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RepoClear

Repo clearing

Trends, developments and outlook

Recent volatility in the UK gilt market has highlighted the repo market's need for central counterparty stability, predictability and resilience. LCH RepoClear unpacks the trends and key developments of 2022, and shares an outlook for 2023

How have macroeconomic developments and subsequent volatility in 2022 impacted repo market participants?

The world is changing rapidly in a number of ways: from the economy and geopolitics to environmental issues and public health. These dynamic factors are creating new challenges for financial markets, leading market participants to seek efficiency and optimisation. This has been reflected in the growing demand for cleared repo, which, according to the latest International Capital Market Association European repo survey,[1] represents around 50% of the outstanding loan value of the overall European repo market – a trend fuelled in part by the need for market participants to access safe and secure liquidity pools enabling efficient collateral transformation. Stressed markets have certainly played their part in the increased demand for clearing, as witnessed during the period of volatility in the UK gilt market. On the back of this recent turmoil, many repo market participants, including pension funds, are actively reviewing their toolbox of execution options – including cleared repo – to improve their liquidity management.

How have stressed markets impacted central counterparties (CCPs)? How has LCH managed this volatile situation?

CCPs have been once again proven to be resilient to the increased volatility seen in 2022. LCH is available for its members and clients in all market conditions, normal or stressed. LCH adapts and meets participants' expectations for CCP stability, predictability and resilience. This was illustrated by the recent gilt market events, where some extreme market movements were observed. At that time, the market benefited from LCH's reliable margin models. Any adjustments to the margin resources required were predictable, within expected parameters and were communicated to members with no changes to the rule book.

Could similar events occur in euro markets? How has LCH prepared, and what mechanisms does it have in place to manage market disruption?

Yes, similar events could occur in the euro markets, but LCH's robust risk management framework, and the diversity of our debt clearing offering acts as a cushion to absorb market shocks because risk appetite can quickly change within the same liquidity pool: members can reposition and change exposure between core and peripheral debt. The internationalisation and diversification of LCH's membership also acts as a stabilising factor, as new members have varied risk appetites and requirements. Diversity brings stability, which we continue to support across our clearing services, collateral deposited and in our membership base.

We've asked how LCH has reacted and prepared, but how can repo clearing offer more opportunities and efficiencies for the buy side as well as the sell side?

Repo clearing has never been more relevant. In recent times, government debt issuance has increased, but there has been no relaxation of the balance sheet constraints or the number of institutions that can intermediate in the market. Clearing, and LCH RepoClear specifically, can play a major role in easing potential tensions and resource management in the market.

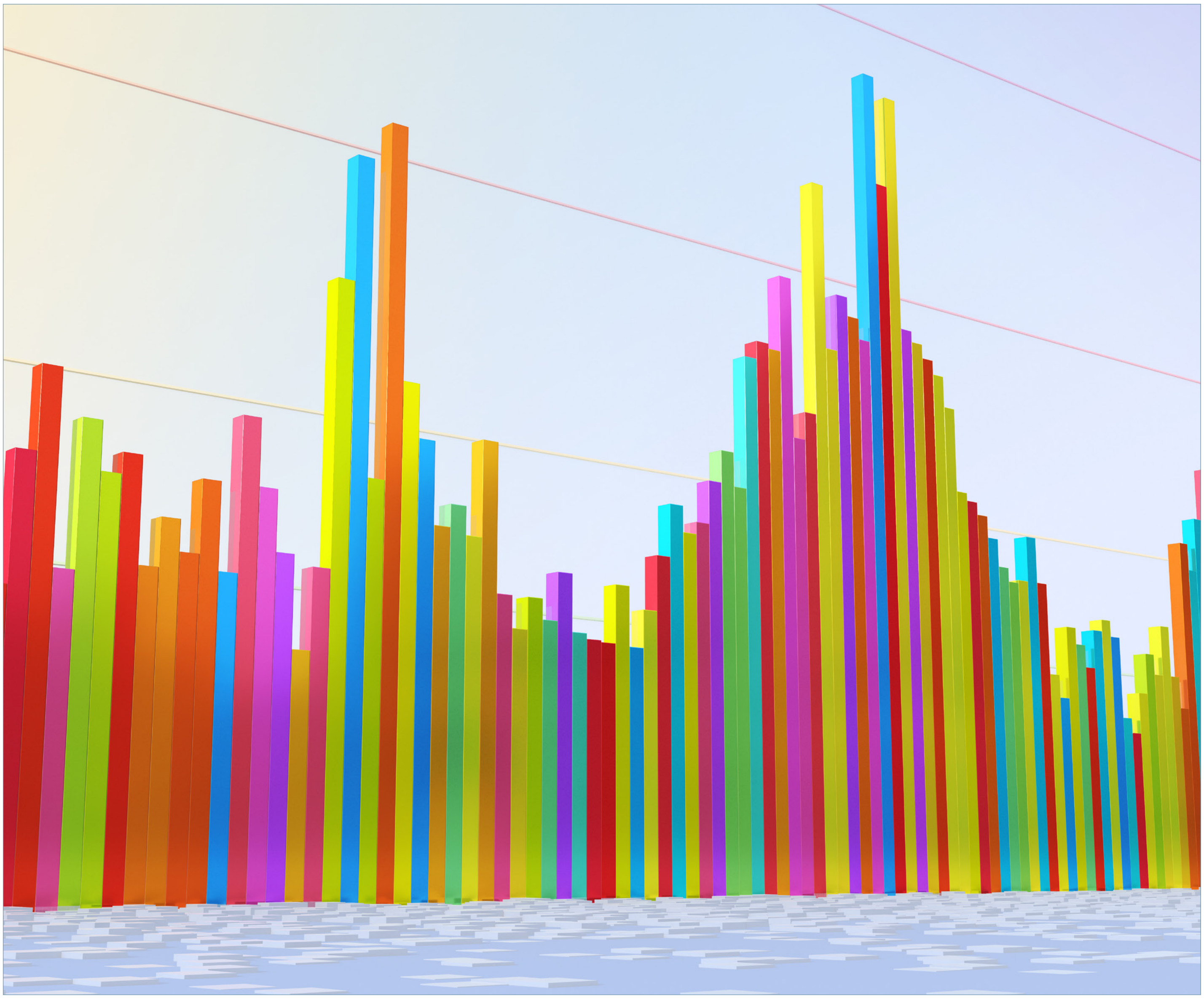
Through RepoClear's Sponsored Clearing model, we allow the buy side to gain access to secured cleared collateral transformation. Sponsored clearing facilitates efficient market intermediation as it provides CCP access to new types of participants in a way that reduces banks' resource requirements. This releases further resource capacity for banks.

