# Question & Answer Report: ICMA Professional Repo Market & Collateral Management Online Course 2021

**Day 3 – Monday, 4 October 2021**

- **Tri-party repo --- application and developments,** Richard Glen, Head of Collateral Management, Clearstream
- **Triparty interoperability: connecting collateral pools,** Marije Verhelst, Director, Head Business Development Collateral Management and Securities Lending, Euroclear, Euroclear
- **CCP: margining & default management,** Dhruve Bhavsar, Head of Business Risk for RepoClear and EquityClear, LCH
- **CCP client-clearing,** Frank Odendall, Senior Vice President, Head of Securities Financing Product & Business Development, Eurex; Tom Archer, Product Development Manager, RepoClear and EquityClear, LCH
- **Electronic repo panel (D2D and B2D) -** John Edwards, Managing Director, Global Head of BrokerTec; Oliver Clark, Head of Product, MTS; James Kelly, European Head of Repo, Tradeweb; Gareth Mitchell, Co-Founder, Connexxion

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- **Q1:** Hi, with Euro zone do you mean all countries that use EUR? Or all Euro zone counties (incl Sweden, Denmark...)
- **A1:** All Eurozone countries

- **Q2:** With Blockchain settlement in Tri-party what are the main benefits other than speed of settlement? Can it provide other efficiency gains?
- **A2:**
    - Richard Glen: The baseline for a Blockchain settlement model sees collateral assets immobilized at different CSD and custodian locations and therefore reduces operating friction across the settlement process. This obviously has a significant benefit in terms of cost but it also comes with additional benefits e.g. increased opportunity for collateral optimization, more opportunities for faster collateral re-use across different products, harmonized reporting and connectivity models in particular for collateral receivers, streamlined asset servicing and regulatory reporting processes, simplified default management process.
    - Richard Comotto: Probably a good idea to look at HQLX. In addition to speed, DLT allows settlement at agreed and precise times (reducing capital and intraday liquidity) and easier interoperability, ie the parties can use different custodians and triparty agents.

- **Q3:** For floating rate repo in TP, how many times throughout the day is the rate updated?
- **A3:** A floating rate will only be updated when contractually specified, ie daily for OI. Triparty does make a difference to this.

- **Q4:** Will any clearing members who were invited to be part of the DMG be eligible to bid on the auction? If so, isn't there some sort of conflict of interest?
- **A4:** The DMG members act with fiduciary duty to the Clearing House. They are asked to provide advice on whom to invite to the auction. They can advise to invite their own firms if they feel they have balance sheet, but we will ensure a fair and competitive auction by inviting multiple members to the auction then taking the most competitive bid.

- **Q5:** What was the lowest level of waterfall that had to be used in past crises? Did LCH ever had to go beyond defaulter collateral and defauler individual contribution to the funds?
- **A5:** LCH have never been past the first layer of the waterfall for any previous Default - i.e. the default has been closed out within Defaulters' resources.

- **Q6:** How long does it take to complete the Default Management Process (in days)?
- **A6:** We aim to complete the the Default Management Process within 5 days. In reality in past Defaults and in the annual test exercises, we are able to manage a Default within 2 business days.

- **Q7:** My question is regarding practices on a long-term (2 years) repo agreement. In our example, fixed repo rate is applied annually and we are expected to receive no cashflow during the period but we are going to receive the repurchase amount at the end of 2 years. In terms of collateral, we are wondering, should we require a collateral that covers the initial purchase amount and increase it periodically to make sure exposure is backed by sufficient collateral. Could you please advise on what is the common practice for the long-term repos?
- **A7:**
    - <u>Richard Comotto</u>: The top up would be done by variation margin. Essential.Long-term repo often pay interest periodically.
    - <u>Dhruve Bhavsar</u>: If we draw parallels to the cleared repo space (LCH also offer 1 year term, 1 year forward starting repo). We would call Variation Margin Daily to account for the change in price of the bond used on the repo. In additon we would recalculate the IM daily and top up the IM on a daily basis if required.

- **Q8:** Can you give us an idea of the size of sponsored repo in Europe compared to US?
- **A8:** <u>Tom Archer:</u> US sponsored repo currently attracts larger volumes than European Sponsored Repo. I believe in the US its circa $250bn per day. Unfortunately I am not able to disclose any numbers on LCH sponsored volumes but whilst they are certainly lower than in the US, we have seen consistent growth since our launch in 2017. However it's worth remembering that Sponsored clearing in the US is far more mature (around since 2005) and available to a much broader set of entities (something which is being addressed over here in Europe as we seek to extend the range of buyside entities which can join the clearing house).

