

ICMA ERCC Gilt Repo Market Taskforce

Enhancing the resilience of the gilt repo market

Bank of England Discussion Paper

November 28, 2025

Background and overview of the response

ICMA is pleased to be able to respond to the Bank of England's exploratory discussion paper on enhancing the resilience of the gilt repo market. As the Bank duly notes, a well-functioning repo market is critical to the smooth and efficient operation of the gilt and other sterling fixed income markets, as well as for the effective transmission of monetary policy. Any additional costs to accessing the gilt market are a cost to UK taxpayers and savers, while any measures that make the gilt market more vulnerable to market volatility, or threatens its ability to function normally, particularly in times of stress, is a direct threat to the UK Government's growth agenda. This is particularly pertinent at a time when the UK's debt-to-GDP ratio, like that of many developed economies, is far into deep and uncharted waters.

In responding to this discussion paper, ICMA, convened a dedicated taskforce (the "Taskforce") from its diverse membership. This was coordinated through ICMA's European Repo and Collateral Council as well as through its Asset Management and Investor Council (AMIC). The Taskforce includes gilt-edged market maker (GEMM) repo traders, other active sell sides in the gilt repo market, buy sides, including pension funds, insurers, UCITS asset managers, money market funds (MMFs), alternative investors (hedge funds), trading venues (cash and repo), central counterparties (CCPs), and custodians. Essentially, the Taskforce represents the entire gilt and gilt repo market ecosystem, and so a diversity of perspectives and priorities. Throughout this response, references to ICMA's views are those of the Taskforce, unless otherwise clarified.

It is perhaps important to note that many in the Taskforce felt that the paper seemed to take the position that minimum haircuts, and possibly mandatory clearing, were credible policy options for the UK gilt repo market, rather than being truly exploratory and balanced in its approach, particularly given the absence of alternative measures.

That said, the Taskforce was highly engaged in discussing the various questions put forward in the paper with a view to responding constructively, while questioning some of the Bank's arguments for its two main policy proposals, and, importantly, looking beyond these to more practical and credible measures to enhance gilt cash and repo market liquidity.

Of particular note:

- ICMA recognises the important benefits of central clearing for gilt repo, and the potential for increased non-bank participation, not least in reducing counterparty credit risk and
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expanding liquidity provision. ICMA notes the initiatives currently being undertaken by CCPs to support broader clearing participation, while maintaining the integrity of CCP risk management frameworks. Furthermore, ICMA identifies a number of regulatory initiatives that could help to remove barriers to access and so encourage non-bank participation in central clearing.

- Based on the **unanimous** consensus of the Taskforce, ICMA strongly opposes the suggestion of mandatory clearing for gilt repo. This would increase costs and restrict access for some participants, undermine the maturity transformation function of repo intermediation, and increase procyclicality. It is also not clear what the purpose of mandating clearing would be, and that the arguments relating to transparency, leverage, or counterparty credit risk are each flawed in the context of the UK market. Ultimately this would be a cost, and a risk, to gilt market stability and so to the UK economy. Clearing should be a commercial choice based on cost and risk considerations of the market participant and their clients.
- Also based on broad consensus within the Taskforce, the suggestion of minimum haircuts should be dismissed for a number of reasons. Prime among these are: the fact that haircuts are a transaction level tool intended to hedge liquidation risk and not intended to manage leverage; they do not take account of firms' individual, counterparty-level risk management frameworks and risk appetite; and that they can introduce an additional and unnecessary cost and friction to trading in benign markets while quickly becoming redundant in volatile markets.
- There are a number of other policy measures, beyond improving access to clearing, that could be considered to enhance gilt market resiliency. Chief among these is the potential for enhancements to the operational resilience of the Sterling Monetary Framework (SMF) which could be the most meaningful and ultimately valuable outcome of this consultation. Promoting bank risk management practices, in a number of areas, could also be a positive contributor to market resilience.

Characteristics of the gilt repo market

Q1. *Do you agree with assessment of the gilt repo market dynamics described in Section 2? Are there any further dynamics that you would highlight, beyond those identified above? Which of the issues described in Section 2 do you see as key risks to gilt repo market resilience, given current market structure?*

ICMA recognises many of the dynamics described in Section 2. However, we would like to share the following important observations.

Dealers, including cash and repo desks, face and manage market, credit, and liquidity risk, as well as balance-sheet constraints, under all market conditions; not just those simulated in the Bank's system-wide exploratory scenario (SWES). However, as volatility increases, particularly in stressed market environments, it is not necessarily balance sheet that becomes the binding constraint, but rather risk metrics (and risk appetite). Furthermore, under such scenarios, banks may decide to re-allocate their relatively constrained balance sheet and risk capacity to more profitable or demanding business lines, and not necessarily into providing more gilt market liquidity. In this respect, it may be important to define more clearly what is meant by market resilience, particularly when comparing normal market conditions with more stressed scenarios.

Post the start of quantitative normalisation, with higher and more volatile bond yields, hedge funds have become a prominent element of the sovereign bond ecosystem, including gilts. Based on a number of reports, it is estimated that as much as 60% of secondary market volumes in the outright gilt market are driven by hedge funds.¹ The various macro and micro relative value strategies they employ not only support price discovery and efficiency, as well as liquidity, for gilt cash, futures, and repo, but hedge funds are also significant absorbers of gilt supply.

The arbitrage discount provided through the cheapest -to-deliver (CTD) basis trade (in the form of a negative net basis)² could be viewed as hedge funds being paid a warehousing cost for holding gilts in place of capital constrained banks or real money investors. Furthermore, empirical evidence suggests that despite their systematic use of leverage, hedge funds, similar to banks, are highly responsive to increases in market volatility, de-levering relatively quickly.³ It could also be noted that during the 2022 "Truss incident", hedge funds were largely the main buyers of gilts before the Bank's intervention.⁴

LDI and MMF cash buffers have improved since the September 2022 incident, however this will always remain a recurring vulnerability for any market during episodes of heightened stress. Furthermore, any incremental increase in buffers in low volatility markets could be absorbed by significantly higher haircuts or increased CCP initial margin in response to heightened volatility.

ICMA strongly disagrees with the paper's unqualified assertion that low haircuts on bilateral repo trades could be indicative of market failure. As explained in more detail in the response to Questions

¹ <https://www.reuters.com/markets/wealth/hedge-fund-dominance-latest-risk-febrile-uk-debt-markets-2025-03-21/>

² The net basis is the difference between the bond price and the conversion factor adjusted futures price, taking into account the repo financing rate to delivery.

