



## Professional Repo Market and Collateral Management Course *European repo market infrastructure*

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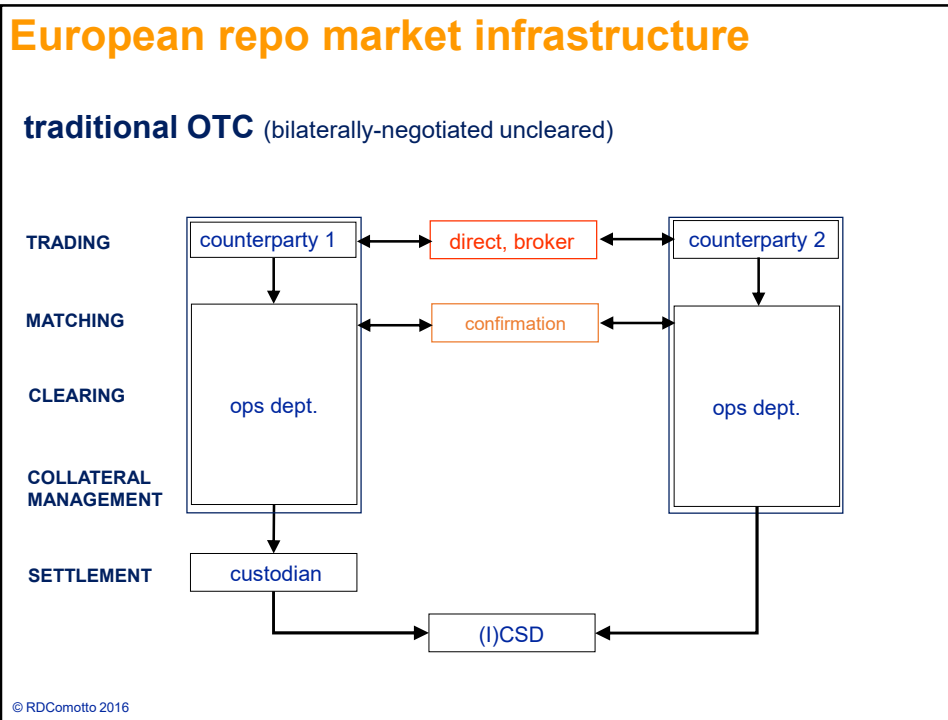
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## European repo market infrastructure

