

## Inaugural Meeting of the Collateral Initiatives Coordination Forum

**Monday 30 January 2012**

Location: 23, College Hill, London, EC4R 2RP

Time: 10:00 – 12:00

Attending:

Godfried De Vidts (Chairman)

Katrina Dixon

Werner Frey (by phone)

Stephen Burton

Matthew Jones

Rory Cunningham

Frank Reiss

Jarkko Syyrila

Guy Sears

Catherine Brady

Hugh Gibson

Mike Johnstone

Julian Le Fanu

Joyce Martindale

Alex McDonald

Martin Scheck

René Karsenti

Paul Richards

David Hiscock (Secretary)

Richard Comotto

Representing:

ABI

AFME

AFME

AIMA

EACH

ECSDA

EFAMA

IMA

ISDA

ISLA

LMA

NAPF

NAPF

WMBA

ICMA

ICMA

ICMA

ICMA

ICMA

## **Minutes**

### **1. Introduction**

The Chairman opened the meeting and introduced the inaugural Collateral Initiatives Coordination Forum (CICF) meeting – a copy of the text of his opening remarks is appended hereto.

As requested by the Chairman, each of those present at the meeting then briefly introduced themselves – noting the association they represent and expressing their interest to participate in CICF. The Chairman noted the emphasis that buy-side participants placed on safety.

### **2. Meeting discussions**

The Chairman led off by providing some background from the 18 November meeting of the ECB's [contact group on euro securities infrastructures](#) (COGESI). The scope of the ECB's [Collateral Central Bank Management](#) (CCBM2) project is being reduced, with a new focus on harmonisation of collateral management procedures. As reported under point 7 of the 18 November [COGESI meeting summary](#), there are 6 specific collateral topics identified which could benefit from harmonisation.

The Chairman noted that regulatory authorities have already taken actions impacting collateral; and are considering further actions which will also do so. This includes the new regulations for liquidity buffers, which effectively drain high quality collateral securities from the market place. A similar effect also arises in consequence of central bank interventions in the securities market – the question has already been asked as to whether there is an acceptable way in which such securities could be recycled into the market.

Mr Frey recalled the October 2011 report of the [Expert Group on Market Infrastructures](#) (EGMI) and the European Commission's 24 October [conference in Brussels](#) to discuss the road ahead for the European post-trading landscape. Support was expressed for the notion of continuing work to remove the Giovannini barriers, but it was unclear exactly how to proceed.

A new initiative is now being taken to establish a small but influential post-trade board, to drive reforms that will improve the safety, efficiency and competitiveness of Europe's post-trading. This will involve representatives of the Commission, ECB, ESMA and the private sector. The board will drive the process, leveraging existing workstreams and creating new expert working groups when additional workstreams are required. CICF could potentially fit in this framework as a reference group for collateral questions. Concerned that prior efforts may have overly lead by consideration of equities / exchanges, the Chairman stressed that work must be suitably differentiated across assets classes (equities, fixed income, derivatives) and balanced across platforms (exchanges, OTC).

Some discussion ensued concerning some of the different ways in which parties are involved with collateral eg. giving and receiving under derivative CSA arrangements or providing high quality collateral through upgrade (collateral swap) transactions. There are a number of concerns about the risks in these activities, albeit that the benefits are also recognised. This highlights that there is a need to ensure adequate information is available and that applicable education is available to ensure correct levels of understanding.

The Chairman observed that whilst he expects CICF will promote the benefits of collateral it must clearly balance this with caution over potential risks. Taking steps to improve understanding may be done through publications, including targeted press efforts. It importantly includes educating public authorities, who are often lacking in experience. The Chairman recalled the publication "Collateral: Securities Lending, Repo, OTC Derivatives and the Future of Finance", by Danny Corrigan and Natasha de Terán, which is a very useful guide but sadly out of print at present. It was pointed out that the Securities Lending Guides produced and published in conjunction with the Bank of England's [Securities Lending and Repo Committee](#) (SLRC) offer a useful example which could be built upon.

The Chairman observed that promoting good market practice is another way to help achieve the desired transparency and safety of collateral transactions. For instance same day settlement and effective margining can mitigate many of the exposures which parties may otherwise face. It was noted that at the EU level one of the challenges is the existence of constraints in legal frameworks. The Chairman pointed out that the EU collateral directive already goes some way towards addressing this concern but acknowledged that there is more to be done. He stressed that CICF does need to think and act on an EU wide basis.

In further conversation it was noted that the cost of satisfying collateralisation requirements will be high. Whilst improving collateral market availability and efficiency in use may be ways in which to mitigate some of this cost, there needs to be adequate risk identification and management to ensure safety. The Chairman pointed out the importance of collateral reuse in order to improve liquidity. It was noted that this should not be at the expense of safety and acknowledged that achieving good liquidity is a higher priority than improving transparency.

Issues such as reuse and segregation need to be carefully and thoroughly explored. Projects on specific topics of this sort will need particular skills, with a consequent need to engage different groups of people on a topic specific basis. The Chairman acknowledged that some member expertise will be a necessary complement to direct trade association contributions. This is akin to the COGESI approach reviewed earlier, where 6 specialist workstreams are being established to feed into the overall effort being coordinated by COGESI.

