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Financial Markets Department
Bank of Japan

# Summary of Discussions at the Repo Market Forum on May 14, 2015[1]

The Financial Markets Department of the Bank of Japan held a conference titled "Repo Market Forum" on May 14, 2015 at the Bank's head office in Tokyo.

The repo market plays a critical role both at home and abroad. Following the recent financial crisis triggered by the collapse of Lehman Brothers in 2008, various discussions have been taking place at international forums, with the aim to enhance the transparency and strengthen the risk management of repo transactions. Moreover, in Japan, market participants have been paving the way to shorten the settlement cycles of JGBs and its repo transactions.

The Financial Markets Department of the Bank of Japan has been deeply involved in the above-mentioned developments at home and abroad, and is willing to contribute to the further development of the repo market. As part of such initiative, the department hosted a forum to encourage the exchange of views among wide-ranging players in the repo market such as financial institutions, financial market infrastructures, industry associations, the Financial Services Agency, and the Bank of Japan.

The following is the summary of discussions at the forum.

[1] The original text is in Japanese. (http://www.boj.or.jp/announcements/release_2015/data/rel150529b.pdf)

**(Agenda of the Forum)**

**Opening Remarks**

**Hiromi Yamaoka** (Director-General of the Financial Markets Department, Bank of Japan)

**Session 1. Recent Developments of the Repo Market in Japan**

Reporter: **Akihisa Shinmi** (Head of Market Infrastructure Division, Financial Markets Department, Bank of Japan)

**Mr. Shinya Ohnishi** (Joint General Manager, Markets Business Division, Central Tanshi Co., Ltd.)

**Session 2. Discussions on the Repo Market at International Forums**

Reporter: **Mr. Masayuki Sato** (Deputy Director, Office of International Affairs, Financial Services Agency)

**Akira Tsuchikawa** (Director, Market Infrastructure Group, Financial Markets Department, Bank of Japan)

**Session 3. Shortening of the JGB Settlement Cycle and Repo Market in Japan**

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)

**Mr. Shinsuke Mitsuji** (Deputy Director, Financial Markets Division, Financial Services Agency)

**Itaru Fukuda** (Head of Market Infrastructure Group, Financial Markets Department, Bank of Japan)

**Closing Remarks**

**Akihisa Shinmi** (Head of Market Infrastructure Division, Financial Markets Department, Bank of Japan)

**Opening Remarks**

(**Hiromi Yamaoka**, **Bank of Japan <BoJ>**)

Financial intermediation, which is indispensable to the economy, is based on each financial institution's activities to invest their liquid assets such as cash and deposits in more profitable but less liquid assets. Through these activities, financial resources are allocated efficiently to productive investments and thereby economic development is promoted.

However, each economic entity cannot fully predict the liquidity needs it will face in the future. Under such circumstances, repo transactions, which facilitate temporary exchanges of funds and financial assets, enable economic entities to accommodate uncertain liquidity needs. Rather, thanks to the repo market, financial institutions are able to efficiently allocate financial resources while managing liquidity risks stemming from inherent uncertainties in the economy. In this regard, repo transactions should be regarded as one of the essential part of financial intermediary functions.

On the other hand, repo transactions are flexible vehicles that can be structured to collateralize wide-ranging assets and have various maturities, and can also be used for transactions with larger risks and higher leverage. Indeed, some argue that riskier repo transactions expanded overseas prior to the financial crisis triggered by the collapse of Lehman Brothers in 2008, and therefore repo transactions have attracted much regulatory and supervisory attention in international forums since the crisis.

Nonetheless, if repo transactions become unavailable and thus require financial institutions to hoard large amount of liquidity for needs in the future, financial intermediation of long-term investments could be substantially impaired. Moreover, if financial institutions are forced to obtain liquidity through "fire sales" of their assets instead of through repo transactions, the overall risk in the market including contagion risks would increase. Therefore, in regulatory debates on repo transactions, there needs to be an appropriate balance among the soundness of repo transactions, the financial intermediation function, and the impacts on the financial markets other than the repo market.

It is also important for relevant entities in the repo market to take appropriate actions by their own initiative to enhance the stability and the efficiency of repo transactions. Such actions are critical to the sound development of the repo market and the enhancement of financial intermediary functions, and are also beneficial for well-balanced regulatory debates on repo transactions.

I thank all the participants for coming to this forum with your considerable expertise in the repo market. The agenda covers a variety of issues including the global regulatory framework, data collection, shortening of the settlement cycle, and the shift of agreements used in repo transactions to a more globally accepted repurchase agreement model. I believe that this forum would greatly contribute to further developments of the repo market in Japan.

**Session 1: Recent Developments of the Repo Market in Japan**

**Akihisa Shinmi (BoJ)** illustrated the recent developments and characteristics of the repo market in Japan, and presented comparative analyses of Japan and abroad, including the United States. The following are main points of the report:

- In Japan, the repo market is one of the core markets in the short-term money market and plays a vital role in financial intermediation.
- The outstanding amount of repo transactions in Japan has been increasing significantly, in contrast to that in the United States.
- While there are notable differences among repo markets in Japan, the United States, and Europe, comparison of some indicators implies that there seems to be room for further growth of the market in Japan.

