Welcome
Godfried De Vidts
Chairman of the European Repo Council
Brussels, 8 April 2013
ERC work – a sample

- 25 May 2012
  [ICMA European Repo Council (ERC) Repo Margining Best Practices 2012*](#)
- 20 August 2003
  [Repo Trading Practice Guidelines of 20 August 2003](#)
- 12 July 2012
  [Floating-rate repo conventions](#)
- 25 July 2011
  [ERC recommendation on Repo matching as a driver for risk reduction (25 July 2011)](#)
- 9 November 2007
  [Resolution by the ERC Committee on the Harmonisation of GMRA mini close-out provisions and ICMA buy-in rules (9 November 2007)](#)
- 16 November 2004
  [Recommendation regarding fails in negative interest rate repos, approved by the International Repo Council on 16 November 2004](#)
- 19 April 2004
  [Confirmation of second leg of buy/sell back transactions (Letter from the ERC committee chairman to firms active in the repo market, dated 19 April 2004)](#)
24th European repo market survey, conducted in December 2012

Headline numbers

EUR 5,611 bn
24th European repo market survey, conducted in December 2012

Currency analysis

- EUR 61.4%
- USD 17.3%
- GBP 13.3%
- JPY 4.5%
- Other 3.5%
24th European repo market survey, conducted in December 2012

Collateral analysis

- DE 22.0%
- IT 8.7%
- FR 11.0%
- ES 4.9%
- US 2.6%
- UK 14.2%
- EUR 6.7%
- BE 3.4%
- Japan 3.2%
- etc 23.3%
24th European repo market survey, conducted in December 2012

Maturity analysis

- 1D: 17.0%
- 1W: 16.3%
- 1M: 17.2%
- 3M: 16.0%
- 6M: 4.1%
- 12M: 2.9%
- +12M: 5.9%
- fd-fd: 7.8%
- open: 12.7%
The impact of the FTT on the repo markets and its consequences

- much analysis has started from the wrong point
- this is the non-fiscal objective of the FTT --- to curtail financial intermediation
- direct issuer-investor interaction in primary market
- limited secondary market, passive investment strategies, agency brokers
- could inspiration be the equity market --- order-driven, commission-paying, exchange-traded?
- terms of the debate are focused on the utility of secondary markets
The impact of the FTT on the repo markets and its consequences

• would the DG Tax model work in fixed income?
• very different market:
  • high-volume risk-free government issues, typically plain vanilla --- challenge is rapid distribution
  • lower volume credit issues, typically complex structures --- challenge is pricing & smooth distribution
• key role for primary dealers & market-makers
The impact of the FTT on the repo markets and its consequences

- consequences for the repo market
- incidence of flat rate of 0.10% on short-term transactions
The impact of the FTT on the repo markets and its consequences

FTT & repo revenue

<table>
<thead>
<tr>
<th>term to maturity (days)</th>
<th>1</th>
<th>2</th>
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<td>500</td>
<td>1000</td>
<td>1500</td>
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</table>

revenue from typical repo EUR per million

<table>
<thead>
<tr>
<th>repo term</th>
<th>0.05%</th>
<th>0.10%</th>
<th>0.15%</th>
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</thead>
<tbody>
<tr>
<td>1D</td>
<td>1.39</td>
<td>2.78</td>
<td>4.17</td>
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<tr>
<td>1W</td>
<td>9.72</td>
<td>19.44</td>
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<td>1M</td>
<td>43.06</td>
<td>86.11</td>
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<tr>
<td>3M</td>
<td>126.39</td>
<td>252.78</td>
<td>379.17</td>
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<tr>
<td>6M</td>
<td>252.78</td>
<td>505.56</td>
<td>758.33</td>
</tr>
<tr>
<td>12M</td>
<td>506.94</td>
<td>1,013.89</td>
<td>1,520.83</td>
</tr>
</tbody>
</table>
The impact of the FTT on the repo markets and its consequences

repo seller → collateral → market-maker → collateral → repo buyer

repo seller → cash → market-maker → cash → repo buyer

pay EUR 1,000 per million
The impact of the FTT on the repo markets and its consequences