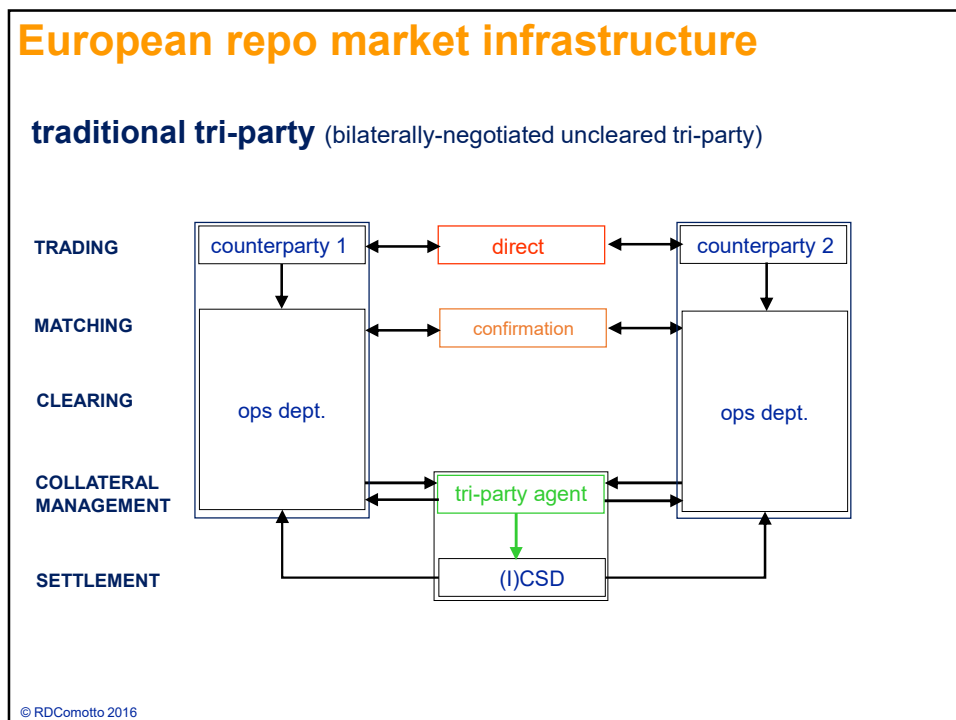
### trading

- **direct**
  - telephone or electronic messaging --- one-to-one
  - need bilateral confirmation
  - collateral management
    - bilateral --- between parties' own back offices
    - tri-party --- delegated to agent
  - clearing
    - post-trade CCP-clearing
    - bilateral technical netting (pairing)
- **voice-brokered**
  - telephone or electronic messaging via arranger --- many-to-many
  - need bilateral confirmation
  - tend to use bilateral collateral management
  - clearing
    - post-trade CCP-clearing
    - bilateral technical netting (pairing)

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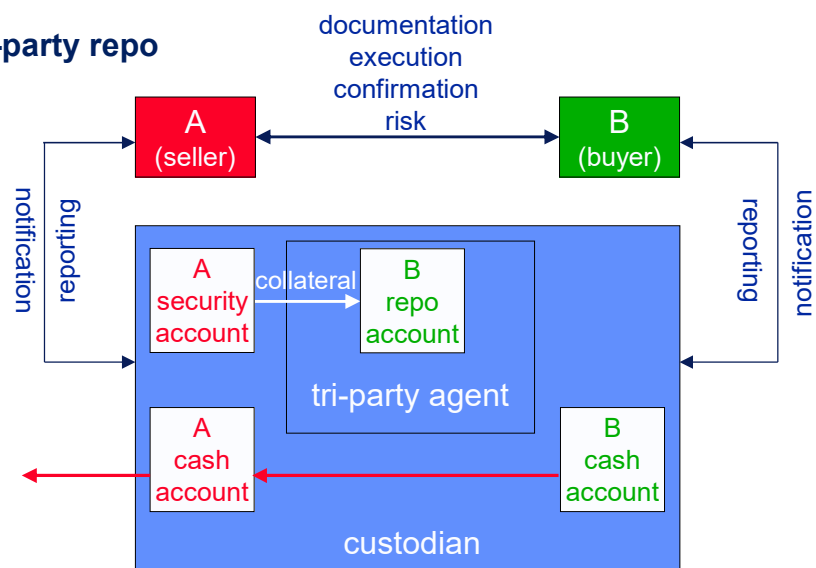
### tri-party repo

- alternative to:
  - **delivery repo** --- incurs settlement costs but ensures buyer has control & possession of collateral --- safe but expensive
  - **hold-in-custody (HIC) repo** --- no settlement costs but buyer does not have control & possession of collateral --- risky but cheap
- parties delegate collateral management to common custodial agent:
  - settlement is DVP across books of tri-party agent, not across securities settlement system --- lower settlement cost
  - buyer gets control & possession of collateral, so clear transfer of legal title --- safe

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### tri-party repo



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### tri-party repo

- no change in legal structure of repo: agent is not a counterparty
- tri-party repo is out-sourcing back office functions:
  - custody & settlement
  - transaction & collateral selection
    - **auto-allocation**
      - collateral selection by agent using algorithm for repos or all tri-party products
      - selection traditionally by cheapest-to-deliver
      - selection increasingly by regulatory status of collateral (eg non-HQLA for repos beyond LCR) and transaction prioritization (eg priority to CCPs & central banks)
    - pre-agreed collateral baskets of eligible collateral incorporating limits and initial margins
  - on-going collateral optimization & substitution
  - valuation & margining of transaction exposures
  - management of corporate events & income payments
- in default, agent refuses instructions from defaulter

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## European repo market infrastructure

### who trades tri-party repos?

- tri-party repo is typically **dealer** versus **risk-averse cash investor**
- exception is **GC financing facility**, which is inter-dealer
- tri-party is preferred route into repo market for **non-dealers**, who lack inhouse collateral management capabilities
- because collateral is selected by agent, not the parties, tri-party repo is purely **cash-driven** = GC repo
- repo may be **cross-currency**
- collateral selected for each repo typically consists of **multiple issues**, often **multi-currency**
- tri-party deal size typically **larger than normal** --- easy to assemble large baskets of eligible collateral

