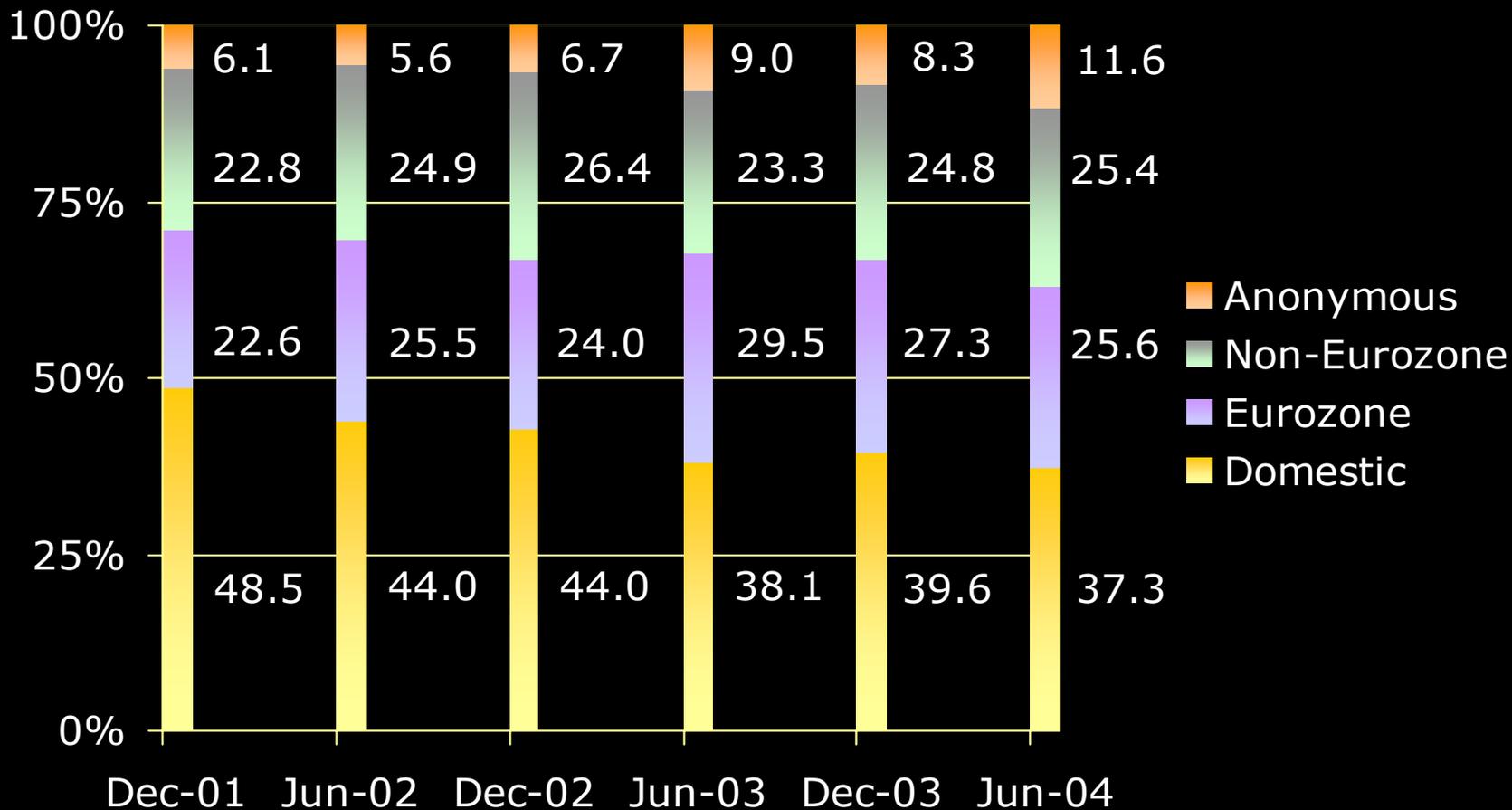


Geographical analysis

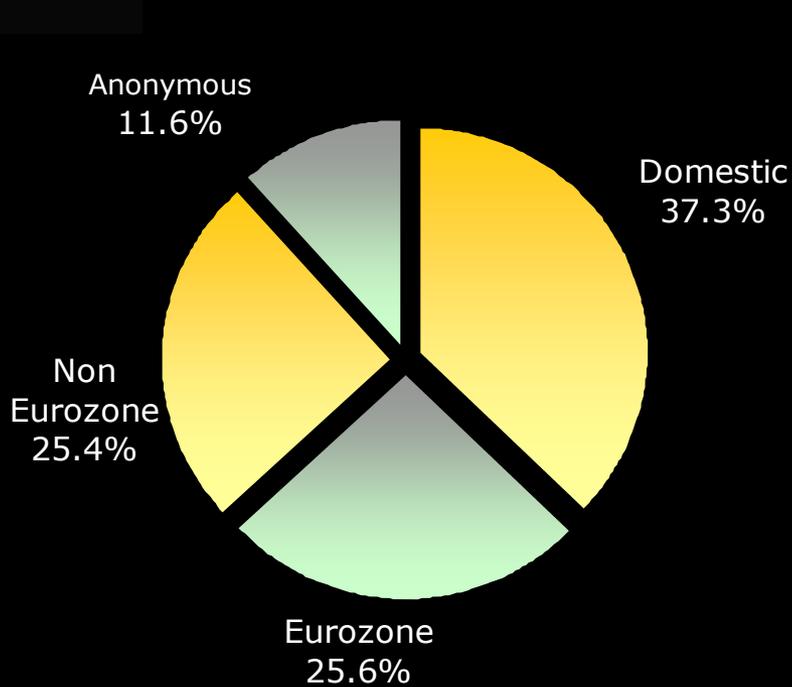




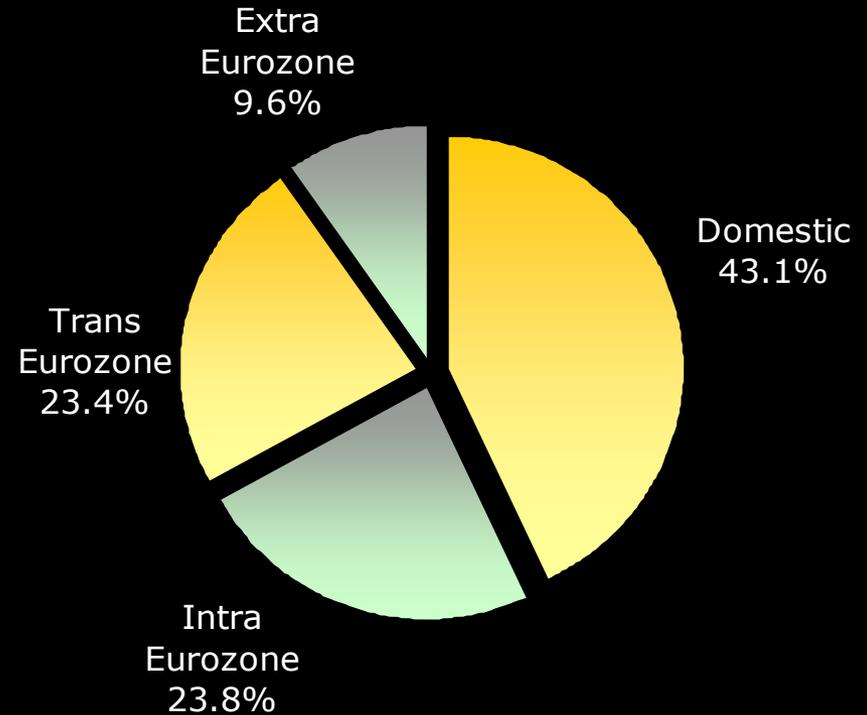
Geographical analysis



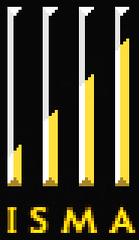
Geographical analysis v brokers



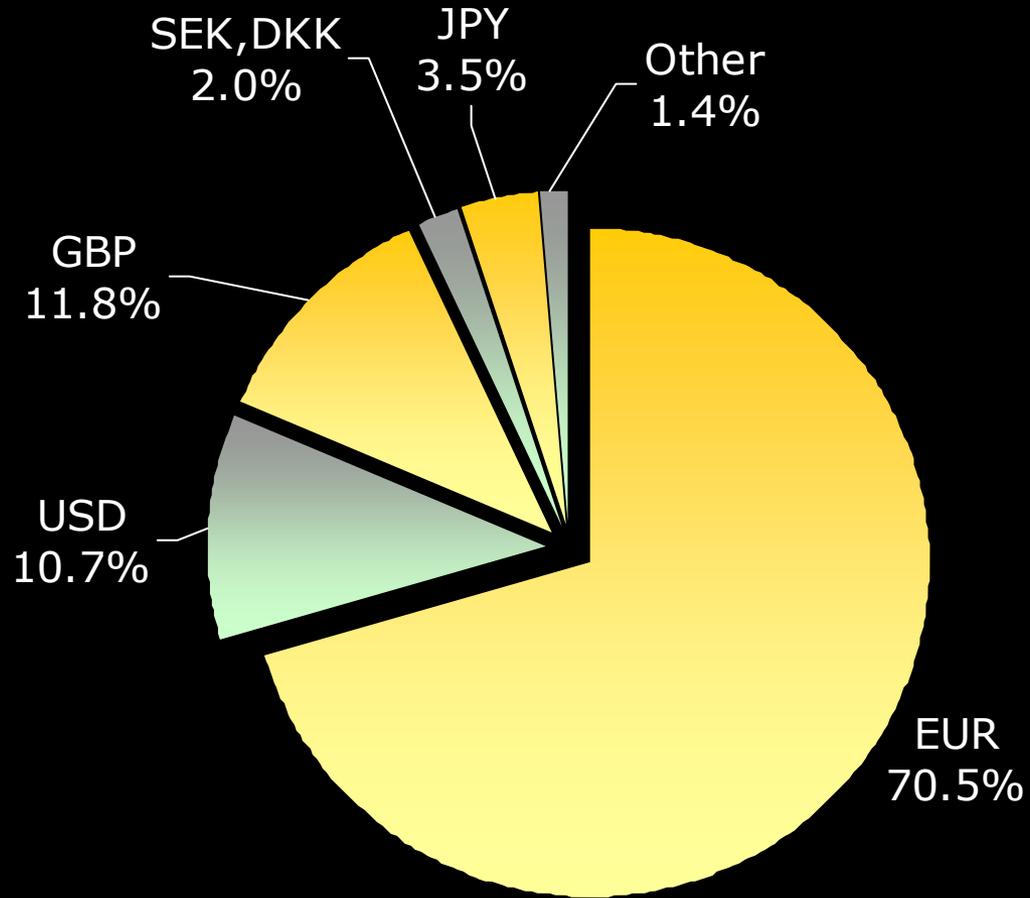
principals

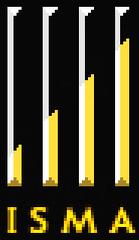


brokers

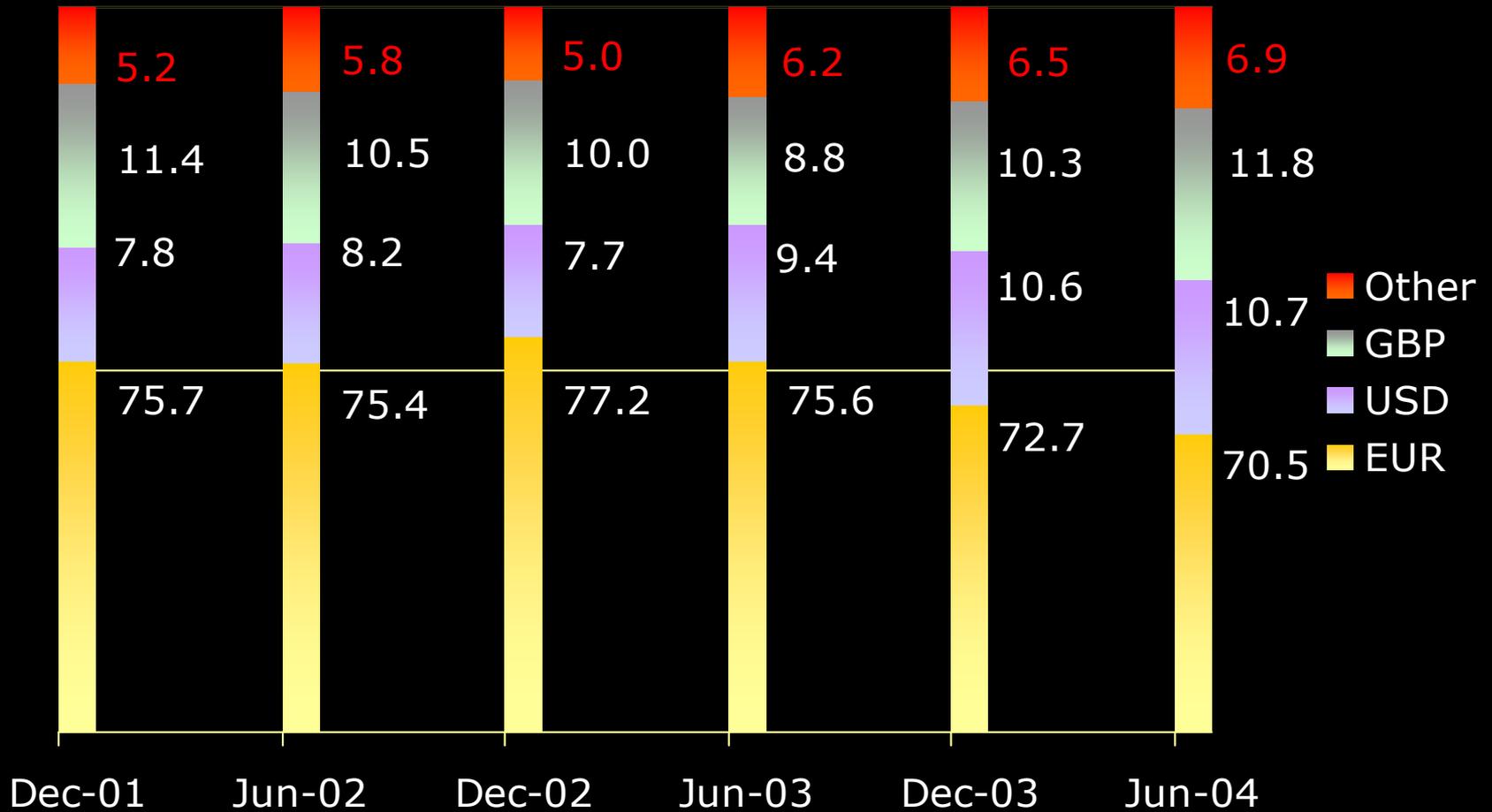


