

# CCP client-clearing - ERCC Professional Repo Market and Collateral Management workshop 2021

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# Drivers behind central clearing for repos for clients (1/3)

- (Reverse) repo transactions are expensive for banks from a leveraged based capital cost point of view as received collateral cannot be offset (CRR II Article 429b (1)(b))
- Balance sheet (leverage ratio) netting can reduce costs for banks, but it is not permitted across multiple bilateral (reverse) repo counterparties (CRR II Article 429b (4))
- Banks have a regulatory incentive to hold HQLA given LCR, but are disincentivised to raise cash through short-term repos under NSFR (CRR II Article 428k (3)(c))
- Regulatory driven counterparty & collateral concentration limits (CRR II Articles 401 (4) and 403 (1)(b)) and SFTR reporting requirements increase costs further for banks
- Banks frequently not able to charge full costs of repo business due to competitive pressures
- As a result, banks have frequently restricted buy-side's access to its balance sheet for bilateral (reverse) repos or dropped out of the market altogether

# Drivers behind central clearing for repos for clients (2/3)

- Meanwhile, buy-side demand for (reverse) repo is increasing due to
  - (1) collateralisation requirements<sup>1</sup> from cleared & uncleared derivatives,
  - (2) risk considerations, and
  - (3) search for yield
- In addition, existing operational capabilities at buy-side are frequently inadequate to meet new enhanced collateral management requirements, e.g. often not possible to raise cash via bilateral repos intraday to meet potential margin calls
- Therefore, whilst buy-side demand for (reverse) repo increases, the sell-side cannot provide sufficient (reverse) repo capacity for some clients

<sup>1</sup>See [recent Risk.net survey on Buy-side focus areas](#) in 2021 and beyond

# Drivers behind central clearing for repos for clients (3/3)

- CCP cleared client repos can increase banks' repo business profitability, improve available repo balance sheet capacity to buy-side, enhance operational efficiency and mitigate counterparty risk given:
  - (1) improved likelihood of repo balance sheet netting for banks as CCP sole counterparty<sup>1</sup>,
  - (2) reduction in risk based capital costs through multilateral netting and 2% risk weight (CRR II Article 306)
  - (3) removal of regulatory counterparty & collateral concentration limits for banks (CRR II Article 400 (1)(j) and 403 (1)(b)),
  - (4) standardisation of legal documentation & processes, and
  - (5) increase in liquidity as number of trading counterparties and product set grows substantially<sup>2</sup>
- In addition, overall market resilience and transparency is greatly improved
- Eurex quantified the benefits in a recent [whitepaper on CCP cleared client repo](#)

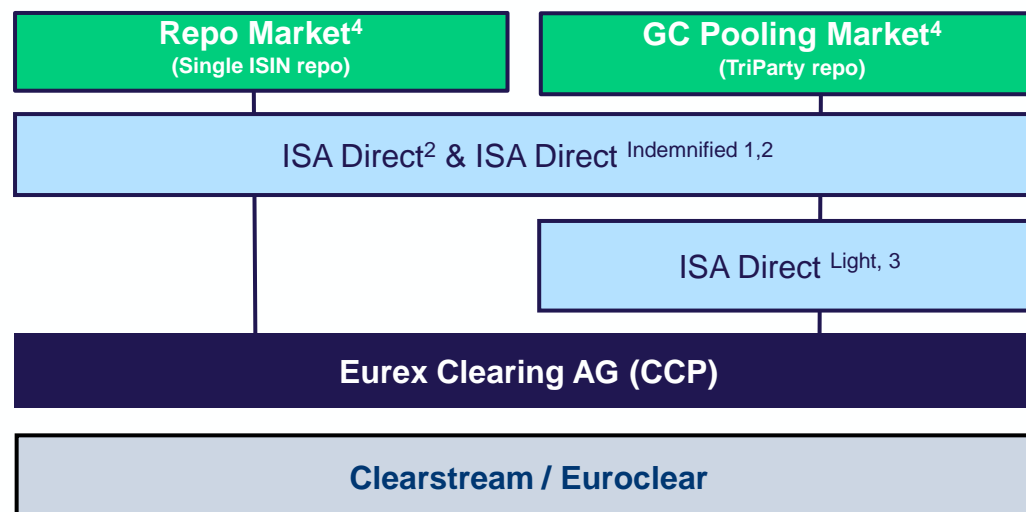
<sup>1</sup> see also [Eurex'whitepaper on balance sheet netting](#); <sup>2</sup> E.g. Eurex Repo has more than 150 participants as per [Eurex Repo participants list](#) and accepts more than 14,000 ISINs as collateral

