International
Capital
Market
Association

Press release

News from the International Capital Market Association (ICMA)

Dreikönigstrasse 8, CH-8002, Switzerland
www.icmagroup.org

Please see foot of release for contact details

Wednesday, 18 November 2015
For immediate release

Post crisis regulation is driving radical change in the European repo market says new ICMA study

(Zurich, Switzerland) The European Repo Council (ERC) of the International Capital Market Association (ICMA) has today launched a new study: 'Perspectives from the eye of the storm: the current state and future evolution of the European repo market', which looks at how the repo market in Europe is changing in response to regulatory pressures.

The repo market plays a vital and central role in the modern financial ecosystem. It facilitates secured lending, supports liquidity in bond and derivative markets, sources and mobilises collateral, and transmits monetary policy. Repo market liquidity is provided by bank repo desks that act as market-makers for repo and collateral.

The study records growing concern that the cumulative impact of various prudential and market regulations, along with extraordinary monetary policy, could be affecting the ability of the European repo market to function efficiently and effectively. This could, in turn, have wider repercussions for the broader capital markets and so for the real economy.

The ICMA-ERC study is a qualitative assessment of the current state and future evolution of the European repo market, based on interviews with a wide range of market participants and stakeholders, including bank repo desks, fund managers, inter-dealer brokers, electronic trading platform providers, agency lenders and triparty agents.

The main findings of the study are:

- Basel III, incorporating Risk Capital Requirements, Leverage Ratio, Liquid Coverage Ratio, and Net Stable Funding Ratio, is the single greatest regulatory driver of change, transforming the structure and dynamics of the repo market. Each of its four components impact the repo market in different, yet cumulative ways, significantly adding to the cost of capital required to run a repo trading book. The Leverage Ratio (with the Supplementary Leverage Ratio for larger US banks), is having the most profound impact on the repo market, to the point where repo is becoming unprofitable as a traded product.

- ECB monetary policy since the 2007-08 crisis has produced excess bank reserves and negative interest rates which dampen repo activity. It has also led to a reduction in the stock of high quality collateral, which is identified as a concern for future fractures in the market, particularly given the widely expected increase in the size and speed of the purchases programme.

- There is concern about the effect of planned future regulatory initiatives, in particular the Net Stable Funding Ratio, CSDR mandatory buy-ins, and the provision under the Bank Recovery and Resolution Directive (BRRD) for resolution stays.

- Most banks have already restructured or are restructuring their business models. Key trends include de-risking, deleveraging, transformation from a profit-centre to a cost-centre, reducing head-count, and the merging of repo desks with other funding functions to create centralized liquidity and collateral management hubs. Many banks now provide repo liquidity to preferred clients as a loss-leader to support other, more profitable businesses and services.

- There is a sense amongst the repo market stakeholders interviewed that regulators do not fully appreciate how the repo market operates, and that this is apparent in a number of regulatory initiatives, both directly and indirectly related to the repo market. There is concern about the cumulative burden of regulation and the cost of its implementation.

- Stakeholders are trying to adapt and innovate to meet the challenges and looking for potential new opportunities. Most innovations relate to balance sheet optimization, and creating more netting capabilities. Others are being driven by the need for improved liquidity and collateral management. Electronic solutions and improved automation are also being discussed. However the uncertainty being brought about by regulation is making business planning extremely challenging.

- There are still many unknowns arising from both regulation and monetary policy making predicting the future evolution of the European market difficult. The consensus views are: an expected reduction in the size of the market; an increase in the diversity of participants; a general widening of bid-ask spreads; and the ongoing merging of banks funding and collateral management functions.

- The overriding concern among market participants is that in future, although they expect the repo market to continue in some form, it may be unable to function as effectively and efficiently as it has in the past in providing liquidity and collateral fluidity to the financial system, with potential negative consequences both for markets and the broader global economy.

Godfried De Vidts, Chair of the ICMA European Repo Council said: "The ERC has highlighted the value of the repo market for decades and was swift to recognise the need for regulatory reform in the aftermath of the financial crisis, but this latest study clearly shows that uncoordinated measures by legislators, regulators and prudential authorities are radically altering the short term secured financing market and may even compromise the success of regulatory measures such as EMIR which depend on the fluidity and availability of collateral. We hope that this new study will raise understanding among regulators of the true state of repo in Europe and of its essential role as a component of the Commission's plan for Capital Markets Union with its implications for jobs and growth".

International
Capital
Market
Association

ICMA

Download a copy of 'Perspectives from the eye of the storm: the current state and future evolution of the European repo market'

Notes for editors

International Capital Market Association (ICMA)
ICMA represents financial institutions active in the international capital market worldwide with some 500 members in 60 countries. ICMA's market conventions and standards have been the pillars of the international debt market for close to 50 years, providing the framework for good market practice which facilitates 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

ICMA Communications

Allan Malvar	Margaret Wilkinson
+44 20 7213 0322	+44 20 7213 0323
+44 7738 696 451	+44 7931 100 499
allan.malvar@icmagroup.org	margaret.wilkinson@icmagroup.org