International
Capital
Market
Association

Fourth Meeting of the Collateral Initiatives Coordination Forum

Thursday 7 February 2013

Location: 2 Broadgate, London EC2M 7UR

Time: 10:00 – 11:30

Attending:	Representing:
Godfried De Vidts (Chairman)	
Werner Frey	AFME (dialling-in)
Stephen Burton	AFME
Soraya Belghazi	ECSDA (dialling-in)
David Hiscock (Secretary)	ICMA
Annika Wahlberg	ICMA
George Handjinicolaou	ISDA
Catherine Brady	ISDA
Kevin McNulty	ISLA
Hugh Gibson	ISLA
Mike Johnstone	LMA (dialling-in)
Alex McDonald	WMBA
Observers:	
Wesley Lund	AIMA (dialling-in)
Guy Sears	IMA (dialling-in)
Helen Roberts	NAPF (dialling-in)

Minutes

1. Introduction

Welcoming the participants, the Chairman opened the meeting by noting that the topic of collateral continues to attract a lot of attention, as for example in Ralph Atkins' 6 February FT article concerning fears of a collateral crunch. The Chairman next observed that Manmohan Singh, from the IMF, has been very busy on the topic of collateral and is in regular contact. The Chairman reported that the European Commission is aware of concerns regarding collateral but, for the time being, are very busy on a number of other priorities. The Chairman stressed that the need for the CICF is more evident than ever; and that, despite the reluctance of buy-side associations to fully engage, it is clear that the importance of the collateral topic is seen by many buy-side firms. The Chairman closed his initial comments by reporting that on 6 February he had met with the CFA Institute. They are interested to do a study relating to collateral and expressed particular concern about the impact on the buy-side of derivatives margining (collateralisation) requirements.

Mr Handjinicolaou stated that ISDA is focussed on the interaction of collateral with the real economy. Manmohan Singh has been putting forward the idea that that collateral financing plays a role which is effectively parallel to that of money. The various initiatives which are increasing the demand for segmented high quality collateral will lead to a continued withdrawal of collateral from circulation, which is equivalent to a decrease in the money supply and implies a significant quantitative tightening. In particular the proposed initial margin requirements for non-CPP cleared OTC derivatives imply a need for an amount in the range of $1 trillion – $10 trillion, depending on assumed modelling details – particularly including as to the level of netting which will be achieved. The Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commission's (IOSCO) Joint Working Group on Margining Requirements (the WGMR) has gathered information through a questionnaire and has performed an impact study based on actual bank portfolios. This looks just at the incremental requirement driven by the proposals for initial margining on non-CCP cleared derivatives and supports the aforementioned range, the upper value arising if standardised tables are used for the calculations and the lower end in case there is full use of modelling and netting. Whatever the outcome, this will be a big number, which is a problem as central banks continue their current efforts to inject increased liquidity into the economy. It seems that regulators are beginning to realise the importance of these relationships, which have moved collateral from being an afterthought to a position of central importance.

Mr McNulty stated that it would be good to develop greater clarity regarding what is driving the demand for collateral, with another example in the EU being the recent limitations imposed upon UCITS. The case needs to be well articulated as to why imposing too much collateral demand will prove bad for the real economy. Mr Handjinicolaou reported that there are some who express the view that too much collateral was one of the problems which lead to the crisis. It is important to realise that the cases where there were problems relate to the use of lower quality assets as collateral.

As an example of continuing official expressions of concern, the Chairman drew attention to the 1 February remarks of William C. Dudley, President and Chief Executive Officer, FRB NY at the New York Bankers Association's 2013 Annual Meeting & Economic Forum, The Waldorf Astoria, New York City: "Fixing Wholesale Funding to Build a More Stable Financial System".

Prompted to clarify his earlier observations on potential quantified impacts, Mr Handjinicolaou noted that the amounts are incremental requirements from proposed new higher risk management requirements for non-CCP cleared OTC derivatives. In terms of the work of Manmohan Singh Mr Handjinicolaou drew attention to the 17 January presentation given at Clearstream's 17th Global Securities Financing Summit in Luxembourg, "The Changing Collateral Space" (a related subsequent IMF staff working paper is also available via the CICF's resources page), slide #21 of which draws a view of collateral inclusive of estimated amounts. It is acknowledged that the potential pool of collateral is large but equally it is well known that much of this is not available for use. What needs to be better understood is how much collateral is in fact circulating. The Chairman mentioned that on 18 October 2012 he had given a presentation, entitled "Operational impact of regulation on collateral – will demand outstrip supply?", at a meeting of the ECB's operations managers' contact group (OMCG) (a copy of which is being circulated to CICF participants with these minutes). He noted that improved transparency regarding collateral would be a good thing. One seeming paradox is that central banks indicate that they see that banks have collateral which is not being utilised, yet nevertheless it was evident that banks found their access to liquidity constrained during the crisis.

