Vítor Constâncio: Repo market and securities lending – towards an EU database

Introductory remarks by Mr Vítor Constâncio, Vice-President of the European Central Bank, to the ECB workshop "Repo market and securities lending – towards an EU database", Frankfurt am Main, 3 December 2012.

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Ladies and Gentlemen.

I am pleased to welcome you all to this workshop. Your presence today makes clear the wide interest and also the urgency to enhance the monitoring of the EU repo market. I want particularly to highlight the participation of the US authorities that kindly accepted to share their experience, the Bank of England, with whom we share the same transparency concerns, and last but not least the European Commission and ESMA who have their special say on the subject of regulatory reporting and trade repositories regulation.

For years before the crisis, repos provided a stable and liquid market. Since the start of the euro, the euro repo market proved to be very successful. In the past years secured lending via repos has increased significantly, and, according to our estimate, since 2002 its daily turnover more than doubled. This increased importance of the repo market particularly since the onset of the financial crisis stems, of course, with the market perception of credit risk concerns linked to unsecured transactions. The growth in this market was also underpinned and promoted by key legislative changes such as those brought by the Collateral Directive, which provided for a clear and harmonised framework across the EU.

Yet, in 2008, following deterioration in market confidence, financial integration in money markets deteriorated, as witnessed in an upward drift in cross country dispersion for overnight rates and a significant decline in interbank market activity, particularly in the unsecured segment. Some leading commentators (Gorton and Metrick[1]) even argued that the core problem of the financial crisis in the US was a run on repos. As a result of the combined effect of the measures implemented by the ECB, the euro money market conditions improved during 2012, although its fragmentation remains still high.

Against this background, a key lesson from the crisis is that we need to better understand and monitor the repo as well as the securities lending markets, given their importance for the efficient functioning of the financial system. This has been confirmed by the analysis conducted at global level by the Financial Stability Board (FSB). Also our US friends are conducting initiatives aimed at the same objective.

The workshop today gathers together key representatives from public authorities, regulators and market representatives with the aim to achieve a common understanding of the following key issues: first, what are the expected benefits from requiring additional and more granular data for monitoring repo and securities lending markets and which data is essential to make such a data collection effort useful for all relevant stakeholders? Second, how could these data be better collected, to inform the public authorities assessment about firm-level and systemic risks?

As to the first question, addressing the lack of transparency is as a matter of fact of primary importance as it paves the way for tackling six other key issues identified by the FSB related to securities financing markets, namely the pro-cyclicality of system leverage and interconnectedness, potential financial stability issues associated with collateral re-use,

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1 Gorton, Gary (2008) "The panic of 2007" NBER wp n.14358: Gorton, G and Andrew Metrick (2009) "Haircuts" NBER wp n. 15273 and Gorton, G and Andrew Metrick (2010) "Regulating the shadow banking system"

potential risks arising from the fire-sale of collateral assets, the potential risks arising from agent lender practices, securities lending cash collateral reinvestment and insufficient rigour in collateral valuation and management practices.

Increased transparency can help regulators or supervisors on the one hand as well as market participants themselves on the other hand.

For regulators a more detailed information set provides insights that may help them to identify trends in the build-up of risks over time, either for a specific institution, a specific asset class, or for the market overall. Information availability furthermore allows regulators to monitor changes in market activity that can lead to the emergence of potential new risks. Finally enhanced transparency can support the development of appropriate policy responses in times of stress.

Improved transparency can help ***market participants*** as well as it allows participants to observe how market activity is evolving over time with respect to pricing, liquidity and other characteristics that affect their own risk management and profitability. It additionally can provide information regarding risks that could impact market participants.

Increased transparency might also benefit central banks in the implementation of its monetary policy operations. More specifically, it can provide information on structural aspects of the repo market regarding asset categories eligible for monetary policy operations and the extent of their use by counterparties as well as information on risk control measures applied. Such information could guide Eurosystem policy decisions (in particular in times of financial stress) with respect to the Eurosystem's own collateral eligibility criteria and the calibration of its risk control framework.