- **Q9:** What's the driver for regulation not permitting the buy-side to contribute to the mutualization process?
- **A9:** It's an open-ended risk that is likely to be beyond their risk management capabillity and not appropriate to investors like money market funds.

- **Q10:** Can you give us an idea of the costs involved in sponsoring? And how are they charged? If the are charged via the interest rate, how do sponsors cope with low interest rates and compressed spreads that barely allow to charge a margin?
- **A10:**
    - Direct clearing costs for a Sponsor (Agent) are relatively low and limited to the collateral charges for the margins/resources posted by the agent (to give you an idea, for non-cash collateral LCH charges circa 10bps for any margin utilised). Agent banks also need to factor in collateral funding costs and capital charges (e.g. Risk -based capital) for providing this service. whilst we are not privy to the capital calculations of

individual sponsoring banks, we think this would amount to a few basis points cost. in the current environment, as you point out it is indeed challenging. However, if the dealer banks can save balance sheet and capital through clearing (by netting client business), and this saving outweighs the costs of clearing (clearing fees, Agent capital costs, Agent fees etc), Sponsored repo can make commercial sense for all parties. A definite challenge in the current environment I agree - but this will not always be the case.
    - From a theoretical point of view, the cost of sponsoring is rather small for a Clearing Agent, as the agent is not part of the repo transaction

- **Q11:** This year the FICC in US expanded sponsorship from DVP to tri-party repo. Which model do we have in Europe? And what stands in the way of developing sponsored Repo in Europe?
- **A11:**
    - This is the Sponsored GC Service. But there was also triparty with the CCIT client-clearing service. In Europe, triparty is involved with all Eurex client-clearing except where trades are on Eurex Repo but Frank can confirm.
    - LCH: Just to pitch in from an LCH perspective - both the GC triparty offerings that are available to 'regular' member in LCH - Term Sterling GC (DBV) in LCH and EuroGC+ in LCH SA - are also available to sponsored members.

- **Q12:** How does the Agent Member finance the Default Fund contributions/Agent Resources? Does it request contributions from sponsored members? Or does the CCP (LCH) fund this via a different entity?
- **A12:**
    - Typically the Clearing Agent will provide the relatively small default fund contributions out of his own resources and then charge a clearing fee or perhaps a spread on the CCP cleared repo to cover his expenses
    - Tom Archer: LCH requires the Agent member themselves to provide the default fund directly. It is up to the Agent member as to whether they will fully fund it themselves (and perhaps incorporate the cost of doing this within Agent Fees charged to the Sponsored Member) or whether they expect the Sponsored member to provide the funds to the Agent. LCH is agnostic as to the arrangement here – it only required that the default fund is provided by the Agent

- **Q13:** Who Bears the cost of Sponsored repo? Is it mainly the sponsored borrower, the sponsored lender or is it charged evenly between both of them?
- **A13:** I don't think customers ever get anything free but if the bank is getting benefits (eg balance sheet), the cost will not be the full cost of sponsorship. Clearing fees are typically a direct cost to the buy-side connecting to the CCP. We would expect that this is more than compensated by more attractive repo rates and liquidity offered at CCPs

- **Q14:** How does the sponsored clearing model overcome the issue of mutualisation of losses from some clients e.g. MMFs
- **A14:** Buy-side is not required to contribute to the CCP`s default fund or participate in the Default Management. This is the legal obligation of the Clearing Agent

- **Q15:** Richard, can you please give some more details of the arbitrage between CCP repo clearing and synthetical repo?

- **A15:** I'm not sure CCP-cleared repos are used in arbitrages with synthetics.

- **Q16:** How can a trade be executed automatically, if there is not auto matching algo?
- **A16:** No.

- **Q17:** Gentlemen, you are surely aware about the breakdown in USD repo market in September 2019 and March 2020. what are the chances of a similar event in Europe and what are you doing to prevent it?
- **A17:** The September 2019 was a combination of special circumstances unique to the US and the moment (eg govi issuance, tax, concentration of bank capacity, concentration in overnight, etc). How do you think the March 2020 markets were different?

- **Q18:** If the platform is peer to peer, how do the clients decide on the correct rate to trade at, since this usually would come from the dealer who should have better visibility?
- **A18:** The correct rate is completely dependent on the counterparties involved and the collateral quality. The client has the ability to propose trades to their legally contracted clients and view the levels.