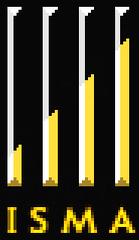
Currency analysis



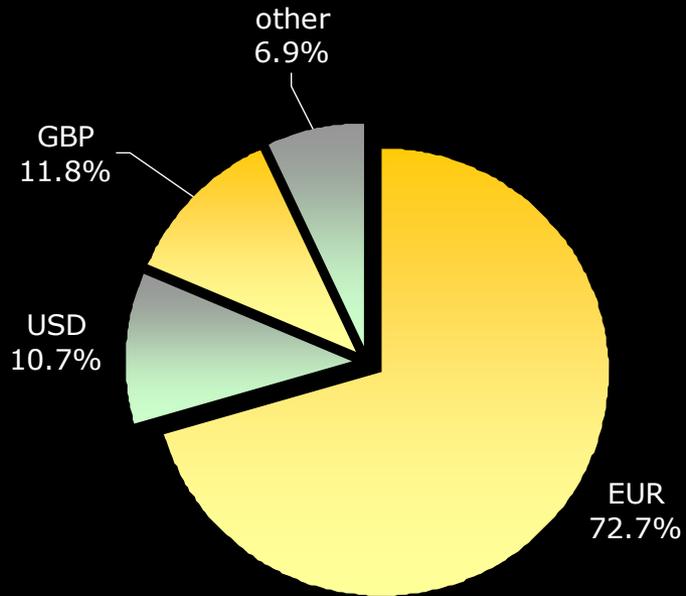


Currency analysis

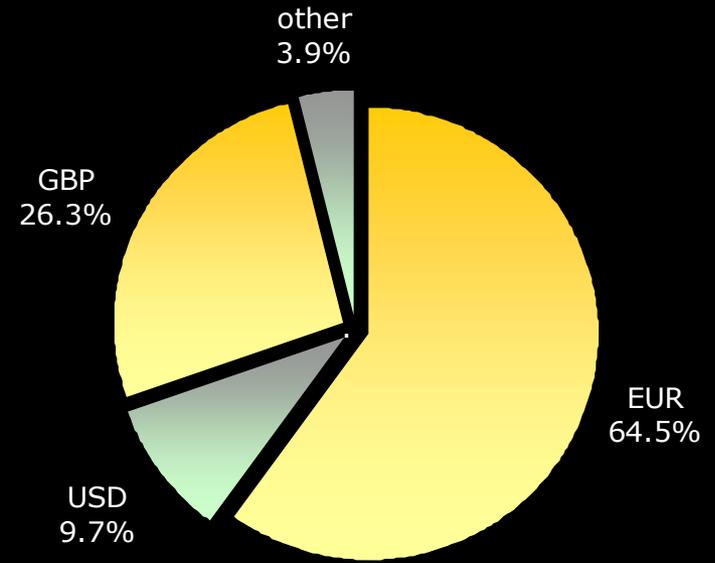




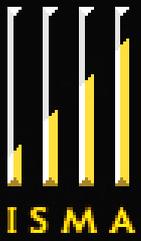
Currency analysis v brokers



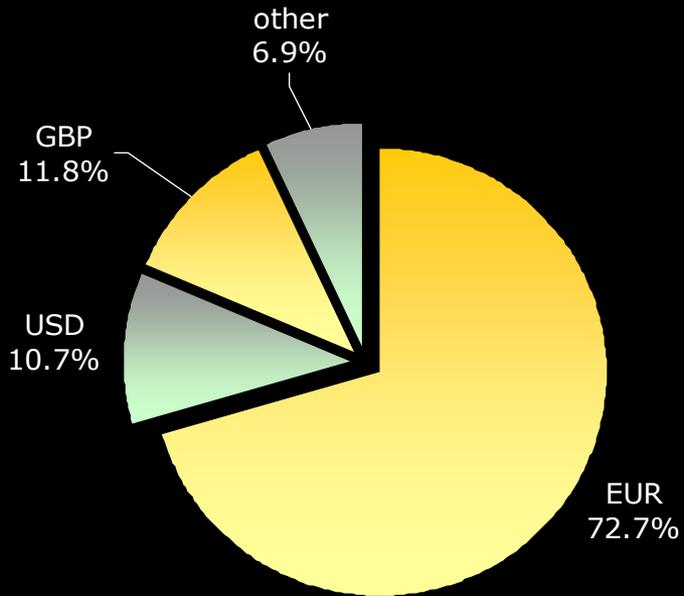
principals



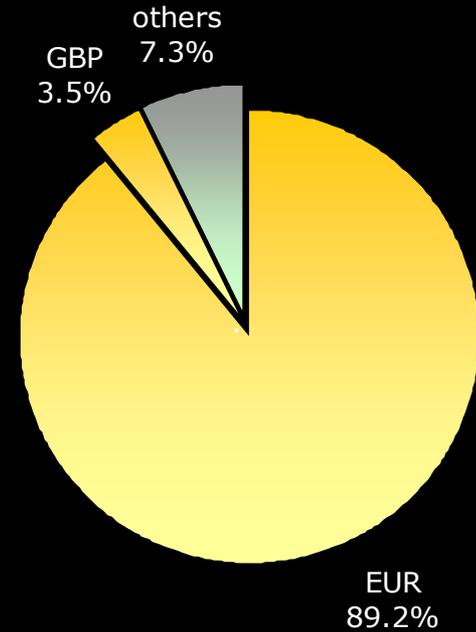
brokers



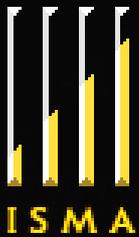
Currency analysis v ATS