As the work carried out by the FSB has shown, the actual set of information to adequately gauge systemic and firm-level risks arising from securities financing transactions is as a matter of fact rather straightforward. Assuming a specific home-currency for the transactions covered, six transaction specific information items are essential: (1) the counterparty of the transaction, (2) the principal amount, (3) the interest rate or lending fee, (4) information on underlying collateral (including type, issuer, maturity, currency and valuation of the collateral), (5) information on the applied haircut as well as (6) the tenor or maturity of the transaction. I would add to these also information about re-use of securities.

The workshop today intends to assess the grounds designing an infrastructure and data collection set-up ensuring confidentiality, efficiency in the data transmission, but also looking for potential synergies, and ensuring through the publication of different levels of data aggregation to relevant stakeholders that this exercise can be beneficial to regulators or supervisors as well as market participants. The involvement of all relevant stakeholders from the very beginning should allow that synergies can be explored and benefits reaped.

Turning now to the second of my initial questions, how could these data be better collected?

I have earlier this year, in a Conference organized by the European Commission,[2] launched a proposal to create a EU central Database on repos, as a joint effort by public authorities and the financial industry. I am counting on this workshop to launch the practical discussion about the main issues and the challenges to be addressed and, most importantly, the possible solutions for this proposal to become reality. When I first launched my proposal last April I noted that due to its role in macro-prudential financial stability and the closeness of repo to monetary policy, the ECB would be well placed to centralise the data gathering for the euro repo market. This remains true, but today I would like to emphasise that the ECB

[2] See Constâncio, V (2012) "Shadow banking – The ECB perspective" Speech by Vítor Constâncio, Vice-President of the ECB, Towards better regulation of the shadow banking system, European Commission Conference, Brussels, 27 April 2012

organised this workshop by taking a wider perspective on the subject and acting just a catalyst. Although the ECB stands ready to provide any assistance that may be required I think, for instance, that a trade repository, acting as an aggregator of several others, could ensure the most suitable data coverage, leaving us the flexibility to shape the data aggregation and analysis in line with our evolving needs . However what is important is ensuring a timely and detailed, complete central view on the market. In fact, the ECB does not need to centralise itself the data gathering, provided it has access to all the information it requires.

Having talked about potential synergies that could be explored I would as a side remark also like to point to the potential use of a trade repository to establish a new benchmark on secured financing. The discussions on potential improvements of current unsecured or secured rates pointed to the need to move to more transactions based figures. A repo trade repository at first sight looks as a promising candidate for establishing and calculating a new benchmark for repo rates based on actual transactions.

So I leave it to today's joint discussion among the representatives of the industry and authorities to debate what could be an optimal solution to achieve the result we need. Whether we will need an EU central database as opposed to a complete, fully fledged trade repository as done for other market segments will depend on several factors that you are going to debate in the course of the day.

In the case of repo, and contrary to other financial market segments, plenty of relevant data of interest to central banks are already channelled from the trading layer for execution to various categories of intermediaries, oftentimes via CCPs, to the payment clearing and settlement systems. One key topic for discussion today is thus how to ensure this set of highly critical but dispersed data can be adjusted, formatted, complemented if necessary, and channelled, to form the much needed central view on the market.

It will be indispensable today to identify practical solutions on how information can effectively and efficiently be retrieved and fed to a database, by whom, and to whom, under what governance and technical channels, and what shall be the indispensable confidentiality requirements to ensure an appropriate level of data disclosure taking into account the needs of authorities and different stakeholders. While I say "practical" issues, I am aware that they entail sensitive policy discussions and choices to be made that may affect market participants in various ways, not least in terms of costs.

In the light of the way ahead that will emerge from the discussion today, authorities will have the possibility to draw some final conclusions, including on how in their specific roles they can and may wish to further support this initiative.

Because market interconnectedness knows no borders, a global alignment in terms of repo market transparency is desirable (in results, not necessarily in solutions). On this side of the Atlantic, undoubtedly, I think we should aim for an EU and not only a euro-area central view on the euro repo market and securities lending data.

To conclude, let me say clearly that in this discussion, the ECB is today acting as a catalyst for change, to help setting out arrangements needed for financial stability monitoring, thus ensuring the efficient functioning of financial markets. I see this workshop and the follow-up I expect from it, as indispensable first steps, leading to a more structured project, involving a wider set of stakeholders and market participants.

I hope that the exchange of views today will prove fruitful to our common endeavour.

Thank you for your attention.