

**Minutes of the ERCC Committee meeting held on 25 January 2017 in Luxembourg**

Present:	Mr. Godfried De Vidts	BrokerTec (ERCC Chairman)
	Mr. Eduard Cia	UniCredit Bank (ERCC Vice Chair)
	Mr. Michael Manna	Barclays
	Mr. Eugene McGrory	BNP Paribas
	Mr. Andreas Biewald	Commerzbank
	Mr. Michel Semaan	Crédit Agricole
	Mr. Daniel Trew	Deutsche Bank
	Mr. Jean-Michel Meyer	HSBC
	Mr. Nicola Danese	JP Morgan
	Ms. Amanda Brilliant	Nomura
	Mr. Sylvain Bojic	Société Générale
	Mr. Richard Hochreutiner	Swiss Reinsurance
	Mr. Nicholas Hamilton	JP Morgan (ERCC Ops Co-Chair)
	Mr. David Hiscock	ICMA
Mr. Alexander Westphal	ICMA (ERCC Secretary)	
On the phone:	Mr. Dan Bremer	BAML
	Mr. Romain Dumas	Credit Suisse
	Mr. Ronan Rowley	Deutsche Bank
	Mr. Francois-Xavier Bouillet	Goldman Sachs
	Mr. Andrea Masciovecchio	Intesa San Paolo
	Ms. Lisa Cleary	ICMA
	Mr. Andy Hill	ICMA
Mr. Richard Comotto	ICMA Centre	
Apologies:	Mr. Grigorios Markouizos	Citigroup (ERCC Vice Chair)
	Mr. Johan Evenepoel	Euroclear Bank
	Mr. Gareth Allen	UBS Limited

**Welcome**

The Chairman welcomed all participants in the room and on the phone and briefly introduced the agenda for the meeting. Following on from previous discussions with the CGFS in relation to their work on repo markets, they have agreed to a further meeting with ERCC Committee members, in London on 30 January. Given the CGFS' particular interest in the buy-side perspective, a few of the ERCC's buy-side members have been asked to join the meeting.

It was noted that a couple of members have spoken separately, in the previous week, with a few CGFS representatives. The purpose, as with the upcoming meeting with the ERCC Committee, was to follow up on previous discussions and to focus particularly on the difficult conditions in the European repo market around year-end. It is understood that the CGFS report is due to be

published in February; and that this work will not directly feed into the ongoing Basel consultation in relation to the Leverage Ratio, but is rather expected to inform the work of the FSB over the medium term (next 12-18 months). Amongst other things, it has been drawn to the attention of the CGFS that current initiatives and rhetoric, on the part of some regulators, around perceived problems regarding collateral re-use are misleading and potentially dangerous to market function.

The Chairman also informed members of an upcoming short ERCC report on the dislocations in the European Repo market around year-end 2016, which Mr. Hill is currently working on. A first draft of this report should be ready within one week and will be sent to Committee members for review. The study is due to be published and presented at an ICMA ERCC press briefing on 14 February in London, alongside the latest Repo Survey which is currently being prepared by Mr. Comotto. The preparation of this short year-end report has also already been announced to the ECB, as they are very interested in the issue, and a small ERCC delegation will go to Frankfurt, on 15 February, to meet with the ECB.

Members had a discussion on the year-end events and the causes for the dislocations. It was noted that the impact on the cross-currency basis was even more pronounced than on the repo market itself, as market participants long of EUR strived to obtain USD funding. Mr. Manna mentioned that would give a presentation at the GFF Summit the next day, which includes some further analysis in relation to the year-end dislocations (see [slides](#)). One interesting question posed by the year-end volatility is whether this was a unique event or whether it has longer term implications and thus indicates a new normal in the repo market. Members also discussed the role of central banks in this context and the viability of opening access to non-banks through a "European RRP", following the experience of the Fed in the US. In Europe, a similar step was however considered unlikely given the role and restrictions of the ECB. National central banks could perhaps be more flexible in this regard.

#### **1) Minutes from previous meetings**

The minutes of the last ERCC Committee meeting, which took place on 14 November 2016 in Brussels, were unanimously approved.

