



Is the bilateral repo market working for the buy side?

Christopher Page, VP for product and business development at Eurex, explains that the benefits of CCP-cleared repo far outweigh the costs, delivering greater capital efficiency and significant operational and legal simplification over bilateral channels

As regulation continues to drive change, increased capital costs for banks have stifled capacity for the buy side in the bilateral repo market, which has increased costs and limited trading opportunities. This has led to a search for new sources of repo liquidity which rely less on bank balance sheet, while also offering the ability to maintain existing bank relationships. Experience shows that the bilateral repo market has not been very liquid in stress situations and the additional capital

and liquidity constraints on banks have further reduced the available capacity. These challenges have been difficult to address in light of scarce resources and a heavy regulatory workload, taking away from infrastructure-led projects.

Meanwhile, cash management and collateral transformation has become increasingly important for the buy side due to regulatory

challenges, such as Uncleared Margin Rules (UMR) and the end to the pension fund clearing exemption. The operational burden on the buy side has increased, which has created the need for efficiencies in relation to legal documentation, balance sheet optimisation and data. Ensuring access to cash for Variation Margin (VM), and having the right collateral in place to cover operational risks and collateral demands, has brought collateral management into the front office. The related scarcity of quality collateral means that the buy side must now understand sources and uses of collateral as well as the constraints and costs even better.

Regulatory pressures have led to a convergence of securities finance and derivatives and there has been a need for consolidation and optimisation across asset classes and desks. In contrast, the majority of bilateral client repo is still transacted manually using outdated settlement infrastructure.

Eurex expands its buy-side repo offering

Eurex is seeking to address these challenges through its pioneering ISA Direct for Repo models: ISA Direct, ISA Direct Light and the newly launched ISA Direct Indemnified. Through these models, Eurex is able to offer direct access to CCP-cleared repo to a wide array of buy-side participants, adding them to the already diverse range of counterparties on the Eurex Repo trading platform. Eurex allows a principal client relationship between the buy side firm and Eurex Clearing, providing access to a new source of repo liquidity. Additionally, by bringing the buy side into Eurex's repo clearing ecosystem, dealer banks have increased opportunities for balance sheet, leverage, and risk-based capital optimisation, leading to lower capital requirements which, consequently, should drive better execution terms for the buy side.

We are excited to introduce the ISA Direct Indemnified model, which builds on our established direct access model for the buy side, ISA Direct, by broadening its availability to a greater range of market participants, including hedge funds. These firms, and their counterparty dealer banks, will now be able to benefit to an even larger degree from the capital, risk management and operational advantages that come through direct access to repo clearing at Eurex. By extending the benefits of direct CCP access to a greater number of market participants, Eurex can deliver greater efficiencies and create new opportunities for specific ISIN financing and treasury management. Eurex is pleased to be working with several banks and hedge funds to pilot the new offering this year.

Eurex's existing ISA Direct for Repo offering, designed for buy side banks, pension funds, asset managers and insurance companies, continues to go from strength to strength. We currently enable multiple beneficial owners through several asset managers to access the benefits of Eurex cleared repo directly. April 2022 volumes marked a 135 per cent year-on-year increase in buy side activity under the ISA Direct model, showing that the service has become an indispensable tool for both managing cash and accessing funding. Eurex is actively working with new clearing agent banks and buy side firms to bring more participants into repo clearing at Eurex.

Solutions for a changing environment

Continued uncertainty and volatility over the past few years has shown that now is the time to add additional sources of liquidity to the toolbox. While concerns remain around legal documentation and margin calls, the benefits of CCP-cleared repo going forward far outweigh costs and lead to operational and legal simplification over time. Lessons from UMR, and the impending end to the pension fund clearing exemption, highlight the importance of alternative liquidity sources that are underpinned by a centralised 'golden source' framework and standardised data.

CCPs are uniquely placed to offer a capital-efficient framework for repo, which is why today we see the majority of interbank repo in Europe being centrally cleared. By expanding this to a wider range of market participants, Eurex addresses liquidity concerns and regulatory challenges. The balance sheet netting opportunities available to banks within a CCP can lead to more capacity and better pricing for the buy side. Additionally, the automated nature of CCP cleared repo addresses operational challenges and leads to higher settlement efficiency than in the bilateral repo market.

By accessing Eurex Repo's liquid markets, participants can access multiple liquidity providers under one standardised legal agreement, with reduced counterparty risk, electronic trading, and straight-through processing. Our markets have provided proven liquidity in times of stress and Eurex Clearing has the benefit of decades of experience in risk and default management.

Eurex is proud to offer ground-breaking solutions for the buy side and looks forward to this new phase in establishing repo clearing for a wider pool of participants. Our ISA Direct for Repo solutions lead to increased repo capacity, lower risk, and improved profitability. ■