ICMA paper identifies the systemic risks of restricting collateral movement

ICMA’s European Repo Council today published a paper, ‘Collateral is the new cash: the systemic risks of inhibiting collateral fluidity’, which describes the increasing importance of collateral and how it effectively underpins the functioning of capital markets which provide the basis for economic growth.

The paper calls for regulators to consider the impact of financial regulation on the movement of collateral, highlighting the potential systemic risks of inhibiting collateral fluidity and the negative impact this could have on the stability and efficiency of capital markets.

‘This paper will fuel constructive dialogue between the industry and its regulators and help market participants understand the interdependencies at work in the use of collateral, the cumulative effect of different regulatory proposals on its availability, and its role in the functioning of the financial system and in supporting economic growth. As we build the framework of new financial regulation for safer markets we should steer clear of embedding systemic risks which could contribute to future financial crises’ said Godfried De Vidts, Chair of ICMA’s European Repo Council.

The paper highlights that:

- Much of Europe still suffers from largely fragmented, pre-euro legacy infrastructures with many barriers to efficient cross-border settlement. New market infrastructure is needed to ensure collateral can flow freely. There are initiatives under way, eg T2S and CSDR, which are designed to help resolve these issues and which should take into account the specific needs of the repo market, which is the main means by which collateral circulates.

- Bank funding desks act as intermediaries between providers and users of collateral, thereby ensuring liquid and efficient short term funding markets. Measures such as Basel III affect the ability of bank funding desks to function effectively.

- Reduced collateral mobility has negative implications for secondary market liquidity, asset price volatility, hedging, trade execution and the pricing and management of risk. These in turn dampen GDP growth in the real economy through reduced investment in capital and businesses, higher borrowing costs for governments, increased funding costs for corporates, increased cliff-effect risks for pension and other institutional investment funds, and a greater reliance on central banks to support the markets.
The paper will be launched at a conference for policy makers and market participants in Brussels on 3 April.

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International Capital Market Association (ICMA) & European Repo Council
ICMA represents financial institutions active in the international capital market and has members located in 53 countries. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants including regulatory authorities and governments.

ICMA’s European Repo Council is the body that helps to forge consensus solutions to the everyday issues which arise in this rapidly evolving and increasingly vital marketplace. As part of its commitment to the efficient functioning of the repo product ICMA oversees the standardised repo documentation in the form of the Global Master Repurchase Agreement (GMRA), supported by annually-updated legal opinions in more than 60 jurisdictions. The GMRA is the predominant standard master agreement in the cross-border repo market and plays a critical role during the crisis in ensuring the orderly resolution of defaults. www.icmagroup.org