ICMA

International Capital Market Association

EUROPEAN REPO COUNCIL

PRESS RELEASE

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The systemic importance of collateral and the role of the repo market - ICMA European Repo Council paper highlights the disruptive impact of the proposed FTT on the widespread use of collateral that underpins the modern financial system

A supplementary paper from the ICMA's European Repo Council explains the importance of collateral to the stability and efficiency of the financial system. It highlights how the proposed Financial Transaction Tax (FTT) would impact the movement of collateral, posing significant systemic risks and interrupting the flow of money between banks, to governments and to the real economy.

The paper notes that global regulatory initiatives such as Basel III are built on the even more extensive use of collateral. Collateral is essential to the intermediation of credit through the financial system to the real economy, which makes it of macro-economic importance. Furthermore collateral is also the link between the financial markets and central banks and therefore crucial to the conduct of monetary policy.

Collateral is priced, mobilised and moved in the repo market. This paper, produced for the ICMA ERC by Richard Comotto, an academic from the ICMA Centre at Reading University, suggests that regulators, central banks, financial intermediaries, investors and borrowers should be seriously concerned by the prospect of the FTT, as one of its major effects would be to make collateral movements prohibitively expensive and, by extinguishing the repo market, it would disrupt the matching of supply and demand for collateral.

The paper concludes by questioning why the European Commission is proposing to replace repo with secured loans when repo is already doing the job very well.

Godfried De Vidts, Chair of the ERC said: "Every single home owner understands the value of collateral, as home loans are only available from mortgage providers against the security of bricks and mortar. Similarly, for today's financial markets, collateral represents the raw material underpinning the G20 regulatory requirements for safer centralised and bilateral clearing, as well as the implementation of central bank monetary policy. The current FTT proposals would paralyse the movement of collateral, damaging its essential role at the heart of markets."

'A supplementary note on the systemic importance of collateral and the role of the repo market' published 7 May 2013 is available from: www.icmagroup.org

This paper follows on from an earlier paper: 'Collateral damage: the impact of the Financial Transaction Tax on the European repo market and its consequences for the financial markets and the real economy' published on 8 April 2013 available from: www.icmagroup.org

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Notes for editors

For more information about the operation and functions of the repo market see: http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/frequently-asked-questions-on-repo/

International Capital Market Association (ICMA) and European Repo Council

ICMA represents financial institutions active in the international capital market worldwide. ICMA's members are located in 50 countries. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. The ICMA European Repo Council is a special interest group established under the auspices of ICMA to represent the major banks active in Europe's cross-border repo markets.