ICMA EUROPEAN REPO and COLLATERAL COUNCIL

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel
Switzerland

18 April 2016

Dear Sirs,

Response submission from the ICMA European Repo and Collateral Council

Re: FSB Consultative Report "Possible Measures of Non-Cash Collateral Re-Use"

Introduction:

On behalf of the European Repo and Collateral Council ("ERCC") of the International Capital Market Association ("ICMA")[1], the purpose of this letter is to provide feedback in response to the Financial Stability Board's ("FSB's") 23 February 2016 consultative report documents regarding "Possible Measures of Non-Cash Collateral Re-Use". The ICMA ERCC notes that the FSB has invited comments on this consultative report, which represents a further step in the FSB's package of measures designed to transform shadow banking into resilient market-based finance; and that this consultation is intended to contribute to the derivation of a meaningful measure(s) of collateral re-use to be used to evaluate global trends and to assess risks to financial stability.

Commentary:

The ICMA ERCC is concerned about the persistent suggestion that procedures need to be developed to allow the tracking of collateral in securities financing transactions ("SFTs"). This concern stems first and foremost from the fact that, given the fungibility of securities from within a single securities' issuance, such tracking is simply not feasible; but, furthermore, it is unclear why attempting to track re-use is really necessary and what benefits such an endeavour would bring. In addition, the ICMA ERCC sees that collateral fluidity (the ease with which collateral can flow around financial markets) is essential to the effective functioning of financial markets and in order to allow measures intended to deliver financial stability to operate effectively; with recent mandatory clearing requirements expected to increase the use of collateral even further, across both sell and buy side participants, and whether trading derivatives/equities on exchange or OTC. Achieving an adequate degree of collateral fluidity depends upon some element of collateral re-use to boost collateral velocity (a measure of the rate of collateral flow), so great care needs to be taken not to act in ways which could in fact unduly hamper collateral re-use and consequent fluidity. Accordingly, before going on to address the specific questions posed by the FSB in this consultative report, these overarching concern of the ICMA ERCC are further articulated in the following paragraphs of this consultative response submission.

[1] Background to the ICMA ERCC is provided in the Appendix to this response.

A. Comments regarding the tracking of collateral re-use in SFT markets

The infeasibility of tracking collateral

Just like cash, collateral securities forming part of the same issuance of securities (i.e. having the same ISIN) are fungible; and consequently indistinguishable amongst themselves (in fact with dematerialised collateral securities the infeasibility of tracking individual securities is even more complete than with cash, as bank notes each carry an individual serial number whilst there is no such distinguishing feature in respect of any single dematerialised collateral security).

Large financial entities will have multiple sources and uses of securities, including from investment, securities market making and trading, asset and liability management, securities financing transactions and margining (e.g. initial and variation margins). As a result of all these sources and uses securities will be flowing in and out, with multiple transactions in any given line of securities (i.e. ISIN) occurring on a daily basis. Whilst it will be the case that the records of transactions ensure that the aggregate outstanding amount of securities of any given ISIN is known at all times, the indistinguishable nature of the securities under that ISIN will mean that it is simply infeasible to say which have or have not been re-used in the performance of the ongoing stream of transactions.

Tri-party repo is a transaction for which post-trade processing – collateral selection, payment and settlement, custody and management during the life of the transaction – is outsourced by the parties to a third-party agent. Tri-party agents are custodian banks; and, in Europe, the principal tri-party agents are Clearstream Luxembourg, Euroclear, Bank of New York Mellon, JP Morgan and SIS. In the case of tri-party transactions the notion of tracking collateral is even less feasible, with control of collateral movements having been ceded to the tri-party agent, so that the outsourcing party is kept informed of the position but is not directly involved in the specific selection of particular securities being used as collateral at any particular point in time. One of the attractions of such arrangements is that the collateral is dynamically managed by the tri-party agent, in order to optimise collateral utilisation, but this can give rise to the situation in which the same line of collateral is moving in and out of utilisation multiple times in a single day.

Even in case allocation rules were to be devised, such as to say that the various different types of transaction are presumed to utilise securities from an aggregate holding on a first-in-first-out basis, there would still be no way of being able to consistently keep track of whether incoming securities of a particular ISIN were returns of securities previously delivered out or rather the receipt of previously unutilised securities of that ISIN.

The tracking of collateral does not seem necessary

One widely discussed point of concern which appears to colour thinking regarding the need to track collateral is a perceived need to keep track of where other peoples' assets have got to. This has led some to call for re-use to be monitored, but in the context of the European repo market the term re-use is itself a misnomer. In a repo effected using the EU's legal form of a title transfer financial collateral arrangement ("TTCA" – as occurs in repos under ICMA's Global Master Repurchase Agreement ("GMRA")), the buyer becomes the owner of the collateral at the start of the transaction and can dispose of the collateral when and as wished. The buyer's right of "re-use" is not a right granted by the seller, but is rather an inherent right arising from property ownership. In other words, it is a right of "use", as would apply to any other fully owned property and not really a matter of re-use. The closing leg of a GMRA repo is a forward dated contract for an offsetting exchange of equivalent (not the identical) assets.