³ <https://www.ecb.europa.eu/press/blog/date/2024/html/ecb.blog20240923~d859db790b.en.html>

⁴ <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2023/an-anatomy-of-the-2022-gilt-market-crisis.pdf>

9 to 13, this seems to indicate a lack of understanding by the paper's authors on the role of haircuts in the bilateral repo market.

ICMA felt that one element missing from the paper's discussion of market dynamics was an overview of the uses and users of the gilt repo market, which we have attempted to summarise in Box 1. This will be important when considering the potential consequences of specific policy recommendations and the implications for the wider market ecosystem.

Box 1: Uses and users of Gilt repo**Principal uses:**

- I. Facilitating collateralised borrowing and lending
- II. Supporting market-making and non-bank investment strategies
- III. Liquidity and collateral management
- IV. Facilitating monetary policy transmission

Market participants:

- **Gilt Edged Market Makers (GEMMs):** *financing long and short inventory. Using repo and reverse repos, often short-dated, but occasionally for term. Focus on specials, rather than GC/triparty.*
- **Other bank trading desks:** *Bank swap market making desks and credit trading desks also borrow/lend gilts to finance short/long gilt hedges. Mostly short-term specials and GC.*
- **Bank repo desks:** *through “matched-book” trading, providing two-way repo financing (bonds and cash) for a broad range of clients (leveraged and real-money), which can range from short-term (overnight/open) to relatively long-term (one year or longer). Key to this service is the maturity transformation function of repo desks. Focus on both specials and GC/triparty.*
- **Bank Treasuries:** *use repo market to fund bank’s balance sheet, as well as managing liquidity requirements (LCR/NSFR). Trades include repo (funding), reverse repo (investing excess liquidity / sourcing HQLA), collateral upgrades (lending non-gilts vs borrowing gilts). Mixture of short-term and longer-term trades. Mainly GC/triparty.*
- **Pension Funds:** *use repo as part of liability driven investment (LDI) strategies. This leverage-based investment strategy involves term repo financing (up to and beyond a year) and is used to boost investment returns for pension contributors. Also use repo market to raise cash to meet variation margin requirements on derivatives and term repos. Generally net lender of collateral (GC) for very long-term or very short-term.*
- **Insurance Companies:** *borrow gilts to fund interest rate hedges, lend cash to manage short-term excess liquidity, and use collateral upgrades to source gilts to post as initial margin for derivatives exposures. Can also use repo market to manage duration exposures. Mix of GC/triparty and specials, mostly short-term, but some longer-term structures not uncommon.*
- **Money Market Funds:** *generally cash lenders (reverse repo) and short-term. Preference for GC/triparty.*
- **UCITS:** *relatively restricted in terms of repo market usage, but may use repo market for liquidity management, including margin calls against derivatives hedges, or limited tactical leverage. May use reverse repo market to invest liquidity buffers. Also possible direct lending of specials to supplement investment returns. Mostly GC/triparty, some specials, primarily very short-term.*
- **Hedge Funds:** *primarily use repo market to fund diversity of leveraged macro and micro relative value investments. Strategies include long and short gilt positions, often in combination with derivatives, such as futures basis, swap spreads, curve trades, CDS basis, and sovereign credit spreads.*

- **Corporate Treasurers:** *use repo market to invest short-term liquidity on a secured basis as well as to source gilt collateral for initial margin for derivatives exposures. Strong preference for triparty given operational ease. Generally, very short-term lenders of cash.*
- **Agent lenders:** *lend gilt specials to banks to fund house and client shorts (usually very short-term or open), so earning incremental income for clients. Also invest short-term liquidity (triparty) as well as collateral down-grade trades (gilts vs non-gilt triparty), which tend to be longer maturities/structures.*
- **CCPs:** *invest members' cash variation margin securely in short-term gilt GC/triparty.*

In terms of key risks to market resilience, ICMA identifies two.

First is the scale of the UK's current debt levels relative to GDP and the sustainability of further gilt issuance in the absence of meaningful economic growth. This also has to be viewed in light of the wider global surge in public and private debt issuance, whereby borrowers are increasingly competing for a limited supply of investor funds. Policy measures that make the gilt market relatively more expensive or cumbersome to access, even at the margin, could have significant consequences for the UK's ability to fund itself. Tweaking the gilt repo market cannot compensate for prudent fiscal policy and sound debt management.

Secondly, there is an urgent need to address the widely recognised operational inefficiencies in the Bank's Sterling Monetary Framework. The various operations are not viewed by users as being particularly smooth or frictionless. The term "repo" facility is largely a misnomer, noting that the operations are actually collateralised loans, not true repos, and does not do justice to the potential cost and relative clunkiness of the framework. As described in more detail further on in this response, modernising the SMF to something fit for the 21st century, particularly in light of the Bank's transition to a demand-driven, repo-based monetary policy framework, could be a significant enhancement for gilt repo and cash market resilience.

Potential measures to enhance gilt repo market resilience

Q2. *What is your view on the potential benefits, risks and broader market implications of greater central clearing of gilt repo? To what extent do you expect greater central clearing, especially in the dealer-to-client segment, would expand dealers' gilt repo intermediation capacity in normal times and in stress? To what extent would greater central clearing reduce counterparty credit risk exposures as well as uncertainty during periods of stress and counterparty defaults, and increase market participants' appetite to extend further gilt repo lending? How do you expect dealers would deploy any additional capacity, both in stress and in stable market conditions?*

ICMA identifies several benefits of central clearing for repo, including providing access to certain non-banks, based on the appropriate calibration of the sponsored or agent clearing model. Reducing counterparty credit risk and freeing up bank balance sheet through leverage ratio netting are clear commercial incentives for utilising CCPs for repo, and this is reflected in the fact that around 33% of gilt repo is currently centrally cleared.⁵ Not to be underestimated, particularly in light of the move to shorten settlement cycles (although less relevant for the gilt market), central clearing can enhance settlement efficiency through the internal netting process (LCH UK estimates that its internal activity reduces gross settlement volumes by around 70%).