denominated in various currencies

# Eurex Clearing's "ISA Direct" buy-side repo offering meets core requirements of sell- and buy-side

- Traditional client clearing model not suitable as any back-to-back CCP cleared repo between buy-side, clearing member and CCP results in prohibitively high capital cost for clearing members
- Buy-side needs to become a direct counterparty to the CCP in a centrally cleared repo offering
- However, buy-side typically not permitted or willing to contribute to the mutualised CCP's default fund or participate in the mandatory CCP default management process (DMP)
- Therefore, all Eurex repo clearing models for the buy-side have three main components:
  - (1) Buy-side has contractual relationship with the CCP & sole legal responsibility to perform on the (reverse) repo towards Eurex and vice versa,
  - (2) Buy-side has no legal obligation to contribute to the CCP's mutual default fund, and
  - (3) Buy-side has no legal obligation to participate in DMP

# Eurex offers three distinct repo clearing models for the buy-side: ISA Direct Light, ISA Direct & ISA Direct Indemnified<sup>1</sup>



<sup>1</sup> ISA Direct Indemnified clearing model received regulatory non-objection in 2021 and is expected to launch formally in Q4 2021

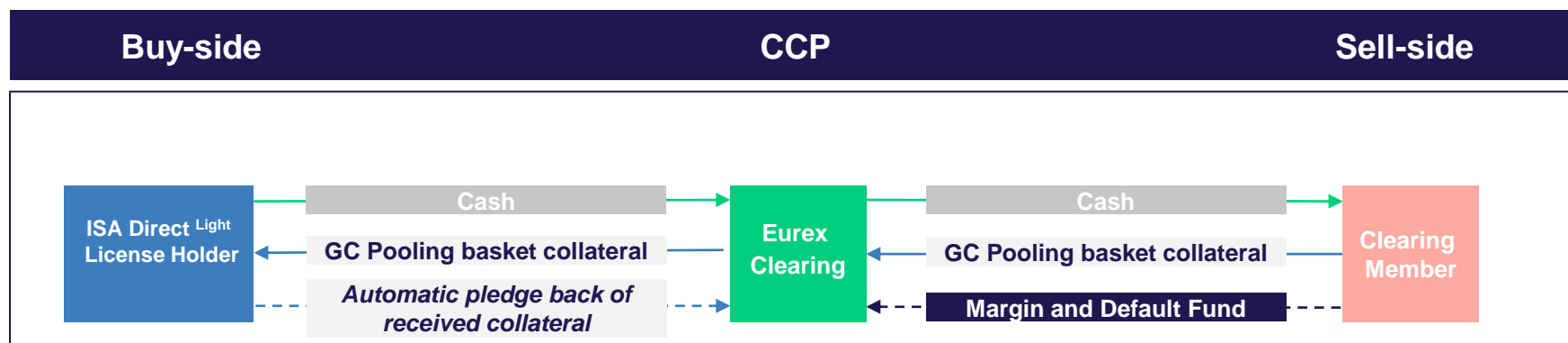
<sup>2</sup> ISA Direct & ISA Direct Indemnified Clearing Members can buy and sell securities in both repo market segments offered by Eurex Repo

<sup>3</sup> ISA Direct Light License Holders are required to be a net cash provider at all times and can only access the GC Pooling repo market segment offered by Eurex Repo

<sup>4</sup> See [Eurex Repo's](#) webpage for further details on eligible ISINs and currencies and on the repo trading and clearing offering in general