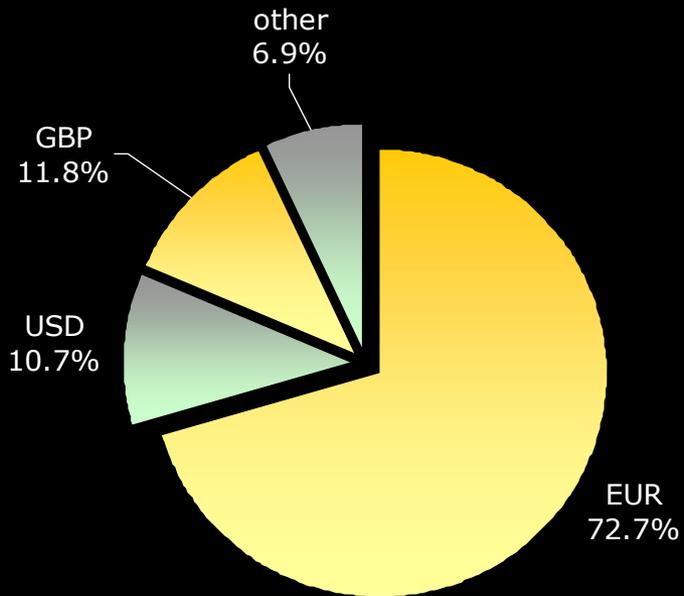
ISMA



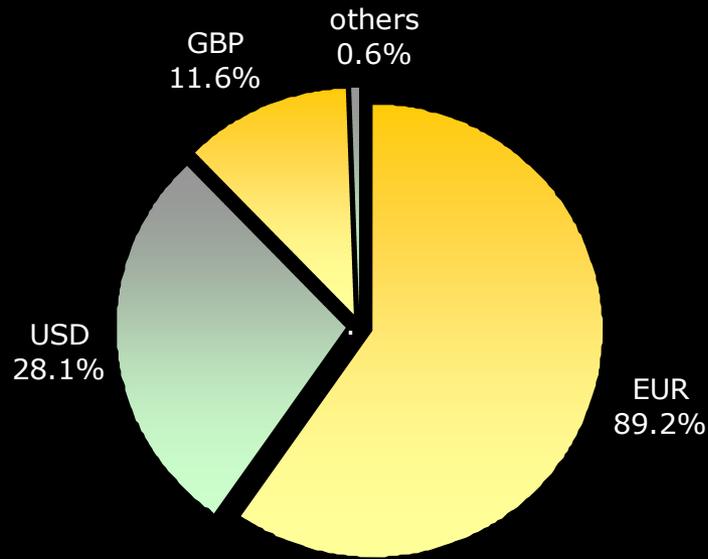
ATS



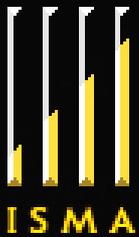
Currency analysis v tri-party repo



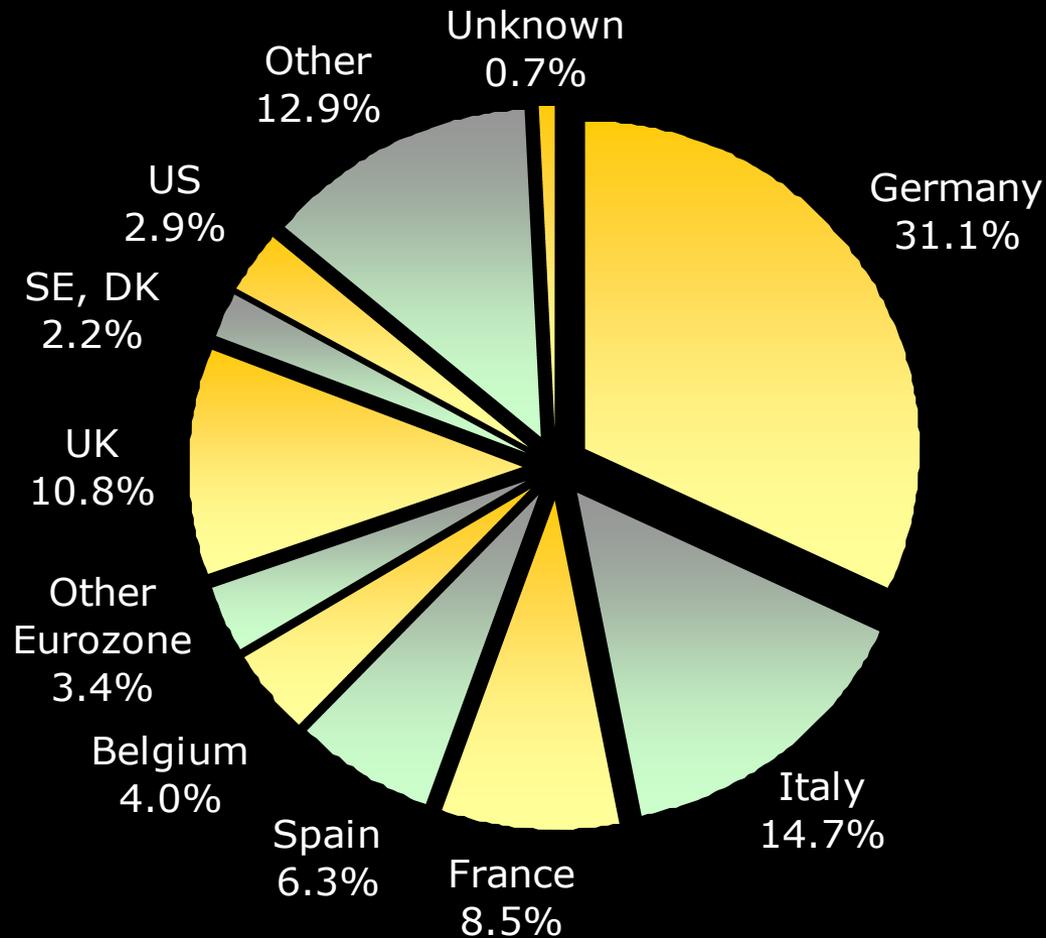
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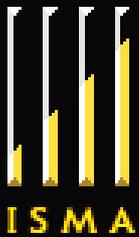


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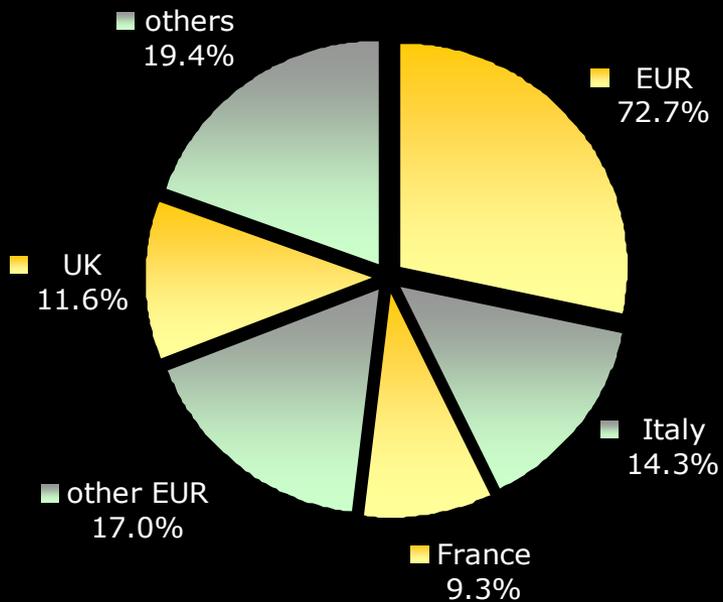