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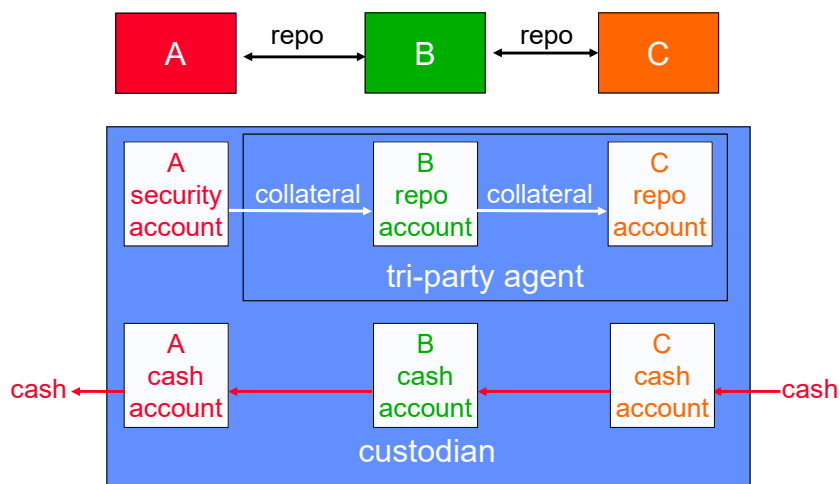
### re-use of tri-party collateral

- tri-party agent did not originally allow re-use of collateral, as collateral is automatically selected by agent, who may select a security as collateral which seller sells off in cash market, so agent needs to be able to retrieve securities by means of **substitution**
- inability to re-use could create **re-characterization risk**, so agents allow it in theory but would in practice withdraw from collateral management
- inability to re-use creates **regulatory problem** in that a tri-party reverse repo would cease to hedge liquidity risk of buyer, so agents have introduced internalized re-use facility

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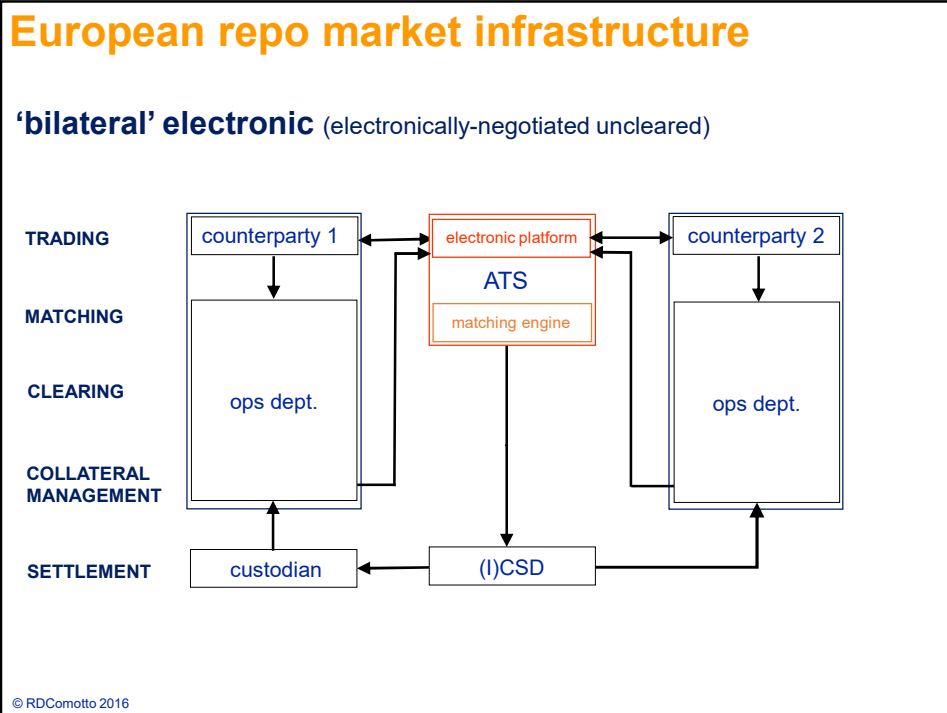
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### collateral re-use facility



