

**MEMO# 24301**

May 18, 2010

# **Task Force on Tri-Party Repo Infrastructure Issues Final Report; New York Fed Releases White Paper on Tri-Party Repo Reform; Comments Requested by June 16**

[24301]

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TO: MONEY MARKET FUNDS ADVISORY COMMITTEE No. 18-10  
SEC RULES MEMBERS No. 45-10 RE: TASK FORCE ON TRI-PARTY REPO INFRASTRUCTURE  
ISSUES FINAL REPORT; NEW YORK FED RELEASES WHITE PAPER ON TRI-PARTY REPO  
REFORM; COMMENTS REQUESTED BY JUNE 16

In the fall of 2009, the Federal Reserve Bank of New York ("New York Fed") asked the Payments Risk Committee ("PRC"), a private sector group sponsored by the New York Fed, to form a group of industry stakeholders to address tri-party repo market infrastructure weaknesses exposed during the financial crisis of 2008 and 2009. The PRC created the Tri-Party Repo Infrastructure Task Force ("Task Force"), and included tri-party repo market participants, service providers, and representatives from industry groups, including ICI. Yesterday, the Task Force issued its final report. [\[1\]](#)

At the same time, the New York Fed also issued a white paper on tri-party repo reform to discuss policy concerns regarding weaknesses in the infrastructure of the tri-party repo market as well as to seek comment on the Task Force's recommendations to address these concerns. [\[2\]](#) Comments on all aspects of the Task Force's proposed recommendations, as well as the policy concerns described in the New York Fed's white paper are due to the New York Fed by June 16.

## Task Force Report

The report notes that during the recent financial crisis, the tri-party repo market took on particular importance in relation to the failures and near-failures of several financial firms. Indeed, the report states that the potential for the tri-party repo market to cease functioning, with impacts to various market participants and to the liquidity of the U.S. Treasury and agency securities, has been cited by policy makers as a key concern behind aggressive interventions to contain the financial crisis.

Based on this analysis, the Task Force identified the following areas where improvements are needed:

- *Operational Arrangements.* As a way to reduce the market's reliance on intraday credit provided by the tri-party repo clearing banks and clarify the credit and liquidity risks borne by market participants, the Task Force focused on specific actions needed to fundamentally strengthen the operational arrangements at the heart of the tri-party repo market. Specifically, through the "practical elimination" of intraday credit extended by the clearing banks through the "auto-substitution" of securities collateral supporting a tri-party repo transaction, the Task Force believes any potential threat to the solvency of the clearing banks due to this exposure is removed.
- *Dealer Liquidity Risk Management.* The report notes that tri-party repo activity must be an essential focus for any tri-party repo dealer's liquidity risk management. As such, the Task Force believes that dealers should account for the loss of secured funding within their liquidity risk management plans and liquidity stress tests. In addition, dealers should lengthen and stagger the maturity profile of their financing, seek to combine short-term and long-term financing with the same counterparty, and continue exploring alternative mechanisms that may be able to achieve more durable financing of certain types of securities.
- *Margining Practices.* The Task Force believes that margining practices must be broadly strengthened in the wake of the crisis. The report notes that market participants should undertake statistical analysis and stress testing of collateral price movements that allows them to assess the potential for losses at different levels of margins and to make decisions based on their appetite and capacity to absorb losses. The report also notes that cash investors should seek information that allows them to assess the potential concentration of repo counterparties with respect to a particular type of security.
- *Contingency Planning.* The Task Force believes that tri-party repo cash investors should develop "liquidation plans" for the management and liquidation of repo collateral in the event of a dealer default. These plans should cover both practical aspects such as custodial arrangements, as well as stress tests of potential losses due to collateral price movements and stress tests of possible liquidity needs. Additionally, DTCC and/or other interested providers should explore the development of a "collateral liquidation manager" service that would be made available to a broad range of market participants on a voluntary basis. In response to possible impediments to the rapid liquidation plans by cash investors that would increase uncertainty and systemic risk, the Task Force also believes that the Securities Investor

Protection Corporation should agree not to impose a stay on repo counterparties exercising their contractual remedies.

- *Transparency.* The Task Force believes that the tri-party repo market requires greater transparency and as a result has worked with the New York Fed to develop a template for regular publication of key information provided by the clearing banks. A pilot version of this template is included in the report and includes data showing the aggregate size of the tri-party repo market (broken down by asset category, with associated measures of dealer concentration) and margin haircut levels reported by the clearing banks for each asset category. The report also notes that because transparency of collateral valuation is an essential component of secured funding, the Task Force will establish a working group of valuation specialists across tri-party repo market participants to evaluate collateral pricing methodologies and make recommendations for improvements, including the feasibility of same day pricing.

The Report also includes an assessment of the potential impact of the Task Force's recommendations. In aggregate, the Task Force notes that its recommendations will drastically reduce, although not eliminate, many of the weaknesses of the tri-party repo market. Finally, the report includes concepts for further review including: a liquidity stabilization utility that would function as a bank with the explicit purpose of providing liquidity against collateral to cash investors after a dealer default; committed lines of credit for cash investors; a central counterparty facility that would substitute its credit standing for that of individual dealers in the tri-party market; and an emergency bank that a troubled dealer could transfer its repo portfolio to, possibly supplemented by an additional guarantee fund. The report notes that because there were a number of challenges with each of these concepts, the Task Force is not endorsing any of them.

## **New York Fed White Paper**

The white paper first includes an overview of repo market terms and describes the current market structure and its primary benefits. The white paper then discusses the areas of concern with respect to the current design of the tri-party repo infrastructure that led to the formation of the Task Force. These include: (1) the market's reliance on large amounts of intraday credit made available to dealers by the clearing banks that provide the operational infrastructure for these transactions; (2) the risk management practices of cash investors and clearing banks—practices that were, according to the New York Fed, with the benefit of hindsight, clearly inadequate and vulnerable to procyclical pressures; and (3) a lack of effective plans by market participants for managing the tri-party collateral of a large securities dealer in default without creating potentially destabilizing effects on the broader financial system. The paper then provides an overview of the Task Force and provides comments on the Task Force's recommendations. Finally, the white paper includes questions that are designed to encourage meaningful discussion and thoughtful analysis of the issues and to help the New York Fed assess the Task Force's recommendations.

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## endnotes

[1] The report is available on the PRC's website at [http://www.newyorkfed.org/prc/report\\_100517.pdf](http://www.newyorkfed.org/prc/report_100517.pdf).

[2] The white paper is available on the New York Fed's website at [http://www.newyorkfed.org/banking/nyfrb\\_triparty\\_whitepaper.pdf](http://www.newyorkfed.org/banking/nyfrb_triparty_whitepaper.pdf).

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