Mr Handjinicolaou highlighted that the previously mentioned numbers for non-CCP cleared derivative margin requirements would escalate in a time of crisis, which could in itself then serve to exacerbate problems. The Chairman concluded by noting that it would be good to develop a clearer estimate of the various collateral demands and Mr Handjinicolaou suggested that this might be something that Manmohan Singh could help to provide.

2. CICF publications

The Chairman recalled the CICF's 7 November 2012 publication of the Collateral Fluidity White Paper and the Collateral Fundamentals. He noted that he has received good feedback on the White Paper and has been encouraged to ensure that the CICF keep up its good work.

3. Regulatory developments impacting collateral

(i) Mr Frey provided an update on the European Post Trade Group (EPTG); reporting that the EPTG has met twice since the CICF's last meeting, firstly in London on 19 October, chaired by industry (Bank of New York Mellon), and secondly in Paris on 4 February, chaired by ESMA. Subsequently the EPTG's website (which is being hosted by the European Commission) has gone live. This provides access to the EPTG's terms of reference and list of members; and will be kept updated with EPTG meeting agendas and subsequent minutes.

Mr Frey noted that at the 4 February meeting Simonetta Rosati, from the ECB, had delivered a presentation on collateral, which portrayed a picture with respect to derivatives margins similar to that already discussed in this CICF meeting. At the same EPTG meeting, ESMA acknowledged the need to get at the facts by systematically assessing the supply of and the demand for collateral. Mr Frey also flagged that the CSDs are acting as lead sponsors for work on the harmonization of settlement deadlines outside T2S (i.e. the removal of Giovannini barrier 7).

The Chairman queried if the CICF would be invited to participate in the EPTG; and Mr Frey replied that this was not currently envisioned, the EPTG being focussed on pro-actively dealing with the 9 priority items agreed for inclusion on its action list.

(ii) The Chairman briefly commented on the on-going COGESI work regarding collateral harmonisation. One of the workstreams has drafted a list covering the collateral eligibility requirements of the major central banks. This draft will be discussed at an ad-hoc COGESI meeting scheduled for 27 February, in Frankfurt, and will be made public once the work is finalised. Another of the workstreams has drafted a paper on cut-off times. A problem in this area is that the view presented by CSDs does not present the effective cut-off times actually faced by market participants, particularly when transacting on a cross-border basis and working through networks of local agents who impose their own earlier cut-offs. The ERC has asked Richard Comotto to investigate this and will feed its findings into the debate.

The fact is that barriers persist and need to be addressed, including as to open access which is part of the challenge being faced by the third COGESI collateral workstream. The Chairman stated his hope that this COGESI work will precipitate actions and pointed out the encouraging speech delivered on 16 January by Benoît Cœuré, Member of the Executive Board of the ECB, at Clearstream's 17th Global Securities Financing Summit in Luxembourg. Prompted by a question about the interaction with MiFID, the Chairman noted that there are elements of both MiFID and EMIR which relate to the debate about access; and also drew attention to the CPSS-IOSCO principles for financial market infrastructures (FMIs) – in which principle 18 clearly states that FMIs should allow fair and open access, subject only to reasonable risk related restrictions. Given the push to increase the usage of CCPs, this question of access is now more important than ever.

On a separate note, Mr Frey observed that the ECB has helpfully reaffirmed that it will remove its collateral repatriation requirement by 2014; and the Chairman added that it is also useful to have the ECB going ahead with the adoption of triparty repo.

(iii) Concerning the FSB's on-going work in relation to shadow banking, the Chairman reported that, in his capacity as the Chair of ICMA's European Repo Council (ERC), he had attended a meeting in New York, hosted by the FRB, on 29 January (which was the reason that this CICF meeting had to be rescheduled from that date). This meeting brought together the FSB's workstream on repos and securities lending with market participants, to add input to the formal written submissions made in respect of the FSB's consultation on draft proposals (which formally closed on 14 January). The 29 January discussions were in three parts, firstly involving participants speaking (1) for the repo market; then (2) for the securities lending market; and finally, in a separate session after lunch, (3) for prime broking.