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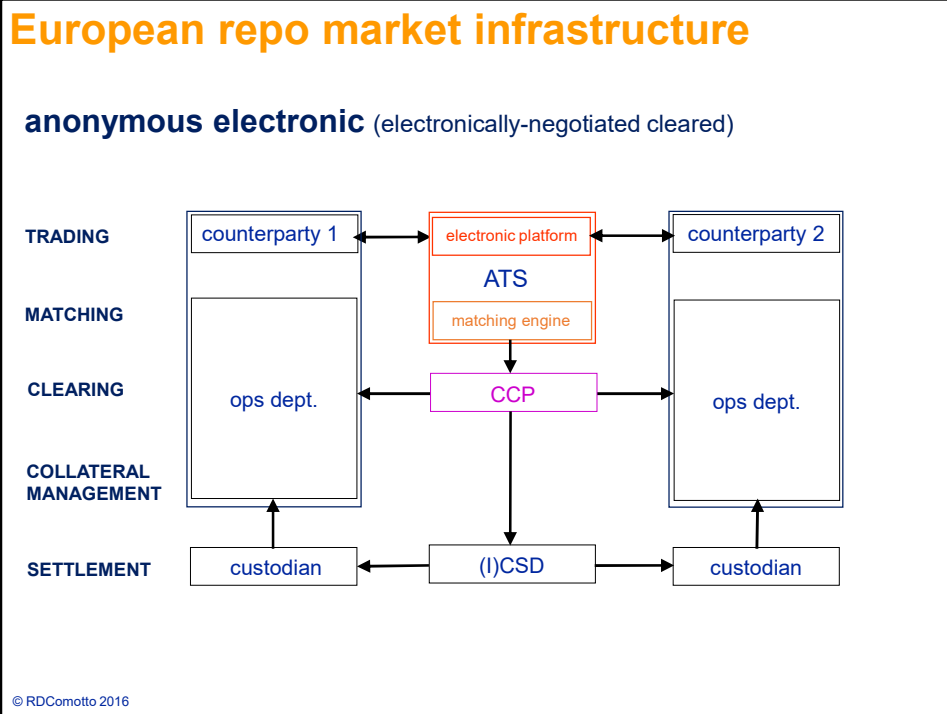
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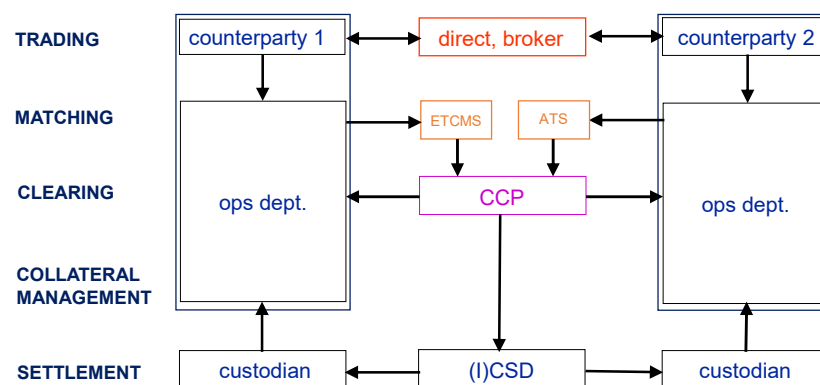
### who trades CCP-cleared repos?

- most CCP-clearing is of **automatic electronic transactions**, which tend to be very short-term repos against government bonds
- but there is also **post-trade registration** of direct & voice-brokered trades
- CCPs are reluctant to clear repo for non-dealers & against credit collateral but are experimenting with client-clearing on ring-fenced basis

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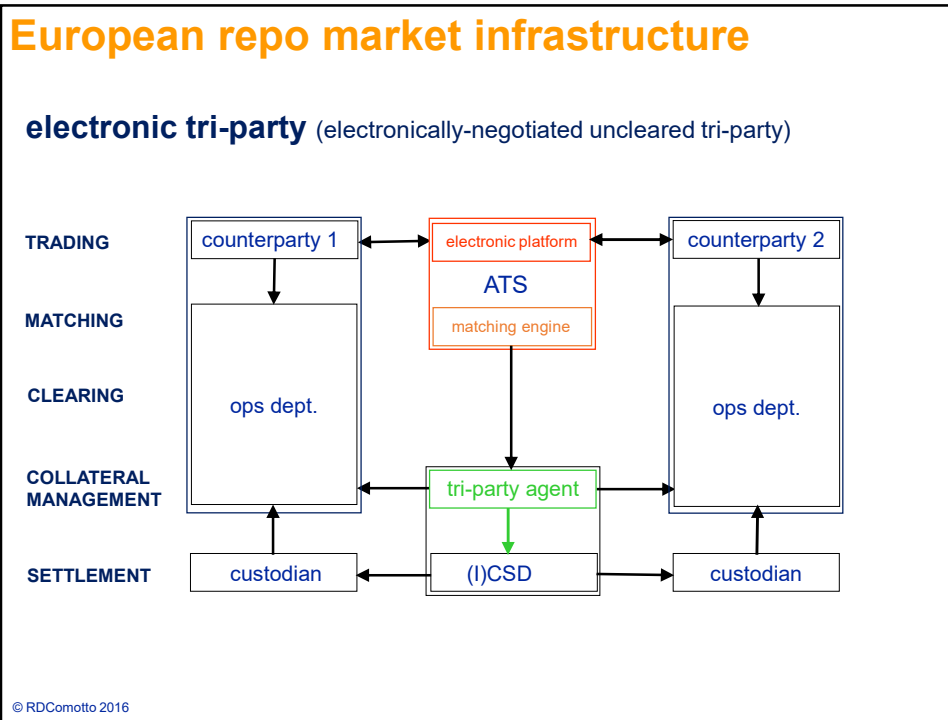
### post-trade clearing (bilaterally-negotiated)



