Market Update – Introduction of Margining in the Australian Repo Market

21 December 2011

In May 2011, AFMA's Repo Committee examined the desirability for the Australian market to change to margining from repricing, in line with global practice, and the Committee unanimously agreed that the local market will adopt margining commencing 1 July 2012 or earlier as practicable on a bilateral basis. The Repo Committee is responsible for maintaining and keeping the AFMA Repo Market Conventions up-to-date with market developments.

Repo markets are an essential component of liquid debt markets, acting as a transmission belt between money and debt markets, as well as serving to conduct key functions for the efficient operation of debt markets. Repos are frequently used by holders of debt securities to fund their positions.

To limit the potential exposure to counterparty default, the cash provider may demand a margin (or 'haircut') on the security's value. If, during the life of a repo, the value of the securities changes by a sufficient amount, either party may ask for the repo to be repriced (or, alternatively, may make a margin call), thereby realigning the cash value of the repo with the value of the securities. Repo margining is designed to take a net exposure and reduce it further by collateralising it. Depending on the transaction involved and the fluctuations in the value of the relevant securities the size of a party's exposure may vary from day to day. The exposure may also switch between parties so that Party A may have a net exposure on Party B, and on the next day Party B may have a net exposure on Party A. Margining is typically governed by the provisions of a master agreement between the parties, commonly in the form of the Global Master Repurchase Agreement (GMRA). Under the terms of such agreements, the parties can monitor their net exposure on a daily basis and call for margin from their counterparty to cover it, which can be in the form of cash or other agreed securities or assets.

Market practice in Australia to date has been to maintain margin by the 'repricing' method. Repricing does not involve the making of margin transfers. Instead it seeks to equalise the value of the two legs between the cash payment leg (purchase price) and the securities transfer leg (purchased securities) instead of giving margin to make up their difference in value. In effect this removes the exposure rather than collateralising it. Using this method has been out of step with practice in major financial jurisdictions where margining is the preferred method.

AFMA has set up a working group looking at issues relating to the transition to repo margining, which draws together persons knowledgeable from the trading, operational and legal perspectives. Initial work has focused on gauging member operational readiness, confirming that there are no legal issues that need to be dealt with and developing conventions to give guidance on market practice.

AFMA will be holding a workshop to improve operational understanding of repo margining practice in early 2012, details to be advised. AFMA will continue to keep the market updated on developments and initiatives in the introduction of repo margining. For more information on this initiative, please contact secretariat@afma.com.au or (02) 9776 7907.