



Growing Asia's Markets

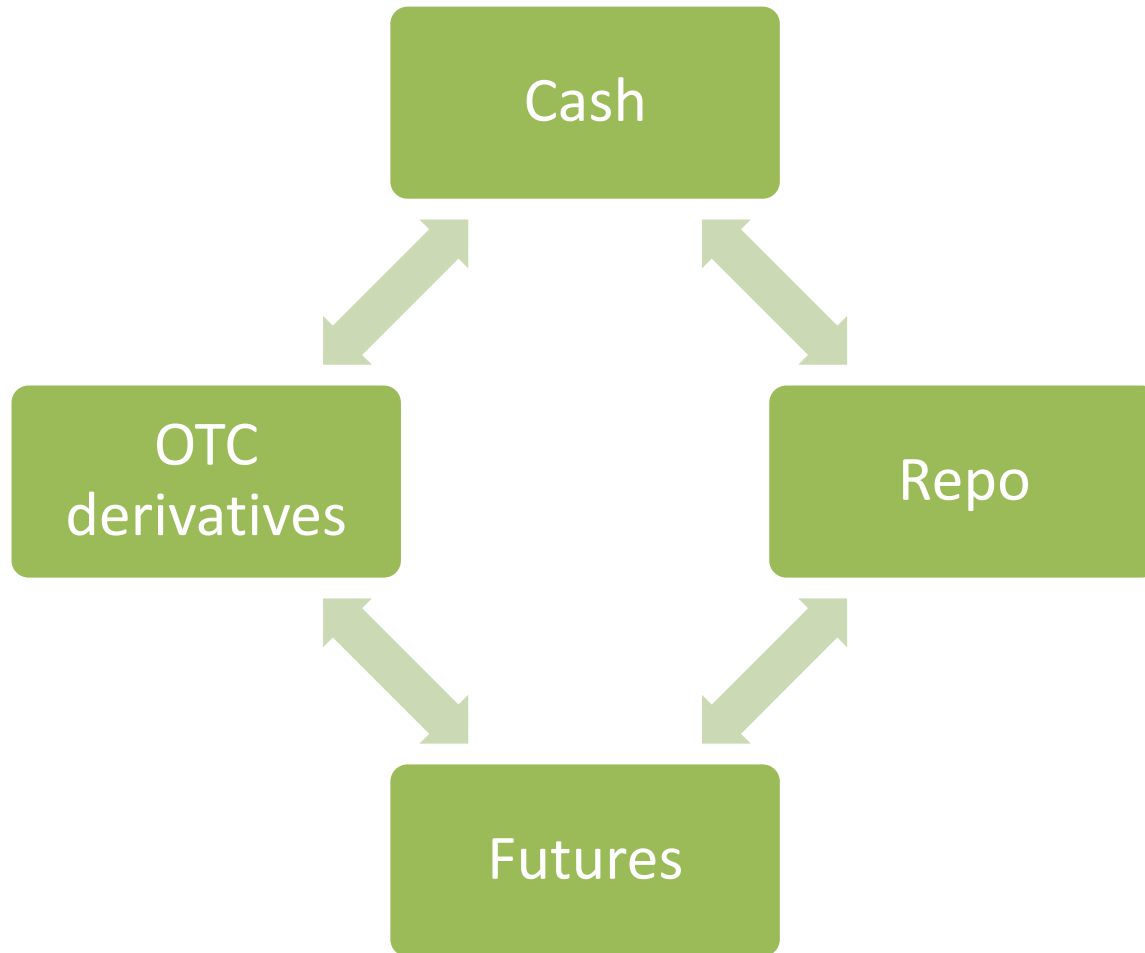
Asia Securities Industry & Financial Markets Association

