



Borrow bonds, lend cash, any questions? – The evolving landscape of international repo markets



by **Gareth Allen**

On our repo desk there used to be a phrase written on a board: “Borrow bonds, lend cash. Any questions?”

It stayed there for years. It was partly a joke, but there was also a lot of truth in it.

At its heart, repo is a remarkably simple product. One party needs cash and has securities. Another has cash and is prepared to lend it against those securities.

The same simplicity applies to risk management, where I think of it as four levers: counterparty, collateral, haircut and tenor.

The ordering matters. My primary risk is the counterparty; the collateral is there to mitigate that risk. So the first question is simple: do I actually want to give this counterparty a billion dollars?

Only then do I move on to the collateral. Is it liquid? What haircut do I need? What happens if the counterparty fails and I have to sell it? And what does the tenor and maturity profile look like?

Those basic questions have not changed much in twenty years. Almost everything around them has.

Repo is no longer just repo

When I started in the market, almost everything was manual: keeping track of trades on paper and reconciling my blotter at the end of the day. If you needed a particular security, you called a counterparty or sent a Bloomberg message: *have you got this, can I borrow it?*

Electronic trading and automation have probably been the biggest technological change I have seen. Today, large volumes can be executed electronically and flow automatically into firms’ systems. Availability can be searched, borrowing automated and much of the process happens with far less manual intervention.

But the more important evolution is not simply automation. Repo increasingly needs to be understood as part of a wider secured-financing toolkit.

A repo might finance a bond position, provide leverage, raise cash, invest cash or support market-making. Other secured-financing transactions can often achieve similar economic outcomes. That interchangeability matters: change the economics, regulation or balance-sheet treatment of one product and activity may migrate into another.

At transaction level, repo can still be remarkably simple. At system level, it sits inside a much larger and increasingly interconnected collateral ecosystem.

Cash and collateral

We naturally think about cash as sitting at the centre of the financial system. But increasingly, institutional cash does not move on its own. It moves with collateral.

There simply isn’t the risk appetite for the modern financial system to operate on unsecured credit alone. Compare lending a billion dollars unsecured with lending it against highly liquid government securities. In both cases you still need to understand the counterparty, but collateral gives the lender more confidence and allows larger amounts of money to move more safely and at greater speed.

That matters because the financial system itself has become bigger and faster, creating an enormous requirement for cash and collateral to move efficiently.

That is why I think of collateral as more than a risk mitigant attached to an individual trade. It is part of the infrastructure that allows money to move through the financial system safely, at scale and at speed. Repo is one of the principal mechanisms that makes that possible.



Why should anyone outside repo care?

Because this plumbing ultimately supports ordinary savings, investments and credit.

Pension and investment funds use repo to finance assets, manage liquidity and invest cash securely. It is largely invisible to the end investor, but part of the machinery supporting their savings and investments.

Banks also use secured funding to manage liquidity and support lending. So when repo markets function well, most people never need to think about them. When they do not, the effects can spread through market liquidity, funding costs and ultimately the availability and price of credit.

The better question is not “*who cares if repo stops working?*” It is:

What happens if money and collateral stop flowing efficiently around the financial system?

Leverage, liquidity and regulation

The growth of non-bank financial institutions and leveraged investors has understandably attracted attention. But I do not think leverage, by itself, is the problem.

Leveraged investors, hedge funds in particular, can bring two things that are extremely valuable to markets: liquidity and pricing arbitrage. Repo is often the financing mechanism that enables those strategies.

The difficulty may come if leverage is poorly managed.

For me, the obvious questions are concentration and liquidity. How large and crowded is the position? How much margin might be needed, where will the cash come from, and how does the financing behave under stress?

A portfolio can be highly leveraged and still be managed with a clear understanding of those risks. That is very different from being highly leveraged without understanding the potential risks.

It does not matter how attractive a trade looks if you cannot meet the margin call tomorrow morning.

This is also why repo is difficult to regulate. It does many things at once: funding, leverage, cash investment, market-making and collateral mobilisation. A change aimed at one particular risk can create consequences somewhere else.

If the concern is too much leverage in one part of the market, making repo more expensive may reduce it. But the next question has to be:

Where will that leverage migrate to?

Creating a constriction may be exactly the right thing for financial stability. But there is a balance between stability and liquidity, and activity may move into another product, market or jurisdiction rather than disappear.

This is where ICMA has an important role as a bridge between market practitioners and regulators: bringing product expertise into the debate, while providing the standards and best-practice frameworks that help turn regulatory objectives into workable market practice.

Repo is one of the key markets through which collateral is priced, transformed and mobilised. Change the cost or availability of doing that and the consequences can extend far beyond the individual transaction.

Clearing, margining and risk

The same principle applies to clearing, netting and cross-product margining: efficiency is not necessarily the same thing as risk reduction.

Repo is not a derivative. The products are closely connected through collateral, margin, liquidity and balance sheet, but default mechanics are different. In repo there are physical securities, and close-out requires securities to be bought or sold in the market. Liquidity, market depth and position size therefore matter.

For large direct clearing members, the attraction is overwhelmingly balance sheet: netting can materially reduce the amount required to support a given level of activity.

But with client clearing, there is a danger that “cleared” becomes shorthand for “safer”. The underlying client still has to meet margin calls and remain liquid through stress. Better netting may reduce the balance-sheet cost, but may also allow more activity and more leverage to be supported by the same balance sheet.

Cross-product margining raises a similar question. If positions genuinely offset, recognising that can reduce margin and risk-based capital. But a modelled offset is not necessarily genuine economic risk reduction.

Relationships that look stable in normal markets can behave differently under stress, and markets are not acting in the way they used to.

Developing markets and ICMA’s role

For a repo market to develop successfully, the first requirement is legal certainty. Participants need confidence that agreements are enforceable and close-out will work as expected.

After that comes the plumbing: custody, settlement, operational infrastructure, and a collateral market of sufficient quality, liquidity and scale.

ICMA is making a very practical difference in emerging and frontier markets: combining the GMRA framework with education, and bringing together local participants, infrastructure providers and regulators to help build the market around it.



China is particularly interesting because of the size of the opportunity. It is already a vast financial market. The opportunity is to connect more of it into the wider global system, allowing cash, collateral and capital to move more efficiently between domestic and international participants.

More broadly, ICMA's combination of market expertise, education and established standards helps connect these markets with international practice.

Seeing the market in all its glory

Technology has transformed repo, but connectivity between systems is still a major challenge. And once systems are connected, the next challenge is the data: making sense of what all those transactions actually mean.

What I would ultimately like to see one day is where the cash is flowing, what collateral is moving against it, in what currency, and on a net basis how those flows move between different types of market participant.

Digital markets and the tokenisation of collateral may add another layer of efficiency, but the fundamental economics remain the same.

Borrow bonds, lend cash still applies...

What excites me is the prospect that one day we may be able to see this market in all of its glory: not simply as millions of individual trades, but as the huge flows of cash and collateral through the financial system keeping it moving.

The market has become larger, faster and more interconnected, but the fundamentals remain surprisingly simple.

Who is my counterparty? What collateral am I holding? What haircut have I applied? What is the tenor and maturity profile of the portfolio?

ICMA has been one of the constants in the repo market for decades, helping the industry adapt as markets, technology and regulation have evolved.

Technology will help us see the system more clearly. Regulation will make it more resilient. Standards will allow markets to connect and develop safely.

But ultimately, the purpose of repo remains simple: to allow cash and collateral to keep moving safely through the financial system.

Borrow bonds, lend cash. Any questions?

Gareth Allen is Global Co-Head of Investment, Funding and Execution, UBS AG
