SIFMA
The Asset Managers Forum

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Response to The Federal Reserve Bank of New York Questions

On the Tri-Party Repo Infrastructure Reform

The Asset Managers Forum would like to acknowledge and applaud the tremendous work of the Tri-Party Repo Infrastructure Reform Task Force in identifying the systemic risk within the tri-party repo market and developing strong recommendations to mitigate those risks. We realize there are still unanswered questions and much work ahead for the industry to accomplish this massive reform. The Asset Managers Forum ("AMF") completely agrees that once these recommendations are fully implemented we will have a stronger and more robust tri-party repo market.

The Asset Managers Forum is the operations oriented affiliate of the Asset Management Group of SIFMA. Dedicated to facilitating collaboration among the buy-side operations community, AMF brings together subject matter experts to discuss and develop practical solutions to highly topical operational challenges. The AMF's mission is to provide thought leadership and guidance on pertinent industry issues and to create a premier venue for operations professionals to develop and share best practices in order to drive industry change.

We would like to thank The Federal Reserve Bank of New York for the opportunity to comment on the Task Force recommendations. The responses below were formulated by the AMF Tri-party Repo Working Group and represent the consensus views of the working group members.

1. *Have the sources of systemic risk in the tri-party repo market been identified correctly? What additional vulnerabilities or material risks should be considered in evaluating the need for reforms in this critical market?*

A source of systemic risk that was not identified is the fact that the tri-party repo market functions with only two Clearing Agents, and with the majority of business concentrated with one single Agent.

It is worth noting that the recommendations do not eliminate the systemic risk of a dealer's default and its impact on the Clearing Agents, rather, the risk remains with the Cash Investor for an extended period of time.

Also, there could be a dramatic impact on the success of the Task Force work if the provisions within the Senate and House Financial Reform Bills that would have an adverse effect on the functioning of the tri-party repo market make it into the final combined version of the legislation. In particular, the 3-day stay; claw back provisions; and the Miller-Moore Amendment have the potential to negate much of the positive progress made by the work of the Tri-Party Repo Task Force.

The AMF working group would also like to point out that margins are only as good as the integrity of the pricing of the underlying collateral. Cash Investors monitor pricing of collateral; however, there are a limited number of vendors and the clearing banks are essentially utilizing the major vendors. In essence, Cash Investors are monitoring them using the same pricing source clearing banks are using. Also, collateral pricing is based on size. The underlying collateral may be in small blocks; therefore, is its pricing representative of its true value in the event of liquidation?

2. *Are the recommendations proposed by the task force appropriate and adequate to address the policy concerns articulated in this paper?*

A) *Please comment on specific recommendations that you think are most likely to be effective.*

<u>Recommendation 1G. Implement market-wide, three-way, real-time, point of trade confirmation solution(s).</u> This recommendation will be effective as it creates more efficient communication between all parties in the repo market, overall significantly aiding the elimination of the daily unwind.

<u>Recommendation 9. Cash Investors to put in place and regularly review contingency plans for a Dealer default and the liquidation of collateral.</u> This recommendation will be an extremely effective tool in case there is a Dealer default in the future.

<u>Recommendation 13. Initiate monthly publication, via the Federal Reserve, of aggregate statistics on tri-party repo collateral and Cash Investors margin levels.</u> This recommendation is a great tool to add to the repo market, as any additional transparency added to a market is a good thing.

<u>Recommendation 1C. Agree to standardized intraday settlement time(s) for maturing repo trades.</u> This recommendation will provide true clarity to the market on when trades start and mature off.

B) *Please comment on specific recommendations that you believe will not be effective.*

Recommendations 3 and 4. Dealer Liquidity Risk Management section 5, lack true substance. How would market participants know if a Dealer truly acted on these recommendations (what is the documentation or product that a Dealer must produce to indicate the recommendation was completed)? The demands on the Cash Investor are very substantial within the paper and, while we agree with them and will work to accomplish those tasks, we feel the Dealer's demands lack adequate accountability.

C) *Please comment on specific recommendations that you believe may have unintended consequences.*

Recommendation 6. Cash Investors, Dealers, and Clearing Agents are to determine appropriate collateral margins in line with the principles set out in Section 6 of the Report, taking note of monthly published tri-party repo statistics. With the publication of the repo statistics, there is a potential for Cash Investors to increase margins on what is considered a weaker Dealer and thus drive up margins on other Dealers throughout the market. With the publication, there is also a possibility for Cash Investors to react quickly and alter margins before fully vetting out the rationale for changes to the report.

Recommendation 1 and 1C. Cash Investors that exchange principal and interest on a daily basis will be forced into some form of netting structure. There are also potential settlement and cash dislocation issues with Cash Investor's custodians. It is not clear what the effect of these recommendations will be on these areas.

3. *Are the task force recommendations, including targets for reduction of intraday credit extension by clearing banks, achievable in the timeframes outlined? What barriers or challenges to implementation do you anticipate?*

The main challenge will be to implement an industry standard under the aggressive timeline and to have all three parties in agreement with the changes unless there is clear guidance from the Task Force (or other industry body).

4. *What business impact do you anticipate from the recommendations? For example, what impact would you expect this series of reforms to have on the structure, volumes, collateral, or other parameters of the tri-party repo market?*

   - Cash Investors will be much more critical of a dealer's credit worthiness which could potentially affect the following: Margins, Collateral types accepted, Average maturity ranges, and Continuation of funding a dealer.
   - Dealers are moving in a direction to do more term repo and less overnight; while the new 2A-7 rules require Cash Investors to be more liquid.
   - Potentially less demand for and liquidity in the non-traditional repo market due to the increased scrutiny of collateral.
   - Higher margins and funding costs for the dealers.
   - Greater diversification within Cash Investors' portfolios.

5. *Considering a dealer default scenario, what additional measures should be considered to address concerns regarding potential liquidity pressures on cash lenders and surviving dealers, and the potential for fire-sale conditions?*

Clear guidance from the regulators around the ability of funds to hold collateral in case of a dealer default will help ensure an orderly liquidation process.

6. *What measures could be taken to reduce the likelihood of cash lenders running from a troubled dealer?*

Dealers need to provide transparent measures to the market and be held accountable for those measures so a situation does not arise where Cash Investors do not feel comfortable in their lending practices with a Dealer. Dealers need to demonstrate sound liquidity management practices and communicate backstops and liquidity plans clearly and on a regular basis.

A) *Are there ways to increase a lender's ability to effectively deal with a scenario in which it must accept collateral in lieu of cash following a dealer default?*

7. *What other approaches to assessing and mitigating systemic risk in tri-party repo business arrangements should the Federal Reserve or industry leaders consider?*

The paper addresses the tri-party repo market and not specifically the bilateral repo market and the potential, or reasons, for that market to expand going forward.

A) *For example, would implementation of a central counterparty be desirable in this market? If so, what specific features of a central counterparty would be most desirable, and why?*

There are many issues with a central counterparty that impact desirability, such as: a) Cost to establish a central counterparty, b) Control of collateral / margins, and, c) Sharing of losses – all of which would be an issue for many funds.

The Asset Managers Forum welcomes the opportunity to work with all industry constituents in the implementation phase of the Tri-Party Repo Infrastructure Reform. Our main goal is to assist asset managers in the operational implementation of the Task Force recommendations. For more information regarding the Asset Managers Forum, and its Tri-party Repo Working Group, please contact Tim Cameron, Managing Director, SIFMA Asset Management Group at tcameron@sifma.org, or Elisa Nuottajarvi, Manager, SIFMA Asset Management Group at enuottajarvi@sifma.org.