Collateral analysis

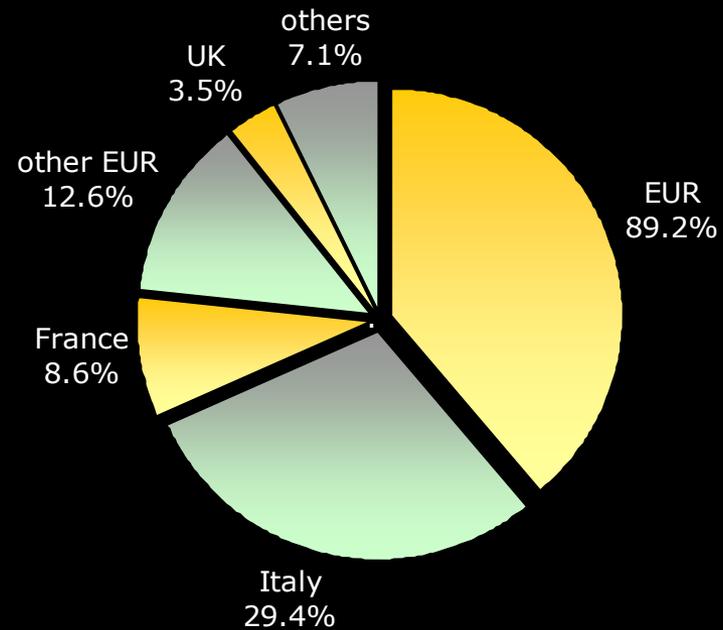




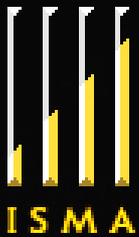
Collateral analysis v ATS



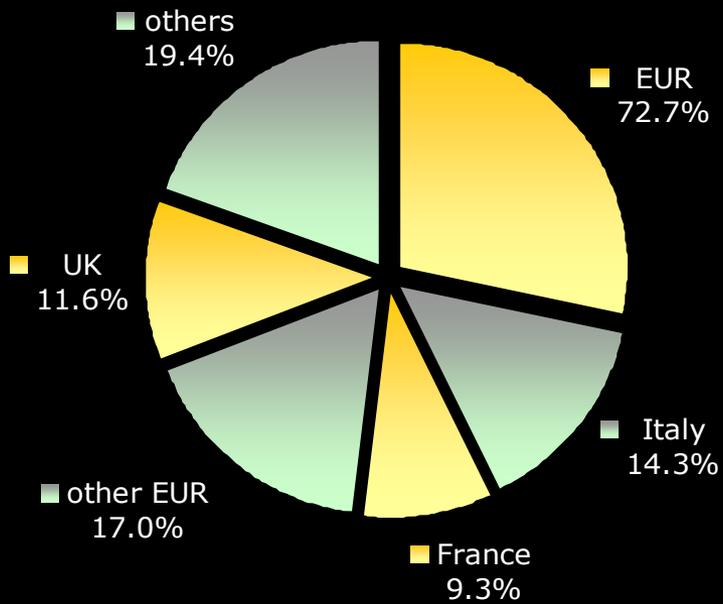
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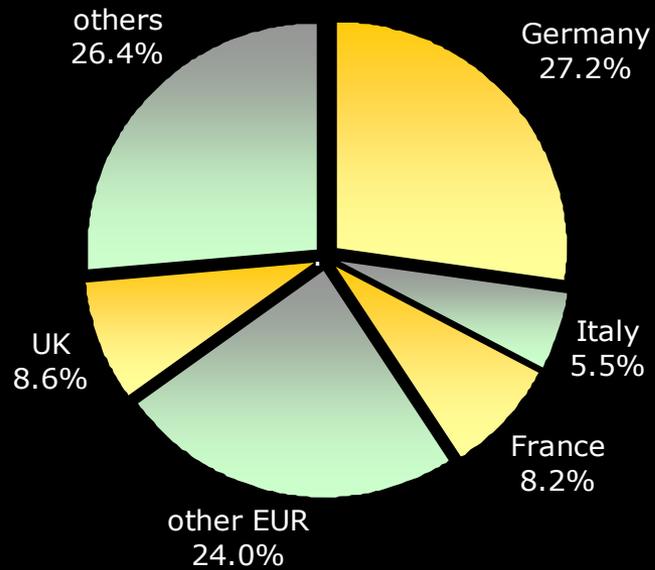
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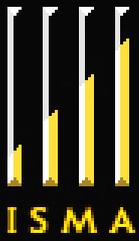
Collateral analysis v tri-party repo



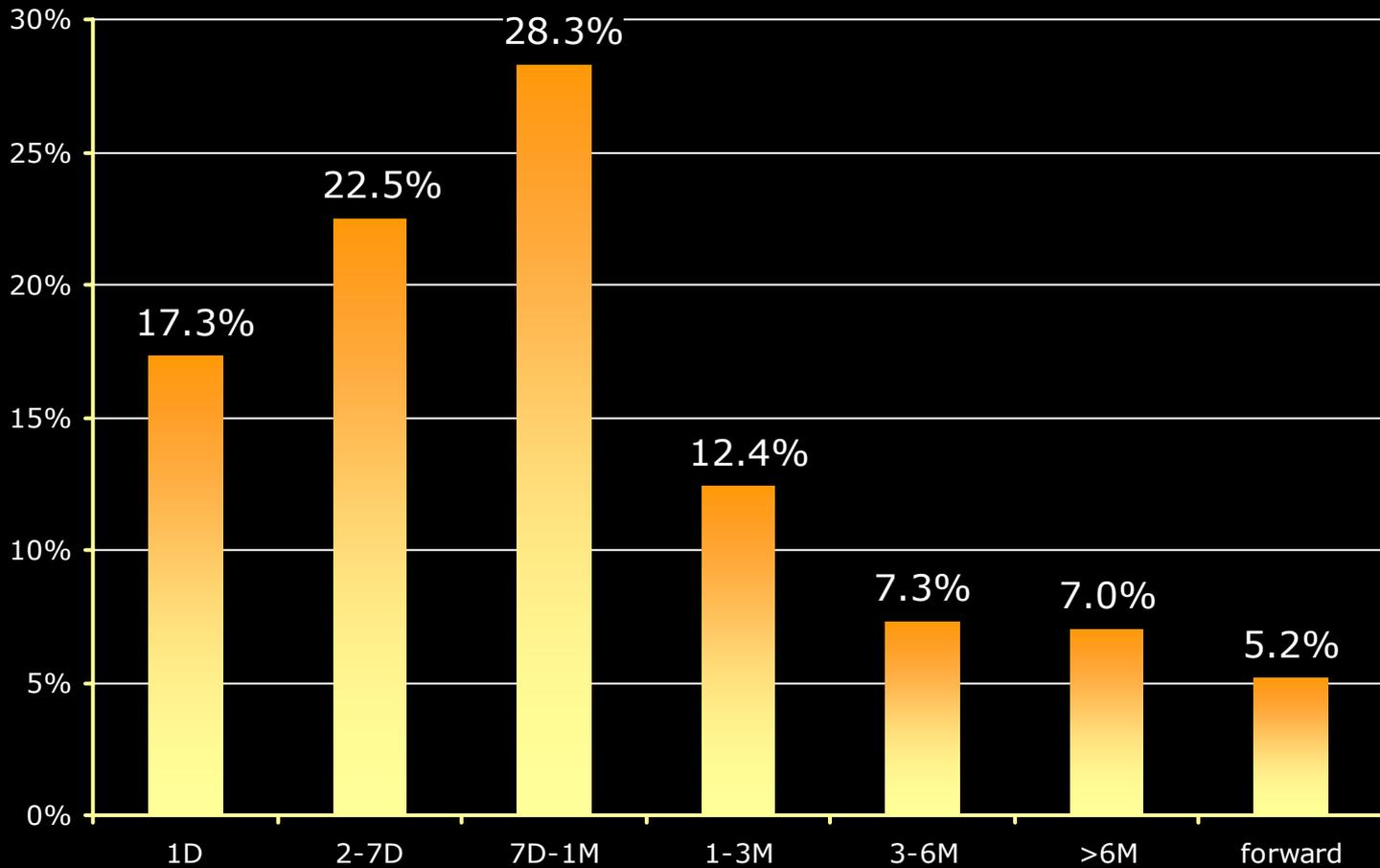
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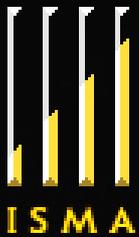


