

Position limits for the Italian Repo Market

Background

- Cassa di Compensazione e Garanzia (CC&G) and LCH Clearnet SA are two CCPs.
 - CC&G belongs to Borsa Italiana, which in turn belongs to the **London Stock Exchange Group**
 - LCH Clearnet SA belongs to LCH Clearnet Group Ltd, whose controlling shareholder (57.8%) is the **London Stock Exchange Group**
- Together, they have a very large share of repo market in Italian paper.
- LCH Clearnet SA is submitted to regulation by the Autorité de Contrôle Prudentiel, Banque de France, Autorité des Marchés Financières, Banque National de Belgique, De Nederlandsche Bank, Autoriteit Financiële Markten, Banco de Portugal, Comissão do Mercado de Valores Mobiliários
- CC&G is jointly regulated by Banca d'Italia and CONSOB

What's new

- LCH-Clearnet wishes to tame the risks arising from using Italian debt collateral.
- In practical terms, they have lowered the thresholds above which larger haircuts are applied.
- As a consequence, large reverse-repo investors, keen to have Italian debt as a collateral, demand higher rates for their monies.

Before, LCH applied the following rules:

- As far as “large exposures” limits were concerned, thresholds were already in place:

Threshold 1: €5 bln

Threshold 2: €10 bln

LEM* 1: 10% of the difference between the current net open position and Threshold 1

LEM* 2: 20% of the difference between the current net open position and Threshold 2

Total LEM = LEM 1 + LEM 2

above these thresholds, LCH asked more cash/collateral.

- On top of the above, investors bore a:

Term Concentration Limit: €2 bln, above which a Term Concentration Margin will be applied:

Term Concentration Margin: 5% of the difference between Forward Open Position and the TCL

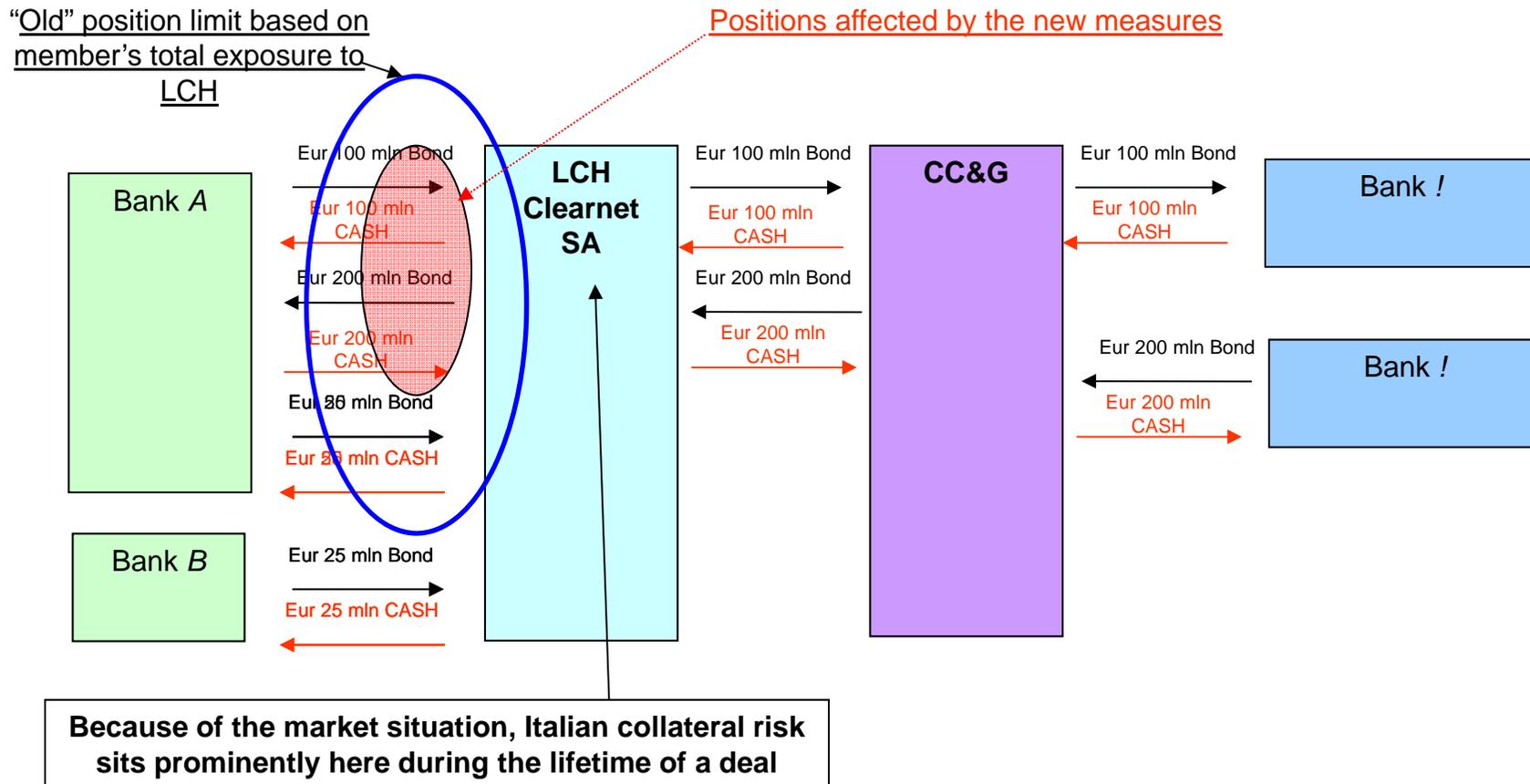
- **These limits were not applied by CC&G to its counterparties**

LEM=Large Exposures Margin

Forward Open Position is the maximum absolute daily net open position as of 30 calendar days, from a given business date to the last settlement date of all transactions (open and fwd)

Affected transactions

- When dealing with **Italian paper as collateral**, investors will bear a higher cost and/or obtain lower liquidity versus pre 10th may situation



New thresholds after May 31st

“OLD”

Threshold 1: €5 bln

Threshold 2: €10 bln

TCL: €2 bln

“NEW”

Threshold 1: €3 bln

Threshold 2: €10 bln

TCL: €2 bln

To be applied for each firm, each member, each account

Effects/consequences

- **Investors in Italian paper must pledge a higher amount of cash collateral, which is non remunerated;** implicit total return of a reverse repo transaction is lower.
- If an investor would use bonds as collateral instead of cash, **available counterbalancing capacity would be reduced.**
- Because of the different composition of LCH and CC&G's clients base (generally investors for the former, generally borrowers for the latter), prices have started to differ for those trades using only CC&G as CCP and those trades using both CCPs. **Some counterparties exit the CCP channel and seek bilateral business.**
- CCP are privately owned, locally regulated entities; **decisions on their risk assessments may have profound impacts on markets structure.**
- Increased cost of financing and potential reduction in the available market liquidity, may have negative implications on the interest rate structure of debt and on issuing capabilities.