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Repo trading would benefit from scrutiny

Vendors are not alone in ignoring a €6.4 trillion market, writes Natasha de Terán

Regulatory scrutiny and media analysis are not always as damaging as feared. The credit derivatives market, its participants and the providers of systems that serve it have benefited from the attention of supervisors and the media in the past few years. It has been a strain but operations have improved and processes streamlined. As a result, volumes have flourished and business opportunities have abounded.

But the repurchase agreement markets have not enjoyed the same scrutiny. There is one organisation that has good reason to rue its absence – the International Capital Markets Association, (Icma) the self-regulatory trade association that represents financial institutions in international repo markets.

Icma relaunched its Trax system under the Trax2 badge last June. Trax was originally a trade confirmation and risk-management system designed for over-the-counter cash credit markets. It had limited repo reporting capabilities but these were criticised for being cumbersome and were not widely used.

Icma tried to address these shortcomings with its Trax2 system in the hope that it would be widely adopted by buy and sellside groups for automatically matching and confirming repo trade details.

The initiative is important because only a minority of repo trades are struck on automated trading platforms that include such matching capabilities.

Most repo trades, and almost all customer-facing repo deals, are struck verbally and have little or no post-trade support. In other words, the credit derivatives and other OTC derivatives markets are not the only ones to have been operating with outdated manual, paper-based systems.

Ian Holden, operations manager at European Credit Management, a UK investment management group, said when he heard Trax2 was extending its service to the buyside he saw it as a “big win”. Until Trax2 came along, all European Credit Management’s confirmations were received by fax and had to be processed and checked manually. Exceptions also had to be dealt with on a manual basis. Such systems not only incur additional costs, use up staff resources and introduce operational risk but also diminish the safe qualities of repo or collateralised lending, which makes it all the more surprising the issue had been ignored.

Holden, whose group deals in the cash, swaps, credit derivatives and repo markets, said this was because repo was a forgotten product for the providers of post-trade systems.

European Credit Management uses Omgeo for its cash confirmations, SwapsWire for its interest rate swaps confirmations and the US Depository Trust and Clearing Corporation’s OTC/DerivSERV platform for its credit derivatives trades. The group has been unable to find a similar system for repos until now. “There has been nothing – the vendors have simply ignored the market,” Holden said.

At €6.4 trillion, and counting, the European repo market is too big to ignore but vendors are not alone in neglecting it.

The regulators have not expressed worries about the stacks of unconfirmed or mismatched repo trades and the media have not focused on the issue either. This will have made Icma’s task in promoting Trax2 more difficult but the organisation has made substantial inroads in attracting users to the new system.

Among those using it are market heavyweights, such as Goldman Sachs, JP Morgan, Nomura and Credit Suisse. And although the service was extended to them only this month, some buyside groups, led by European Credit Management, have adopted it.

But systems are rarely deemed perfect by their users and the repo market is no exception. Buy and sellsides of the repo business have their gripes with Trax2. Several participants say the system should be extended beyond the confirmation stage to settlement before it becomes truly useful. Holden is not so demanding but reckons that if Trax2 could be linked, so trades are matched on the platform and sent directly to depositories, it would be better.

An additional bonus would be that pair-offs and coupon payments that require manual intervention and introduce scope for operational problems could also be automated this way.

Buyside slow to upgrade

Buyside firms willing to prioritise operational improvements and adopt new post-trade systems to support them are in a small minority.

According to research by consultancy Celent, most buyside firms are cost conscious and slow to adopt new technology and are dragging out the drive to automate over-the-counter derivatives processing.

This is not an accusation that can be levelled at European Credit Management. Not only was the investment management group an adopter of the Trax2 system but it has been quick to espouse systems supporting other derivatives operations and has been vocal about operational matters.

But so dire is the buyside situation that some sellside groups believe the only hope is for regulators and supervisors to swoop on the sector in much the same way as they did with the sellside a few years ago. Regulatory pressure might help but small or occasional buyside derivatives users are apparently the worst offenders.

European Credit Management may be able to afford what it costs to subscribe or connect to systems to support its derivatives plays but its smaller brethren may not. Such is the way the systems have developed that solutions are highly fragmented.

Vendors have tried to address the issue by rolling out services for their non-core markets; SwapsWire started with rates and now services credit and equity derivatives; the Depository Trust and Clearing Corporation’s OTC/ DerivSERV started with credit but has ventured into equity and rates. Doubtless both have plans to complete their offerings by servicing the commodities business. But dealers have cast the die by adopting preferred providers for each asset class.

Regulators may step up their efforts to extend buyside adoption of the systems but dealers have their own silo-based mentalities to blame.