The Chairman indicated that one clear role for CICF is to act as a channel for exchange of information. He suggested that CICF ought also to provide a platform for the identification of common views. Where this proves possible, such views would be useful and powerful inputs to official workstreams, such as that being led by David Rule on behalf of the FSB – which will produce proposals, by the end of 2012, for regulation of repos and securities lending. Such views might include suggested alternatives to official proposals.

The conversation turned to the official promotion of CCP clearing and the consequent risk concentration that arises within CCPs. It was noted that the EU's EMIR proposal should soon be agreed as a level 1 legislative text. Much more detailed new EU wide requirements will then be agreed upon through ESMA. In light of the problems which have been highlighted by the MF Global failure, it is likely this will include requiring that all clients be offered segregated accounts – thus drawing even more collateral into CCPs. The Chairman pointed out that despite the increased use of CCPs, they will only clear the standardised (and hence, broadly speaking, simpler) contracts, whilst much exposure will still have to be managed in the bilateral market.

Another forthcoming regulatory proposal is the EU CSD Regulation. The Chairman wondered if this could be a test case for the development of an agreed CICF position, leading to a CICF response paper. He proposed that appropriate efforts be made to channel requisite information through CICF and to discuss relevant views. One complicating factor may prove to be the different stages which CICF participants are at in terms of their own work and thinking on the topic of collateral.

It was noted that other proposals are also on their way. Again responses could be considered but it is also worth seeking opportunities to get ahead of the curve. If CICF could produce discussion papers agreed across the industry these should prove quite influential. Recent work which AFME has contributed heavily to on global legal identity identifiers was cited as an example of an industry consensus being used effectively to help shape an agreeable way forward. The Secretary highlighted that CICF was deliberately being launched as a very broad based group, creating the potential to identify concerns and views from right across the industry. The Secretary indicated that other associations, including EBF and AMAFI who had expressed an interest but been unable to attend on this occasion, might also contribute to CICF. Any specific suggestions of associations to be contacted, regarding their potential CICF involvement, should be put to the Secretary who will reach out accordingly.

Other examples of proactive efforts by individual associations were cited. The Chairman suggested that there is an opportunity for the different participants to help each other, with the CICF providing a vehicle to allow this to happen. It was agreed that this could be a good way to validate views within the industry and to avoid industry being seen to present conflicting views. It was suggested that CCP account segregation point (mentioned above) might be worked on as a test case for CICF collaboration in formulating an industry position paper. Mr Cunningham agreed that he would discuss this to see what EACH members think. Another possible proactive topic that was suggested was the impact on repo when QE reverses.

The Chairman mentioned efforts underway through the ICMA European Repo Council to broaden the available repo collateral to include credit claims; and that conceptually there could be many other assets which could serve a useful purpose as collateral. It was noted that a general concern when considering alternative forms of collateral is how easily their value can be established, including any adjustment needing to be taken into account for how easily the asset can be liquidated in case of default of the counterparty. This led to some brief reflection on the implications of the over encumbrance which is likely to arise if the monetisation of assets is pursued too far.

The Chairman commented on the need for a balance between secured and unsecured financing; and queried if rule changes might need to be considered to boost the relative attractiveness of unsecured.

It was agreed that CICF can certainly play a helpful role in information sharing and education. It was observed that the first of these involves a flow of information and is likely to be largely effected through e-mail exchanges amongst CICF participants. The second element involves a stock of information, more akin to a reference library. The Secretary indicated that ICMA will establish a CICF website page on the ICMA website. Over coming weeks this can be built up to include links to existing collateral reference materials, offering a point of access to such currently dispersed materials. Participants are invited to suggest links to the Secretary to facilitate this task.

It was suggested that it could be useful to develop a short paper / presentation covering collateral fundamentals. What is it; how does it work; what issues need to be considered; what proposals are under consideration; etc.

It was proposed that CICF should be mentioned to the SLRC at its 31 January meeting. Responsive to a question regarding whether there were similar bodies elsewhere who should be informed of CICF, the Chairman mention ACI Germany (in conjunction with the BaFin/Bundebank). The Bank of England's [Sterling Money Markets Liaison Group](#) (MMLG) was also mentioned. Vital interlocutors at the European level will include the ECB and the Commission, who the Chairman has already made aware of CICF's establishment.

### **3. Conclusion and next steps**

It was agreed that CICF has a role to develop in information sharing and education – the Secretary should coordinate the former and start to build up reference material links in support of the latter. A [CICF website page](#) should be hosted on the ICMA website. Thought should be given to the development of a short paper / presentation covering collateral fundamentals; and potentially to other guides (akin to the Securities Lending guides produced and published in conjunction with the SLRC).

It was agreed that CICF may have a role to play in developing common positions on official proposals and in producing proactive discussion papers. Good examples need to be agreed for the CICF to work on. The upcoming CSD Regulation might suit for the former and CCP segregated client accounts might be a good example for the latter. Participants (particularly Mr Cunningham in the latter case representing EACH) should offer further feedback ahead of discussion at the next CICF meeting.