CCPs, working with their members, potential members, and regulators, are developing new innovative models to facilitate more non-bank participation in clearing. This includes introducing measures to indemnify any increase in the potential loss mutualisation risk arising from the introduction of such counterparties. Anti-procyclicality (APC) measures, in line with local rules as well as the global CPMI and IOSCO Principles, further enhance the appeal of central clearing for non-banks and their sponsors.

The main models for so-called "client clearing" are outlined in Box 2.

Despite the development of such non-bank access models, with more innovation likely, it is fair to say that the uptake of client clearing for gilt (and European government bond repo more broadly) has been disappointing. While it is expected to gain more traction in time, particularly with targeted regulatory support, as specified in our response to Q8, the value-add of central clearing needs to be viewed in the context of the underlying market micro-structure (and here we would like to draw attention again to Box 1).

Firstly, if the hope of clearing is to increase capacity for dealer intermediation, this is relatively limited in terms of scope, and mainly focused on very short-dated (primarily overnight and tom-next) repo where the leverage ratio netting opportunities primarily exist. This is highlighted in the Bank of England paper, [*The potential impact of broader central clearing on dealer balance sheet capacity: a case study of UK gilt and gilt repo markets* \(June 2023\)](#). There would be little advantage or commercial incentive, for instance, for banks and LDI funds to clear their long-term, one directional business.

The role of MMFs in the gilt repo market, while important, is relatively miniscule compared to that in the US repo market (noting that GBP MMF assets under management are around £530bn,⁶ 90% of which is EU domiciled, compared with \$7.4tn in the US⁷), making the classic US-centric repo model whereby MMFs fund hedge funds via intermediating banks, far less relevant in the UK context. That

⁵ <https://bankunderground.co.uk/2023/09/14/central-clearing-and-the-functioning-of-government-bond-markets>

⁶ <https://www.fsb.org/uploads/P270224.pdf>

⁷ <https://www.ici.org/research/stats/mmf>

said, MMFs could be more incentivised to utilise clearing where it provides access to a broader pool of liquidity. While hedge funds, too, at least for very short-term financing, could see benefits from central clearing where margin netting is available, particularly on a cross-product basis.

Short-term, cash-only providers, such as corporate treasuries, could also be attracted to clearing, so long as the costs were digestible and access was not overly onerous or operationally burdensome.

In the case of asset managers, the use of clearing is an important part of their best execution policy, which needs to be justified, particularly if it is relatively more expensive than transacting in the noncleared market.

ICMA would further refer to the FSB report on *Liquidity of Core Government Bond Markets*⁸ which suggests that there is “limited evidence to suggest particular market structures significantly and uniformly contributed to better outcomes” and “the resilience benefits of changes to structures seem to be context-specific and jurisdiction-dependent”.

There is a cost to central clearing, as with any risk mitigation tool, that may or may not be justifiable depending on the counterparty, market use, and clearing model, and which is ultimately borne by the end investor. However, more could be done in the regulatory sphere to help make clearing for repo more attractive to both non-bank users and bank sponsors, thereby supporting a natural evolution of the cleared repo market. These are discussed in the response to Q8.

⁸ <https://www.fsb.org/uploads/P201022.pdf>

Box 2: Basic models for client clearing

1: Only allow net cash lenders into client-clearing and the CCP takes a lien on the collateral given to the client. The gross collateral far exceeds the default risk, so no need for mutualisation. The excess also means there is no need for IM, VM, or default fund contribution, which reduces operational cost. And there is no done-away model because the client does not have to be a member of the CCP (although this is possible), which prevents disintermediation. While the CCP and clearing members take the tail risk, this is far outweighed by the gross collateral. This is the model used by Eurex Select Invest and DTCC CCIT. The recent Collateral-in-Lieu is an attempt to reposition the CCIT model.

2: There are two sub-models. In both, clients are allowed to be limited members of the CCP but have to be guaranteed/sponsored by a clearing member or other acceptable principal.

In model 2a, the sponsor guarantees the VM and IM. In model 2b, the CCP mutualises this tail risk. So, a mutualisation obligation for the client is avoided but, under 2a, is just minimised for the clearing members. The sponsor acts as processing agent, which reduces operational obstacles for the client and the risk of disintermediation for the clearing member/sponsor/guarantor.

Examples of 2a are LCH Sponsored Clearing and Eurex Select Finance.

Examples of 2b are DTCC Sponsored Repo, Eurex ISA Direct Indemnified and LCH's forthcoming indemnified facility.

Q3. *How do you expect greater central clearing would impact the build-up and unwind of highly leveraged, concentrated trading strategies in the gilt repo market? Which market activities and types of participants do you expect would be most affected?*

By “greater central clearing”, ICMA assumes that this would be voluntarily driven based on banks’ and non-banks’ assessments of the advantages of centrally clearing more trades than currently. In which case it is not clear how this would impact investment firms’ choice of strategy or use of leverage, since these would be the primary considerations. Whether to clear or not would be a secondary consideration based on access to market liquidity and cost. Ultimately, firms will only choose to use central clearing if it makes commercial sense (see response to Q8). If it is advantageous to centrally clear more trades, then this is potentially a systemic benefit in terms of reduced counterparty credit risk. However, if it were detrimental to firms’ investment strategies, business models, and risk tolerance, then they would not choose to use central clearing.

Q4. *What would the largest impacts of greater central clearing be for market participants? How would it affect your business model/trading strategies and what actions would you take in response? How would greater central clearing impact cash gilt market liquidity and pricing? Please provide worked examples or quantitative evidence where possible.*

Again, ICMA is assuming that the question relates to a scenario of “greater central clearing” as a result of commercial incentives, which could include greater access to liquidity and improved pricing in some instances. In which case, if the incentives are there, then this can be seen as an overall positive with respect to reducing counterparty credit risk. But if they are not, then firms will not elect to use clearing. Either way, assuming voluntary clearing, the net impact on pricing and liquidity should be neutral at worst and a small positive at best.

Q5. *To what extent do you think market participants would be prepared to manage the potential increases in liquidity needs that could come with greater central clearing in the gilt repo market? Which policy initiatives might be able to help mitigate this risk?*

Once again, greater use of central clearing will depend on the commercial incentives, which include the cost and accessibility of client clearing models and the willingness of banks to act as agents or sponsors. Liquidity needs for meeting margin requirements or other associated costs of clearing will be an important consideration. This is likely to depend largely on the business model, such as short-term funding needs versus long-term, and the ability to achieve margin netting (ie one-directional transactions, particularly when lending securities, would likely be un compelling).