This is very different from the legally distinct case of re-hypothecation (or re-pledging), which is widely used by prime brokers involved in the collateralisation of derivatives transactions with hedge funds. In a pledge, title to collateral remains with the collateral-giver. If the collateral-giver grants a right of re-hypothecation to the collateral-taker, the collateral-giver retains the ownership but only until the collateral-taker exercises his right. When the right of re-hypothecation is exercised, the collateral-giver loses his title to the collateral, which is transferred to the third party to whom the collateral has been re-hypothecated. Instead, the collateral-giver is then given a contractual right to the return of fungible collateral, but this is unsecured (although the collateral-giver is likely to have received funding in return for giving the right of re-hypothecation to the collateral-taker and, in the event of the collateral-taker's insolvency, the collateral-giver typically has a contractual right of set-off of all mutual obligations against the collateral-taker). It is this activity of re-hypothecation which, quite rightly, is the subject of the FSB's recommendation #7, which calls for regulations governing re-hypothecation of client assets in order to ensure that there is appropriate transparency and control over this particular activity[2].

A second point of concern which appears to lead to the belief in a need to keep track of collateral involves the risk of default triggering interconnected collateral liquidation risks through a chain of re-use. This, however, is not the case when considering TTCA repos, as a default only gives rise to a liquidation requirement on the part of the directly impacted party; whilst all other contracts throughout a chain of re-use remain fully valid and enforceable. Hence there is no need to track collateral back through the chain to see where it came from – since the use of TTCA as the basis for repo transactions gives rise to a series of discrete links between parties, rather than forming a single inter-linked chain. And the scale of the liquidation which needs to take place upon a default is constrained, since it is a function of the amount of directly impacted contracts and not a function of the length of theoretical collateral chains spread through the market. For all this to work optimally it is of course important that the party faced with a default has the ability to act clearly and decisively to liquidate his collateral and close out his risk, which is one reason why robust legal agreements need to be in place.

Regulators, however, already require repos to be documented under robust written legal agreements like the GMRA, supported by regularly updated legal opinions, as a condition of recognising the reduction of credit risk by collateral in the calculation of regulatory capital requirements. Accordingly, the ICMA has developed and improved the GMRA over many years and, to ensure that the GMRA remains effective, the ICMA commissions legal opinions every year on the enforceability of the whole agreement, its transfer of title provisions and its netting in insolvency mechanism; in over 60 jurisdictions for transactions with banks and other companies, and, in many countries, various types of non-bank financial institutions. The GMRA includes detailed provisions to govern what happens if a party fails to deliver collateral in a repo, including under a range of default scenarios. The robustness of these arrangements has been put to the test on a number of occasions over the years and the GMRA has proven itself to be fit for purpose – given which it appears reasonable to conclude that default risk associated with GMRA repos is not in itself a financial stability concern.

And a third point of concern related to the need to keep track of re-use is the creation of excessive leverage. Some have theorised that it could be possible for someone to buy a security using their own funds and then repo out that security to raise more funds, which funds could then be used to buy another security, which could be repoed out for yet more funds, and so on, ad infinitum. However, in practice, this infinite multiplier would come up against the credit limits imposed by all banks on their counterparties and regulatory constraints.

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[2] FSB Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, 29 August 2013 (http://www.financialstabilityboard.org/2013/08/r_130829b/).

Indeed, the appropriate way to control the potential for excessive leverage is directly, rather than trying to consider whether measuring re-use can assist in doing so. This is just what the adoption of the Basel leverage ratio requirement (complimented by the supplementary leverage ratio and additional buffers for G-SIFIs/G-SIBs) is designed to do. Practical constraints such as the impact of haircuts or initial margins, where the purchase price is set below the market value of collateral, are also of relevance in this context; and their recommended use has already been adopted by the FSB in order to control the potential for SFTs to give rise to excessive leverage amongst non-banks[3]. And, furthermore, it is not just leverage control that has been put in place but rather a whole package of measures, including other stricter capital requirements and liquidity requirements, the aggregate effect of which is to impose constraints not only on the taking of leverage but also on procyclicality, such that it is far from clear that there also needs to be an intense focus on collateral re-use in order to try and mitigate these same risks.

Transparency of SFTs is being put in place

As called for by the FSB in August 2013 (see footnote #2), the EU is pressing ahead with putting in place a detailed regime for the transparency of SFTs, through the EU SFT Regulation. This will mean that authorities have the information about which SFTs are taking place and can monitor where any risk concentrations are building up in the market. Wherever collateral is being re-used in a subsequent SFT this will already form part of the reported information, as that subsequent SFT will itself fall to be reported. This should provide authorities with more than adequate information. As such, the ICMA ERCC considers that concerns over interconnectedness and potential contagion at a systemic level should be monitored based on periodic reporting of positions between the largest global banks, broken down by types of collateral. The need to track individual pieces of collateral through the system does not arise.