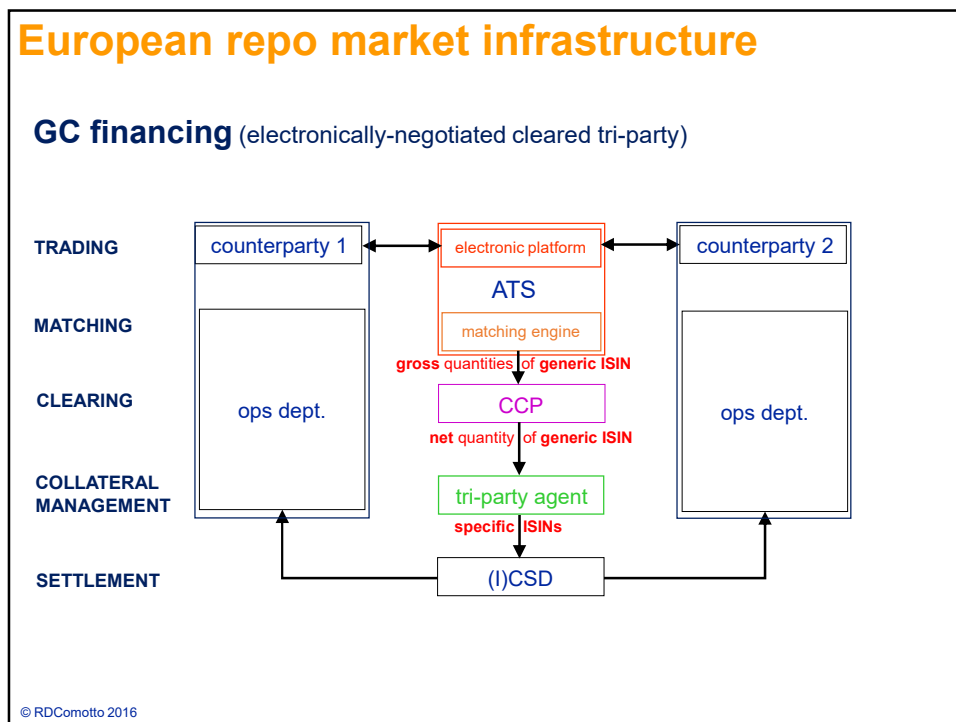
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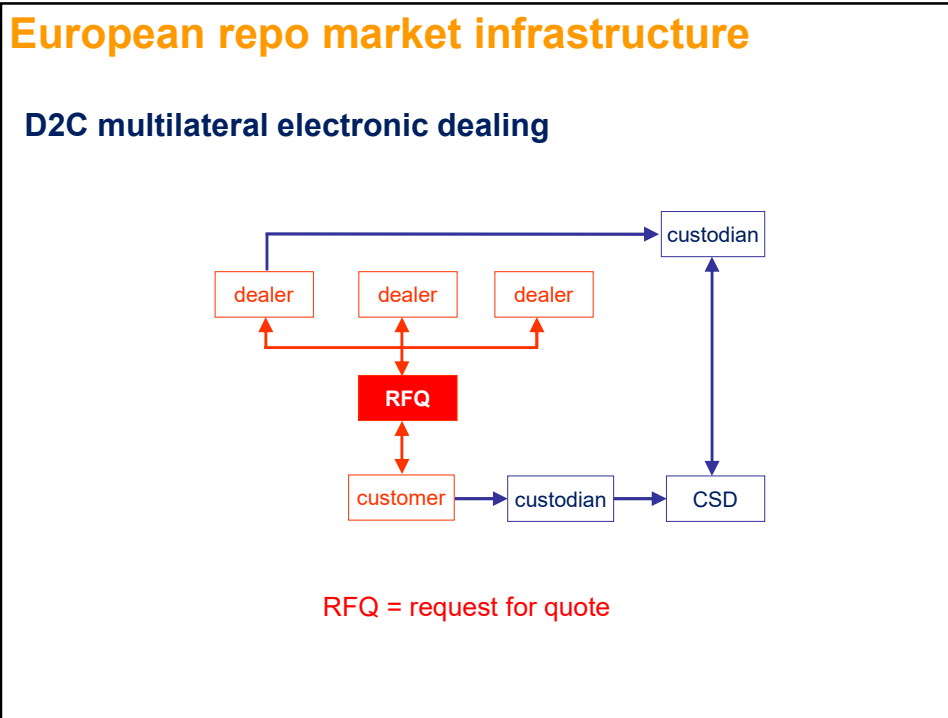