#### **2) MiFID II Best Execution requirements for SFTs**

Mr. Hill updated members on recent work related to the treatment of SFTs under MiFID II, in particular the best execution requirements set out in RTS 27. There is a lot of uncertainty in the market on the question whether the technical standards apply to SFTs or not. RTS 27 itself is not explicit on this (although RTS 28 is) and no regulator has yet provided further clarity if and how the relevant best execution requirements can be applied to SFTs. A first ICMA ERCC letter was sent to the Commission in October to request clarification. As we only received a very vague response to this letter, this was followed up more recently with a detailed discussion paper explaining the (im)practicalities of applying RTS27 to SFTs, an accompanying set of slides and another letter to the Commission, with a request for a follow-up meeting to discuss this issue in more detail. The letter will be sent out next week and will be copied also to relevant contacts in the ECB and ESMA.

Members confirmed that achieving clarity on this question is a top priority for firms. Given the approaching implementation date it will be important to move fast. In the absence of any clarification, firms will have to make a judgement whether they consider SFTs in scope or not, as the necessary resources for implementation need to be allocated. Given that there is currently

nothing in the text to the contrary, most firms will probably have to assume for compliance reasons that the requirements do apply to SFTs, despite all the impracticalities.

It was agreed that the letter should be sent out as soon as possible. Some discussion took place around the approach to be taken in the letter. In particular, members stressed that the letter should make it very clear that firms need urgent clarification and that our assumption, which needs to be confirmed, is that SFTs are out of scope of the requirements. Based on the discussion, Mr. Hill will lightly redraft the letter and send a final draft version to the Committee.

There was a short related discussion around the prohibition of TTCAs (which includes GMRA repos) with retail clients in art.16 of the MiFID II level 1 text. Mr. Hiscock recalled our previous discussions on this issue, which have indicated that this provision was not seen as unduly problematic. One issue to keep in mind is that some entities (local authority, municipality) will have to actively opt into the professional regime in order to be eligible as GMRA repo counterparty.

### **3) EU SFT Regulation**

Mr. Hamilton, Co-Chair of the ERCC Operations Group, provided an update on the EU SFT Regulation, one of the key priorities for the Ops Group. ESMA's latest consultation on SFTR draft technical standards closed on 30 November 2016. The ERCC submitted a comprehensive [response](#) to the consultation. Despite many outstanding concerns with the future SFTR reporting regime, it is positive that the ERCC has established a constructive dialogue with ESMA over the past months, illustrated by the fact that ESMA is reaching out to us with follow-up questions. Most recently this has been the case on the reporting of re-use. Mr. Hamilton briefly went through the key messages from the ERCC response.

With the adoption of the final standards approaching, the focus of the industry now needs to urgently shift to implementation. Cross-industry collaboration will be a critical component of this, given the short time to deliver solutions for the heavy implementation challenges. As a first step, the ICMA ERCC will be holding an industry meeting on SFTR on [8 February](#), jointly organised with ISLA. The aims of the event will be to identify key problem statements related to SFTR, to exchange ideas with the relevant vendors on how to shape the operating model going forward, and finally to intensify the dialogue with trade repositories which will be another critical element of SFTR implementation.

Mr. Westphal briefly explained the further timeline of SFTR adoption and implementation. ESMA is expected to finalise the RTS by end March and submit them to the Commission. Review and adoption of these standards by the Commission and subsequently by Parliament and the Council will then take another few months. Adoption of the final RTS is thus currently expected around October 2017. From that moment on financial institutions will have one more year (ie until around October 2018) until the actual reporting obligation applies.

### **4) Other regulatory updates**

ERCC Committee members considered a few other relevant recent regulatory developments. At a general level, members commented that the current difficult macro environment with Brexit and the newly elected US administration is a significant constraining factor for policy makers in Europe, which also translates into a lot of uncertainty in relation to the future direction of travel on financial regulation generally and the Basel rules more specifically. Overall, the shift of focus and the high level of uncertainty is likely to lead to further delays in the implementation of new

rules, which is probably not bad news given that it provides some opportunities for the ERCC to reiterate existing concerns.

**a) NSFR:**

Mr. Hiscock updated members on the latest developments in relation to NSFR. On 23 November, the Commission adopted a comprehensive package of [Proposed amendments to the CRR/CRD framework](#), including on NSFR. These proposals will now go through the usual legislative process, involving the European Parliament and Council, which can each propose amendments to the proposals. This process will take many months and will provide us with an opportunity to push for changes. On NSFR specifically, the Commission included some helpful elements, in particular to reduce the asymmetry in the treatment of SFTs, but also some other helpful elements e.g. adaptations related to the treatment of derivatives margins. The key question to the Committee is whether we are happy with these small improvements or whether we should continue to strongly push for further change (e.g. to completely remove the asymmetry). Members are asked to send any comments to the Secretariat so that we can start building a position. We will also aim to coordinate with AFME on this file given that they are generally in the lead for prudential regulation.

