April 7, 2017

Financial Markets Department

Bank of Japan

Summary of Discussions at the Third Repo Market Forum

The Financial Markets Department of the Bank of Japan held the Third Repo Market Forum on March 22, 2017 at the Bank's head office in Tokyo.

The repo market plays a critical role in the financial markets both at home and abroad. Under global initiatives following the global financial crisis, there have been ongoing discussions aiming to enhance the transparency and strengthen the risk management of repo transactions. Furthermore, in Japan, market participants have been paving the way to shorten the settlement cycle of JGBs.

The Financial Markets Department of the Bank of Japan, in its capacity as a central bank, has hosted conferences titled "Repo Market Forum" to support such discussions and efforts. In light of the progresses in discussions and studies following the previous two conferences, the Department decided to host the third conference to enable wide-ranging players in the repo market to share their insights and discuss latest developments of the market.

(Outline of the Forum)

- Date and Time: March 22, 2017 (16:00-18:00)
- Venue: The Bank's head office in Tokyo
- Participants: 40 participants consisting of major players in the repo market (e.g. banks, securities companies, insurance companies and asset management companies), financial market infrastructures, industry associations, the Financial Services Agency (J-FSA), and the Bank of Japan

(Agenda of the Forum)

Opening Remarks

Seiichi Shimizu (Director-General of the Financial Markets Department, Bank of Japan)

Session 1.	**Recent Developments of the Repo Market**
Reporter:	**Kota Iijima** (Head of Market Infrastructure Division, Financial Markets Department, Bank of Japan) **Shingo Ishizaka** (Director, Coordination and Market Analysis Division, Financial Markets Department, Bank of Japan)
Session 2.	**Discussions on the Repo Market at International Forums and Preparation for the Domestic Implementation of Internationally Agreed Policies**
Reporter:	**Mr. Yoshinori Harada** (Deputy Director, Office of International Affairs, Financial Services Agency) **Sayaka Yamazaki** (Director, Market Infrastructure Division, Financial Markets Department, Bank of Japan)
Session 3.	**Progress towards Shortening of the JGB Settlement Cycle**
Reporter:	**Mr. Satoshi Yoshida** (Managing Director, Corporate Planning Department, Daiwa Securities Co. Ltd., and Chair of the Working Group on Shortening of JGB Settlement Cycle at Japan Securities Dealers Association)

Closing Remarks

Kota Iijima (Head of Market Infrastructure Division, Financial Markets Department, Bank of Japan)

(Views provided by participants)

Participants exchanged views following each of the three sessions. Views provided by participants are as follows.

<u>On recent developments of the repo market</u>

- The amount outstanding in the repo market in Japan is on an increasing trend, while that in the United States is gradually decreasing.
- The increasing trend in the amount outstanding in the repo market in Japan can be partly attributed to an increase of transactions by non-residents.
- Reasons for non-residents to trade in the repo market in Japan include the need to invest yen-denominated funds received through currency swaps in safe assets such as JGBs. In addition, they also include the need for JGBs as collateral at overseas CCPs. In this regard, overseas CCPs seem to limit the amount of assets acceptable as collateral considering their liquidity. Therefore, it is important to maintain the liquidity of the JGB markets.
- Repo rates have been showing irregular moves, such as spikes observed at the end of each quarter due to financial regulations, and their spread from Overnight Index Swap (OIS) rates is widening. This makes the funding cost of JGBs different from that of cash even though they are both risk-free assets. In this regard, while currently the common practice is to discount both JGB collaterals and cash collaterals with OIS rates in evaluating derivative transactions, the spread between repo rates and OIS rates may become a subject of discussion in relation to such evaluation method of derivative transactions.
- With a globally increasing demand for safe assets as collateral due partly to financial regulations, it is important to manage collaterals as efficiently as possible. With this in mind, our company has been trying to achieve optimal collateral allocations across global locations on a T+0 basis.

<u>On repo regulations</u>

- There have been growing incentives to use CCPs in repo transactions, following the progress of international financial regulation reforms. Under such circumstance, overseas CCPs have been working to improve their usability. CCPs in Japan are also expected to strive for greater convenience by, for instance, inviting a wider range of participants.

On shortening of the JGB settlement cycle

- The long efforts for shortening of the JGB settlement cycle will enter the final phase by implementation of T+1 outright transactions and T+0 general collateral (GC) repo transactions planned on May 1 , 2018.
- There has been a firm progress in the preparations for shortening of the JGB settlement cycle, including IT systems. Each market participant should also work on the shift to new *Gensaki* transactions.
- Results of the Tokyo Money Market Survey show that mainly the players with large transactions in the repo market have been preparing for the shift to new *Gensaki* transactions. However, nearly a half of the repo market participants are still in the process of gathering information. We will need to engage with these participants to advance the shift further.
- There seem to be different degrees of interests in the preparations for shortening of the JGB settlement cycle between financial institutions that engage in repo transactions and those that do not. It is important that those that engage mainly in outright transactions, notwithstanding those that will engage in the Subsequent Collateral Allocation Method GC repo transactions, fully prepare for shortening of the JGB settlement cycle by properly understanding the impact that it will have on their transactions and by participating in the Running Test starting this fall.
- It appears that those that only engage in outright transactions and conventional repo transactions, as well as those that will engage in the Subsequent Collateral Allocation Method GC repo transactions, have moderate interests and have taken measures to prepare for the Running Test.

On the Subsequent Collateral Allocation Method GC repo transactions

- In order to achieve T+0 repo transactions, the Subsequent Collateral Allocation Method GC repo transactions (transactions in which Japan Securities Clearing Corporation (JSCC) undertakes allocations of JGBs as collateral just before settlement) will be introduced. Initially, bonds whose coupons would be paid on the following day of collateral allocation were planned to be exempted from such allocation. But after some discussions, it was decided that they could be allocated only at the first collateral allocation, which takes place on the preceding business day of settlement. In this regard, it is desirable to continue the discussions, after the implementation of shortening of the JGB settlement cycle planned on May 1, 2018, to allow them to be also allocated at the second and the third collateral allocations, which take place on the settlement day, in order to relax funding constraints.

- The data message of the Subsequent Collateral Allocation Method GC repo transactions sent to JSCC through the Pre-Settlement Matching System (PSMS) of Japan Securities Depository Center (JASDEC) has different formats from that of conventional repo transactions. Therefore, in order to conduct the Subsequent Collateral Allocation Method GC repo transactions, not only financial institutions engaged in the transactions but also investment managers who involve in generating the corresponding data message will have to adapt their IT systems. Concerned parties should make sure to work on this point.
- In July 2016, the master agreement applicable to the Subsequent Collateral Allocation Method GC repo transactions was published. Although the agreement was drafted to incorporate the prevailing practices in the Best Practice Guides for securities lending transactions and *Gensaki* transactions as much as possible, some points remain to be discussed. Therefore, the Bond *Gensaki* Transaction Study Group has begun to review the Guides while taking such points into consideration. It is necessary to establish plans of the review as swiftly as possible, with due consideration, so that market participants can refer to the Guides when they make use of the new master agreement.