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Understanding Repo and the Global Master Repurchase Agreement: A Legal and Commercial Perspective

Authored by Nisha Raj - Director, Legal

What is a Repo?

A repurchase agreement, commonly referred to as "repo," is a financial instrument serving as a crucial mechanism for liquidity management and collateralized borrowing. They are employed by various institutions, including banks, hedge funds, and other financial entities as short-term borrowing instruments. It involves the sale of securities with a commitment to repurchase them at a specified future date and price. This transaction facilitates immediate liquidity for the seller on a short-term basis while providing the buyer with a low-risk investment secured by collateral, as such making it a secured investment.

A repurchase agreement typically consists of two primary transactions: the initial sale of the securities and the subsequent repurchase.

Repo Transactions can be structured in various ways, and any asset that is capable of being transferred from one person to another may be subject to repo. The most common types of assets that are repo'd are debt securities (bonds), equity securities (shares) and other financial assets such as loans and commodities.

A "reverse repo" occurs when the situations are reversed—the buyer of the securities agrees to sell them back to the seller at a predetermined price.
Both repo and reverse repos are utilised in managing liquidity in financial markets and play a pivotal role in the operations of central banks, money market funds, and other financial institutions.

If the seller defaults during the life of the repo, the buyer (as the new owner) can sell the asset to a third party to offset its loss. The asset therefore acts as collateral and mitigates the credit risk that the buyer takes on the seller

What is the purpose of The Global Master Repurchase Agreement (GMRA)

The GMRA was developed by the International Capital Market Association (ICMA) to standardize the terms of repos globally. The GMRA serves as a comprehensive legal framework designed to govern repo transactions in a consistent manner across jurisdictions. One of the significant legal advantages of the GMRA is its capacity to facilitate netting allowing for the offset of claims and liabilities resulting from multiple transactions. This feature

+44 734 201 0729
100 Wood Street, London, EC2V 7AN, United Kingdom
nisha.raj@mountstreet.com

enhances the credit risk profile of participants by limiting their exposure. Further a GMRA will usually stipulate that in the event of a default, the buyer has the right to liquidate the collateral to cover any losses, thus providing a layer of protection against credit risk.

The enforceability of the GMRA can vary based on jurisdiction, and understanding local variations and restrictions is paramount. For instance, repurchase agreements may be treated distinctly under local insolvency laws, impacting the rights of parties in the event of default. Commercially, the repo market is influenced by various factors, including interest rates, economic conditions, and regulatory changes. Currently, with monetary tightening observed in many jurisdictions, there has been increased scrutiny on collateral eligibility and the types of assets that can be transacted. Market professionals need to maintain consistent due diligence and oversight to align their repo strategies with prevailing conditions.

Current market trends

The market for repos is expanding in Europe and the US and there are rapid emergences of relatively small repo markets in China. There are differences in the way that repo works in Europe compared with the US, and between the structure and operation of the two markets. In Europe, repo transfers legal title to collateral from the seller to the buyer by means of an outright sale. Under New York law (the predominant jurisdiction for US repos), transferring title to collateral is not straightforward. As such, collateral is pledged but exempted from certain provisions of the US Bankruptcy Code that normally apply to pledges, particularly the automatic stay on enforcement of collateral in the event of insolvency. Further unlike in traditional pledges, the pledgee/buyer in a US repo is given a general right of use of collateral.

Repos and the GMRA are instrumental in the financial services landscape, providing essential avenues for effective liquidity management.

Mount Street has significant experience of the repo market, both in Europe and the US, and provides best in class services to both lenders and borrowers in connection with their repo transactions. The growing need for liquidity amid the macroeconomic uncertainties our clients are experiencing has led to a significant increase in activity in the repo market, particularly over the past 12 months. Mount Street remains dedicated to working closely with our clients to ensure that our services meet the evolving financial landscape and effectively address the uncertainties and challenges that lenders and borrowers face in today's market.

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