B. The importance of collateral fluidity

Repo and collateral markets – the heart of the financial market system

The ICMA ERCC wishes to highlight that repo plays a vital role within the financial system. It underpins the functioning of secondary and primary capital markets, where corporate and government borrowers raise money to finance their long-term needs. The cost of borrowing in the capital markets will be increased in case there is not a well-functioning repo market. Repo is also the key component of the shorter-term money markets, which provide an essential mechanism to allow for the efficient management of short-term cash and collateral requirements. Since repo provides a secured means of financing in this market it is the instrument of choice, with market participants and public authorities keen to avoid the proliferation of unsecured counterparty exposures. In case the repo market is unable to fulfil this role, commercial banks would have no choice other than to conduct all their liquidity management through central banks.

The ICMA ERCC also observes that collateral now plays a key role in financial markets, in no small part as a result of official policy interventions designed to mitigate the risks of financial market activities. For these measures to work as intended, it is essential that there is sufficient collateral fluidity – such that the right amount, of the right type, of collateral can be available whenever and wherever needed. This needs a good infrastructure for the movement of collateral, but also a robust repo market, since the repo market provides the principal mechanism for the transfer of collateral.

[3] FSB Regulatory Framework for Haircuts on Non-Centrally Cleared Securities Financing Transactions, 12 November 2015 (http://www.fsb.org/2015/11/regulatory-framework-for-haircuts-on-non-centrally-cleared-securities-financing-transactions-2/).

The essential need for collateral fluidity

Whilst numerous studies have attempted to estimate whether there is an adequate supply of collateral to meet these rising demands or whether there might be a shortfall, inevitably nobody actually has the exact answer. Yet with the supply of safe assets dwindling at the same time as demand for them is rising, it is plainly essential that high-quality collateral be managed as a scarce resource. The ICMA ERCC considers that the aggregate amount of collateral is likely to prove large enough to meet the demands, but sees the risk of suffering from more localised demand-supply imbalances. These will arise in case it is not possible to ensure that the right amount of the right type of collateral is available at the right time, in the right place to meet applicable requirements.

Given this, the ICMA ERCC has already done much over the last couple of years to emphasise the importance of collateral fluidity, which allows collateral to move around the system to meet varying demand requirements across the financial markets landscape. Concretely, at the beginning of 2012, ICMA convened the Collateral Initiatives Coordination Forum ("CICF"), which led to the production of the CICF's *Collateral Fluidity White Paper*[4], which was published on 7 November 2012. A further ICMA ERCC paper, *Collateral is the New Cash: The Systemic Risks of Inhibiting Collateral Fluidity*[5], was published on 3 April 2014. This describes the increasing importance of collateral and calls for regulators to consider the impact of financial regulation on the movement of collateral, highlighting the potential risks of inhibiting collateral fluidity (just as cash is freely re-usable, without concerns being expressed over the money multiplier/velocity of cash, so should collateral fluidity be). The paper explains why it is that achieving an adequate degree of collateral fluidity requires the simultaneous existence of robust and efficient settlements infrastructure (the "plumbing"), as well as bank funding desks that are able to source, price, manage, and mobilise collateral (the collateral "pump").

Yet in the European markets both these elements evidence significant need for improvement. Notwithstanding the efforts made over many years, currently most visible in the process of transition to the use of T2S by many of the EU's CSDs, the European market settlements infrastructure remains subject to many inefficiencies associated with its historic evolution in individual EU Member States. The ICMA ERCC is closely involved in work to address this, albeit that the European Commission has shockingly failed to fully involve the ERCC in its latest infrastructure review effort, being conducted by the newly formulated European Post-Trade Forum ("EPTF"). At the same time, the ICMA ERCC's November 2015 study into the state of the repo market[6] records growing concern that the cumulative impact of various prudential and market regulations, along with extraordinary monetary policy, could be affecting the ability of the European repo market to function efficiently and effectively. Uncoordinated measures by public authorities are radically altering the short term secured financing market, degrading the performance of the pump, which may even compromise the success of certain regulatory measures, such as the margining of derivatives, which depend on the fluidity and availability of collateral.

The important role of collateral re-use

Given the competing demands that exist for the use of collateral assets, the management of collateral needs to encompass the deployment of optimisation techniques. These aim to ensure that the available collateral is utilised as effectively and efficiently as possible. This will be best achieved in

[4] Collateral Fluidity White Paper, 7 November 2012 (http://www.icmagroup.org/assets/documents/Regulatory/CICF/Collateral-Fluidity-WP-7Nov2012.pdf).

