TMPG | Treasury Market Practices Group

Proposed Frequently Asked Questions (FAQs): Treasury Repurchase Agreement Risk Management

The following proposed FAQs refer to the Treasury Market Practices Group (TMPG) proposed recommended best practice on Treasury repo haircuts (or margin) on the value of the securities, in concert with other risk management techniques.

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What is the TMPG proposed best practice recommendation for risk management around Treasury repurchase agreements?

The TMPG's guidance regarding Treasury repurchase agreements states the following:

> "Consistent with appropriate risk management of counterparty exposures, all Treasury repurchase agreements (repo) should include prudent haircuts (or margin) on the value of the securities, in concert with other risk management techniques. The haircut should reflect the counterparty credit risk, as well as the liquidity and market risks of the collateral. The haircut can be applied together with other risk management tools, such as position limits, netting agreements, and/or portfolio margining, when supported by a robust risk management framework and a complete set of legally enforceable written agreements."

Why does the TMPG propose recommending the use of haircuts (or margin) for all Treasury repos?

The TMPG has identified a number of risks associated with current risk management practices for the Treasury repo market. For repo transaction risks that are bilaterally managed, there is a lack of consistency and transparency in risk management practices. Additionally, as a result of these dynamics, the full amount of leverage provided in repo market may not be completely understood by market participants, and as such may not be properly risk managed or priced. Large quantities of repos without haircuts could pose systemic risks to overall market functioning if one or more market participants were to default. Counterparties can help to mitigate these risks by imposing haircuts or margin on these transactions. Widespread use of haircuts for Treasury repo enhances financial system stability and supports market function during periods of market stress.

How does the proposed TMPG best practice recommendation for haircuts (or margin) on Treasury repo apply to repos that are intermediated into central clearing?

For repos that are intermediated into central clearing market participants should adhere to the TMPG's best practices around risk management. In particular, market participants should apply appropriate risk management rigor to the clearing and settlement of all trading activity. When establishing intermediated central clearing arrangements, market participants should ensure that any risks the client may pose to the participant facilitating clearing are well managed.

What kind of legal agreements should be used for implementing the Treasury repo risk management best practice?
There should be legal agreements that describe, in all material respects, the margining regime, including timing, frequency and thresholds of margin calls and exchanges; valuation of exposures and collateral; and close out netting and liquidation in case of counterparty failure. Legal agreements should be legally enforceable even when a counterparty defaults or becomes insolvent. In circumstances where close-out netting may not be legally enforceable, market participants should ensure that they have compensating risk management controls in place.

Can portfolio margining or netting agreements be used in place of haircuts on Treasury repo?
Haircuts can be used in concert with other risk management tools, such as position limits, netting agreements, portfolio margining, and liens, when supported by a robust risk management framework and a complete set of legally enforceable written agreements. Any portfolio margining written agreements should be complete, and should fully contemplate the market, liquidity, and counterparty credit risks associated with the portfolio of transactions. These arrangements should consider the degree to which the risks of various positions across the counterparties' transactions can become correlated and whether margin collected for other financial instruments can and will be used to cover Treasury repo transactions in the case of a counterparty failure. These risks should be modeled using stress scenarios, including hypothetical stress scenarios and past events, and consider the size and concentration of the counterparty's positions.

Does the TMPG provide guidance for recommended haircut levels?
The TMPG is not prescribing a minimum or specific haircut for Treasury repo transactions. However, the TMPG does recommend that market participants address how such terms are determined in their written risk management policies and procedures. The TMPG expects that market participants will evaluate the appropriateness of the levels of haircuts consistent with the prudent management of counterparty, market, and liquidity risk and will negotiate in good faith.

Does the proposed Treasury repo haircut practice apply to all transactions in the Treasury repo market?
The TMPG recommends a risk-based approach to best practice implementation. This could include considering the size of the exposure, the nature of the counterparty, or other risk mitigation measures included in the transaction. Trading desk management and individuals responsible for the determination of credit management policies should be sure to consider the counterparty and market risks associated with all transactions and to develop robust risk management processes, including applying a margining practice where needed to prudently manage counterparty exposures.

Does the TMPG provide guidance for the timing and frequency of margin calls?
The TMPG recommends that market participants address these terms in their written agreements, subject to good faith negotiation between market participants and consistent with the prudent management of counterparty risk. In addition, the TMPG encourages all market participants to negotiate reasonable timeframes for the timing and frequency of margin calls and, where consistent with their risk management guidelines, take into consideration operational constraints of their counterparties when drafting bilateral agreements.

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About the Treasury Market Practices Group

The TMPG is composed of senior business managers and legal and compliance professionals from a variety of institutions—including securities dealers, banks, buy-side firms, market utilities, and others—and is committed to supporting the integrity and efficiency of the Treasury, agency debt, and agency mortgage-backed securities markets. It is sponsored by, but is not part of, the Federal Reserve Bank of New York. Any views expressed by the TMPG do not necessarily represent the views of the Federal Reserve Bank of New York or the Federal Reserve System. More information is available at: www.newyorkfed.org/tmpg.

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