Whilst not formally presented, the ICMA ERC had summarised its views on a few slides (a copy of which is being circulated to CICF participants with these minutes) in preparation for the 29 January meeting. Mandatory minimum haircut proposals are a topic of particular concern. Especially in the case of interbank repos this would introduce a cost with no aggregate benefit to the system as a whole, despite the fact that the banks involved are already subject to significant other prudential regulations. The Chairman went on to report that further discussions have taken place in Zurich during the previous week, which encouragingly seem to have focussed on risk management and the need for good margining procedures. Mr McNulty agreed with the concern expressed about mandatory minimum haircuts, which, if set at too high a level, could effectively kill the securities lending market. The Chairman observed that with high quality collateral and strong margining processes, to keep collateral values current, there should be relatively little risk left to be covered by any haircuts. Mr McNulty commented that there are structural issues to be considered and that there are some related debates about possible exemptions. What could be helpful is some more quantified assessment of how haircuts have actually behaved over time. The Chairman highlighted that an ICMA ERC paper, written by Richard Comotto, was published in February 2012, which showed that changes in haircuts were relatively muted except in the case of certain specific cases involving structured securities collateral.

Enhanced transparency is another element of the FSB's draft proposals and discussions regarding how to most effectively build on what exists have already commenced. It is being stressed that there is a parallel need to collect strong market intelligence, without which it will not be possible to properly interpret what is being seen in raw data. Mr Handjinicolaou observed that the topic of trade repositories (TRs) has been a major item on the OTC derivatives market's agenda for the past several years. Notwithstanding that data is being fed to derivatives' TRs, it is evident that the necessary tolls and knowledge to make use of this data have not yet been sufficiently developed. There is also a problem with the proliferation of TRs, which adds the incremental complication of first having to consolidate data before it can be used. Nevertheless the advent of TRs has removed the argument that there is a lack of transparency and it will be possible to develop useful metrics based on the data. The Chairman stated that the ICMA ERC does endorse the idea of a repo TR, but sees the need for further work on defining what is really needed. It is not obvious that it would be helpful to get huge volumes of data about overnight repos, which will already have matured before there is time to process the data and do anything with it. Mr McNulty agreed that an appropriate way needs to be found to meet the legitimate needs and concerns of officials, but part of the problem is that the FSB is itself a diverse group and there are mixed views as to what is being sought and why. The Chairman stated that discussions with the FSB are on-going and recalled that the FSB has stated its intention to publish finalised proposals in September 2013.

(iv) Considering the on-going work of BCBS/ISOCO on margins for non-CCP cleared OTC derivatives, Mr Handjinicolaou pointed out that the WGMR's follow up report has now been expected for some time; but it seems continued disagreements mean that it remains delayed for now. The treatment of FX products is also a point of debate. The US has announced its intention to exempt them, whilst many elsewhere feel that FX should be in scope – a possible compromise could see variation margin applied but an exemption from initial margin.

Mr Handjinicolaou went on to explain that a second consultation is expected to deal with some specific issues, thought to include rehypothecation and possible provisions for extended phasing-in; but for now there is only speculation and no official word.

(v) Picking up on other matters, the Chairman asserted that any imposition of FTT on repo would be a huge impediment. This is not solved by the suggestion of an exemption for central bank repos, which would simply imply that central banks would become locked into satisfying everyone's repo financing needs. Mr McNulty echoed these concerns, noting that adoption of an FTT as mooted would kill securities lending; and pointed out that the existing French and Italian implementations of FTT have explicitly not applied the tax to securities financing transactions.

Mr McNulty flagged the fact that the European Commission is working on EU securities law legislation proposals, which are expected to include something on rehypothecation – potentially leading to some form of restriction on the re-use of securities. Discussions then also touched on concerns about (a) the on-going MiFID proposals, particularly as to how the intermediation role of matched principal brokers may be impacted (a new AFME report, highlighting investor concerns over the proposed MiFID fixed income transparency regime, was also mentioned); (b) the EU short-selling regulation, which has increased demands on collateral by imposing strict borrowing requirements to ensure that sales are covered; and (c) ESMA's 4 December 2012 guidelines on repo arrangements for UCITS funds, which impose constraints to ensure that UCITS are able to recall assets at any time.