### FTT & repo revenue

<table>
<thead>
<tr>
<th>term to maturity (days)</th>
<th>EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.05%</td>
</tr>
<tr>
<td>23</td>
<td>10.34%</td>
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<tr>
<td>45</td>
<td>2.37%</td>
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<tr>
<td>67</td>
<td>0.84%</td>
</tr>
<tr>
<td>89</td>
<td>0.45%</td>
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<tr>
<td>111</td>
<td>0.25%</td>
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<tr>
<td>133</td>
<td>0.30%</td>
</tr>
<tr>
<td>155</td>
<td>0.35%</td>
</tr>
</tbody>
</table>

### implied break-even spreads %pa

<table>
<thead>
<tr>
<th>repo term</th>
<th>normal bid/offer spread</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.05%</td>
</tr>
<tr>
<td>1D</td>
<td>72.05%</td>
</tr>
<tr>
<td>1W</td>
<td>10.34%</td>
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<tr>
<td>1M</td>
<td>2.37%</td>
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<tr>
<td>3M</td>
<td>0.84%</td>
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<td>6M</td>
<td>0.45%</td>
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<td>12M</td>
<td>0.25%</td>
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</tbody>
</table>
The impact of the FTT on the repo markets and its consequences

The European repo market will contract by at least 66%.
The impact of the FTT on the repo markets and its consequences

- repo is pivotal to:
  - secondary market-making
  - primary dealing
  - short-term institutional investment
  - bank funding
  - monetary policy implementation
  - financial stability (eg CCP, liquidity buffers)
The impact of the FTT on the repo markets and its consequences

- loss of repo & money market securities --- secondary market
- DG Tax says securities volume down 15% --- optimistic
- loss of repo plus direct impact of FTT
- flight of foreign investors
- how to distribute high-volume government debt?
- how to distribute low-volume corporate debt?
- portfolio valuation become more difficult
- delivery failures increase
The impact of the FTT on the repo markets and its consequences

- loss of repo & money market securities —- primary market
- DG Tax says securities volume down 15% —- optimistic
- DG Tax says buy primary issues, follow long-term investment strategies
- pricing become more difficult
- issuer & investor overheads & risk rise
The impact of the FTT on the repo markets and its consequences

- loss of repo & money market securities --- investors
- DG Tax says central bank repo & secured loan --- not feasible
- EU11 investors’ choice:
  - overnight unsecured deposits
  - capital flight outside the EU11
The impact of the FTT on the repo markets and its consequences

- loss of repo & money market securities --- banks
  - banks lose wholesale funding
  - banks lose bond debt funding
  - accelerated, perhaps disorderly deleveraging
  - shortage of working capital in real economy
The impact of the FTT on the repo markets and its consequences

- loss of repo & money market securities --- central banks
- no collateral framework for monetary policy implementation
- no market mechanism to monitor & signal
- further fragmentation of eurozone
- EU11 collateral at ECB becomes illiquid
The impact of the FTT on the repo markets and its consequences

- loss of repo & money market securities — financial stability
- movement of collateral too expensive, only cash collateral
- no collateral market
- de-collateralisation reverses impact of Basel
- liquidity buffers more expensive & difficult to build
- operational risk increased
The impact of the FTT on the repo markets and its consequences

• loss of repo & money market securities --- real economy
  • capital flight
  • shortage of working capital
  • investment capital more expensive
  • long-term growth potential
  • competitive disadvantage
  • relocation of financial services
The impact of the FTT on the repo markets and its consequences

• some final remarks
• relationship with the non-EU11
• cost of transition
• tax as a regulatory tool
• how (not) to redesign the financial system