Additionally, RepoClear offers meaningful operational and settlement efficiencies to the sell and buy sides. With more than €1 trillion euros per day cleared across euro debt and gilts, close to 99% of the value cleared settles on the intended settlement date. This is because reduced settlement risk and operational efficiency is built into RepoClear's DNA – CCP settlement netting decreases settlement and liquidity risk by reducing the physical settlement of securities and cash by more than 70% compared with the uncleared market.

LCH and RepoClear are focused on efficiency in addition to safety. But what about optimisation?

Our members and their clients have told us that efficient resource management and optimisation are growing priorities for them. These priorities can be categorised as the calculation of margin, the timely settlement of transactions with the CCP and the optimisation of collateral posted to the CCP.

To address this, LCH invests heavily in tools that help members optimise. Our data, analytics



and optimisation services increase efficiency and reduce costs across the trade lifecycle, and introduce digitisation into operational workflows, which includes our recently released Settlement Monitor tool to improve settlement monitoring and performance.[2]

In addition, LCH RepoClear's margin calculator helps members understand their historic and current margin obligations, and gain visibility through simulations into how much margin they should be paying.

What are the repo clearing developments to watch for in 2023, and how can LCH help?

As the European Market Infrastructure Regulation mandatory clearing exemption for pension funds in the European Union expires on June 18, 2023, pension scheme arrangements (PSAs) will be subject to the clearing obligation and therefore need to improve their liquidity management infrastructure.[3] Strengthening capacity to manage liquidity and transform securities into cash is a key consideration for pension funds, which will be required to post variation margin (VM) to the CCP for their derivatives trades.

Historically, PSAs have held large amounts of high-quality, liquid assets as part of their investment strategies. We think cleared repo is the connective tissue between their investment strategies and their ability to post cash VM for their swaps clearing activity.

Instead of posting the bonds under a bilateral credit support annex, PSAs can use their bonds via the cleared repo market to generate the cash for posting at the CCP. The cleared repo market has the benefits of all cleared markets in this context, allowing more reliable access to liquidity in times of stress. Additionally, as previously discussed, LCH's Sponsored Clearing model has been designed with the buy side in mind, including PSAs. Indeed, PSAs have been among the earliest adopters of these models, and we look forward to extending access to clearing to an even wider range of buy-side participants in the future, as sponsored models and the cleared repo liquidity pool develop further, including hedge funds, under a guaranteed sponsored clearing model.

[1] *International Capital Market Association (October 2022),* European repo market survey, Number 43, *www.bit.ly/3WnA0zB*
[2] *LCH (October 2022),* Introducing the Settlement Monitor from LCH RepoClear, *www.bit.ly/3hGWQmT*
[3] *European Commission (June 2022),* Report from the Commission to the European Parliament and the Council, *www.bit.ly/3GbC34d*

LCH RepoClear is here to partner with the market to provide strong risk management and access to a range of cleared repo markets. Contact **LCH RepoClear's specialist sales team** or visit our **website** for further information.