Members discussed some of the proposals put forward in more detail. In particular, it was mentioned that there do not seem to be any improvements in the treatment of open repo trades under the new NSFR proposals. The same is true for the related proposals regarding the leverage ratio (LR) which do not include any reference to the netting of open trades. This is problematic and would seem to overwrite previous rules set out in the previous Directive. In this context, the April 2016 Basel consultation on the Leverage Ratio is of relevance as it aimed to clarify the treatment of open repo, although no final conclusions have been published yet. If the final BCBS recommendation includes any helpful clarification, this is hoped to then be appropriately reflected in EU rules as well.

Generally, members suggested that previously submitted comments in relation to NSFR and LR would be a good starting point to identify the key issues for ERCC members with the most recent proposals. However, members also cautioned that some of the previous comments were quite far reaching, particularly asking for a full NSFR carve out for short-term money market activities (including repos). Although ideal, repeating this message is probably not very promising. It was felt that a more targeted approach, focused on the easy wins and concrete (technical) improvements to the rules, is probably more effective. In terms of arguments, it was remarked that we would ideally need to provide some evidence showing the specific impact of regulation, which is something that regulators are very keen to receive. This is however extremely difficult to do and the year-end dislocations have shown again that there is a complex interplay of factors that lead to the problematic aggregate outcome.

Members also commented on the modelling assumptions underlying NSFR, which are seen as unrealistic, given that they are in some regards less prudent than the standards reasonably applied internally by banks. This leads to banks overperforming according to the NSFR calculations, which might become problematic in case the assumptions should be tightened at some later stage.

Mr. Hiscock asked members for their views regarding proposals to introduce a waiver that would allow firms to apply NSFR on a consolidated group level as opposed to individual legal entity level. This seems to be particularly relevant for non-EU institutions which may well need to create a dedicated EU holding company in accordance with the Commission's proposals and could then

benefit from such waiver. Members remarked that some regulators are generally very reluctant to allow any such waiver at all, which has been very apparent in the implementation of LCR.

Mr. Hill mentioned recent discussions in the Commission's Expert Group on Corporate Bond Market Liquidity, on which he represents ICMA. The objective of the Group, which is composed of a broad range of market participants, will be to produce a report with recommendations for the Commission. Although focused on cash bond markets, repo is of course an important part of the picture and thus also covered in the discussions. He proposed to produce a short study on the European corporate credit repo market. Overall, the initiative is helpful and the Commission has made it very clear that they are open to consider some targeted tweaks to existing rules, but also that repealing any of these rules is not considered an option.

**b) CCP Recovery and Resolution:**

The Chairman introduced a discussion on CCP Recovery and Resolution mentioning the recently published EU [Draft Regulation](#) on CCP recovery and resolution, but also, on a related note, a worrying recent increase in fail rates at LCH. This increase is very concerning from a macroprudential perspective given the ability of CCPs to close out unsettled positions.

On the fails in LCH, members agreed with the importance of the issue but remarked that it is very difficult to more closely assess this as LCH does not publish any aggregate figures. One member pointed to figures from the ICSDs' auto-borrow service which can be seen as a proxy for the health of the market. These clearly confirm that there is an issue. One specific problem related to Germany, which seems to have contributed to the increase in fail rates in relation to Bunds, is the concentration of the latter in Clearstream. This poses a problem to clients of Euroclear's auto-borrow service as the latter can only provide limited relief. Other members commented that the increased number of fails in LCH also poses a reputational risk to the repo product more generally as it might undermine the case for using repo.

On the Draft Regulation proposed by the Commission on 23 November, the Chairman remarked that officials do not seem to fully acknowledge the relevance of repo related concerns in this context. However, CCPs clearly are an increasingly important factor in the repo market, so we need to ensure that our perspective is appropriately taken into account during the legislative process. Mr. Hiscock said that it will be important for the ERCC to carefully consider the proposals and to think through what we want to achieve here. A balanced view is certainly warranted given the importance to safeguard CCPs. On the other hand, it will be important to identify and push against any particularly disadvantageous proposals.