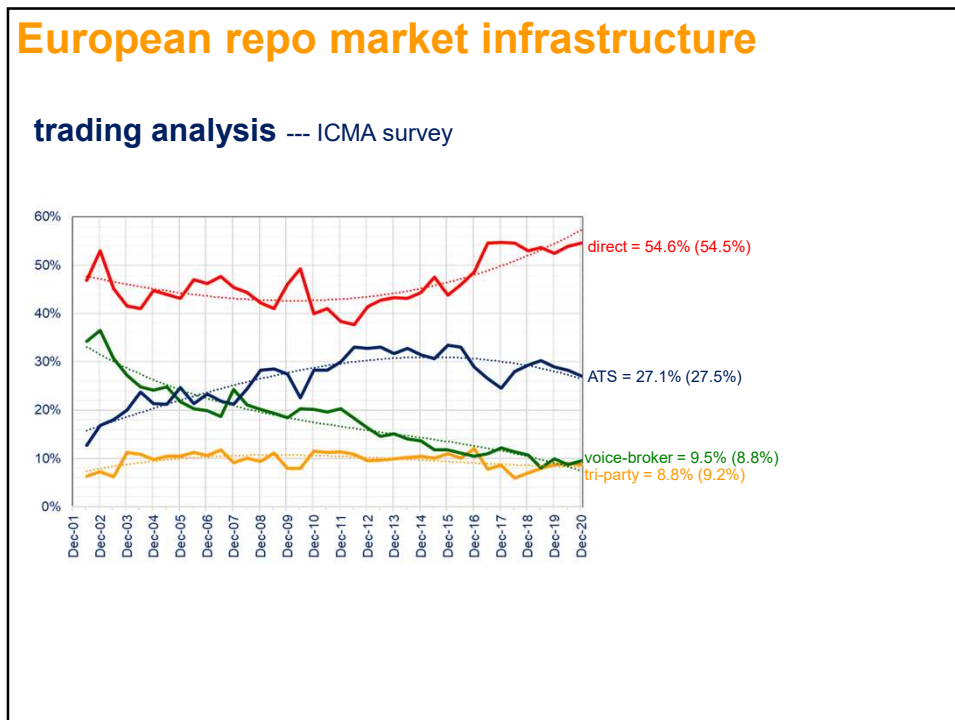
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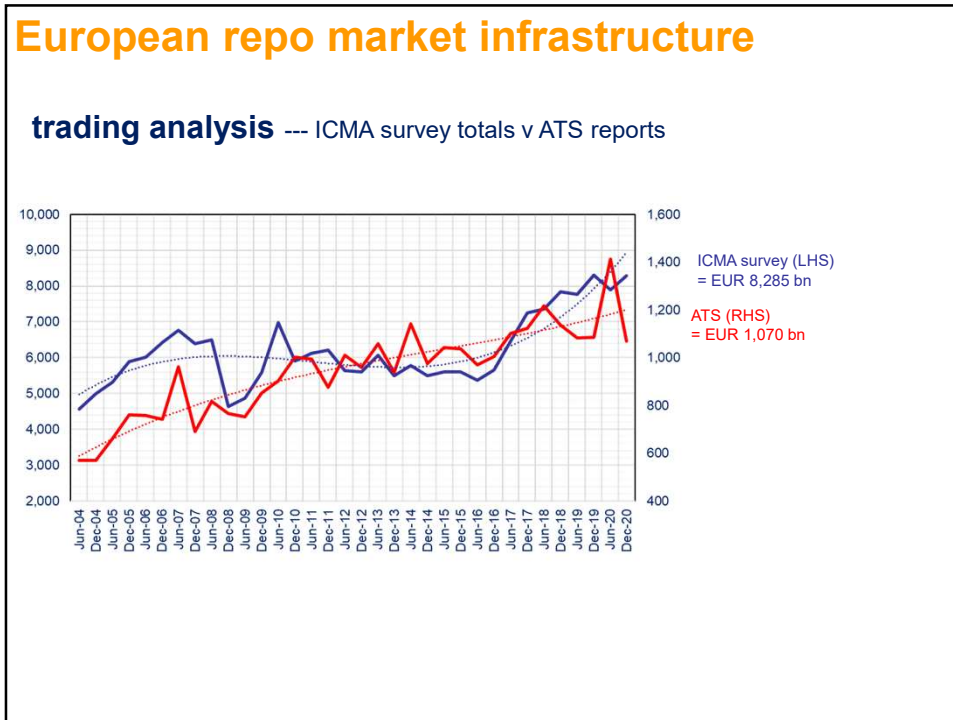
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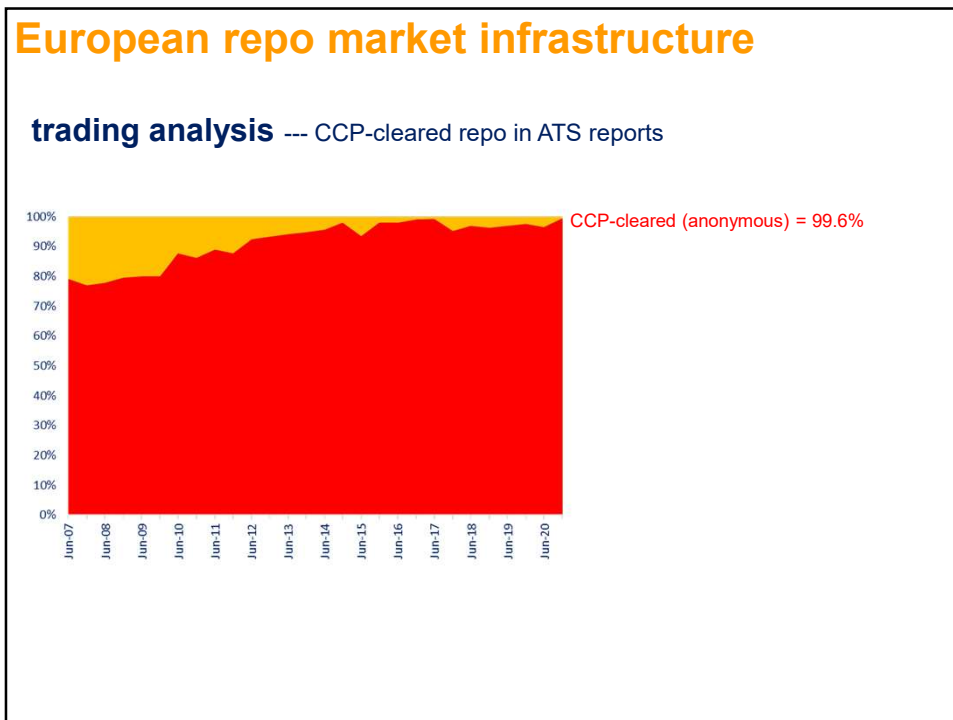
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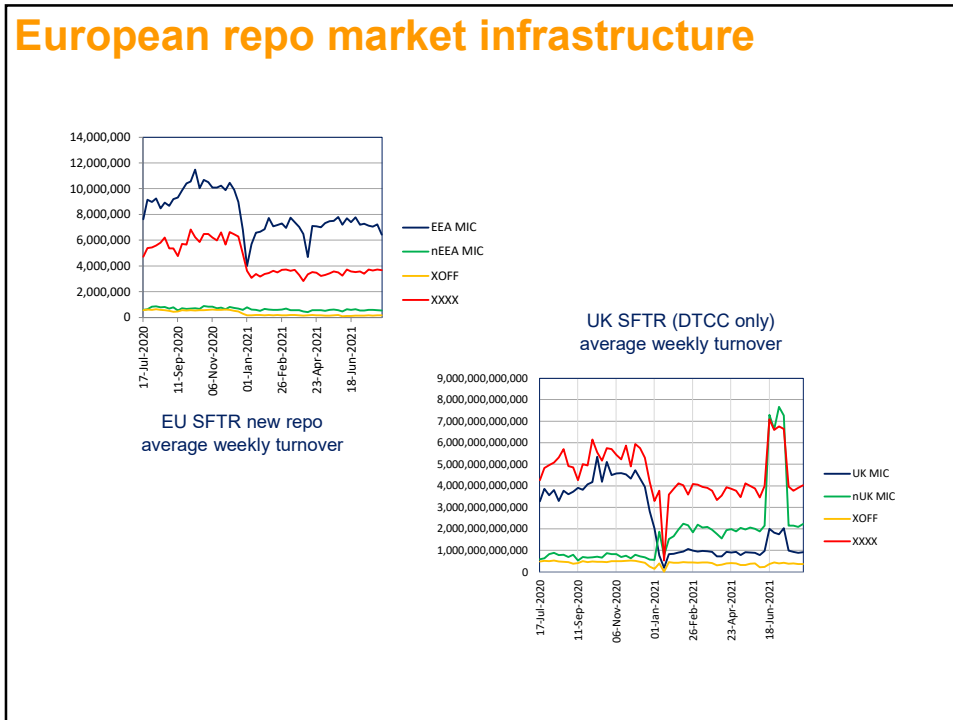