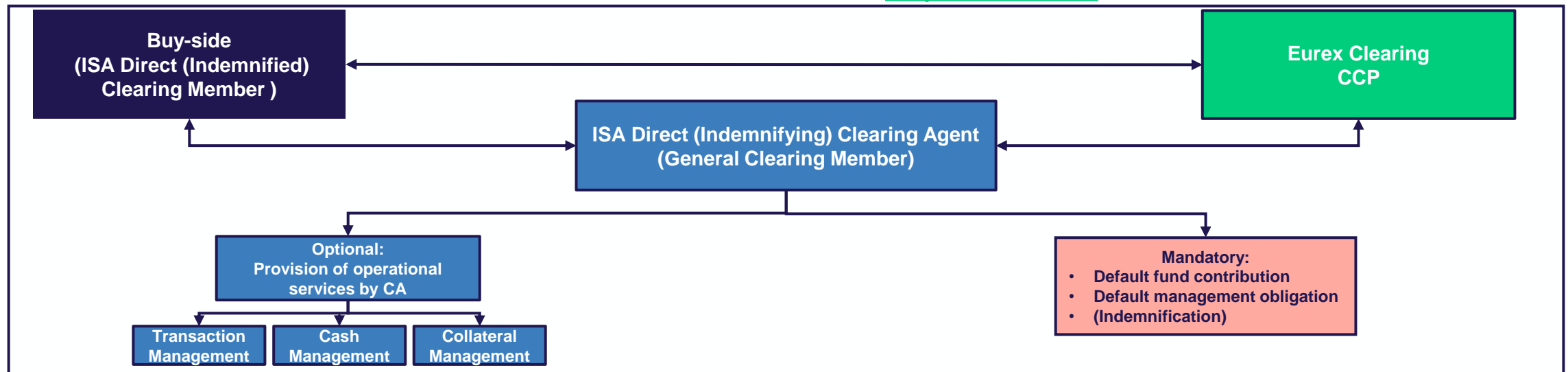
# ISA Direct <sup>Light</sup> was launched to allow for secure & efficient cash investment in Eurex benchmark GC Pooling repo market

- ISA Direct <sup>Light</sup> launched in 2013
- Trade Execution protocols: RFQ or Pre-arranged
- Target client base: Corporates, Insurances & Investment Funds
- Repo trading limitation: Cash providing only (but repos permitted to close positions)
- CCP Margin requirements for Buy-side: No
- Default Management requirements from supporting (Indemnifying) Clearing Agent bank: No
- Combination with OTC IRS clearing available: No



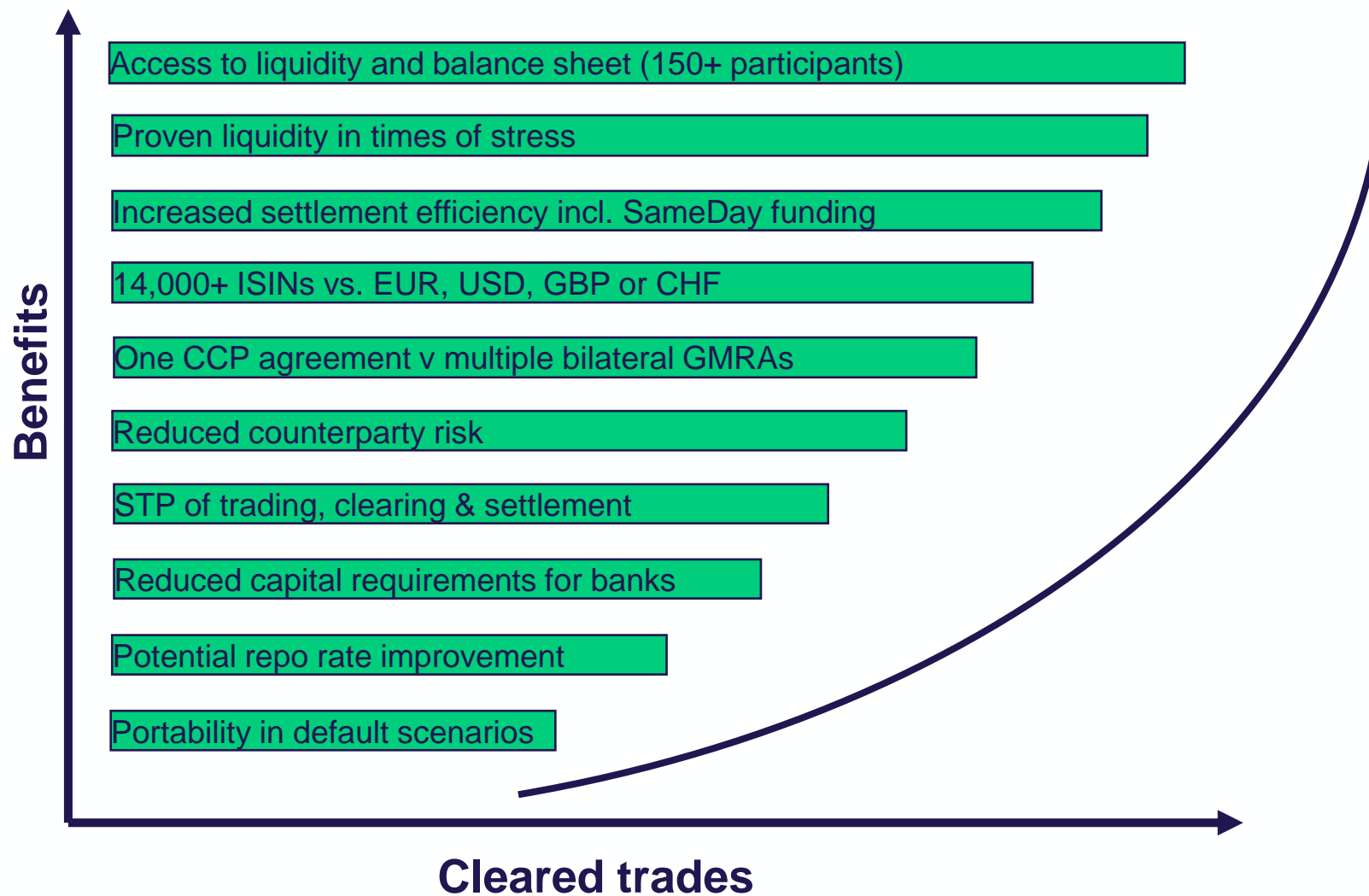
# ISA Direct & ISA Direct Indemnified grants buy-side full access to all of Eurex' centrally cleared repo markets