***Promoting Deep, Liquid “Classic”
Repurchase (Repo) Markets for Asia***

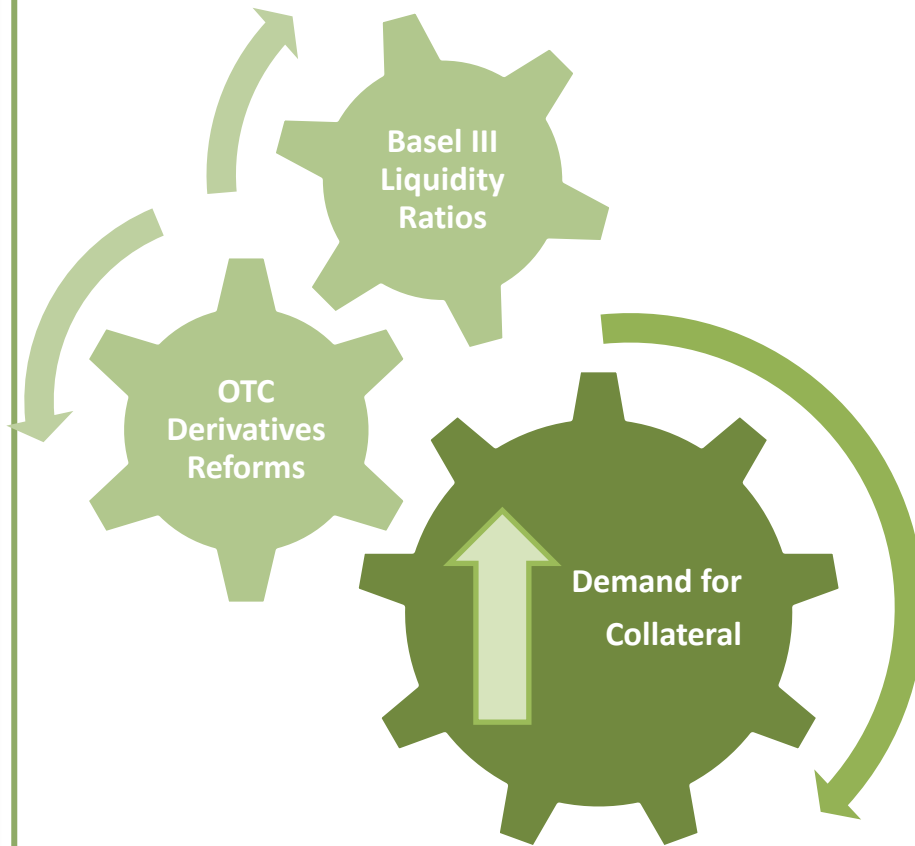
Seven Basic Requirements for Liquid Fixed Income Markets

1. Disciplined issuance and reissuance programs to support large benchmark issues
2. Liquid “classic” term repo markets that allow easy short selling of government bonds
3. Active, liquid government bond futures markets
4. A broad range of liquid OTC derivatives contracts and exchange-traded derivatives contracts
5. High-quality, efficient and cost-effective electronic price discovery, trading, clearing and settlement platforms
6. A broad, active domestic and foreign investor base (e.g., pension funds)
7. Market friendly regulatory, accounting and tax regimes: no withholding taxes and no transaction taxes

Fixed Income Symbiotic Relationships



Financial Reform has Increased the Demand for Collateral



Factors increasing demand for collateral:

1. Shift from unsecured to secured funding (post GFC)
2. Basel III liquidity ratios (LCR and NSFR)
3. OTC derivatives reforms, including:
 - margin requirements for cleared and un-cleared derivatives trades;
 - collateral eligibility criteria for CCPs; and
 - limits to rehypothecation of collateral.

Financial regulatory reforms introduced in the wake of the financial crisis “will elevate the importance of repo markets, which facilitate the efficient transfer and transformation of collateral.”
– EMEAP, Repo Markets State of Play, 2014

Key Challenges to Repo Market Development in Asia

- Repo (repurchase) markets, and indeed local currency bond markets, are underdeveloped in much of the Asian region;
 - In fact, HKMA estimated that the overall size of repo markets is less than 1.8% (as % of GDP) in Asia ex-Japan (as of 2013).
 - In comparison, US and European repo markets are approximately 40-50% of GDP.
- The Asian repo market environment is fragmented and lacks a consistent legal architecture, contract enforceability, clear netting opinions and close-out rights and tested bankruptcy proceedings in many markets;
- Standard repo documentation such as the Global Master Repurchase Agreement (GMRA) is not universally utilized in Asian markets;
- Asian repo markets suffer from lack of benchmark yield curves, short tenors (predominantly overnight), lack of liquidity and adverse tax treatment.

Current Repo Market Dynamics in some Asian Jurisdictions

	Sale & purchase (Classic or buy and sell backs), borrow & lend, and pledge	Use of GMRA	Tax Treatment Basis	Withholding Tax
China	Pledged repo (mainly)	N	Loan and Outright	N
Hong Kong	Classic repo	Y	Loan	N
Japan	Borrow & lend (mainly), also classic repo (<i>Gensaki</i> market)	Y	Loan	N
Korea	Classic repo	Y	Loan	Y
Indonesia	Buy/Sell-back (mainly) & Classic repo	N	Loan	Y
Malaysia	Classic & Buy/Sell-back	Y	Loan	N
Philippines	Classic repo	N	Loan	Y
Thailand	Classic repo (mainly)	Y	Loan	N
Vietnam	Classic repo	-	-	-

Sources: Ryuichi Shiina of Japan Securities Dealers Association's working document for the ABMF, "Enhanced Comparative Analysis of Repo Markets in 9 ASEAN + 3 Countries & Jurisdictions," 15 April 2014; and EMEAP, *Repo Markets: State of Play, 2014*, http://www.emeap.org/emeapdb/upload%5CWGMeeting%5CEMEAP_Working_Group_on_FinancialMarkets_Report_on_EMEAP_Repo_Markets_....pdf.