As described in more detail in the response to Q8, in order to attract more firms to utilise clearing for repo, CCPs and regulators could consider a number of initiatives such as: cross-product margining; cross-CCP margining; posting collateral as variation margin (EMIR Art 47.3); collateral re-use by UCITS to fund margin; capital relief for agent/sponsor banks (netting counterparty repo and derivatives exposures, in line with cross-product margin netting practices); and possible access to SMF facilities through clearing.

Q6. *Do you see any risks to financial stability generated by an increase in centrally cleared gilt repo activity at CCPs and, potentially, a limited number of sponsoring banks? In your view, how material are these risks, and how could they be best mitigated?*

As discussed in the response to Q8, *mandatory* clearing for gilt repo would be a *material* and potentially existential risk to UK financial stability. However, voluntary clearing would not, since firms would only utilise central clearing where it made commercial sense (from a cost, liquidity, and risk management perspective), so supporting the further, natural expansion of the cleared repo market. Otherwise, firms would elect to utilise the non-cleared market. This emphasises the importance of choice and the optionality for firms to transact both cleared and non-cleared. Part of the decision to clear voluntarily would also include the availability of sponsoring (or agent) banks.

The option to transact bilaterally, in itself, is a pressure valve in times of stress and the ultimate mitigant for market instability and systemic risk (as was proven in the 2011 Eurozone crisis when CCPs became amplifiers of sovereign stress).⁹ Taskforce members also point to the importance of the flexibility afforded by bilateral repo in the case of the September 2022 Truss incident.

⁹ <https://www.esrb.europa.eu/pub/pdf/wp/esrbwp10.en.pdf>
<https://www.bis.org/publ/work515.pdf>
https://www.funcas.es/wp-content/uploads/Migracion/Articulos/FUNCAS_SEFO/000art05.pdf

Q7. *In your view and given your business model, what are the costs and benefits of different clearing models? What are the key features of a central clearing model which maximises benefits to market resilience and financial stability while minimising any potential increase in trading costs?*

ICMA's Taskforce represents a broad range of gilt market participants and business models, as described in Box 1. As outlined in the responses to previous questions, voluntary use of central clearing will rest on a number of considerations that impact them and their potential agent or sponsoring bank, as well as the clearing models available, and regulatory limitations on users, sponsors, and CCPs.

The currently available models for non-bank access to central clearing for repo are outlined in Box 2. However, the features of an effective model could be summarised as:

- Optional clearing that promotes participation by removing regulatory barriers but avoids compulsion.
- Counter-cyclical margining and haircut policies to support resilience without draining liquidity.
- Eligibility standards that preserve risk mutualisation among similarly rated participants.
- Transparent but proportionate data reporting, avoiding duplication of existing regulatory disclosures (ie SFTR).

To the extent that clearing models achieve these key objectives, it is reasonable to assume that there is some scope for the use of clearing to increase, at least for some market users, in particular those who operate in very short maturities or are net lenders of cash (utilising the "collateral in lieu" model), and contingent on some regulatory support as outlined in the response to Q8 below. However, once again, it is the optionality that is central to bolstering financial stability by providing an important pressure valve in times of heightened stress.

Q8. *To what extent could incentives achieve a sufficient expansion in central clearing to deliver meaningful benefits to the resilience of the gilt repo market? Would a clearing mandate be necessary?*

Starting with the first part of the question, and building on points raised in the responses to previous questions, there are a number of incentives that could make central clearing more appealing for some gilt repo users, including non-banks, and a reason to include it in their business models as a viable and useful option.

These include:

- Providing cross-product margin netting (eg repo and futures). Particularly for firms that actively use derivatives as well as repo, this could be an important incentive to utilise repo clearing without a significant increase in cost.
- Providing inter-CCP margin netting. This would not only prevent liquidity clumping in single CCPs, but it would also take account of the fact that not all CCPs are multi-product, with firms clearing derivatives in one clearer and cash and repo in another.

- Providing capital relief for sponsoring banks. Currently, the Basel Rules do not allow for the netting of derivatives and repo counterparty exposures under the new standardised capital requirements calculation methodology for banks.¹⁰ This is a disincentive to banks acting as sponsors or agents to non-bank clearing models, which involves absorbing counterparty credit exposure into their risk weighted asset (RWA) calculations. Removing this disincentive is already something that is being advocated by a number of associations in the wake of the SEC clearing mandate for US Treasuries.¹¹
- The widening of eligible collateral for IM could be a further incentive, particularly for short-term cash providers such as MMFs. For example, the ability to post fund units as collateral.
- Revising UCITS rules to allow for collateral re-use in order to raise margin could be an incentive for more open-ended fund usage of repo clearing.¹²
- The ability to post high quality collateral (ie gilts) as VM as an alternative to cash could be an incentive for pension funds to utilise central clearing, not only for repo but also for interest rate swaps.¹³
- Making the Bank's own repo facilities accessible through clearing could not only be helpful in supporting financial stability (see response to Question 14) but it would send a strong message to the market that it sees benefits in using central clearing for gilt repo. This could be paralleled with the recent announcement by the ECB that it intends to make its PSPP holdings available for borrowing through CCPs,¹⁴ and the indication that the Federal Reserve is also potentially considering the advantages of making its standing repo facility (SRF) available through clearing, not least the ability to maintain control of the Fed Funds rate.¹⁵ A reticence by the Bank to use central clearing itself would merely confirm some of the arguments that participants lean on for not utilising clearing.

It is important to note, however, that any increase from the current levels of cleared gilt repo will rely entirely on the ability to expand client clearing. This accounts for 70% of all gilt repo volumes, with the inter-dealer market virtually fully cleared.

Addressing the second question related to mandatory clearing, the straight answer is *no*. The unanimous view of ICMA's Taskforce is that this would be detrimental to gilt market functioning in normal conditions and potentially catastrophic under market stress.

As already outlined in this response, the micro-structure of the gilt repo market does not naturally lend itself to widespread client clearing. The additional cost and operational lift would exclude many smaller investors, including pension funds, from participating in the market. Meanwhile, term trades, which would have greater exposure to changes in IM and VM, as well as being more challenging to net from a leverage ratio perspective, would become prohibitively expensive, thereby undermining the bank maturity transformation function of repo. A market-wide reliance on very short-dated financing would make the gilt repo market even more vulnerable to spikes in short-term rates.