[5] Collateral is the New Cash: The Systemic Risks of Inhibiting Collateral Fluidity, 3 April 2014 (http://www.icmagroup.org/assets/documents/Regulatory/Repo/COLLATERAL-IS-THE-NEW-CASH-THE-SYSTEMIC-RISKS-OF-INHIBITING---4-April-2014.pdf).

[6] Perspectives from the eye of the storm: The current state and future evolution of the European repo market, November 2015 (http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/icma-european-repo-market-reports-and-white-papers/The-current-state-and-future-evolution-of-the-European-repo-market/).

case minimum acceptable collateral requirements are clearly stated and, wherever appropriate, harmonised, taking due account of the different classes of potential collateral assets. At the same time, although collateral is a good mitigating tool to reduce counterparty risk, there ought also to be focus on how to reduce the risk in the system. Netting through fixed income CCPs is such a measure. Risk reduction tools, like compression in the OTC derivatives markets, are another. This calls for firms to fully appreciate their sources and uses of collateral and to then identify how best to manage these. This is a multi-dimensional challenge of ever increasing complexity, in an increasingly regulated financial market environment; and must be faced against a backdrop of continued exceptional monetary policies, including central banks purchasing and holding securities, and market volatility, in ever less liquid markets. One essential element in the efficient management of collateral is to understand which collateral can be re-used and to be able to utilise this flexibility in order to make best use of available assets and sustain an appropriate level of collateral fluidity.

As already outlined above, the use of TTCA in the European repo market makes the possibility of re-use (as distinct from the special case of re-hypothecation) the normal state of affairs, in a legally robust manner. This is a valuable starting point for the market, which can help facilitate collateral fluidity. Yet in spite of this structural element supporting re-use, there are already a number of other ways in which collateral re-use is being constrained. Examples include the specific provisions of Article 15 in the new EU SFT Regulation[7], but also more importantly situations such as where payment systems (eg CREST) require the posting of collateral, which constrains re-use to one time; and "Seg-IA" (under CFTC rules), which means that any bilateral independent amount exposures above $50mm must be deposited with a third-party segregated account – the effect of which is that any such seg-IA margin can only be re-used once. Furthermore, the leverage ratio serves to limit re-use behaviour, since posting more collateral than is already owned or received would increase balance sheet as more collateral then needs to be received – which is a costly thing to do. And as a practical matter market volatility also puts a limit on re-use, since volatility increases trigger the need to post more margin, which, will either mean more collateral posted under seg-IA, and/or more collateral that needs to be received (and so more balance sheet usage).

So collateral re-use is a good thing, in that it can assist in achieving necessary collateral fluidity, yet multiple reasons already exist as to why it is constrained. In case measuring collateral re-use, rather than continuing to focus on the more specific concerns associated with re-hypothecation, should lead to any incremental limitations on re-use, the implications for collateral fluidity would be negative. It is important to realise that, even without explicitly imposing new constraints on re-use, such incremental limitations could easily arise in case the practical effect of demanding re-use data is to force market participants to segregate collateral in order to be able to track its subsequent usage; which would be very damaging for collateral market liquidity. In recent years, IMF staff papers have explored the topic of collateral velocity and helped to illustrate how important it is that restrictions do not impose an undue braking effect on this[8]. And it should be recognised that banking authorities already carefully monitor asset encumbrance as part of their oversight of banks' financial condition and flexibility.

Given the role of repo and collateral markets at the heart of the financial system, any inessential constraint of collateral re-use would have negative implications for the smooth functioning of broader financial markets – which would, in turn, lead to increased costs and risk for market participants, including those corporates and governments borrowing to finance their economic needs. At the same time there would also be a detrimental impact on the effectiveness of many of the measures put in place to improve the stability of the financial system, dependent as they are on high quality collateral.

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[7] Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse (http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015R2365).

[8] See in particular "*Velocity of Pledged Collateral: Analysis and Implications*", Singh, Manmohan, November 2011 (http://www.imf.org/external/pubs/ft/wp/2011/wp11256.pdf).

C. Illustrative example of overall concerns with the measures and metrics

The ICMA ERCC is concerned that the different possible re-use measures can give rise to widely differing results, leading to similar differences in the metrics which are then to be derived. This suggests the need for significant caution before adopting a measure which could lead to a spurious level of apparent precision in relation to re-use, which is in fact not something which is readily, if at all, suited to being measured.

To illustrate this, consider a small closed market, with 5 participants and 1,000 of the only collateral ("the bond"). In this market:

A owns 500 bonds and has received 100 bonds posted by D.

A posts 400 bonds to B, who already owns 300 bonds.

B posts 300 bonds to C, and already owns 200 bonds.

C posts 200 bonds to D, who already owns 100 bonds.

D posts 100 bonds to E, and 100 bonds to A (see above).

E is short 100 bonds.

