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Central Clearing of Repos in Australia

ASX Submission to the RBA on its Consultation Paper

AAA	AAE	AAH	AAI	AAJ	AAK	AAO	AAQ	AAU	AAV	AAW	AAZ	ABA	ABB	ABD	ABE	ABF	ABG	ABH	ABI	ABJ	ABK	ABL	ABM	ABN	ABO	ABP	ABQ	ABR	ABS	ABT	ABU	ABV	ABW	ABX	ABY	ABZ	ACA	ACC	ACE	ACH	ACI	ACJ	ACK	ACL	ACM	ACN	ACO	ACP	ACQ	ACR	ACS	ACT	ACU	ACV	ACW	ACX	ACY	ACZ	ADA	ADB	ADD	ADG	ADI	ADJ	ADK	ADL	ADM	ADN	ADO	ADP	ADQ	ADR	ADU	ADV	ADW	ADX	ADY	ADZ	AEA	AEB	AED	AEE	AEG	AEL	AEM	AEN	AEQ	AER	AES	AET	AEU	AEV	AEX	AFA	AFB	AFD	AFG	AFI	AFJ	AFK	AFM	AFN	AFQ	AFR	AFS	AFU	AFV	AFW	AFX	AFY	AFZ	AGA	AGB	AGD	AGE	AGI	AGJ	AGK	AGL	AGM	AGN	AGO	AGP	AGQ	AGR	AGU	AGV	AGW	AGX	AGY	AGZ	AHA	AHB	AHD	AHE	AHI	AHJ	AHK	AHL	AHM	AHN	AHO	AHP	AHQ	AHR	AHU	AHV	AHW	AHX	AHY	AHZ	AIA	AIB	AID	AIE	AIG	AII	AIJ	AIK	AIL	AIM	AIN	AIO	AIP	AIQ	AIR	AIU	AIV	AIW	AIX	AIZ	AJA	AJB	AJD	AJE	AJG	AJI	AJJ	AJK	AJL	AJM	AJN	AJO	AJP	AJQ	AJR	AJU	AJW	AJX	AJY	AJZ	AKA	AKB	AKD	AKE	AKI	AKJ	AKK	AKL	AKM	AKN	AKO	AKP	AKQ	AKR	AKU	AKV	AKW	AKX	AKY	AKZ	ALA	ALB	ALD	ALE	ALI	ALJ	ALK	ALL	ALM	ALN	ALO	ALP	ALQ	ALR	ALU	ALV	ALW	ALX	ALY	ALZ	AMA	AMB	AMD	AME	AMI	AMJ	AMK	AML	AMM	AMN	AMO	AMP	AMQ	AMR	AMU	AMV	AMW	AMX	AMY	AMZ	ANA	ANB	AND	ANE	ANI	ANJ	ANK	ANL	ANM	ANN	ANO	ANP	ANQ	ANR	ANU	ANV	ANW	ANX	ANY	ANZ	AOA	AOB	AOD	AOE	AOI	AOK	AOL	AOM	AON	AOP	AOR	AOS	AOU	AOV	AOW	AOX	AOY	AOZ	AQA	AQB	AQD	AQE	AQI	AQJ	AQK	AQL	AQM	AQN	AQO	AQP	AQR	AQS	AQU	AQV	AQW	AQX	AQY	AQZ	ARA	ARB	ARD	ARE	ARI	ARJ	ARK	ARL	ARM	ARN	ARO	ARP	ARQ	ARR	ARU	ARV	ARW	ARX	ARY	ARZ	ASA	ASB	ASD	ASE	ASI	ASJ	ASK	ASL	ASM	ASN	ASO	ASP	ASQ	ASR	ASU	ASV	ASW	ASX	ASY	ASZ	ATA	ATB	ATD	ATE	ATI	ATJ	ATK	ATL	ATM	ATN	ATO	ATP	ATQ	ATR	ATU	ATV	ATW	ATX	ATY	ATZ	AVA	AVB	AVD	AVE	AVI	AVJ	AVK	AVL	AVM	AVN	AVO	AVP	AVQ	AVR	AVU	AVV	AVW	AVX	AVY	AVZ	AWA	AWB	AWD	AWE	AWI	AWJ	AWK	AWL	AWM	AWN	AWO	AWP	AWQ	AWR	AWU	AWV	AWW	AWX	AWY	AWZ	AXA	AXB	AXD	AXE	AXI	AXJ	AXK	AXL	AXM	AXN	AXO	AXP	AXQ	AXR	AXU	AXV	AXW	AXX	AXY	AXZ	AYA	AYB	AYD	AYE	AYI	AYJ	AYK	AYL	AYM	AYN	AYO	AYP	AYQ	AYR	AYU	AYV	AYW	AYX	AYY	AYZ	AZA	AZB	AZD	AZE	AZI	AZJ	AZK	AZL	AZM	AZN	AZO	AZP	AZR	AZU	AZV	AZW	AZX	AZY	AZZ
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ASX Submission

April 2015

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CONTENTS

Executive Summary	3
Potential Benefits	3
Current Market Structure.....	3
Changes to the Repo Market	4

Executive Summary

ASX welcomes this opportunity to provide RBA with an overview of the potential costs and benefits of the centralised clearing of repo transactions in Australia.

