



REPO TRADE MATCHING GUIDELINES

Australian Financial Markets Association
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Repurchase Agreement (Repo) Trade Matching Guidelines

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1. WHAT THESE GUIDELINES ARE ABOUT

A repurchase agreement (also known as a repo, RP or sale and repurchase agreement) is a transaction where debt securities are sold together with a simultaneous agreement to buy them back at a future date at an agreed price. The repurchase price, which includes interest, is greater than the original sale price except in circumstances where a negative interest rate is applied.

A reverse repo is the opposite of a repurchase agreement. Effectively one party's repo is another party's reverse repo.

The Australian repo market is characterised by trades between institutions purely for liquidity reasons and those dealt to cover short trading positions. Repo transactions are also undertaken by the Reserve Bank of Australia (RBA) as part of its daily open market operations.

These guidelines describe repo trade matching market practice, and by clarifying the responsibilities of the various parties involved in repo transactions they are designed to reduce, to the maximum extent possible, settlement delays and failures.

2. APPLICATION AND ENFORCEABILITY OF THE GUIDELINES

These trade matching guidelines have been prepared voluntarily by the AFMA Repo and Debt Market Operations Committees in consultation with AFMA members. They are intended to assist a financial market participant that engages in repo transactions to ensure that appropriate policies and procedures are in place, and furthermore to assist AFMA members in achieving, to the maximum degree possible, transaction affirmation on the date that it was entered into, thereby optimising the overall risk management of repo products. This notwithstanding, specific challenges are recognised, including circumstances where:

- repo trades cannot always be agreed prior to settlement day
- counterparties are either unwilling or unable to cash settle circles, and in some circumstances are either reluctant or unable to provide stock to break the circle
- counterparties are either unwilling or not in a position to split trades into more manageable tickets, as the day's flow is often not known at the start of the day
- counterparties are unaware that particular trades are repos, and cannot provide trade information on a timely basis
- the matching of interbank trades tends to be given precedence over client trade matching, resulting in unmatched client trades later in the day than is generally considered desirable
- sold details are not input to EXIGO until stock has been purchased
- Austraclear and RITS regulations preclude some clients from settling after the Austraclear EOD.

AFMA acknowledges that members may also need to consider applicable rules in other jurisdictions and their own internal policies in applying these guidelines, which do not replace the statutory obligations that could apply.

AFMA is not a regulatory body and does not have supervisory or disciplinary powers. Accordingly, adherence to these guidelines is a matter for each AFMA member to determine having regard to its own business circumstances. AFMA will not seek to enforce the guidelines or take action against a member who does not adhere to the guidelines.

AFMA will promote these guidelines to its members through appropriate forums, including publication on the AFMA website. The guidelines will be reviewed from time to time to ensure that they remain relevant and useful.

AFMA recommends that its members adhere to these guidelines and incorporate the principles into their business processes.

3. TRADE MATCHING GUIDELINES

3.1. Timeliness of trade matching

The credit and operational risk elements of a repo transaction should be identified and matched as early as possible on the transaction date.

Repo market participants are to endeavour to achieve same day affirmation of repo trade activity, either by electronic means or voice communication. A hard or soft copy of the electronic communication should be held to support the affirmation, and in the case of telephonic confirmation the communication should be recorded.

If trade date matching is not feasible, then it must be conducted as early as possible in the settlement cycle. Market participants are to take all possible steps to facilitate the timely identification of inventory, and communicate instructions accordingly.

Inefficient operational procedures that unnecessarily delay the matching process should be identified and remediated.

3.2. Prioritisation of trade matching

Priority should be given to the affirmation and matching of transactions with the highest economic impact risk profiles arising from any error: For example:

- transactions in excess of A\$50million
- open trades
- term trades longer than 1 week.

Similar prioritisation should be practised in circumstances where trade affirmation and matching is not feasible on the trade date, bearing in mind that regardless, trade matching must be conducted as early as possible in the settlement cycle.

3.3. Transaction details to be affirmed and matched

The following details of a repo transaction are to be affirmed:

- transaction date
- counterparty
- ISIN
- on and off leg value date Term/open/fixed trade
- face value of collateral and currency denomination
- price/yield
- haircut
- consideration and currency denomination
- repo rate – fixed/ floating, day-count convention and spread over details
- call days for open trades.