**Shinmi** also explained that, in the newly introduced international regulatory framework, repo transactions and securities lending transactions of non-sovereign assets (e.g., equities and commercial paper) used for non-banks' funding would be subject to numerical haircut floors by the end of 2017, excluding those cleared through central clearing parties (CCPs). **Shinmi** also reported that participants would be required to conduct daily valuation of financial assets used as collateral in repo transactions and securities lending transactions.

**Shinya Ohnishi (Central Tanshi)** illustrated the changes observed in Japan's repo market before and after the introduction of the BoJ's quantitative and qualitative easing policy (QQE). **Ohnishi** also explained the market conditions of Special Collateral (SC) repo transactions according to the maturities of collateralized securities. **Ohnishi** indicated that volatility in the General Collateral (GC) repo market was recently increasing, and that market participants were narrowing the range of collateral that can be used in GC repo transactions.

In the discussions following the presentation from **Shinmi** and **Ohnishi**, a number of participants pointed out the recent increase in the volume of repo transactions with non-residents. As the background of this increase, they presented a view that overseas investors were showing more interest in Japanese financial markets partly due to the recent monetary policy by major central banks as well as the increase in the amount outstanding of JGB issuance. They also expressed the view that the recent increase in repo transactions by non-residents reflected the increase in JGB transactions by hedge funds.

One participant stressed the importance of enhancing the usability of the repo market in Japan for overseas investors in view of further facilitating cross-border transactions in Japanese yen and JGBs. Another participant stated that reviewing the conditions of BoJ's securities lending facilities once more and encouraging broader market participants to accept the fails practice would have beneficial effects.

Regarding the recent increase in volatility in the GC repo market, one participant pointed out the increase in the market share of several large players and indicated that their transactions were having a larger impact on the GC repo market than before.

Another participant stated that it would be necessary to monitor the impact of the downgrading of Japanese sovereign ratings on the JGB repo market both in and out of Japan.

**Session 2: Discussions on the Repo Market at International Forums**

**Masayuki Sato (Financial Services Agency <J-FSA>)** explained the new framework for international discussions regarding financial regulations and supervision after the financial crisis, and outlined the discussion on "shadow banking" held at the G20 and the Financial Stability Board (FSB). Furthermore, **Sato** referred to the policy recommendations published by the FSB and challenges for the future. **Sato** added that although sovereign securities were initially excluded from the numerical haircut floors in the FSB report (2014), this issue may be brought into the agenda at international forums within a few years. With regard to the implementation of numerical haircut floors on repo transactions in Japan, **Sato** raised issues such as (i) how to determine the specific numerical haircut floors and (ii) how to apply "margin call" to repo transactions including those using commercial paper, in view of the daily valuation requirement. **Sato** stated that the J-FSA would consider regulations on repo transactions to be implemented in Japan through close cooperation and dialogue with market participants and the BoJ.

**Akira Tsuchikawa (BoJ)** explained the proposed framework for the data collection of repo/securities lending transactions currently under review by the FSB as well as the progress of the discussions on repo data collection in the United States and Europe. Regarding the framework in Japan, **Tsuchikawa** reported that the J-FSA and the BoJ were in talks for the BoJ to become the data collecting entity. **Tsuchikawa** also reported that, although international discussions on when to begin the data collection were still undecided, the BoJ and the J-FSA will begin to fully work on the details of the data collection framework through discussions with market participants, so that they will have sufficient time for preparation.

In the discussions following the presentations by **Sato** and **Tsuchikawa**, one participant argued that repo regulations may cause a significant impact on the funding activities by some entities regardless of their transaction volume, and stressed the need for a careful consideration in the implementation of the regulation. Another participant pointed out that because market participants in general do not feel the strong need to apply a haircut to cover market risks when engaging in domestic repo transactions using JGBs, they would be required to change their mindset if a haircut were to be applied. Another participant argued that, although regulations inherently imposed additional costs on market participants, they could take advantage of new regulations and make it a source of profit by acting ahead of them.

In terms of repo and securities lending transactions data collection, a number of participants mentioned that the authorities should design the framework so that collected data will be shared among market participants. One participant argued that the range of data subject to the reporting requirement should be limited to that necessary for monitoring financial stability. Another participant mentioned that the authorities should try to reduce the burden and costs on market participants by utilizing existing data collection tools.

**Session 3: Shortening of the JGB Settlement Cycle and Repo Market in Japan**

**Satoshi Yoshida (Daiwa Securities)** explained the tools for a safer, faster and more efficient transaction of GC repos such as the Subsequent Collateral Allocation Method in which the specific collateral would be designated after the execution of the trade. **Yoshida** also illustrated the scheme for substituting collateral securities adopted in the Subsequent Collateral Allocation Method (the unwind/rewind method). **Yoshida** expressed the view that the GC repo market was expected to become a core market in the short-term money market and the size of the market would be no smaller than the market for negotiable certificate of deposits, commercial papers or the interbank call market. As a background of such view, **Yoshida** pointed out the fact that securities investment trust funds, the major players in the GC repo market, were planning to shift to repo transactions using the Subsequent Collateral Allocation Method. **Yoshida** added that this method was expected to become widely used among securities and brokerage firms.