These market participant holdings and transactions, along with associated re-use measures, can be summarised as follows:

	Own	Receive	Post	Re-use (IA)	Re-use (A)	Re-use rate (IA)	Re-use rate (A)	Own less posted
A	500	100	400	100	67	1.00	0.67	100
B	300	400	300	300	171	0.75	0.43	0
C	200	300	200	200	120	0.67	0.40	0
D	100	200	200	200	133	1.00	0.67	-100
E	-100	100	0	0	0	0.00	0.00	-100
Total	1,000	1,100	1,100	800	491			-100

In this table Based on the calculations consider the FSB's proposed "indirect approximation method" (IA), and the FSB's proposed "approximate measure" (A). We have not given a result for the FSB's proposed "exact measure", as these are fungible assets and it is therefore not even possible to say whether the various amounts being posted by the different entities have come from their own original portfolios or from the collateral they have received.

It can be seen that the IA approach indicates a significant level of re-use (800), whilst the A approach gives a 38.6% smaller, but still not insignificant, re-use figure (491). Yet it can clearly be quite reasonably argued that only 100 bonds have been re-used (by D), since the rest of the posted amounts are covered by the originally owned portfolios of bonds (ie. these transactions may simply be "use" of own assets).

Considering the associated proposed FSB metrics:

	(IA)	(A)
Total re-use	800	491
Re-use rate	0.73	0.45
Re-use reliance	0.73	0.45
Length	3.67	1.81
Multiplier	1.80	1.49

The natural impact on the metrics of the higher re-use measured under IA can readily be seen. Yet again, if the actual amount of re-use is only 100, which it can fairly be considered is the case, then all these metrics are significantly overstated.

D. Responses to specific questions

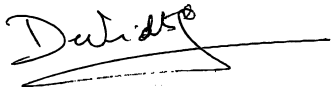
This consultative document articulates 11 specific questions, which the ICMA ERCC has addressed sequentially in the Annex to this response.

Concluding remarks:

In light of the above illustrated measurement challenges, and given that the ICMA ERCC does not consider that the purported risks to the system are well represented nor, given other measures already taken, that they need to be addressed in this way, the ICMA ERCC calls for careful reassessment of what can really be hoped to be achieved through this non-cash collateral re-use measurement initiative. Before instigating a complex effort to create global re-use numbers the ICMA ERCC believes that there needs to be a more rigorously developed use case, with demonstrable incremental benefits which will outweigh the inevitably associated costs.

The ICMA ERCC appreciate the valuable contribution made by the FSB's examination of the issues articulated in this consultative document and would like to thank the FSB for its careful consideration of this response. The ICMA ERCC remains at your disposal to discuss any of the above points.

Yours faithfully,



Godfried De Vidts
Chairman
ICMA European Repo and Collateral Council

cc :	*Sarah John,*	*Head of Sterling Markets Division, Markets, Bank of England;*
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	Adam Farkas	*Executive Director, European Banking Authority*
	Klaus Löber	*Head of the Secretariat, Committee on Payments and Market Infrastructures*
	Paul Andrews,	*Secretary General, International Organization of Securities Commissions;*
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Annex

Specific ERCC responses
– regarding the eleven questions enumerated in the consultative report "Possible Measures of Non-Cash Collateral Re-Use"

Scope of re-use measure:

Q1. ***Does the proposed scope of transactions for data collection (Scope A) provide a practical basis for the meaningful measure of non-cash collateral re-use?***

If not, please explain how you think the scope should be broadened and the reasons why this alternative scope is more appropriate than the proposed scope?

A1. The ICMA ERCC observes that the FSB has changed its definitions since publication of its recommendations (see footnote 2) in August 2013. At that it was stated by the FSB, in paragraph 3.2 (at page 15) that: ""Re-hypothecation" and "re-use" of securities are terms that are often used interchangeably. The FSB finds it useful to define "re-use" as any use of securities delivered in one transaction in order to collateralise another transaction; and "re-hypothecation" more narrowly as re-use of client assets." In the current consultative report, however, the FSB now defines the re-use of collateral as when a firm "receives securities as collateral in one transaction and subsequently sells, pledges or transfers this collateral in a second transaction"; and re-hypothecation is defined as "any use of client assets by a financial intermediary".

These changes in definition have not themselves been consulted upon, yet they have quite a significant impact on the scope of what needs to be considered when discussing the concepts of re-use and re-hypothecation. In August 2013 it seemed clear from the context that the FSB was defining re-use narrowly, considering the case where collateral received is subsequently used to collateralise another transaction. Now the scope of the consultative paper far more broadly considers the scope of re-use to cover the subsequent selling, pledging or transfer of collateral received. And the special case of re-hypothecation has seemingly been expanded from the re-use of client assets to any use of client assets.

The ICMA ERCC observes that this shift in the detailed language appears to move the FSB closer to the position adopted in the EU's SFT Regulation, in which reuse is defined as follows: "'reuse' means the use by a receiving counterparty, in its own name and on its own account or on the account of another counterparty, including any natural person, of financial instruments received under a collateral arrangement, such

use comprising transfer of title or exercise of a right of use in accordance with Article 5 of Directive 2002/47/EC but not including the liquidation of a financial instrument in the event of default of the providing counterparty". In fact, this EU definition is even a little wider than the latest FSB consultative proposal as it considers any subsequent use (other than for liquidation upon default) of collateral received.

