Other considerations

Averaging vs. compounding

Currently, market practice for EONIA-based repo is to apply the average rate over the life of the trade, rather than compounding, even though daily compounding is used in the EONIA swap market. The ERCC agreed that this practice should continue in the case of EONIA or €STR repo, noting that it is also possible for parties to agree to a compounding methodology.

Reference to EONIA in GMRA annexes

While none of the GMRAs reference EONIA, it is understood that some bilaterally negotiated annexes may make reference to EONIA with respect to interest payable on cash collateral. Where this is the case, firms will need to update these bilateral annexes to reference a suitable alternative benchmark. While ICMA cannot do anything directly to assist firms in identifying or updating any bilateral contractual arrangements that may be impacted, in coordination with the ERCC it will look to raise awareness of the issue so that affected firms can take the steps necessary to prepare for the discontinuation of EONIA.

Contact: Andy Hill
andy.hill@icmagroup.org

Recent research on repo and collateral markets

Bank of England, 2019, Decomposing Changes in the Functioning of the Sterling Repo Market

The researchers identify the degree to which changes in gilt repo market functioning have been driven by changes in the supply of – and the demand for – market intermediation. To do so, they use a structural vector auto regression (SVAR) model with sign and zero restrictions. The paper finds that changes in gilt repo market functioning over the past five years have been driven largely by changes in the supply of repo market intermediation by dealers, rather than by changes in the demand of end-users. Following the introduction of the UK leverage ratio, the model suggests that an increase in demand for repo by end-users results in a larger increase in the cost of repo transactions and a smaller increase in their volume. This effect is stronger in the case of transactions that are not nettable via central counterparties. These findings are consistent with the notion that the leverage ratio may reduce dealers' ability and/or willingness to act as repo market intermediaries. This may have implications for the resilience of Repo Markets in future periods of stress.

Bank of England, 2019, Regulatory Effects on Short-term Interest Rates

The researchers analyse the effects of EMIR and Basel III regulations on short-term interest rates. EMIR requires central clearing houses (CCP) to acquire safe assets continually, thus expanding the lending supply of repurchase agreements (repo). Basel III, in contrast, disincentivises the borrowing demand by tightening banks' balance sheet constraints. Using unique datasets of repo transactions and CCP activity, the study finds compelling evidence for both supply and demand channels. The overall effects are decreasing short-term rates and increasing market imbalances in various forms, all of which entail unintended consequences originated from the new

LIBOR and the GMRA

RFR

ICMA published an updated edition of the Global Master Repurchase Agreement (GMRA) in 2011, containing enhancements which (i) provide the non-defaulting party with more flexibility; (ii) account for changes in market practice; and (iii) increase alignment with other industry standard agreements. One of the amendments made in the GMRA 2011 was to remove references to LIBOR (note that these relate only to professional expenses and interest on late payments) and replace these with the concept of "Applicable Rate". Users of the older version of the agreement (the GMRA 1995 and GMRA 2000 versions) will need to consider amending their documentation in the event of a permanent discontinuation of LIBOR. If parties to a GMRA 1995 or GMRA 2000 update their documentation using the 2011 GMRA Protocol, it is possible to amend the aforementioned boilerplate LIBOR references on a multilateral basis by making the relevant elections in Annex 5 of the protocol (subject to both parties adhering to the protocol and making the same elections). With respect to LIBOR references made in bespoke terms (pricing or otherwise), we understand that parties are making appropriate bilateral amendments to their documentation.

Contact: Lisa Cleary
lisa.cleary@icmagroup.org