

Press release

News from the International Capital Market Association (ICMA)

Talacker 29, P.O. Box, CH-8022, Zurich
www.icmagroup.org

Please see foot of release for contact details

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For immediate release

New ICMA European Repo Council paper examines role of ‘haircuts’ in European repo market.

(London, UK)– ICMA’s European Repo Council (ERC) has today published a paper entitled: ‘Haircuts and initial margins in the repo market’, which calls for more detailed understanding of the precise impact of collateral haircuts in the repo market to inform the regulatory debate. The paper, written by Richard Comotto of the ICMA Centre, questions the popular view of the role played by collateral haircuts in the recent crisis.

A haircut is a percentage discount deducted from the market value of a security that is being offered as collateral in a repo in order to calculate its purchase price. The adjustment is intended to take account of the unexpected losses that one party to the repo trade might face in buying (or selling) the security if the other party defaults.

Regulators are concerned that the application of haircuts could amplify negative market trends. They worry that, in a situation when asset prices are falling, increases in haircuts in response to a loss of confidence could reduce liquidity of market users who may then sell assets, so reducing the price and causing haircuts to be increased again. This theoretical scenario has been blamed by some for exacerbating the market crisis.

The paper refutes this view, citing evidence, much of it from official sources, that haircuts did not in fact change much during 2007-2009. Rather market issuers initially responded to the crisis by reducing or withdrawing credit lines, shortening the terms for which they were willing to lend and narrowing the range of collateral they were willing to accept.

The author examines the data on which academic studies of this phenomenon have been based and finds that these have been largely focused on the use of structured credit as collateral in the US market. This has been extrapolated to the wider global market without adequate consideration of the differences in market structure. The paper concludes that there is no empirical evidence to suggest that the imposition of haircuts in Europe was a major contributor to the market crisis.

Godfried De Vidts, Chair of the ERC said: “Repo market participants want to work with the authorities to ensure the operation of the market in Europe is well understood, so that regulatory proposals assist its efficient functioning. Industry efforts have always and continue to be directed at improving market practice and education”.

A copy of ‘Haircuts and initial margins in the repo market’ is available from www.icmagroup.org

Notes for editors

1. ICMA European Repo Council (ERC)

The ERC was established in December 1999 by ICMA. Membership is open to any ICMA member who undertakes dedicated repo markets activity. The ERC seeks to address market practice issues arising in the cross-border repo market in Europe. A core responsibility of the ERC and one of the original reasons for its existence is to assist ICMA in maintaining the legal documentation which underpins the safe functioning of the cross-border repo market, specifically, the Global Master Repurchase Agreement (GMRA).

2. International Capital Market Association (ICMA)

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. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants including regulatory authorities and governments. See: www.icmagroup.org

3. ICMA Communications

Margaret Wilkinson

+44 20 7213 0323

+44 7931 100 499

margaret.wilkinson@icmagroup.org