Members commented that it will be very difficult to strike the right balance. Regulators want to achieve absolute safety for CCPs but increasingly realise that this is only possible through uncapped liabilities for clearing members, which poses a huge problem for the applicable banks in terms of risk management. Furthermore, there is a concern that the proposals are too derivatives focused and thus do not sufficiently take into account the very different characteristics and risk profile of repo. Finally, another concern is the preference for cash settlement at the end of the waterfall (service closure), which would imply that firms have to liquidate their collateral themselves which does not help in terms of overall market functioning.

It was agreed that the ERCC should continue to keep a close eye on the evolution of the legislative proposal and ensure that repo specific aspects are sufficiently taken into account. For this purpose, it will be helpful to coordinate closely with ISDA who will actively contribute to the legislative process from a derivative point of view.

**c) EMIR/MIFIDII:**

Mr. Hamilton discussed a concern that has been raised in relation to the regulatory treatment of bond forwards. MiFID II introduces some uncertainty as regards the correct classification of these instruments as it seems to suggest that certain bond forwards (or more generally bond trades with non-standard settlement dates) are to be classified as derivatives. This has implication in an EMIR context given the upcoming margining requirements for OTC derivatives. Those bond forwards that are classified as derivatives will have to be included in the margining calculations. There is however currently no agreed understanding in the market what the relevant threshold is in terms of settlement date, beyond which bond forwards are considered derivatives. There are discussions within ISDA on this topic but no agreement seems to have been reached so far. As to the question whether the ERCC would need to take a position in this question, members agreed to leave the issue to ISDA given that this was purely related to cash bonds. Mr. Hill also suggested to raise the issue at the ICMA SMPC.

**d) Re-use**

Mr. Hiscock informed members about [two new FSB reports](#) related to collateral re-use that were published today. The first report on *Re-hypothecation and Collateral Re-use: Potential Financial Stability Issues, Market Evolution and Regulatory Approaches* describes potential financial stability issues associated with, and explains the evolution of market practices and current regulatory approaches relating to, re-hypothecation of client assets and collateral re-use. The report assesses among other things whether there is a case for harmonising regulatory approaches to re-hypothecation of client assets. It concludes that there is no immediate need to do so, but recommends authorities to monitor the related financial stability risks.

A second report on *Non-Cash Collateral Re-use: Measure and Metrics* follows up on a consultation in early-2016 and finalises the measure and metrics of non-cash collateral re-use in SFTs that authorities will monitor for financial stability purposes. The FSB has concluded that collateral reuse should be reported based on what they term “the approximate measure”. National regulators are expected to start reporting to the FSB in January 2020. In Europe, the SFTR proposals already anticipate the global reporting regime, including the relevant “approximate measure”.

Members raised some serious concerns with the increasing pressure from regulators to monitor (and restrict) collateral reuse, stressing that this only duplicates efforts to control leverage in the system through the leverage ratio, which is clearly the more appropriate tool for this purpose. If the purpose is to control non-bank leverage not covered by the LR, mandatory haircuts could be a more appropriate and targeted approach, rather than applying any re-use related measures across the board.

**5) European Safe Bonds**

Mr. Manna reported back from a recent event he attended on [European Safe Bonds](#) (ESBies), an initiative explored by the ESRB. The event was organised by a Think Tank on systemic risk created under the auspices of the LSE. ESBies are securitised EGBs and are seen as an interesting new idea to create a new safe financial instrument with characteristics akin to those of jointly issued sovereign debt, but with potentially lesser political problems than proposals for issuance of such joint sovereign debt.

While this is in principle an interesting idea Mr. Manna also pointed to some significant concerns: First, given that this is a securitised product, the investor base would be more limited. Furthermore, regulation can be an issue given the strict rules around securitised products; and finally, it potentially bifurcates liquidity and may increase volatility in the underlying EGBs in a crisis situation. Also, the instrument would need to be accepted in repo markets. While interesting, it may therefore be that the concept is not viable. Other members confirmed the complications with the proposals, also given the reluctance by central banks to accept any securitised product as collateral.

#### **6) ERCC Operations Group update**

Mr. Hamilton, Co-chair of the ERCC Operations Group, provided some further updates on the work of the Ops Group beyond SFTR. Following up on previous discussions in the Committee, the ERCC Ops Group held a workshop with the ICSDs, on 18 November, to further discuss intraday liquidity. The main objective was to better understand the key drivers for intraday liquidity exposures and the role of the sequencing of settlement in this context. The workshop was followed up by a formal letter to the Commission, raising awareness of the issue and requesting a cautious approach from regulators in relation to intraday credit risk exposure between the ICSDs, given that a rushed implementation of the relevant CSDR requirements may disrupt current infrastructure arrangements. The discussions will be followed up, in close coordination with the ICSDs. Other members stressed the important role of the ICSD infrastructure in this context and the need for them to focus on and improve their internal processes. It was suggested to invite the ICSDs to one of the next Committee meetings to provide a further update on their ongoing internal discussions.