¹⁰ Which also has implications for internal models as a consequence of the Output Floor.

¹¹ <https://www.isda.org/a/B4YgE/Cross-product-Netting-Under-the-US-Regulatory-Capital-Framework.pdf>

¹² UCITS-Directive in combination with ESMA UCITS Guidelines paragraph 43i as well as Q6J of the ESMA UCITS Q&A, and MMF Regulation Art. 14(b) and Art. 15(2).

¹³ This would require a refinement to EMIR Art 47.3.

¹⁴ <https://www.ecb.europa.eu/mopo/implement/app/lending/html/pspp-lending-ecb.en.html>

¹⁵ <https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20251029.pdf>

A further potential outcome of imposing a mandatory clearing regime could be to drive gilt activity offshore (out of UK regulatory reach) as well as market participants migrating activity to repo alternatives such as securities lending or total return swaps (TRS).

As was illustrated in the September 2022 Truss incident (which was largely driven by margin calls on swaps positions of LDI funds), banks were able to apply flexibility on their bilateral client exposures based on the best interest of the overall market (and essentially keeping their exposed counterparties solvent). CCP Rules, by their very nature, do not afford the same degree of flexibility and, in the case of mandatory clearing, some Taskforce members posit that this could have pushed a number of funds closer to default, thereby exacerbating the fire-sales and potentially turning the event into an economic crisis. This highlights the importance of encouraging voluntary clearing whilst also maintaining bilateral trading, to ensure flexibility and optionality, even more so in times of stress.

Even if the Bank were to attempt to impose an ill-advised clearing mandate, it is not clear to ICMA how it would implement this, particularly from an extraterritorial perspective. ICMA would be interested to learn from the Bank what its thinking is on this, and how it would go about legally and operationally enforcing market participants to settle through a CCP. This is something that the SEC and the wider US Treasury market are currently grappling with in respect to the extraterritorial reach of the US mandate and the associated legal ambiguities related to scope and obligations.¹⁶

Q9. *What is your view on the potential benefits, risks and broader market implications of introducing minimum haircut on non-centrally cleared gilt repo transactions? To what extent could minimum haircuts effectively address observed market failures around margining practices in the non-centrally cleared gilt repo market? To what extent would this measure reduce counterparty credit risk and uncertainty during periods of stress, and bolster market participants' appetite to extend further repo lending?*

While introducing mandatory minimum haircuts on gilt repo transactions would help to improve banks' counterparty credit risk RWA exposures, this would create additional costs for market users while adding unnecessary friction to trading in the gilt repo market. Any reduction in aggregate leverage would be an indirect and untargeted side effect. Meanwhile, any notion that low or zero haircuts are reflective of a market failure are, in the view of the Taskforce, misguided and suggest a lack of understanding of the purpose of haircuts, or of banks' wider counterparty credit risk management practices.

In responding to this question, ICMA would like to refer the Bank to its recently published paper, *Demystifying repo haircuts (September 2025)*,¹⁷ which attempts to address many of the misconceptions of policy makers and academics with respect to repo haircuts.

Firstly, it is important to recognise that haircuts are intended to manage the liquidation (or replacement) risk associated with the underlying collateral in the event of default. While sometimes the purpose can become blurred, theoretically at least, they are not intended to hedge against counterparty credit risk (that is provided through the collateralised nature of the repo). Who applies

¹⁶ <https://www.risk.net/risk-management/7961096/us-treasury-clearing-mandate-poses-riddle-for-asian-markets>

¹⁷ <https://www.icmagroup.org/assets/documents/Regulatory/Repo/ICMA-ERCC-white-paper-Demystifying-Repo-Haircuts-September-2025-180925.pdf>

the haircut is therefore mainly driven by the motivation of the trade (whether cash-driven or securities driven) as well as the relative bargaining power of the counterparties. Minimum haircuts would therefore need to take account of such motivations: for example, applying minimum haircuts on lenders of specific securities (who generally impose a haircut on their counterparty banks as protection against replacement cost) would close off an important part of the market.

In their intermediation capacity, banks will, as a matter of course, enter into a large number of repo transactions with their (non-bank) clients, which could include both the lending and borrowing of collateral, often with similar (same issuer) or highly correlated underlying securities. In this instance, applying haircuts at the individual trade level can become inefficient, suggesting that margining at the net exposure level would be more effective from a risk management perspective. In reality, this reflects the risk exposure in the event of default where close-out netting is applied. Similarly, this portfolio approach to margining could extend to other transactions and exposures, including prime brokerage margin lending and OTC derivatives. In many ways it makes more sense to calculate and margin holistically at the counterparty level, rather than at the individual transaction level, particularly where set-off netting agreements between different products and their related contractual frameworks are in place.

The assertion that minimum haircuts would address procyclicality in times of stress is also misleading. Given the purpose of haircuts – to manage liquidation or replacement risk – in the case that they are applied to individual transactions there is a direct correlation between the size of the haircut and the price volatility of the underlying collateral. In benign markets, banks may consider the difference between a 0% and 2% haircut relatively irrelevant, with anything above zero being an additional cost to their client. Imposing a minimum haircut would be precisely that: an additional cost. In times of heightened volatility, haircuts can jump significantly (price volatility in long end gilts exceeded 40% during the 2022 Truss incident). In these scenarios, minimum haircuts become an irrelevance, neither reducing counterparty credit risk nor bolstering banks' appetite to extend lending.

This also helps to highlight a common misunderstanding by regulators and other commentators about the role and observed behaviour of haircuts. For example, in the Bank of England blog, *No one length fits all – haircuts in the repo market* (Ivan, et al., July 2024),¹⁸ the authors assert that the data “shows that haircuts charged on LDI funds and PFs increased procyclically during this stress episode and remained elevated for some time, largely reflecting higher credit risk”. What they miss is that this was not a response to potential PF insolvency, rather the problem facing the PFs was the operational procedures to transfer cash from schemes was too slow. What was driving haircuts was the volatility of gilt prices that naturally increases haircuts (as would be expected). And unlike hedge funds (where there was no change in haircuts), they have less bargaining power. This is shown by the increase in haircuts and IM by LCH during this period, where there were no PFs as clearing members.