In case there is to be global aggregation of data it is of course important that there should be consistent definition of the applicable data elements, so the ICMA ERCC is concerned that not only is there a shift in the language being used by the FSB, which if it is intentional the FSB might helpfully explain, but also there is already some difference between the FSB and the EU; and other detailed differences at national/regional level may well be found to exist.

The ICMA ERCC also draws attention to the fact that in its August 2013 recommendations #7 and #8 (at page 16) clearly referred to the need for rules and regulations in the special case of re-hypothecation and did not recommend such action in relation to re-use. In the view of the ICMA ERCC, it should be made clear that re-hypothecation means "any use, with the consent of the pledger, of client assets pledged to a financial intermediary". The focus of rules and regulations should indeed continue to relate to the appropriate control of the use of client assets and not more generally seek to constrain re-use.

Notwithstanding these definitional concerns, the consultative document puts forward two specified alternatives for the scope of the measurement of collateral re-use – namely "Scope restricted to SFTs" ("Scope A") and "Scope extended beyond SFTs" ("Scope B"). Interestingly, when elaborating on the coverage of Scope A, the FSB states that this would be "restricted to collateral posted or received and subsequently re-used in SFTs"; which seemingly returns somewhat to the FSB's August 2013 definition of re-use, in that it concerns cases where collateral received (presumably only in SFTs) is subsequently used as collateral in another SFT. Meanwhile, Scope B is stated to cover also "other types of transactions (e.g. trading of OTC derivatives) beyond SFTs", yet still seems to only consider the subsequent re-use as collateral of collateral received.

Assuming that there is to be a process of data collection, the ICMA ERCC considers that it is better to pursue the Scope A alternative, as proposed by the FSB. The increased complexity of wider approaches seems likely to outweigh any possible incremental informational advantages that might be sought through their adoption.

Collateral re-use measures at the national/regional level:

Q2. Are there any practical issues (e.g. updating current business practices, IT systems) in relation to the three measures of collateral re-use that are set out in this Section?

Are there any ways to improve these measures?

A2. In this consultative report the FSB states that "The practical challenges in collecting the data necessary to create such a measure(s), such as the need to modify current business practices and IT systems, should also be considered in evaluating the alternatives." And, in footnote 7 the FSB elaborates on this by stating that "For example, some market participants may not have data/information to create a meaningful measure(s) of collateral reuse readily available because securities received

as collateral may be treated as a pool of fungible assets together with the firm's own assets. In such case, these market participants do not differentiate or track whether a specific security used as collateral is their own asset purchased outright or is received collateral."

The ICMA ERCC welcomes these statements but considers that footnote 7 falls short of reality, since it seems to imply an exceptional case – when, in fact, it is quite normal that European repo market participants would not separate their fungible securities on the basis of the way in which they were obtained. Such physical segregation would be inefficient and, since firms have a strong incentive to pursue collateral optimisation, is only likely to occur in case of the need to comply with a requirement to do so. Introduction of any new requirement leading to the need for such physical segregation would be significantly detrimental and should only be done in case there is a clear cut cost-benefit justification and no viable alternative.

The ICMA ERCC feels that no clear case has yet been made to justify why firms should be required to make artificial decisions about whether collateral being used was sourced from "own assets" or assets which have been obtained through prior reverse repos executed under the GMRA (as elaborated in A3. below there is no meaningful difference between "own assets", as defined by the FSB and holdings of the same securities obtained through reverse repos). Having to make such decisions may distort firm's collateral management processes; and could also lead to misleading conclusions being drawn by regulators about market behaviour. At both national /regional and aggregate levels (consistent with A1. above & A5. below), it might be more appropriate to consider measures focussed on reliance on the use of client assets

The ICMA ERCC sees that the FSB's third proposed measure, the "indirect approximation of re-use based on data elements", is the easiest to implement. Yet it is also clear to the ICMA ERCC that the results this will generate are no more meaningful than those which would come from using the second of the FSB's proposed measures, the "approximate measure". Whilst computing one or other of these measures consistently over time would give a comparable metric to track, it will be difficult to understand what conclusions should be drawn regarding changes in this metric. Yet there are also significant practical issues associated with seeking to adopt either variant of the FSB's first proposed measure, the "exact measure".

