Reed Statement on Tri-Party Repo Market Hearing

WASHINGTON, DC – U.S. Senator Jack Reed (D-RI), Chairman of the Senate Banking Subcommittee on Securities, Insurance, and Investment today held a hearing entitled "The Tri-Party Repo Market: Remaining Challenges."

Below is Senator Reed's statement as prepared for delivery:

"I want to welcome everyone to our hearing this morning entitled "The Tri-Party Repo Market: Remaining Challenges."

"Last week, Secretary Geithner presented the Financial Stability Oversight Council's second annual report to Congress. The Council is responsible for providing us with a comprehensive, coherent overview of the health of our financial system.

"The Council's report identified structural vulnerabilities in the short-term funding markets, particularly the tri-party repurchase (repo) market, as a continuing area of concern. The report states that: "limited progress has been made in substantially reducing the reliance of this market on intraday credits or improving risk-management and collateral practices to avoid fire sales in the event of a large dealer default." The Council also stated that the industry's suggestion that it will take several more years to eliminate the intraday credit associated with tri-party settlements was "unacceptable" and called for greater government involvement.

"In general, a repo or repurchase agreement is the sale of a portfolio of securities with an agreement to repurchase that portfolio at a later date: the economics of repos are similar to that of short-term loans collateralized by long-term assets. Tri-party repos are typically used by large securities firms and bank holding companies with broker-dealer operations to raise short-term financing from cash investors, such as money market mutual funds. The dealer and the investor typically use one of two clearing banks to settle the transaction.

"This market is very large. Tri-party repos peaked at $2.8 trillion at the height of the crisis in 2008 and are $1.7 trillion today.

"Three major weaknesses of the tri-party market were highlighted by the 2008 financial crisis:

- the market's reliance on intraday credit from the clearing banks
- the pro-cyclicality of risk management practices, and
- the lack of effective plans to support the orderly liquidation of a defaulted dealer's collateral.

"Motivated by these risks, in 2009 the Federal Reserve Bank of New York formed an industry-led Task Force to address the problems highlighted by the financial crisis. Although this Task Force disbanded in early 2012, its work led to a number of important changes, including:

- moving the daily unwind of some tri-party repo transactions from 8:30 am to 3:30 pm, which shortens the period of intraday credit exposure;

- implementing a mandatory three-way trade confirmation between dealers, cash investors and the clearing banks, marking the first time this $1.7 trillion market has had an established confirmation process;
- publishing of a monthly report regarding activity in the tri-party repo market, which includes the size of the market, collateral breakdowns, dealer concentrations, and margin levels. This report enhances the ability of supervisors and market participants to assess trends and call attention to emerging issues before they become systemic.

“However, in its 2012 Report, the FSOC found that “limited progress has been made in substantially reducing the reliance of this market on intraday credits or improving risk-management and collateral practices to avoid fire sales in the event of a large dealer default.” The Council also stated that that the industry’s suggestion that it will take several more years to eliminate the intra-day credit associated with tri-party settlements was “unacceptable.”

“Because FSOC has sounded an alarm about the tri-party repo market and stated the need to more quickly implement additional reforms, we have convened this morning’s hearing to discuss the report, better understand the changes to this market already in place, and explore what more needs to be done.

“Improving the tri-party repo market will make it safer, to the benefit of all market participants. I look forward to hearing from all our witnesses on this important part of our financial markets.”

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