Finally, it is worth noting that the original BCBS proposal for minimum haircuts applied only to non-government bonds. Government bonds were purposely excluded.

Q10. *To what extent could minimum haircuts help dampen procyclical increases in haircuts in stress? What is your view on the materiality of this benefit in the context of broader liquidity shocks that repo market participants may face?*

¹⁸ <https://bankunderground.co.uk/2024/07/10/no-one-length-fits-all-haircuts-in-the-repo-market/>

As explained in the response to the previous question, minimum haircuts do nothing to dampen procyclical increases in times of stress. They merely create additional and unnecessary costs and frictions under normal market conditions.

Q11. *How do you expect minimum haircuts would impact the build-up of leveraged, concentrated trading strategies in the gilt repo market? Which strategies and types of market participants do you think would be most affected?*

Minimum haircuts would naturally, and indiscriminately, reduce overall leverage (despite this not being their purpose), but more importantly, they would reduce trading activity due to the additional cost imposed on market participants. (Note that a buy-side member explained that with sterling money market rates where they are, a haircut is usually the deciding factor on deciding whether to transact.)¹⁹

In terms of market participants and strategies that would be most affected, one-directional users of repo, such as money market funds and LDI funds would likely be most negatively impacted. Hedge fund relative value strategies could also be affected, depending on how haircuts are applied (ie on each leg or on the net package). To the extent that they are, this could be highly detrimental to liquidity and price efficiency, as well as potentially reducing a major source of gilt demand.

Q12. *What would the largest impacts of minimum haircuts be for market participants? How would they affect your business model/trading strategies and what actions would you take in response? How would minimum haircuts on gilt repo impact cash gilt market liquidity and pricing? Please provide worked examples or quantitative evidence where possible.*

Minimum haircuts, by their nature, are an additional cost to one of the counterparties to a trade. Assuming that this is intended to be paid by non-banks, then it could impact their use of the gilt repo market as described in Box 1. The impact on MMFs, LDI funds, and hedge funds is described briefly in the response to Q12. While the overall outcome would likely depend on the extent and calibration of any minimum haircut framework for the gilt repo market, to the extent that it impeded hedge funds from entering into relative value trades, such as the gilt basis trade, this would be negative for market liquidity, price efficiency, and overall demand.

Annex 1 provides worked examples of how minimum haircuts could impact different trading strategies that help to support gilt market liquidity, pricing, and absorption.

Q13. *Is there a particular model or calibration of minimum haircuts which maximises benefits to financial stability while minimising potential costs to market participants?*

The best calibration for applying haircuts is to allow firms to apply their own risk management frameworks based on their commercial models and risk appetite (as well as relative bargaining power). This also seems to be the conclusion of the Bank's own research.²⁰ Imposing an arbitrary

¹⁹ In the case of haircuts, the penalised party will effectively have to cover the under or over collateralised portion of the trade with unsecured financing. Accordingly, in high-interest rate environments, haircuts become even more punitive.

²⁰ <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2022/what-drives-repo-haircuts-evidence-from-the-uk-market.pdf>

minimum requirement on individual gilt repo transactions would be market-distortive in benign periods and redundant in volatile markets.

The importance of flexibility has been raised previously in ICMA's contribution to the debate on the BCBS framework for non-government bond repo,²¹ as well as more recently by the US Treasury Market Practices Group.²²

²¹ https://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Repo-Markets/Haircuts%20and%20initial%20margins%20in%20the%20repo%20market_8%20Feb%202012.pdf

²² <https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG-Proposed-Best-Practices-on-Treasury-Repo-Risk-Management>

Other potential measures to enhance gilt repo market resilience

Q14. *Aside from greater central clearing and minimum haircuts in non-centrally cleared transactions, what are the measures, or combination of measures, that you think could effectively alleviate different constraints to the expansion of gilt repo lending in a stress?*

Firstly, as already explained, minimum haircuts applied to non-centrally cleared transactions will not alleviate constraints to the expansion of gilt repo lending in stressed markets. Rather it will constrain gilt repo lending under normal market conditions.

However, there are a number of potential measures that the Bank and UK policy makers could consider in order to enhance gilt market resilience, particularly in times of stress and in light of the significantly expanded, and potentially increasing, size of the underlying market.

An important initiative could be to modernise and refine the SMF and its various operations. Not only is the effective transmission of monetary policy under all market conditions a critical element of market resilience, but the SMF can also be a source of market stability. ICMA has identified a number of potential improvements, which it previously outlined in its response to the Bank's discussion paper on transitioning to a repo led operating framework (January 2025).²³

- Firstly, the operations are not true repo operations, but rather secured loans. Currently this requires pre-positioning of gilts, or other securities, with the Bank, with payment being received much later in the day.²⁴ This creates an intraday liquidity drain on banks, which is not only expensive, but could be destabilising in times of stress, particularly with the Bank becoming a key source of liquidity. The Bank should consider moving to a delivery-versus-payment triparty model as its standard operating model (as opposed to "on request").
- More regular STR and ILTR operations (ideally daily) would further help provide stability to the market, as would a longer window for their operation. In the case of the ILTR, greater flexibility with respect to term (such as multiple time periods or the ability to close-out early) would also be seen as positive.
- Providing an option to access the STR via central clearing, including a client clearing option, could provide more netting opportunities for banks with more incentive to use the operations during times of stress (see points in the response to Q8 related to the ECB and Federal Reserve).
- De-stigmatising the OSF could help to create an effective corridor for gilt repo rates, similar to the Fed's ON RRP. To this end, a tom-next facility for the OSF would be a further helpful development.

Other potential measures to enhance gilt repo market resilience that were considered by ICMA's Taskforce include:

- The option to exclude bank holdings of gilts from the leverage ratio in times of stress. This could help to free up the intermediation capacity of banks at a time when it is most needed.

²³ https://www.icmagroup.org/assets/documents/Regulatory/Repo/ICMA-ERCC-reponse_BoE-Transitioning-to-a-repo-led-operating-framework-DP_Jan-2025-310125.pdf

²⁴ While the Taskforce acknowledges that DBV against payment (DvP) is possible through CREST, this is not standard settlement and needs to be pre-agreed.