4. CICF collateral events

The Chairman reported that he had met the previous day with the CFA Institute who have expressed interest in the CICF's work. The CFA institute is thinking of conducting its own collateral study, which is to be encouraged; and would be interested to explore opportunities to co-sponsor an event. Firstly however the CICF needs to decide if there is something valuable which could be achieved through organising an event, requiring consideration of questions such as "what message would the CICF seek to convey?" and "when could this best be done?".

The Chairman mentioned that the ICMA ERC is currently organising an academic event of its own, to be staged on 11 June 2013, where it is intended that certain apparent misconceptions about repos will be highlighted. This event is being organised with Mr Comotto; and relates back to his earlier mentioned 2012 work on shadow banking and repos. The Chairman went on to note that other pertinent events in the first half of 2013 include Euroclear's Collateral Conference, in Paris on 11 – 12 March; the joint EU Commission and ECB conference on "Post-trade harmonisation and financial integration in Europe", in Frankfurt on 19 March; and the FRB of Chicago's public policy symposium on OTC derivatives clearing, on 12 April. Mr McNulty highlighted that ISLA's annual conference is taking place in Prague, from 18 – 20 June; and that the planned program for this event includes a specific session on collateral; and it was noted that some banks have their own individual events. Given all of this already organised activity over the coming months, the Chairman suggested that further thought about a possible CICF collateral event should be in context of something for the latter part of the year.

CASS business school was mentioned as another possible party interested to collaborate on staging events, which could have the added benefit of providing a clearer sense of academic independence. It was suggested that Manmohan Singh's collateral work could be something to focus on, a key question being what quantification can be placed on the questions of collateral supply and demand; and how can these amounts be related to their economic impact. It was noted that there is an important linkage to be made with the efficient operation of payments systems and that the on-going internationally coordinated work of the Committee on Payment and Settlement Systems (CPSS) is therefore also of relevance. The Chairman commented that he has long thought that ideally the world's central banks should establish a system allowing that cash can be obtained anywhere in the world against good delivery of collateral, whether in that same place or anywhere else in the world.

Ms Wahlberg observed that ICMA is involved in discussions on the somewhat collateral related topic of encumbrance. ICMA's buy-side Asset Management and Investors Council (AMIC) is involved in these discussions and also has topics such as risk management and valuation on its 2013 work programme. One possibly interesting thing for the AMIC would be a presentation by the CICF regarding collateral. The Chairman noted this and acknowledged that, as repo (along with securities lending) sits at the heart of the management of collateral, this might also be something which could be suitably taken up by ICMA's ERC.

Considering the idea of any possible CICF involvement in training, the Chairman expressed the view that it would be best for the time being to avoid taking on any such initiative; rather leaving training in the hands of existing commercial vendors.

5. Any other business

Some further general conversation ensued about how the supply of and the demand for collateral might be better understood. On the supply side this includes the tricky question of identifying how much collateral is really available, as opposed to the much larger numbers for total potential collateral; and consideration of how the gap between these amounts might be beneficially decreased (e.g. through increased collateral transformation). Beyond coming up with some quantification of the different major elements, there is a need to consider how such information can most usefully be conveyed. Some form of map might be possible to conceive, or it may be that a risk dashboard could be evolved – using traffic light type indicators to flag where it is that collateral fluidity/availability is being imperilled; and why. The Chairman called on participants to further consider such general ideas, with the overall objective of finding further ways to best raise the awareness of collateral related issues.

There being no further business, the Chairman then closed the meeting.

Conclusion and next steps

It was agreed that informal discussions with Manmohan Singh should be continued, particularly with a view to obtaining an improved understanding of the quantification of evolving collateral requirements – which are already quite a feature of the interesting work he is performing.

CICF participants should keep the Secretary informed of any feedback they receive in relation to the CICF's published papers; and in case they have suggestions for further publications which the CICF should consider preparing.

CICF participants should continue to provide the Secretary with relevant materials to enrich the CICF website pages.

CICF participants were tasked to give further thought to the concept of staging a CICF sponsored collateral conference in the latter part of 2013.

CICF participants are asked to further consider ways to best raise the awareness of collateral related issues, including through continued promotion of the CICF.

A further CICF meeting will be organised, most likely towards the end of the first half of 2013.