

CPSS report: Strengthening Repo Market Infrastructures

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Outline

- What role did clearing and settlement infrastructures play during the crisis?
- And how can clearing and settlement arrangement be strengthened?
- Looking ahead: issues for the euro area

Cash-driven Repo

A vital source of secured financing for banks and financial institutions

Severely impacted by the crisis, particularly in some countries

repo clearing and settlement arrangements

- Bilateral settlement
- Triparty repo
- Central counterparties (CCPs)-cleared repo

About 50% of total
repo business
in both EU and US

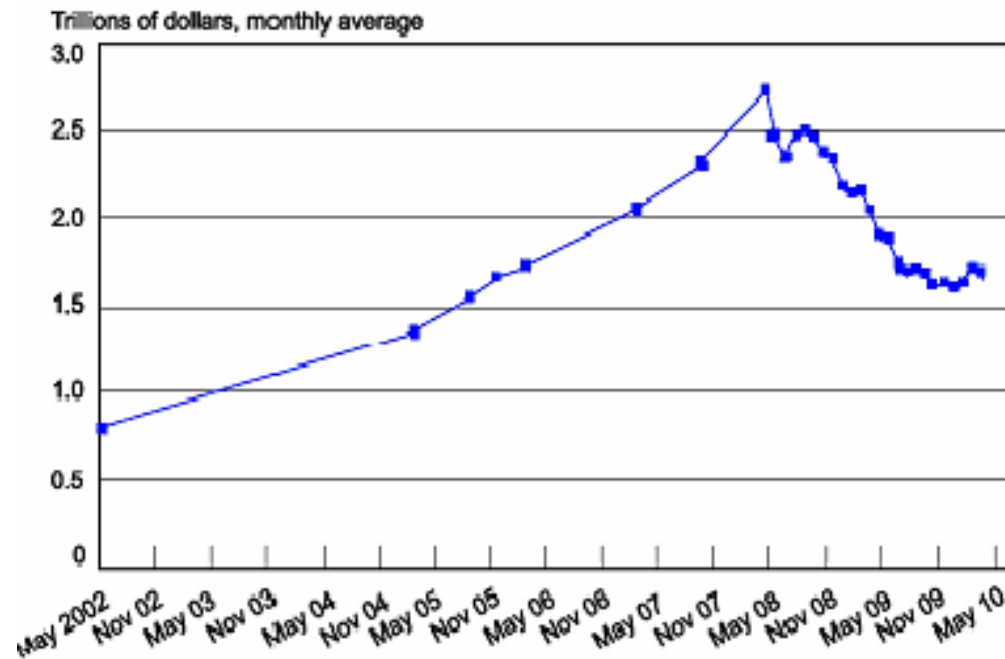
EU: less than 10% of repo business
US: about 50% of repo business

EU: about 40% of repo business
Very limited in US

Repo markets less stable than expected source during the crisis..

- While repo business declined in most surveyed markets...

US Triparty repo Aggregate value of market

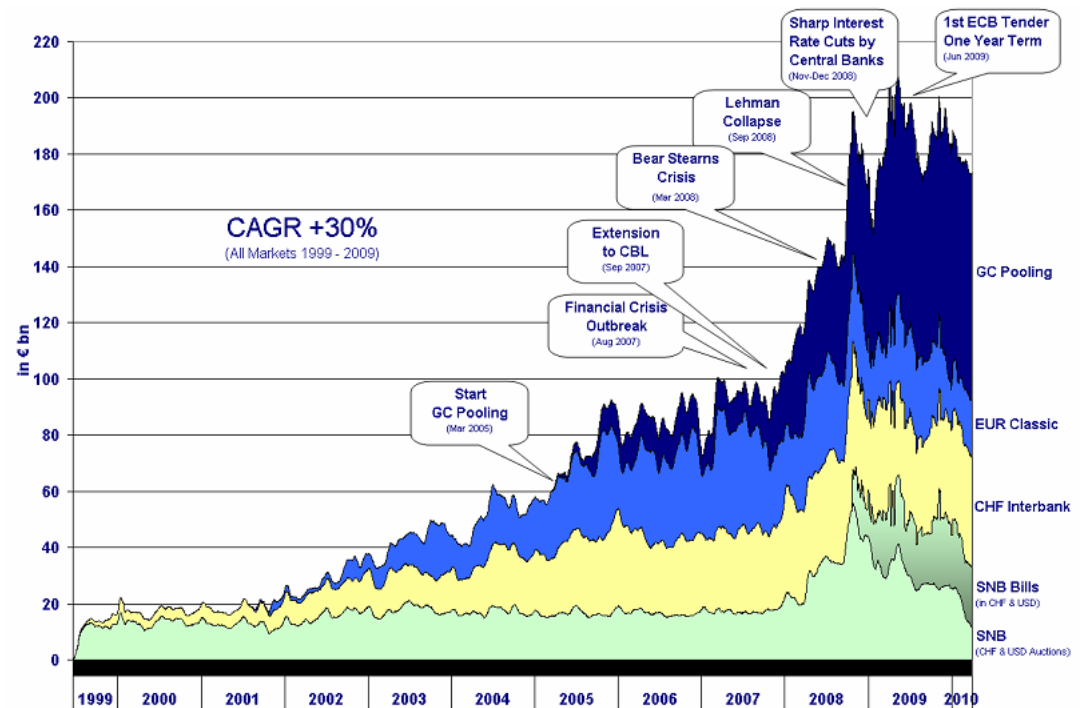


Source: JP Morgan Chase and BONY Mellon,
reported by Fed NY, May 2010

...with a few exceptions

- ...some market segments actually increased
- (similar increasing business trend in other CCPs)

Eurex Repo



Source: presentation by Eurex at ECB COGESI workshop, May 2010

Role of clearing and settlement

BIS - Committee of Payment and Settlement Systems, Report on strengthening repo clearing and settlement arrangements market (September 2010) :

- Did clearing and settlement arrangements play a role?
- Can market infrastructures be strengthened to improve resilience of the repo market, and
- How?