- ISA Direct launched in 2016; ISA Direct Indemnified in Q4 2021 (expected)
- Trade Execution protocols: RFQ or Pre-arranged
- Target client base: Pension Funds, Insurances & Investment Funds as well as Hedge Funds (ISA Direct Indemnified only)
- Repo trading limitation: none - cash taking & cash providing permitted
- CCP Margin requirements for Buy-side: Yes
- Default Management requirements from supporting (Indemnifying) Clearing Agent bank: Yes
- Combination with OTC IRS clearing available: Yes (ISA Direct only)
- See Eurex' short [animated video](https://www.eurex.com/ec-en/join/isa-direct) on ISA Direct for further details or visit <https://www.eurex.com/ec-en/join/isa-direct>





# Why CCP Cleared Repo? Higher capacity, lower risk, better economics



# Buy-side repo clearing already well established in US

- DTCC FICC launched their buy-side [sponsored repo clearing](#) offering already in 2005 with support of State Street, a global Custodian
- Initially only Overnight reverse repos were permitted
- Significant overhaul in 2017, e.g. allowing of cash taking, additional fund types incl. Hedge Funds
- Further expansion in 2019 as also broker dealers were allowed to become Sponsoring Members
- Currently approx 1,900 funds are registered as Sponsored Members
- Repo volumes peaked at USD 564bn in March 2020 but since then receded to a daily average of approx. USD 265bn
- Main differences to European buy-side clearing offering at LCH and Eurex
  1. No CCP margin requirements for buy-side even if cash taking
  2. No CCP clearing of front leg
  3. Large number of Sponsoring Banks (Indemnifying Clearing Agents at Eurex)

# Challenges for broad based take up of buy-side repo clearing in Europe

- Operational, market induced and regulatory challenges, e.g.
  - Implementation costs – often large project as infrastructure outdated
  - Clearing Agent support – limited number of Clearing Agents as some banks see disintermediation risks
  - Repo pricing – bilateral repo capacity sometimes used to win over more lucrative derivative business
  - CCP margining – haircuts not widely used, especially in reverse repos or on Government bonds
  - Clearing costs – Margin costs, clearing agent fees and CCP clearing fees need to be assessed
  - Market environment - ECB`s QE has lowered pressure to improve collateral management
  - European regulation not supportive – Buy-side repo clearing no considered properly in regulation, e.g. no carve out in EU MMF funds or UCITS V regulation on counterparty or concentration limits. See [Eurex whitepaper](#) for this and other items
- However, some first movers, mostly pension funds, have successfully taken up CCP cleared repos, e.g. watch [PGGM's verdict](#), a Dutch pension fund manager with more than EUR 268bn in assets, who reported an increase in repo capacity, operational efficiency and price transparency since going live at Eurex

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