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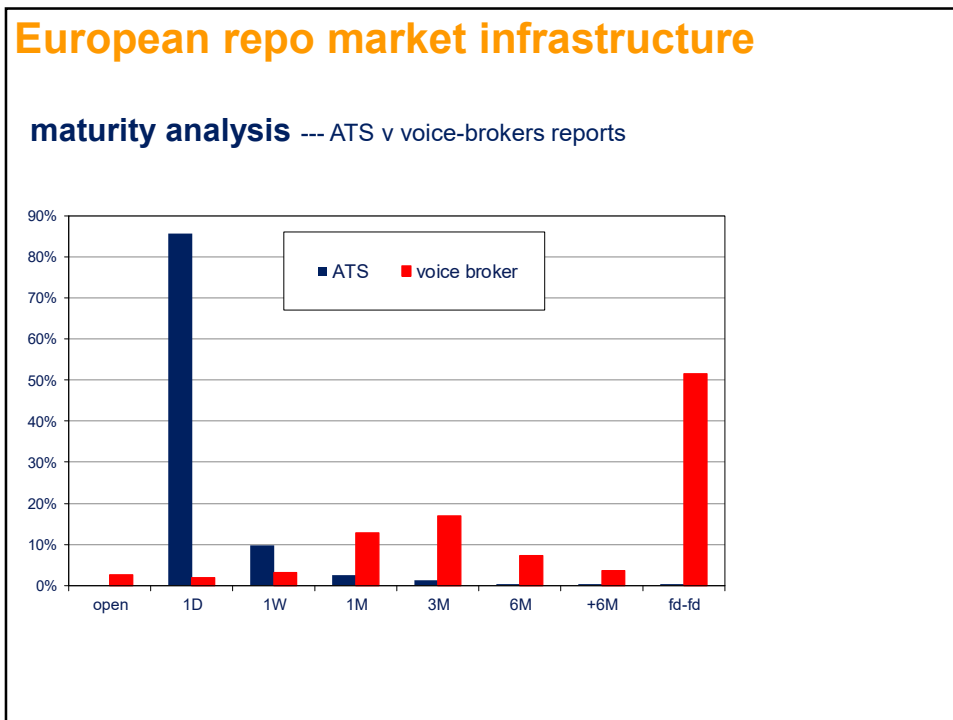
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### who trades in each market segment?

	direct	voice-brokered	automatic electronic trading
<b>tenor</b>	mainly longer term where ATS compete	mainly longer term where ATS compete	mainly very short-term
<b>deal size</b>	includes very large	large	small
<b>forward</b>	yes	yes	no
<b>structured</b>	yes	yes	no
<b>collateral</b>	government & credit	mainly government	government
<b>counterparty</b>	dealers & customers	dealers only	dealers only

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