ASX notes that the RBA is seeking to establish, “whether the capacity of the Australian repo market to safely, efficiently and continuously support the funding and liquidity needs of the Australian financial system would be improved by the availability of a repo CCP.”

ASX believes that there are significant benefits of repo transactions being centrally cleared, but in the short term, the likelihood of such benefits being realised is limited under the current structure of the repo market.

ASX is ready to engage further in a design study with the RBA and industry groups (such as the relevant AFMA committees) to explore in more detail the costs and benefits of the central clearing of repo transactions and the structural changes to the market that would be necessary.

Subject to the results of the design study and commercial feasibility, ASX would be prepared to invest in building a domestically licensed repo CCP service for the Australian market.

Potential Benefits

The benefits of central clearing of repo transactions in Australia are similar to the ASX markets which are already centrally cleared. Typically, these are as follows:

- **Multilateral netting:** counterparty exposures are reduced compared to the bilateral pre-netting currently conducted in the interdealer market. This results in a more favourable treatment in leverage ratio calculations;
- **Collateral and settlement efficiency:** the CCP calculates a single net position for settlement. It can also interface with a centralised collateral management system to streamline processes such as margining, recall and substitution of collateral;
- **Enhanced risk and default management:** risk management is standardised, with initial margin managing replacement cost risk. Default management is co-ordinated by the CCP;
- **Balance sheet efficiency** – centrally cleared transactions maximise balance sheet netting since the counterparty is always the CCP;
- **Regulatory capital benefits** - cleared interdealer repo transactions attract a 2% risk weighting for a bank's exposure to a CCP rather than a weighting of up to 20% for a bilateral counterparty. They also do not incur a credit valuation adjustment (CVA) and associated capital charge; and,
- **Systemic risk reduction** through the ability to ‘ring fence’ a defaulting counterparty from the rest of the market.

Current Market Structure

The Financial Stability Board (FSB) noted that there is significant potential for central clearing. However, in Australia this opportunity is limited because:

- A significant portion of repo activity has the RBA as one of the counterparties. This means that banks dealing with the RBA have one-directional exposures, with no offsetting exposures in the opposite direction;
- The RBA is viewed as a very low risk counterparty and therefore the benefits of credit risk reduction are limited;
- It is also unclear (to be examined in a design study) whether repos against the RBA have the potential to attract a 0% risk weighting for regulatory capital purposes. This would again limit the benefits of central clearing;
- The majority of inter-dealer repos are bilaterally pre-netted under Global Master Repurchase Agreements (GMRAs) ahead of settlement, resulting in a single one-directional settlement per ISIN per settlement day between each pair of dealers; and,
- Multilateral netting benefits would be limited if the product scope of such clearing was restricted solely to repo.

Given the relatively small scale of the Australian market, ASX recommends that RBA considers broadening the product scope to include both legs of all repos (including RBA repos) thus capturing the entirety of the \$110 billion repo market. Moreover, the inclusion of outright purchases and sales of bonds, debt securities (i.e. general collateral, specials and private securities) and equity repo and securities lending would also improve the viability of central clearing.

Changes to the Repo Market

The necessary changes to the way the repo market operates can be summarised as follows:

- Increased use of tri-party collateral optimisation and allocation services such as ASX Collateral;
- Increased use of electronic trading repo platforms such as Yieldbroker; and,
- Decreased day-to-day activity by the RBA as a proportion of the overall Australian repo market.

In the event that these changes were made, ASX could develop an onshore central clearing solution that would leverage existing financial market infrastructure located in Australia. In combination, this would:

- Deliver the benefits of the central clearing of repo transactions in Australia as set out earlier in this paper;
- In particular, deliver operational benefits to the market through straight through processing (STP) of transactions throughout electronic execution, centralised clearing and tri-party collateral management; and,
- Improve liquidity by encouraging a broader range of counterparties into the repo market.

In terms of sequencing the implementation of these changes, it may be preferable to achieve critical mass in tri-party repo and electronic trading as a first step. This would improve liquidity (by adding additional cash providers to the system) and enable the RBA to decrease its relative day-to-day role in the overall repo market before centralised clearing is added.

If this can be delivered, ASX believes this would meet the objective of improving the functioning of the Australian repo market and its capacity to safely, efficiently and continuously support the funding and liquidity needs of the Australian financial system.