Post-trade amendments are also to be affirmed, i.e.:

- re-pricing
- open trade closures
- amortisation events
- capitalisations
- changes in haircut.

In line with global practice, the Australian repo market is currently transitioning to margining from re-pricing. These trade matching guidelines will be reviewed once this transition is complete, to ensure that any additional affirmations required by the margining processes are recognised in the guidelines.

4. CIRCLES IN THE SECURITIES MARKETS

4.1. Commentary

AFMA wishes to bring the practice of conducting ‘circles’ in the Australian market to the forefront of executives minds and ensure that all staff and their respective organisations are fully aware of the risks created by participating in circles. In addition AFMA considers it important to generate discussion with market governing bodies with a view to finding appropriate alternatives to eliminate the practice from the market.

Circles occur in securities markets as a consequence of participants in the marketplace selling securities whilst not actually holding (or intending to hold) the underlying physical assets. Each counterparty is waiting on the other to deliver the securities to effect a settlement on a DVP/RTGS basis. An impasse is created if the underlying security is not physically held by any of the counterparties.

The current settlement procedure is for operations personnel in the major fixed interest players to agree via a phone call that a circle exists and to further agree that the transactions will settle on a cash basis only (i.e. assume that the security has transferred between all counterparties and only the cash component remains outstanding). The full settlement of the transactions now relies on the cash transactions being simultaneously approved, paid/received and cleared on an RTGS basis through the respective Exchange Settlement Accounts (ESA).

Any delay in the payment/receipt clearing cycle can result in one or more of the counterparties being exposed to the loss of the principal without having an agreed transaction in place with each counterparty, or access to the underlying security assets. As the exchange of cash is not simultaneous, at any point a party to the circle may withdraw after the circle has partially settled, leaving the remaining counterparts exposed.

Some market participants advise they have daily settlements limits issued by their Credit Department against counterparties, or do not enter the cash payment until the expected cash from the other counterparty has been received. These mechanisms may provide a level of comfort however they are not a control in mitigating or eliminating the risk. Counterparties with whom the new risk has been created are not necessarily the same counterparties that have a committed transaction. It is therefore unlikely that the failure of a transaction to settle would be protected under the governance of an ISDA Master or any other existing agreement.

The circle process is relying on word-of-mouth from unrelated parties as to who the members of the circle are and their respective ability to meet the newly agreed obligations. In addition, the decision to replace the transaction with a cash settlement and effectively remove the chain of title to the security from the settlement of a security transaction (i.e. breaking the DVP), is being made by relatively junior operations personnel on behalf of each organisation.

AFMA is of the view that the risks associated with circles cannot be effectively managed and the knock-on effect, in terms of the new risks introduced, is significant.

4.2. Recommendations

- 4.2.1. Given the inherent risk associated with circles, firms are encouraged to identify them early and have their operations teams communicate them to the front office. The front office is to make the call, based on Repo Convention 3.24.3, as to whether securities lending facilities are to be used to assist settlement. This will promptly eliminate the identified risks and help to ensure that the settlement market remains stable and robust and the Australian marketplace operates in line with global securities settlement practices for domestic debt securities;
- 4.2.2. AFMA recommends that all operational staff engage in debate within their organisation to ensure that all stakeholders clearly understand the process and risks associated with continuing this practice;

- 4.2.3. AFMA recommends that all market participants ensure that appropriate credit, legal and risk management procedures in place to ensure that, in the event that the participant needs to or is required to access the AOFM or State Government stock lending facilities or to participate in a circle then this action will not be unnecessarily delayed by a sign-off process which has not been carefully designed, adequately documented or effectively communicated;
- 4.2.4. AFMA recommends that all market participants take responsibility for and bear the costs associated with circle remediation in instances where it is evident that the fault lies within.

Market participants are encouraged to use all best endeavours to conduct activities in accordance with these Guidelines.

AFMA appreciates the co-operation of repo participants in our endeavours to improve procedures within our markets.

5. USEFUL ADDITIONAL REFERENCES

ICMA European Repo Council (ERC) recommendation on repo matching as a driver for risk reduction — 25 July 2011

<http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Repo-Markets/Trade%20Matching%20Best%20Practice%20July%202011.pdf>