Participants should inform the Secretary of other associations whose participation in CICF may be desirable.

The Chairman thanked everyone for having participated and asked the participants to feedback any further thoughts and suggestions through the Secretary. He suggested that CICF should regroup in early April, when there should be a further discussion on specific work for CICF to take forward – the exact date was left to be settled in the coming weeks. There being no further business, the Chairman then closed the meeting.

## Appendix

### Chairman's opening remarks:

A very warm welcome to all. The list of participants is witness to the need for this initiative. Increasingly the press has been full of stories about the potential lack of collateral due to the demands of the G20 to increase the use of CCPs, but also for bilateral collateralization.

As most of you may know, I have chaired the ICMA European Repo Council for over 10 years, and in that time the group representing the repo market in Europe has looked at the use of collateral, in particular the range of collateral used by the Eurosystem, but also beyond. Previously I was in charge of global liquidity and collateral management at Fortis (but left before their problems.....).

However, and I want to make this crystal clear, my briefing having received the request from ICMA to be the first chair of this group is not to look at the repo markets only. This should be an industry wide attempt to organize our thoughts around the many facets of collateral in order to be ready for regulatory interventions. Regulatory as to the central bank community, security market regulators, government etc. In this regard ICMA's request that I chair this group also reflects the significant experience I bring from my participation in many other forums which have had cause to consider collateral related issues.

One important regulatory element is the Basel 3/CRD IV work around the liquidity buffer. In the latest ERC repo survey we have seen indications that German collateral is being hoarded. Liquidity needs linked to the LCR are part of the issue, and as a result within the ERC's work to make sure liquidity needs can be fulfilled we have initiatives both to design LCR compliant collateral baskets and to allow easier basket trading of collateral through the use of triparty collateral management tools linking settlement through CCPs.

The range of collateral of interest to the repo community is as wide as one can imagine, so fixed income, equities, gold, ETFs (although synthetic ETFs may be a bridge too far at the moment), Emissions, bank loans (credit claims) on which I chair another meeting this afternoon, the list is endless....

The crisis pushed the debate much further. I have been involved in discussions with ISDA re the use of collateral (and re-use of collateral) for pension funds, where recommendations are that collateral given as default fund contributions/initial margin should not be open for re-use, whilst obviously for daily margin valuation it should be possible.

Whether in consequence of migration to CCPs or responsive to revised requirements applicable to bilateral OTC contracts, the wide range of OTC derivatives, but also commodities and other trading instruments will all be using additional collateral.

Having been actively involved (amongst others here in the room) in COGESI, CESAME 1 and 2, EGMI the lack of full understanding at the official level of the issues around collateral are clear

One helping hand has been Manmohan Singh from the IMF who rang the alarm bell a number of times re the lack of sufficient collateral

The sovereign crisis has obviously created other issues, and we have noticed a remarkable increase of fails in settlement of sovereign bonds which are partly due to the cracks in the post trade area (something highlighted in the ERC's white paper of July 2010, but not always been resolved due to commercial/political domestic unwillingness to change old habits)

The FSB is looking at the shadow banking industry. Some of us attended a meeting on December 1st where re-use, leverage, haircuts have been part of the issues discussed

On haircuts there is more work to be done. As far as I am concerned and for bilateral market use, the level of haircuts is a function of measuring risk of counterparties and as such, we as ERC believe it should not be mandated. In particular for the transmission of liquidity (cash) in the interbank market haircuts on sovereign bonds (of reasonable quality...) would make trading very difficult. So we may very well need more tailor made solutions.

Within the ERC framework we are discussing settlement interoperability between the ICSDs (and eventually CSDs) in order to make sure liquidity/collateral can freely flow independent of the location of the collateral. In that respect we are creating a common evaluation framework to allow transfer of collateral between the ICSDs, which will/can/should be different from each CCPs evaluation.

Last but not least, we are aware of official initiatives, COGESI, Commission, ESMA. Hopefully (and Werner may have more information on this) those 3 official bodies will work closely together.

Industry should ideally have one voice in this debate, and that is in my mind the mission for today. Can we map out the issues through sharing our views, come to appropriate actions/appropriate representations so we do not duplicate efforts. This is not a one man show, we need to make sure we share the knowledge but divide the task where it makes sense. We should be able to react with one voice towards regulatory policy actions which we hope will be useful, appropriate, flexible and forward looking around the use of collateral in the European but also the global context. Accordingly our initial aim has been to build a broad industry grouping, capable of taking as pan-European a perspective as possible and informed by views from right across the industry i.e. representing both buy-side and sell-side; considering elements of trading, clearing and settlement; and also covering not just ICMA's particular interests in repo and bond markets, but also equities, securitised products and derivatives.

So before moving to point 2 on the agenda it may be useful to go around the room, each introduce yourself and your association and share your views as to why you believe this group can be useful ie. why are you here and what you may bring to the table.