Q3. ***For the first measure, are there any practical issues in reporting whether collateral you posted is in the form of "own assets" or in the form of assets that were received as collateral in a previous transaction?***

A3. The FSB defines "own assets" as "on-balance sheet assets owned outright by the reporting entity." The ICMA ERCC believes that in the context of the European repo market this definition suggests an artificial distinction. Securities purchased in reverse repos under a GMRA are the "own assets" of the purchaser every bit as much as the same asset bought outright in the cash market; and are fully fungible in both legal and operational terms. This is because the GMRA uses the mechanism of TTCA, as established in the EU Collateral Directive – which involves a full transfer of legal ownership in just the same way as an outright purchase does. And IFRS accounting requires that the purchase under the reverse repo is recorded on the balance sheet, albeit that the accounting does segregate this asset balance from the

balance for securities purchased outright. This accounting distinction does not, however, provide any way in which to keep track of re-use, since subsequent usage of the collateral will not extinguish the reverse repo asset recorded on the balance sheet – as this only occurs when the forward leg of the applicable repo transaction occurs.

The ICMA ERCC suggests that more detailed thought needs to be given to the significant differences which exist between the use of pledges and the TTCA basis upon which the European repo market operates. It may be that different approaches should be developed, rather than trying to treat all "collateral" as though it is the same. In fact, in a TTCA repo it is not even correct to refer to the non-cash collateral as "collateral", but rather the reference should be to the "purchased securities". In the opening leg of the repo there is an exchange of assets (cash for securities) and the closing leg is a forward dated contract for an offsetting exchange of equivalent (not the identical) assets.

The ICMA ERCC notes that two alternatives are presented by the FSB in respect of the exact measure. Whilst the ICMA ERCC's concerns about the exact measure are germane to both these variants, the ICMA ERCC considers that the alternative approach could prove to be easier to calculate. However, it does require the bringing together of more data elements, which may increase the challenge in accurately sourcing the different components.

Q4. Are there other measures of collateral re-use that the FSB should consider for financial stability purposes?

A4. The ICMA ERCC suggests that the most appropriate matter to be focussed on is how best to obtain an understanding of the evolution of collateral velocity over time. It may be that this calls for the evolution of better data, but the start point should be a consideration of the significant academic work already performed on this topic; and an assessment of how central banks currently estimate the velocity of cash (the flow of which is measured but not constrained). With a more limited focus of this sort, it may be that other ways to obtain suitably estimated data aggregates can be evolved.

Collateral re-use metrics:

Q5. Do you have views on any of the six metrics related to collateral re-use that are set out in this Section?

If so, please indicate the metric(s) and explain the views you have?

A5. **Collateral re-use at the jurisdiction and global level**

Changes in the amount of measured "re-use" may or may not be correlated to changes in leverage levels, as the re-use measure could easily fluctuate for reasons which do not involve overall changes in the amount of leverage being assumed. The ICMA ERCC wishes to highlight that leverage in banks is being measured and controlled directly, which this makes more sense than trying to use re-use as a proxy measure. For non-banks there may not be the same degree if direct control over leverage, but there are many other types of entity which are subject to regulatory scrutiny and control, which can be used to provide relevant oversight of their leverage; and the FSB has itself recommended mandatory haircuts for certain non-bank SFTs, precisely to establish a brake on leverage growth.

Collateral re-use rate

To the ICMA ERCC it seems that the suggestion that this metric could be a possible proxy for the ability of an entity to raise further liquidity through collateral re-use provides an illustration of the risk that "re-use" numbers may get misused. Considering re-use can only possibly provide a very partial, and therefore potentially misleading, picture, as a measure of SFT funding capacity must include other elements particularly including unencumbered own assets.

Re-use reliance rate

The ICMA ERCC observes that the label proposed for this metric appears pejorative – if it is intended to reflect the extent to which re-use is being utilised, why not call it a "collateral efficiency rate"? It seems to the ICMA ERCC that worrying about re-use "reliance" in this way does not make sense; albeit that there might be a good rationale for tracking the extent of reliance on re-hypothecation (ie. reliance on client assets).

Concentration of re-use activities

The ICMA ERCC feels that the value of this metric seems debatable and that it could prove potentially misleading. To take an example, assume that the top 5/10 firms account for 40% of SFTs and re-use 50% of SFT collateral received, whilst the firms doing the remaining 60% of SFTs re-use only 10% of SFT collateral received. This metric will be show a value of 76.9%, which looks highly concentrated – but what unambiguous information is actually being given by comparing re-use by a small sample of core firms with the average level of re-use?

Collateral circulation length

The ICMA ERCC considers that this is a very inaccurate method for calculating the number of links in a collateral chain, which will only work in certain specific cases.

For example, assume A receives 100 and re-uses 50 with B, who re-uses 25 with C, who re-uses 12.5 with D (ie. 1/2 re-used each time). In this case there are three links, but, inaccurately, the metric is 1/(1-(87.5/175)) = 2. If, however, the progression is still three links, but where A receives 100 and re-uses 66.7 with B, who re-uses 44.4 with C, who re-uses 29.6 with D (ie. 2/3 re-used each time), then the metric is accurate, being 1/1-(140.7/211.1)) = 3.