CPSS Report on repo market infrastructures

Main findings:

- Yes, C &S arrangements had the potential to amplify risk concerns of market participants during the crisis...
-but also to alleviate them
- identified **7 areas** for possible improvement of infrastructures

Issues (and areas for improvement) for market infrastructures

1. Risks related to extension of significant amounts of **intra-day credit**
2. Lack of market participants' **awareness** of repo infrastructure roles, responsibilities, practices and procedures
3. Concerns regarding **protection** against counterparty credit risk
4. Inadequate capabilities for **liquidating repo collateral**
5. **Inefficient use of collateral**
6. **Pro-cyclical effects** of certain risk management practices
7. **Insufficient transparency** in the repo market

Conclusion of report

But not all issues relevant in each market

Stakeholders in each market to review how repo market infrastructure could be further strengthened

Step 1 Develop common view of relevance of issues for each market

Step 2 Evaluate which measure(s) most suitable

Example 1 - US triparty repo

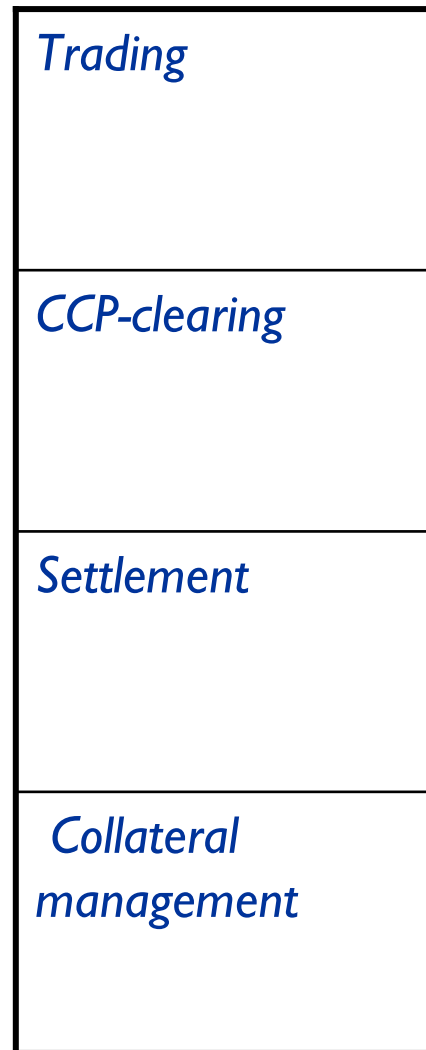
- Whole triparty repo market relies on clearing and settlement in the books of 2 clearing banks (JP Morgan and BONY)
- “Unwinding”: a large size of the outstanding repo market unwound every morning and collateral reversed, to allow for collateral substitution by cash borrowers (mainly broker-dealers)
- As cash is returned to cash-lenders, borrowers go to clearing banks for huge amounts of intra-day credit until unwound repos will be re-entered in the system

Example I - US triparty repo

- In crisis, concerns on soundness of large broker-dealers
- cash lenders (mainly money market funds) unwilling to enter/stay in the market
- Settlement in commercial bank money: Concerns on the soundness of the 2 clearing banks could have precipitated further the crisis
- Clearing banks (had to) cut intra-day credit lines significantly
- Risk of securities fire sales, plus difficulties in collateral liquidation

The market (under Fed NY aegis) launched an initiative to reform the US triparty infrastructure

Example 2 - Resilience of CCP-cleared repo in EU



Up-stream integration:

- *anonymous trading and clearing and*
- *Credit risk relief*

Down-stream Integration:

- *of CCP with triparty service provider*
- *of triparty service with central bank collateral management (e.g. outsourcing by Bundesbank, re-use of repo-collateral in credit operations with Eurosystem)*

Benefits of CCP-cleared repo

- Participants exposed to CCP rather than each other, and integration with anonymous trading platforms
 - ⇒ reduced counterparty credit risk concerns
- Clear roles and responsibilities of CCP
 - ⇒ reduced uncertainty
- CCP responsible for collateral liquidation
 - ⇒ reduced uncertainty
- Sound and Transparent risk control measures
 - ⇒ lower pro-cyclicality effects (compared to informal infrastructures)

But CCP-clearing is not necessarily a panacea

Many factors need to be considered:

- Market size and structure
- Cost
- Systemic risk
- Access to CCP clearing
- Impact on market liquidity
- Efficiency of, and access to, the settlement layer

Looking ahead, issues for the euro area

- **Frictions to access and integration** between the clearing and settlement level remain an obstacle to exploiting all business opportunities
- **Insufficient integration at settlement level** limits efficient use of collateral, particularly at cross-border level
- T2S and CCBM2 will bring benefits to repo market participants and infrastructures



by removing geographical segmentation in securities settlement

(e.g. facilitates cross-system settlement)



by supporting swift and efficient handling of collateral

(e.g. including cross-border use of triparty collateral management services)

Questions to the market

Which among the following issues you see as relevant for the euro area and in case what options to address them do you consider appropriate?

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2. Lack of market participants' **awareness** of repo infrastructure roles, responsibilities, practices and procedures
3. Concerns regarding **protection** against counterparty credit risk
4. Inadequate capabilities for **liquidating repo collateral**
5. Inefficient **use of collateral**
6. **Pro-cyclical effects** of certain risk management practices
7. Insufficient **transparency** in the repo market