- Exempting the STR from the leverage ratio could also be an effective policy tweak, and a potential alternative to making the facility available in clearing.
- Reviewing the calibration of the leverage ratio more broadly with respect to the role of GEMMs in gilt market-making, and the extent to which this becomes a binding constraint on their ability to support market liquidity, including via the repo market.
- Revising CREST's opening hours so that it is aligned with the ICSDs, thereby allowing more time for cross-(I)CSD settlement.
- Looking at best practices for settlement efficiency, such as those put forward in the ICMA Secondary Market Rules & Recommendations²⁵ and the ERCC Guide to Best Practice in the European Repo Market,²⁶ covering tools such as shaping, partialling, and the use of CSD auto-lend/borrow programs. Some of these have also been included in the UK's T+1 implementation plan.²⁷
- Looking at gilt repo market best practices more broadly, perhaps with a view to aligning the Bank's Money Market Code more closely to European repo market standards (as per the ERCC Guide), as well as encouraging wider and more consistent adoption by market participants (similar to the US TMPG).

A further suggestion from members is for the Bank, along with the UK DMO and HM Treasury to review their scope mandate with respect to market intervention, including the repo market, to support liquidity and stability. They note that compared to some of its peers, the gilt repo market often behaves unpredictably, with observations of erratic volatility and price gapping. Perhaps more could be done by market authorities to smooth out some of this price behaviour. This could also be helpful in attracting more market participants, particularly those that rely on leverage and where price predictability is particularly important.

In short, there are a number of positive and relatively straightforward measures that the Bank and UK policy makers could consider in order to enhance gilt cash and repo market resilience beyond greater access to central clearing.

Q15. *In particular, what are the risks and benefits associated with greater private and public disclosures of leveraged positions generated via gilt repo? How do you expect market participants' behaviour to evolve as a result of these potential measures?*

ICMA does not consider that enhancing public disclosures would support market participants in enhancing their liquidity or counterparty credit risk management. Transparency can be beneficial in some circumstances, but there are trade-offs to take into consideration, particularly in the case of public disclosures where it could reveal positions which could be detrimental to some business interests.

From the perspective of fiduciary duty, financial entities cannot be forced to make public any information which may harm their clients' interests. From a risk management perspective, exposing

²⁵ https://www.icmagroup.org/assets/ICMA_Secondary-Market-Best-Practice-in-support-of-settlement-efficiency_June-2022.pdf

²⁶ <https://www.icmagroup.org/assets/Uploads/Compilation-of-ERCC-BP-on-settlement-efficiency.pdf?vid=2>

²⁷ <https://acceleratedsettlement.co.uk/wp-content/uploads/2025/09/AST-Final-Final-Report.pdf>

positions of liquidity providers could also harm liquidity provision and pricing. Public disclosures also risk sending the wrong signal to the market and triggering herd behaviour of fire sales.

ICMA further notes that there are already extensive robust pre-and post-trade reporting requirements and public disclosures in most jurisdictions. Authorities, including those in the UK, should prioritise assessing the effectiveness of the information sharing between the jurisdictions and simplify reporting procedures where possible. The priority focus should be on international harmonisation of existing disclosures, especially in the already highly regulated markets of the US, EU and UK.

While the SWES was a useful exercise (and is now being replicated or considered in other jurisdictions, its scope was relatively narrow, and so did not capture full extent and complexity of market. The Bank could consider widening the pool of entities for any future SWES exercises.

Finally, the Bank, in cooperation with the FCA, should review their current sources of market data, including SFTR, AIFMD/UCITS reporting, EMIR, and MiFIR, to identify what is useful, what is not, and what is missing. This could also provide an opportunity to simplify significantly existing reporting frameworks as well as making them more useful from the perspective of monitoring and identifying systemic risks.

Q16. *In your view, what is likely to be the most effective combination of potential reforms to effectively address the vulnerabilities in the gilt repo market and enhance its resilience?*

The continued expansion of the gilt market in response to fiscal policy naturally makes the gilt market more vulnerable, increasing sensitivity to short-term shocks both in the UK and elsewhere. As discussed in this response, central clearing provides a number of advantages, and the ICMA Taskforce supports measures to be taken to support and incentivise its greater adoption. Notwithstanding, this, by itself, will not address the paper's concerns related to market stability. On the contrary, mandating central clearing for gilt repo would likely be destabilising for certain counterparties and repo activity, particularly in times of heightened volatility, as well as being challenging to implement. Meanwhile, important to note that introducing minimum haircuts for noncleared repo would make the gilt repo market more expensive and less efficient in normal market conditions. Minimum haircuts are not the appropriate policy lever to address market resilience.

Ultimately, better monitoring of the market and greater visibility of emerging risks to stability is key, and in theory should be possible with the existing reporting regimes. Improved and consistent risk management practices by investment firms will also contribute. From the perspective of enhancements to repo market structure, this response has outlined a number of considerations for the Bank and UK policy makers, not least the modernisation of the Bank's SMF. None of these are "silver bullets" in their own right, but in combination they could at least help to support repo market efficiency and stability under normal conditions, while bolstering market resilience in times of stress.

Annex 1: Impact of Repo Haircuts on Gilt Market Relative Value Trades

The following trades are typical relative value (RV) trades that a leveraged investment fund (hedge fund) may consider. In all cases they are targeting marginal gains from small price discrepancies between bonds or bonds and derivatives. Carry (ie the repo rate) is an important consideration in these trades, since this could be the driver of any potential profit. Haircuts are an additional cost to the repo (or reverse repo), which impacts the economics of the trades.

We have selected four common RV strategies that might be used by hedge funds. We use market prices and repo rates. In calculating the impact of haircuts on the repo rate, we have assumed a cost-of-capital of 10%. Any additional funding, or overcollateralization, resulting from the haircut is funded through capital, and we have adjusted the repo or reverse repo rates accordingly. All the trades are viewed on a one-month horizon.

Curve Trade

A common play is the slope of the yield curve. In this example, the trade is a 2s-10s flattener, whereby the fund buys the 10yr on the run gilt, and sells the 2yr on the run gilt, with a view to 10yr yields narrowing with respect to the 2yr yields. The trade is largely non directional, and in the case of a market sell-off, could be viewed as countercyclical, since many real money investors will be looking to sell duration and seek safety in the short end of the curve. This is the opposite trade.