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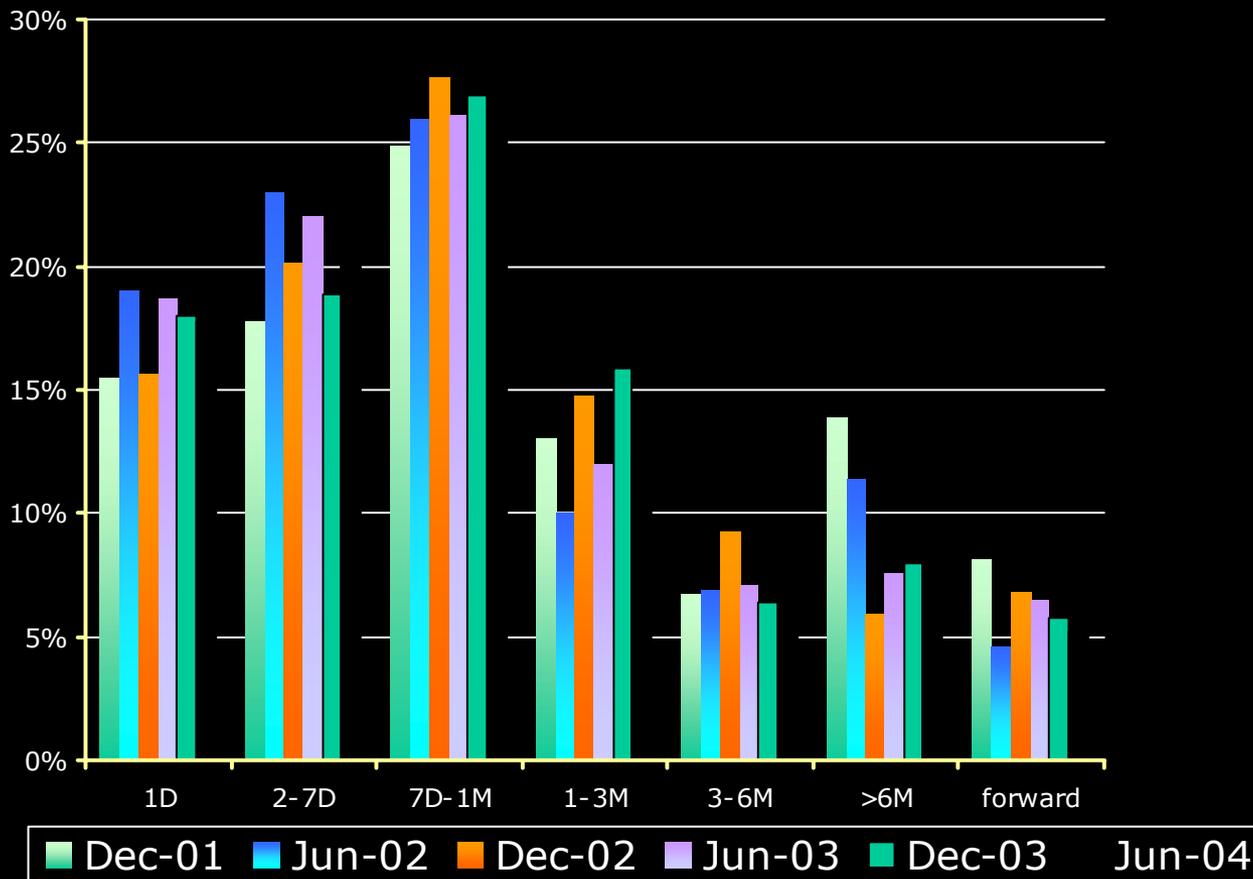