**Shinsuke Mitsuji (J-FSA)** reported the developments regarding the shortening of the JGB settlement cycle, and mentioned that the J-FSA was willing to support market participants' efforts to shorten the settlement cycle and reduce settlement risks. **Mitsuji** also reported that the "Grand Design for Shortening of JGB Settlement Cycle (T+1)" published by Japan Securities Dealers Association's "Working Group on

Shortening of JGB Settlement Cycle" proposed to shift existing repo agreements to a repurchase style agreement (the new *Gensaki* method), and asked market participants to take actions in line with the market consensus from the viewpoint of globalizing the repo market in Japan.

**Itaru Fukuda (BoJ)** reported that JGB repos by non-residents had recently been increasing as a trend. **Fukuda** also reported that the introduction of the Subsequent Collateral Allocation Method would virtually create a new T+0 settled money market. **Fukuda** expressed the view that demand for money market transactions with longer maturities would be stimulated by enabling the substitution of collateral, and that it would lead to the improvement of the quality of price information in the money market. **Fukuda** stated that, although it would be difficult to foresee how the market structure would change in the future, surveys and researches conducted by the BoJ in the past implied that notable differences would continue to exist between the collateralized interbank call market and the GC repo market. **Fukuda** encouraged market participants to respond to the shortening of the JGB settlement cycle, taking into account the possibility that multiple types of market with notable differences would continue to exist and develop respectively.

Following the presentations by **Yoshida**, **Mitsuji**, and **Fukuda**, one participant stated that it would be unrealistic to expect a convergence of the repo market and the interbank collateralized call market, and that it would especially be necessary to examine the differences of players in these markets. This participant added that it would be desirable to encourage participation of a broader range of entities, including investment funds and banks, to the new T+0 GC repo market. This participant also emphasized the importance of continuing to monitor how the fails practice was accepted, and how it would influence the flow of funds.

A number of participants presented their efforts on shortening the JGB settlement cycle. They have already started estimating necessary costs for infrastructure investments to meet the schedule for the Running Test of the new GC repo transactions among market participants, expected to take place in FY 2017. They added that they were willing to further collaborate with other market participants.

Another participant commented that the introduction of the T+0 GC repo market, which would be a new collateralized funding market where market participants could immediately raise funds, would be very valuable in terms of securing multiple venue for funding when the market is under stress. This participant added that money market participants should cooperate and continue to make efforts to introduce the T+0 GC repo market in order to develop a resilient money market with diverse players.

Another participant stated that the new *Gensaki* method would be suitable for term repo transactions and convenient from the viewpoint of making full use of collateral assets especially when the amount outstanding of JGBs held by private entities was decreasing. This participant expressed the willingness to cooperate with counterparties in shifting to the new *Gensaki* method.

**Closing Remarks**
(**Akihisa Shinmi**, **BoJ**)

I believe that the wide-ranging and energetic efforts shown in today's forum are suitable to be called as a "reform" of the repo market. Based on the presentations and discussions today, the key elements of such "repo market reform" can be summarized into the following four points.

First, we need to enhance the transparency of repo transactions. To this end, it would be important for us to establish the framework for repo data collection, paying due attention to operational feasibility and a way to share collected data to market participants.

Second, we need to improve the stability of the repo market. In view of the discussions on the regulatory framework for repo transactions in international forums such as those related to numerical haircut floors, methodology standards for calculating haircut, and daily valuation of collateralized securities, market participants are expected to raise the level of risk management regarding repo transactions.

Third, it is also beneficial for us to further improve the efficiency of repo transactions. In this regard, it would be important for market participants to continue making efforts to establish the T+0 GC repo market, which would be a prerequisite for shortening the JGB settlement cycle to T+1. For such purposes, market participants are required to enhance the efficiency of repo transactions through various measures, such as through the utilization of collateral management services and review of operational procedures.

Fourth, we should work on the globalization of the repo market in Japan. In this respect, it is important for relevant entities to smoothly shift repo transactions to the new *Gensaki* method, which is in concept a more globally accepted form of a repurchase agreement.

The above mentioned "repo market reform" started immediately after the financial crisis following the collapse of Lehman Brothers in 2008, and is still an on-going initiative scheduled to be completed within two to three years. In this regard, this reform will soon be facing its most critical phase. The BoJ believes that the development of the repo market in Japan toward a more transparent, stable and efficient market would also be extremely meaningful in terms of further developing the overall financial market. I strongly appreciate today's discussions, and would like to note that the BoJ, as the central bank, is always eager to contribute to the further development of the repo market by engaging in close dialogue with relevant entities.