									Haircut:	2%	2	Haircut:	5%	5			
Gilt	Pstn	Spot price	Spot Yld	Sprd	Repo rate	1mth Px	1mth Yld	b/e	Equiv rep	1mth Px	1mth Yld	b/e	Equiv rep	1mth Px	1mth Yld	b/e	
UKT 3.75 3/27	-	1,000,000	100.00	3.750	3.75%	100.0000	3.746		3.550	99.9824	3.762		3.250	99.9558	3.785		
UKT 4.5 3/35		1,000,000	100.04	4.494	0.744	3.90%	99.9877	4.501	0.755	4.022	99.9985	4.499	0.737	4.205	100.0147	4.497	0.712

In this scenario, the 2yr gilt is yielding 3.750% and the 10yr gilt is yielding 4.494. The fund is therefore looking to “sell the curve” at +74.4bp, looking for this to move lower. Applying the market one-month reverse (2yr) and repo (10yr) rates, the trade generates positive carry. This means that on a one-month horizon the fund would get paid for holding this trade even if the curve does not move. In fact, the curve could steepen to +75.5bp before the fund would lose money.

Introducing haircuts to both funding legs significantly changes the carry. Applying a 2% haircut would require the curve to flatten to +73.7bp before the fund would make any profit. A 5% haircut on each leg would move to the break-even rate even lower to +71.2bp.

The loss of positive carry, and lower break-even rates, may make this trade less attractive.

Basis Trade

In the classic cheapest-to-deliver carry trade, the fund buys the CTD gilt and sells the exchange traded bond future. If the implied repo rate from entering into this trade (effectively a synthetic repo) is higher than the market repo rate, the buyer of the basis will earn positive carry into the futures expiry and delivery (although they may be able to unwind for a profit without going to delivery). Essentially, this can be viewed as leveraged funds being paid to warehouse gilts in the absence of real money buyers.

In this scenario, the CTD gilt (UKT 3.75 1/38) has a net basis of -4.0c. In other words, after locking in their repo funding for the long bond position, the fund is paid 4c for carrying the bonds to delivery.

							Haircut	2%		Haircut	5%
	Pstn	Spot price		Gross	Repo rate	Net basis	Equiv repo	Net basis		Equiv repo	Net basis
UKT 3.75 1/38	1,000,000	90.59		-0.026	3.90%	-0.04	4.022	-0.029		4.205	-0.013
GZ3	-	980,000	92.84								

When we introduce haircuts, the profit from the trade (ie the net basis) is diminished. In the case of a 2% haircut, the profit from the trade reduces to 2.9c. And in the case of a 5% haircut, this becomes a mere 1.3c. This would likely be seen as too marginal to make the trade attractive.

On-the-run vs off-the-run

In this strategy, funds identify small pricing (ie yield) anomalies between a benchmark gilt and bonds with similar maturities, looking to profit from these reverting to more aligned pricing.

Here we use the example of the current on-the-run 5yr gilt (UKT 4.375 3/30) and an old, low coupon bond that has rolled down the curve and has 5 months shorter maturity than the 5yr (UKT 0.875 10/29). Here the fund looks for the current yield spread between the two bonds to narrow from the current level of 22.4bp (ie the 5yr benchmark is 22.4bp cheaper than the shorter maturity off-the-run).

									Haircut: 2%			Haircut: 5%					
Gilt	Pstn	Spot price	Spot Yld	Spnd	Repo rate	1mth Px	1mth Yld	b/e	Equiv rep	1mth Px	1mth Yld	b/e	Equiv rep	1mth Px	1mth Yld	b/e	
UKT 4.375 3/30		1,000,000	101.89	3.890		3.90%	101.8550	3.889		4.022	101.866	3.887		4.205	101.8820	3.882	
UKT 0.875 10/29	-	1,000,000	89.94	3.666	-0.224	3.80%	90.869	3.662	-0.227	3.600	90.1472	3.667	-0.220	3.300	90.1235	3.674	-0.208

Based on the one-month repo rates to fund the trade, it has small positive carry, meaning that the fund is paid to own the 5yr benchmark and sell the older bond (the one-month breakeven is a slightly wider 22.7bp).

When we introduce haircuts, the carry dynamic changes, and it now costs the fund to hold this trade. In the case of a 2% haircut applied to each leg, the one-month breakeven is 22bp, while for a 5% haircut this is 20.8bp. The lack of positive carry may make this trade less appealing.

Swap spreads

Another classic carry trade is for funds to buy bonds and pay an interest rate swap with the same maturity, particularly where the bond yield is higher than the fixed rate on the swap (effectively they earn the bond yield, pay the swap fixed rate, and earn the difference).

Here we look at holding the 2yr benchmark gilt (UKT 3.75 3/27) against SONIA. This currently provides a spread of 16.8bp. After locking in one-month funding, the breakeven for the trade narrows to 15.3bp (noting that shorter maturities are more sensitive to repo funding rates).

									Haircut:	2%			Haircut:	5%		
				Sprd	Repo rate	1mth Px	1mth Yld	b/e	Equiv rep	1mth Px	1mth Yld	b/e	Equiv rep	1mth Px	1mth Yld	b/e
UKT 3.75 3/27	1,000,000	100.05	3.706		3.90%	100.0635	3.691		4.022	100.0743	3.682		4.205	100.0904	3.668	
SONIA	1,000,000		3.538	0.168			3.538	0.153			3.538	0.144			3.538	0.13

After applying haircuts to the repo rate, the breakeven narrows further: to 14.4bp (-2.4bp) in the case of a 2% haircut, and 13.0bp (-3.8bp) in the case of a 5% haircut. Given that the current 2yr gilt swap spread has a standard deviation of 1.5bp, the haircuts would likely render this trade as too expensive.

Conclusion

Haircuts need to be viewed as an adjustment in the repo rate, making financing more expensive. This effective change in the cost of repo financing changes the carry dynamics associated with relative value trades, such as those outlined above, making them more marginal, less attractive, and possibly unviable. This will have consequences for underlying market activity and liquidity, as well as pricing. It also makes holding gilts more expensive.

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AMIC@icmagroup.org

Contacts:

Andy Hill, Managing Director, Co-Head of Market Practice and Regulatory Policy, ICMA
andy.hill@icmagroup.org

Alexander Westphal, Senior Director, Secretary to the European Repo and Collateral Committee, ICMA
alexander.westphal@icmagroup.org

Irene Rey, Associate Director, Secretary to the Asset Management and Investors Council, ICMA
Irene.rey@icmagroup.org