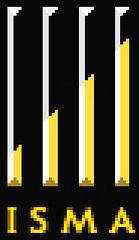
Maturity analysis



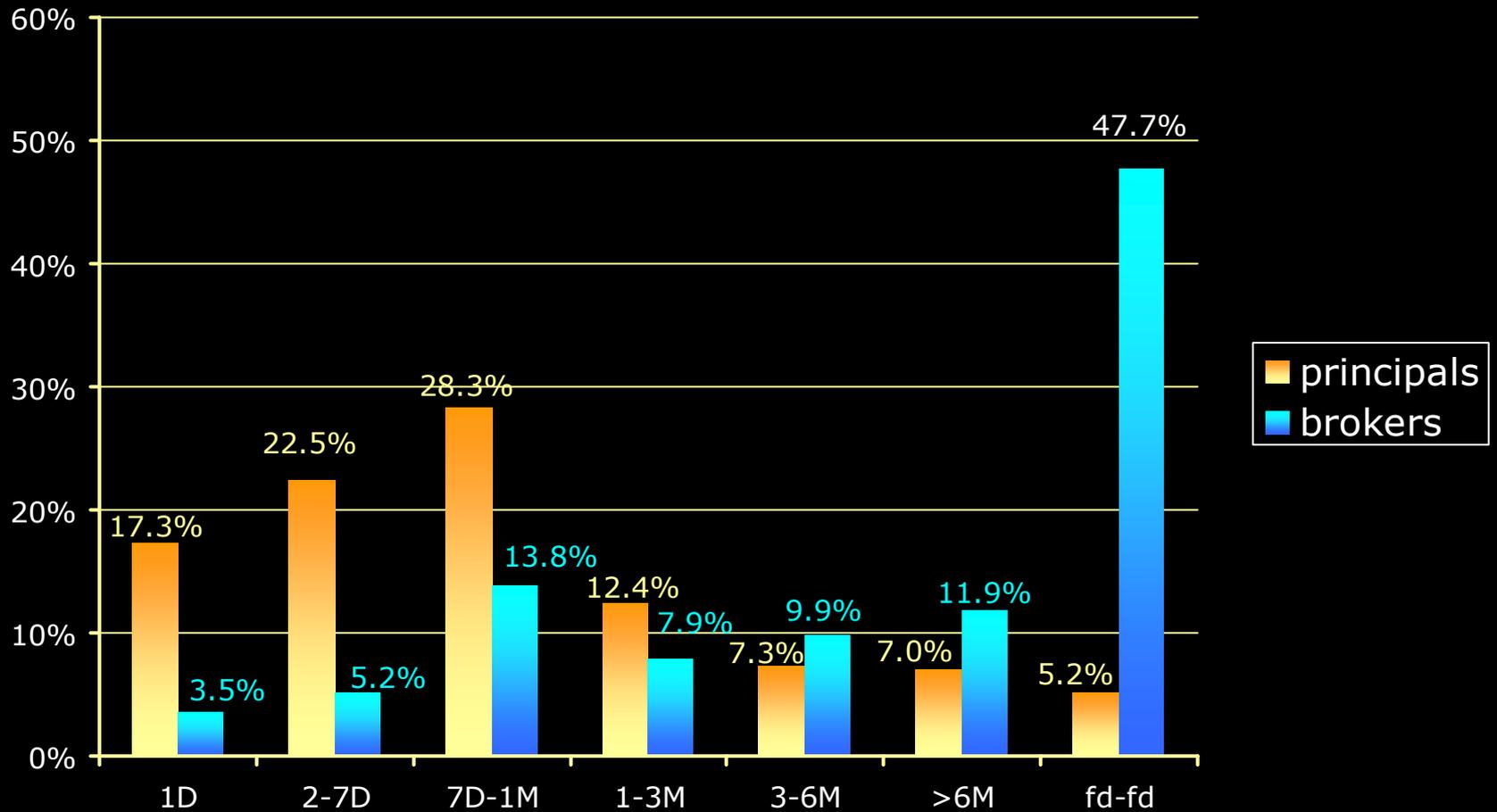


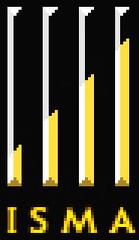
Maturity analysis



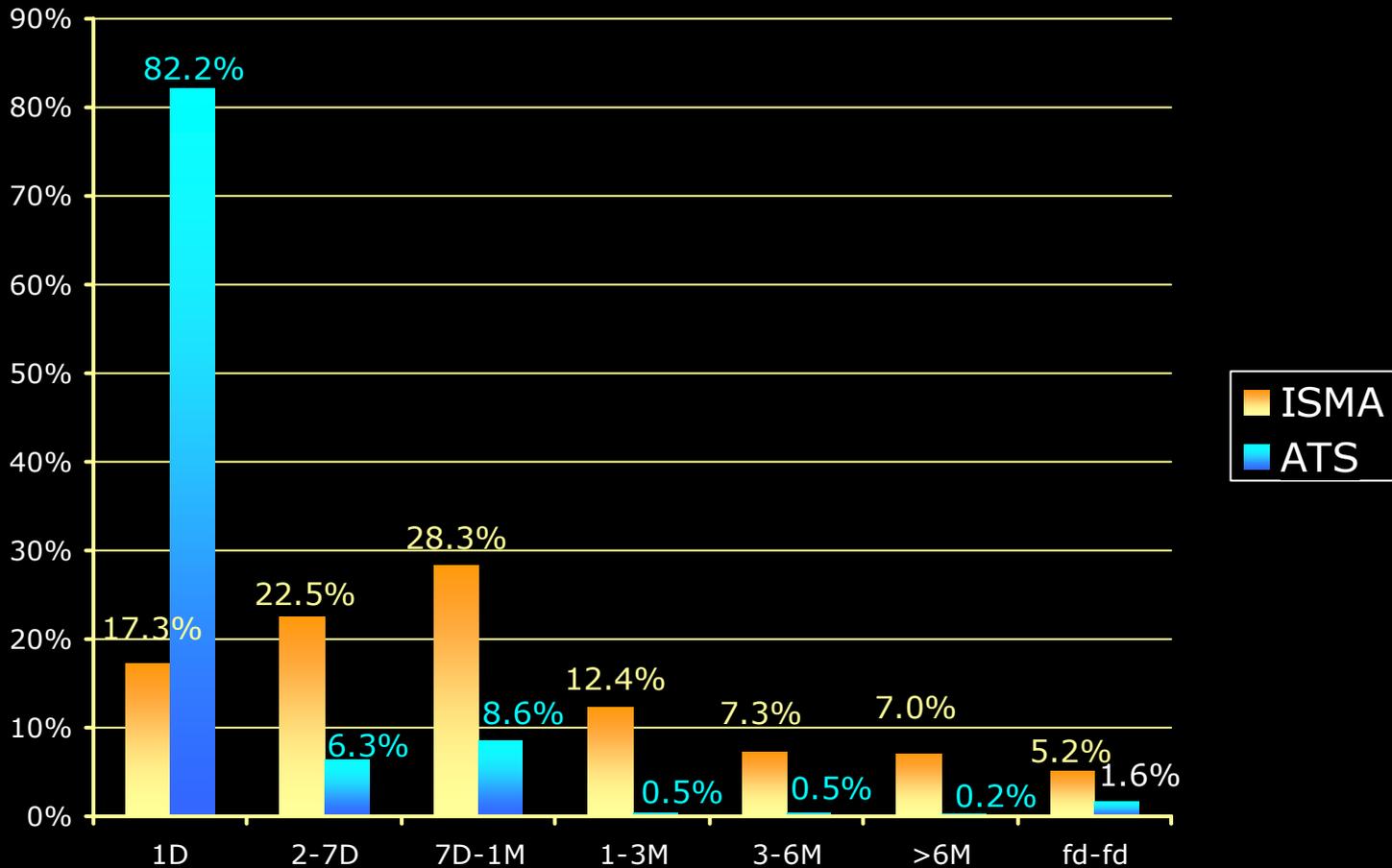


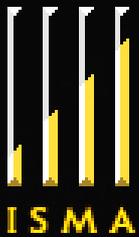
Maturity analysis v brokers



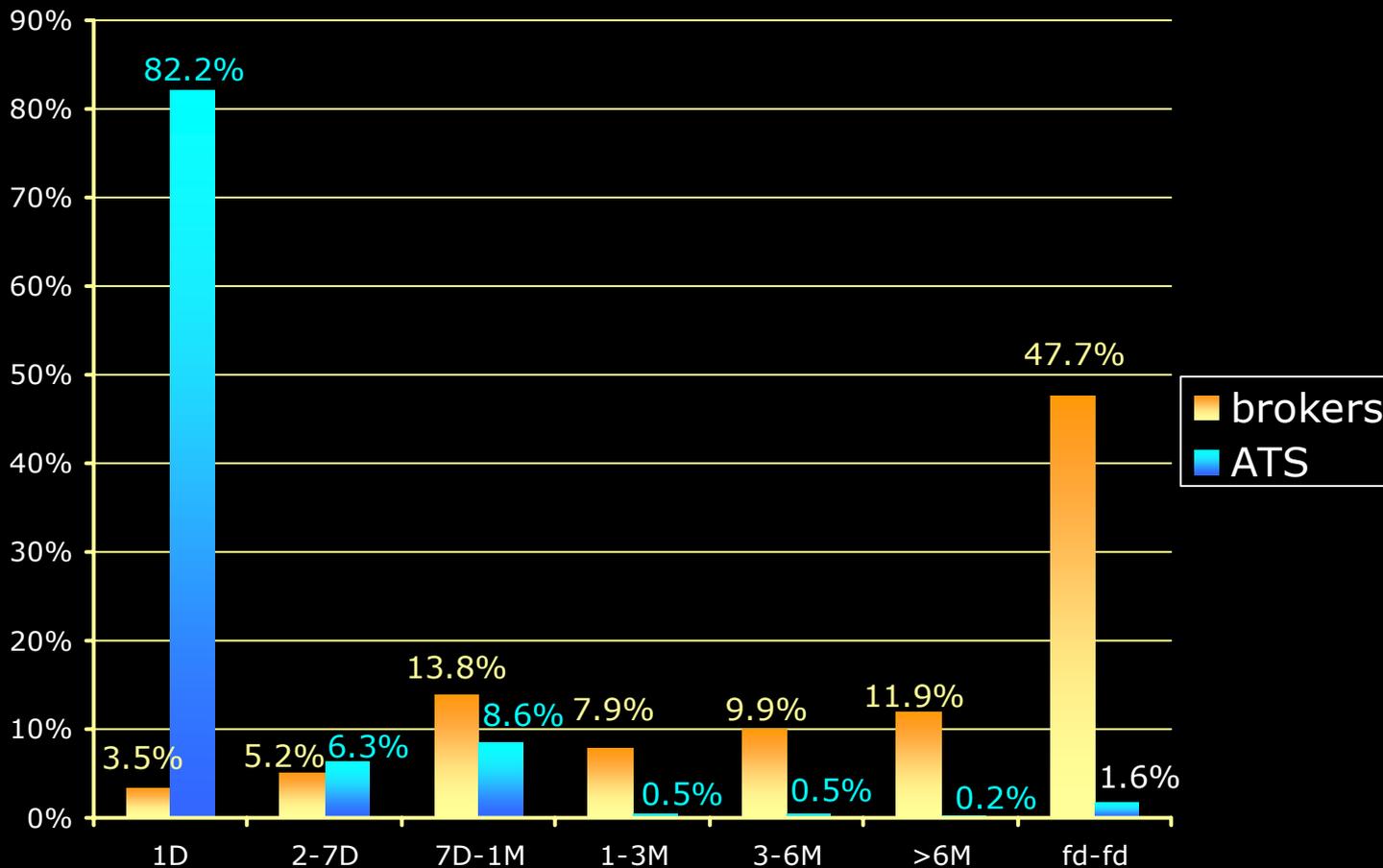


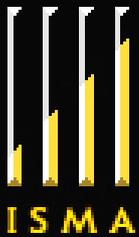
Maturity analysis v ATS



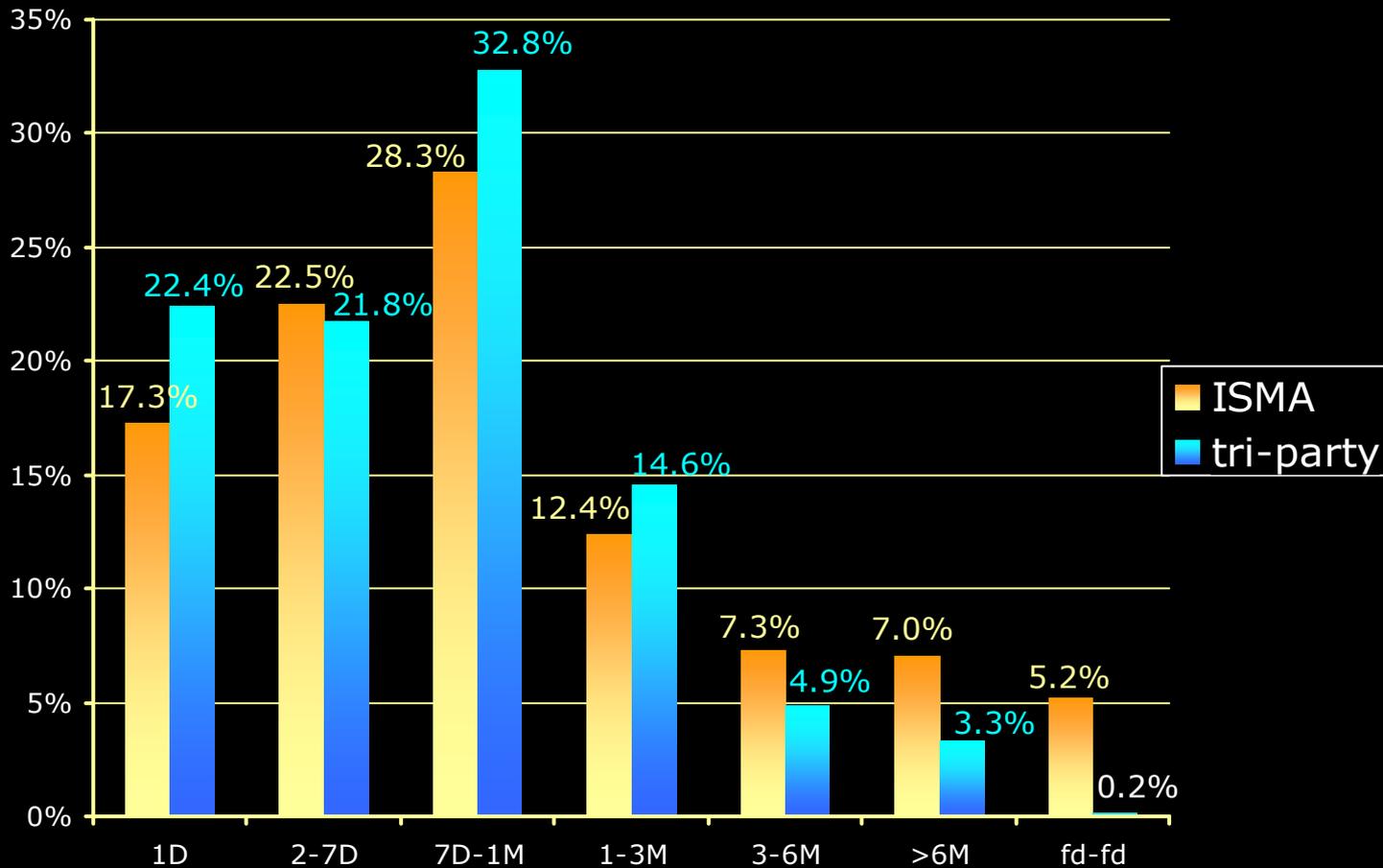


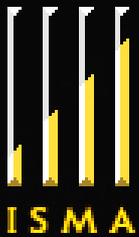
Maturity analysis: brokers v ATS



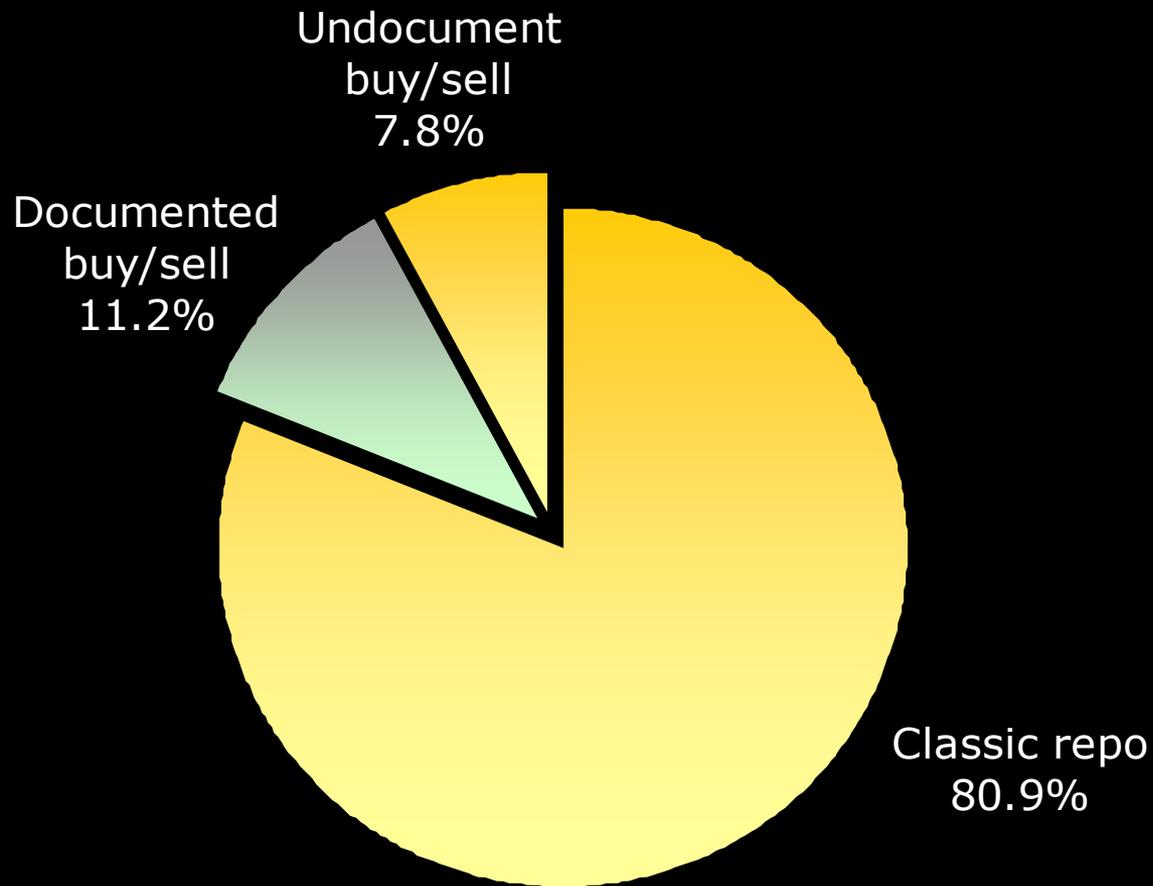


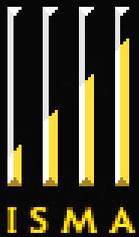
Maturity analysis v tri-party repo



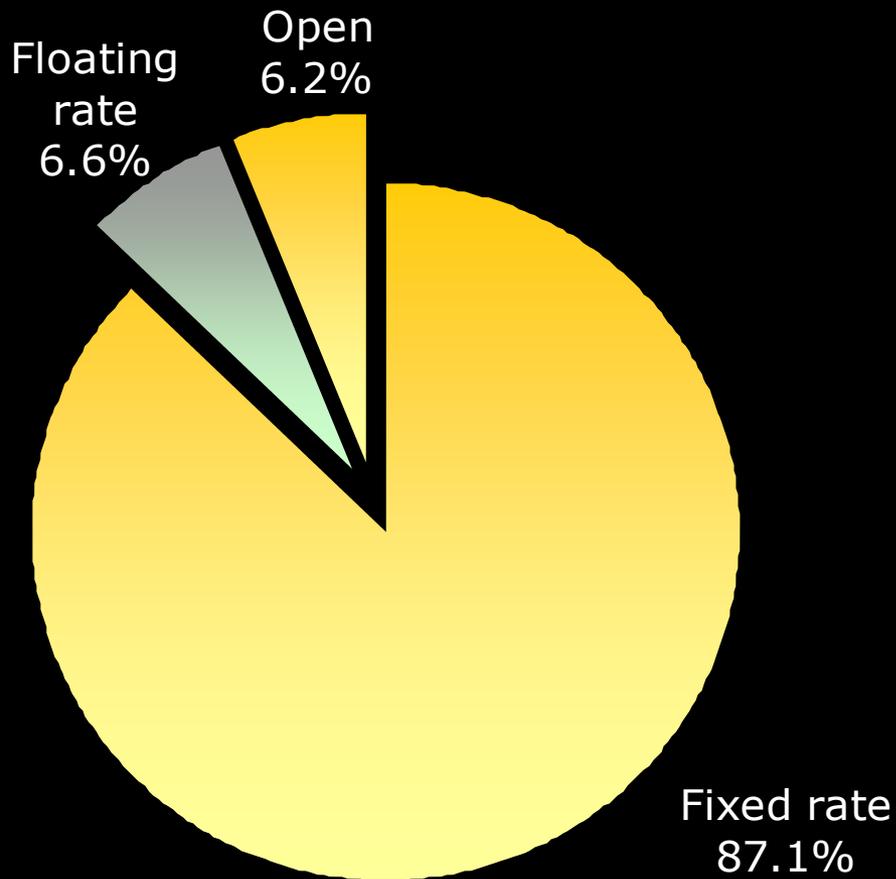


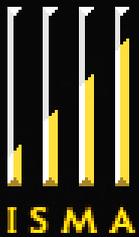
Contract analysis





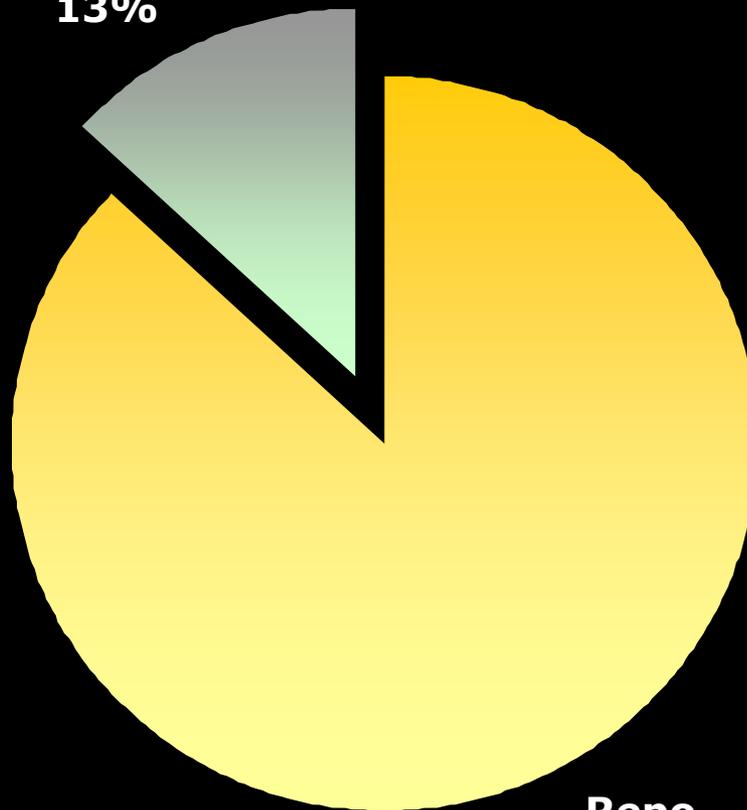
Repo rate analysis



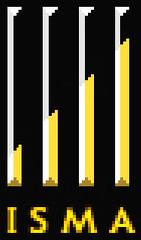


Product analysis

**Securities
lending
13%**



**Repo
87%**



European repo market survey

Next Survey

December 8, 2004

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Attachment 8
ERC general council meeting
October 21, 2004

Euro GC Pooling Secured Funding in Motion

Realising synergies and adding value for the market

Marcel Naas, London, October 21, 2004

Agenda

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- **Business Targets**
- **Added Value**
- **Value Chain of DBAG**
 - **Trading & Clearing**
 - **Collateral Management & Settlement/Custody**
- **Benefits for Collateral Management**
- **Prerequisites to Participate**
- **Implementation Plan**

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eurex
repo

Mastering the balance sheet

- Easy exchange between cash and securities
- Manage proportion of cash and securities on the balance sheet

Optimising the liquidity

- Use of most liquid trading terms (OverNight, TomNext)
- New ECB Tender term - creates a perfectly harmonized “secondary” market for the ECB Week Tender
- Broad range of securities eligible for trading (~9,000 securities)