Mr. Westphal briefly updated members on the work of the European Post Trade Forum (EPTF), which is approaching its final stages. The ERCC submitted two papers on potential new barriers in the post trade space. The first paper explains the discussions around intraday liquidity and a second paper that covers the ongoing work on collateral mobility, particularly under the ECB's auspices. Related to the latter, Mr. Hamilton informed members that the ECB has reformed the structure of its infrastructure related contact groups. A new group, the AMI SeCo, was created merging the old COGESI and the T2S Advisory Group. Mr. Hamilton will have a seat in the Group, representing the ERCC. The new Group will continue the important work started by COGESI in relation to collateral management harmonisation.

#### **7) Update on the ERC Guide to Best Practice and the Bank of England's Securities Lending, Repo and Money Markets Code**

Mr. Bojic updated the Committee on recent progress in relation to the review of the ERC Repo Guide. The review is now approaching its final stage. A final draft has been circulated to Committee members for fatal flaw comments. Following this last round of comments the new version will be finalised and published. The updated Guide will be presented at the planned press briefing on 14 February in London.

Mr. Bouillet provided a brief update on the Bank of England's Securities Lending, Repo and Money Markets Code. The latest draft of the Code was sent to market participants for a final round of comments by 27 January. A near final version is planned to be published in early March. In the meantime, a law firm has been asked to review the draft Guide from a legal perspective. The Guide will apply to all UK market participants (principals) and requires each firm at a senior level to sign an adherence form. Other members mentioned that a few questions remained open as



regards the exact scope of the Code. It also seems that more concerns with the Code were generally raised on the equity finance side. Finally, Mr. Hiscock also cautioned that it will be important to involve people familiar with the new Global FX Code to ensure that, where applicable, there is full consistency between the two Codes.

#### **8) Legal update**

Ms. Cleary provided a legal update. On the ISLA side there seems to be an increased appetite to create a standardised pledge structure for securities lending, supported by legal opinions. A Working Group has been created within ISLA to further look into the issue. Committee members are requested to provide feedback as to whether there already is any similar pledge-based activity in the repo market and whether there is similar demand for a standardised pledge structure in relation to repo. If that is the case, it may make sense to create a joint initiative with ISLA.

Ms. Cleary also informed members of a few additions to the legal opinions, in terms of counterparty and jurisdiction coverage. A note with more details will be circulated to members. Finally, members are also requested to ensure that their firms are appropriately represented in the legal working groups related to the GMRA buy-side annex as well as the pledge structure. A list of the current composition will be sent to members.

#### **9) Committee Election procedure and timing**

Mr. Westphal briefly updated members on the [2017 elections of the new ERCC Committee](#). The electronic vote is due to open on 26 January. Members will then have two weeks to cast their votes for their preferred candidates. Overall, 25 candidates have been nominated by ERCC member firms and will compete for the 19 places on the new Committee. In the context of the elections, three additional firms have been admitted in a written procedure as new ERCC member: Natixis AM, Clearstream Banking Luxembourg and BrokerTec (following the technical resignation of ICAP). Members also discussed one further application received from IHS Markit. The decision was postponed, as members were keen to first get more clarity on the general involvement of service providers in the ERCC and the applicable rules for admission to the ERCC.

#### **10) AOB and further dates**

- **26 January - 9 February:** ERCC Committee elections 2017 (electronic voting)
- **22 February (13:00 – 16:00 UK time):** First meeting of the new ERCC Committee, hosted by ICMA in London (23 College Hill, London EC4R 2RP)
- **20 March (13:00 – 16:00 CET):** ERCC AGM in Zurich, hosted by SIX
- **3 May:** ERCC Committee meeting in Luxembourg, hosted by EIB
- **20-22 June:** ISLA's 26th Annual Securities Finance and Collateral Management Conference in Berlin (ERCC Committee meeting in the margins – tbc)

In addition, an idea was raised for the ERCC to organise a symposium for academics in H2 2017. Members generally welcomed the idea which will be further considered.



The ERCC Chairman:

The ERCC Secretary:

Godfried De Vidts

Alexander Westphal