Furthermore, this metric will be confused by offsetting transactions between firms. For example, assume 100 of collateral is received by firm A and 50 of this is re-used to firm B, which itself re-uses 25 of the received collateral in a repo back to A. The reported re-use for A+B is 75 and their total collateral received is 150, so the re-use rate is 75/150 = 0.5; which implies a collateral circulation length of 1/(1-0.5) = 2.

However, assuming that the 50 received by B from A and the 25 given back to A by B will net, then to all intents and purposes A has only re-used 25 of the 100 received. This effectively changes the re-use rate to 25/125=0.2 and the collateral circulation length becomes 1/(1-0.2) = 1.25. Whilst using position level data would inherently reflect such netting effects, the process would be more complicated in case data is being accumulated a t a transaction level.

The ICMA ERCC is concerned that the desire to explore collateral circulation length in this way reflects misplaced concern about the nature of the interconnectivity in repo chains. As noted in the commentary provided above, prior to these question level responses, the use of TTCA as the basis for repo transactions gives rise to a series of discrete links between parties, rather than forming a single inter-linked chain.

Collateral multiplier (at the global level only)

As noted in A4. above, the ICMA ERCC considers that exploring collateral velocity is appropriate. To that extent, this is a potentially interesting re-use metric; but this may not be the best way in which to try and proportionately derive such a high-level global statistical measure.

Q6. Are there any other metrics related to collateral re-use that the FSB should consider for financial stability purposes?

If so, please define the metric(s) and explain how the metric could be used for financial stability purposes.

A6. The ICMA ERCC would not suggest other metrics which should be considered for financial stability purposes.

Data elements to be submitted to the FSB

Q7. In your view, are the data elements set out in Table 1 appropriate for calculating the collateral re-use measures in Section 3?

Are there alternative data elements that the FSB should consider?

If so, please explain the data elements and the reasons.

A7. The ICMA ERCC thinks that the data elements set out in Table 1 appear to be appropriate in relation to the proposed collateral re-use measures; and does not have alternative data elements to suggest.

Q8. Are there any practical issues on the data elements for calculating the collateral re-use measures that are set out in Table 1?

A8. As already highlighted by the ICMA ERCC, the data elements proposed for the "exact" measure are impractical to provide. These values are not generally available and where dealing with fungible securities they cannot even be identified.

It is evident from Table 1 that, if there is to be adoption of one of the proposed re-use measures, the most practical measure is the indirect approximation proposed in section 3.3 of the consultative report – since this does not lead to data demands over and above those already encompassed by the FSB's November 2015 global securities financing data standards.

Creating new demands for data about "own assets" would be a non-trivial addition to existing burdens, since this requires information about the balance sheet which will not be available through the same systems as the information relating to SFTs.

Q9. ***In your view, should the collateral types for measuring collateral re-use align with those set out in the November 2015 global securities financing data standards as set out in Table 1?***

If not, please explain which collateral types you think are appropriate for the collateral re-use measure(s).

A9. The ICMA ERCC thinks that it is appropriate to stick with the previously identified collateral types.

Data architecture:

Q10. ***Are there any views on the data architecture issues related to measuring collateral re-use as set out in this Section?***

Do you see any statistical issues arising as a result of the proposed aggregation approach?

A10. The ICMA ERCC does not have any specific views on this.

Q11. ***Are there any other views on other aspects of this document?***

A11. The ICMA ERCC has nothing further to add at this stage.

Appendix:

ICMA ERCC Background

Since the early 1990's, the International Capital Market Association (ICMA) has played a significant role in promoting the interests and activities of the international repo market, and of the product itself.

The European Repo Council (ERC) was established by the ICMA in December 1999, to represent the cross-border repo market in Europe and has become the industry representative body that has fashioned consensus solutions to the emerging, practical issues in a rapidly evolving marketplace, consolidating and codifying best market practice.

Consistent with the fact that it is repo desks which can increasingly be equally considered to be collateral desks, it has been the ICMA ERC which has served to guide the ICMA's work on collateral, providing support to its broader efforts and driving many of the ICMA's specific collateral related initiatives. Thus, just as repo and collateral are intimately related in the market, so the ICMA ERC and the ICMA's work on collateral are also intimately related. In recognition of these intimate relationships, with effect from 4 December 2015, the ICMA ERC has been renamed as the ICMA ERCC, the "European Repo and Collateral Council".

The ICMA ERCC also plays a significant role in nurturing the development of the repo market and supporting its wider use in Europe, particularly among banks, by providing education and market information. The ICMA bi-annual survey of the European repo market has become established over more than a decade as the only authoritative indicator of market size and structure and the dominant trends.

ICMA is an active force in the standardisation of repo documentation. The GMRA is the most predominantly used standard master agreement for repo transactions in the cross border repo market.

Membership of the ERCC is open to ICMA members who transact repo and associated collateral business in Europe. The ICMA ERCC currently has about 90 members, comprising the vast majority of firms actively involved in this market.