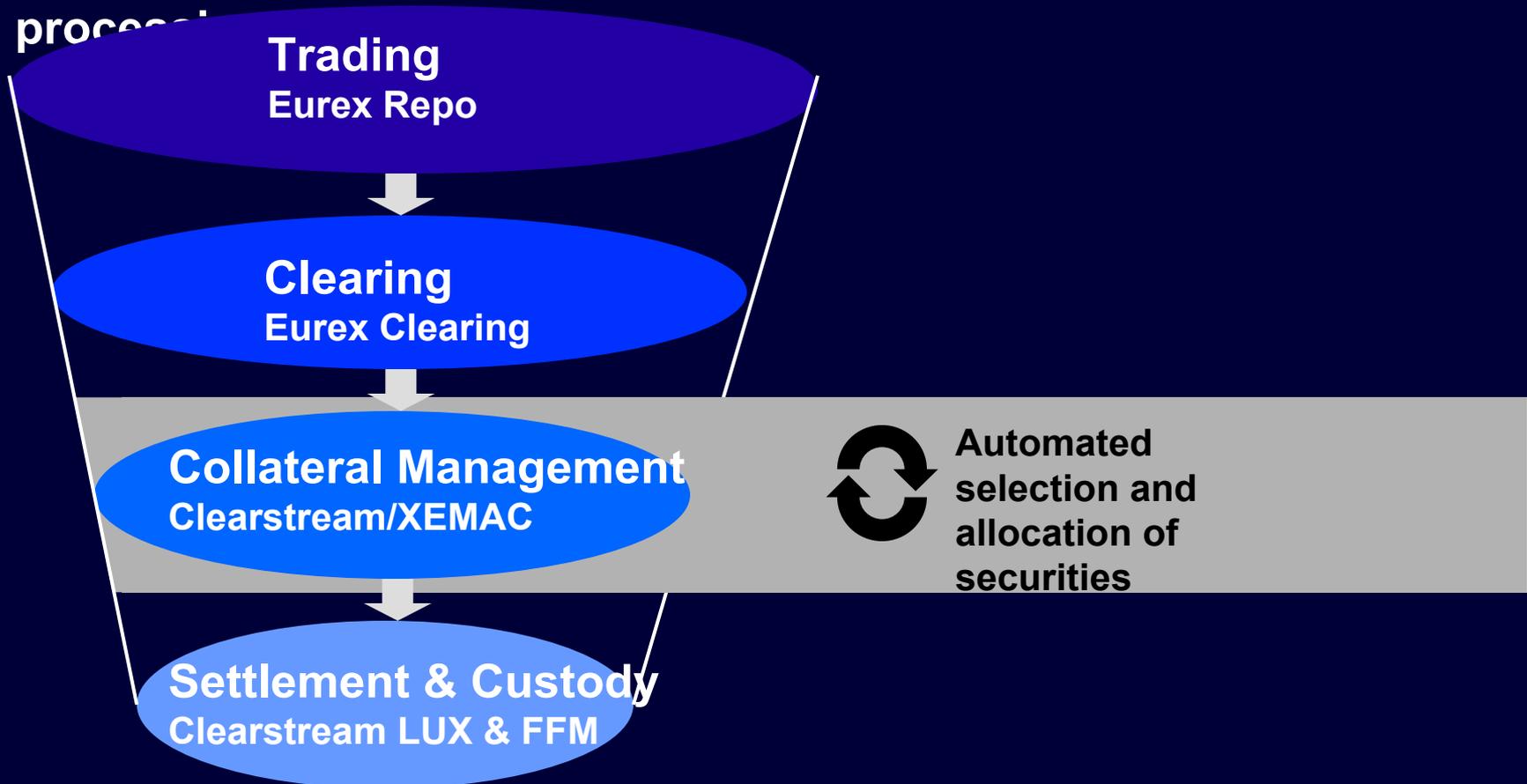
Managing the risk

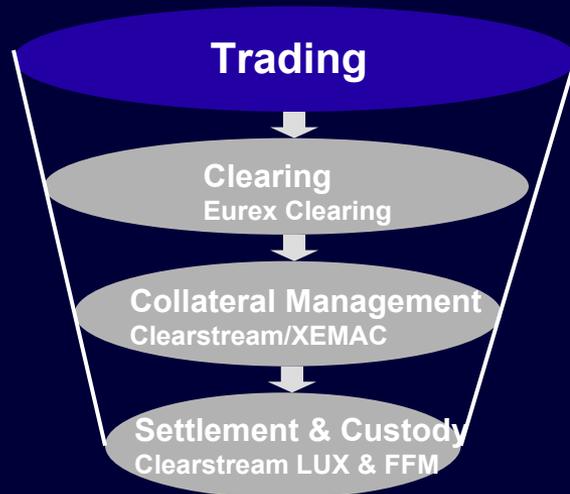
- Reducing the credit risk exposure
- An excellent alternative product to the unsecured cash liquidity funding
- Anonymous trading by use of the Central Counterparty of Eurex

Clearing Seizing the opportunities

- Efficient and secure same day settlement
- Electronically and fully integrated seamless STP:
Trading → Clearing → Collateral Allocation → Settlement → Custody
- Automated allocation of securities. No manual completion of trade. Real time substitution of securities incl. re-use of collateral received (e.g. ECB Tender)

Seamless straight through process





Trading on Eurex Repo

- Anonymous General Collateral basket trading
- ~9,000 ECB/Bundesbank eligible securities
- ON, TN and ECB Tender terms with flexible end-dates
- Use of existing Eurex Repo infrastructure
- Same trading fees
- The repo trade is automatically being processed as “Euro GC Pooling” by selecting the basket

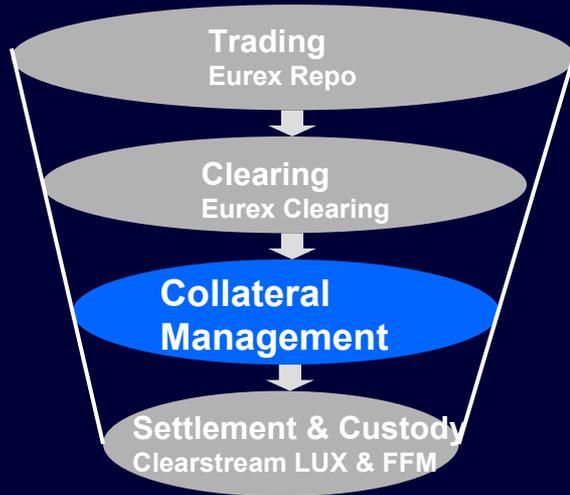


Central Counterparty of Eurex Clearing (CCP)

- CCP steps in as counterparty
- Centralisation of risk, margining, reporting, etc.
- Use of existing Eurex Clearing infrastructure
- Same clearing fees
- Automated transfer of settlement instructions to Clearstream LUX & FFM

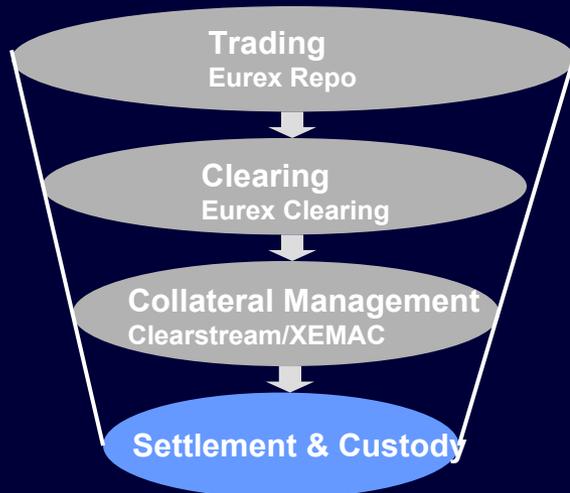
Collateral Management & Settlement/Custody

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Collateral Management with XEMAC

- Automated allocation of collateral in XEMAC
- Automated booking in CASCADE
- Participants have online access to XEMAC for:
 - Substitution of collateral on demand
 - Status supervision in real time
- Xemac fees on net exposure only
- Re-use of collateral received (e.g. ECB Tender)



Settlement & Custody at Clearstream LUX & FFM

- Securities settlement at Clearstream FFM
- Handling of corporate actions
- Use of the collateral basket for GC Pooling allows fast processing beyond settlement batches (RTS)
- Real-time link to Deutsche Bundesbank for cash settlement

Benefits for Collateral Management

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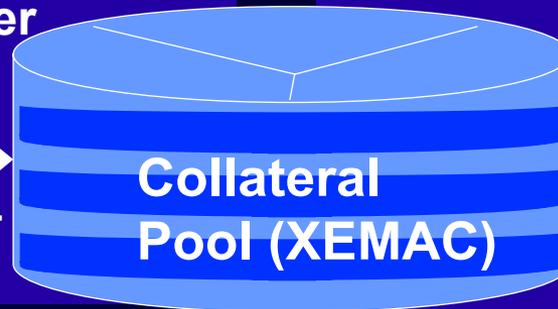
Funding

Liquidity & Balance Sheet Management



ECB Tender

Euro GC Pooling



Eurex Margining



Trading

Cash & Collateral Trading & Management

Prerequisites to Participate

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- Trading admission for Eurex Repo
- Euro GC Pooling admission form
- Direct or indirect participation in clearing process of Eurex Clearing
- Direct or indirect access to CASCADE including Bundesbank account for cash payments
- Direct or indirect connection to XEMAC

**13 international banks (Repo & MM Desks)
committed to be first movers at start !!**

- **Launch Date:** **March 2005**
- **Simulation Phase:** **Feb - Mar 2005**
- **Technical setup:** **Nov - Dec 2004**
- **Start of your application process:** **as of Sep 2004**

For more information

web: www.eurexrepo.com
mail: sales@eurexrepo.com
phone: +49 69 211-15741