Necessary Conditions to Develop Classic Repo Markets

Improve creditor's rights in legal frameworks and judicial proceedings

- Improve investor confidence by improving legal certainty about the right to the title of assets and the right to net in the event of counterparty default, which are vital cornerstones of classic repo transactions
- Bankruptcy and resolution frameworks must protect creditors' rights in insolvency cases for consistency and enforceability of repo contracts

Neutralize tax treatment of repo transactions

- Elimination of stamp duties and transaction taxes for repo transactions
- Exemption from withholding taxes whereby holding period enters into consideration (e.g. *pro-rata temporis* taxes)

Deepen domestic bond markets

- Create large benchmark issues across tenors
- Broaden participation in bond and repo markets, especially long term investors
- Address 'hold to maturity' market conventions to improve collateral mobility and deepen secondary market liquidity

Establish interoperability between market infrastructures

- Link ICSDs and domestic CSDs
- Interoperability between regional payment and settlement systems
- Improve cross-border settlement processing and timing through STP

Address barriers to currency convertibility and market access

- Improve market access for foreign investors
- Assure currency convertibility and repatriation rights

Next Steps for APFF Capital Markets Workstream (Repo Substream)

Finalize Repo Best Practice Guide for Asian Markets

Share findings through a series of workshops

Monitor & Address Financial Reforms that May Impede Market Development

Thank you

Key Challenges for Repo Market Development in Asia

Impediments	Current Status	Recommendations
Legal architecture	Enforceability of repo contracts, investor protections, and bankruptcy procedures vary due to divergent legal treatment and judicial interpretations across jurisdictions	<ol style="list-style-type: none"> 1. Ensure legal frameworks reflect the underlying characteristics of repo agreements (such as the full ownership transfer of assets in “classic repos”); 2. Incorporate protections of creditors’ rights during bankruptcy or insolvency proceedings (such as those reflected in the 2011 GMRA) in jurisdictions’ bankruptcy laws; and 3. Move towards adoption of a “classic repo” market in which the buyer maintains rights to use assets and netting rights in the event of a counterparty default; and 4. Share information with securities regulators and judiciaries on repurchase agreements and the legal contracts that underpin them.
Divergent legal constructions of repo markets	Regional differences in the legal constructions of the Repo (i.e. “Classic Repo” vs. “Buy and Sell Back,” “Pledge,” and “Borrow and Lend” models)	Harmonize legal constructions of repo transactions to enable the full ownership transfer of title, as well as netting and close-out rights during periods of insolvency or bankruptcy
Market conventions and industry best practices	Divergent market conventions and industry practices for: <ol style="list-style-type: none"> 1. collateral management; 2. management of tri-party repo platforms; 3. data issues (such as flows and messaging); 4. risk management and leverage; and 5. interoperability of key market infrastructures; 6. among others. 	<ol style="list-style-type: none"> 1. Adopt industry best practices regarding documentation of repurchase agreements and collateral arrangements (such as the 2011 GMRA); 2. Employ standardized, best practices for data management and trade communications (such as messaging codes); 3. Upgrade risk management practices to international best practice; 4. Adopt international standards for flows and messaging, settlement timing, <i>inter alia</i>, which will enhance interoperability of market infrastructures.
Market access issues	Restrictions on foreign investors, or registration requirements for foreign investors may deter market participation, impede the development of a cross-border repo market, and reduce liquidity	Liberalize market access for foreign and institutional investors across the region to enhance participation, diversify the investor base, and increase market liquidity

Key Challenges for Repo Market Development in Asia (continued)

Impediments	Current Status	Recommendations
Liquidity issues	Liquidity is impeded by: <ol style="list-style-type: none"> 1. Underdeveloped local currency (LCY) bond markets and lack of pricing benchmarks; 2. Limitations to utilize bond holdings in the repo market; 3. Restrictions on foreign investor participation; 4. Insufficient eligible liquid assets to be traded across borders; and 5. Market practice of holding assets to maturity. 	<ol style="list-style-type: none"> 1. Strengthen LCY bond markets and use them as eligible collateral; 2. Collaborate with Asian central banks to establish cross-border collateral arrangements to increase pool of eligible securities to be traded across borders; and 3. Broaden the investor base (i.e. to include foreign and institutional investors).
Restrictions on currency convertibility and repatriation	Restrictions on the amount of currency that can be remitted or repatriated would reduce market access and participation, thereby constraining the development of a cross-border repo market	Liberalization of such controls is necessary to promote cross-border trade and settlement in LCY bond and repo markets
Tax treatment	Withholding taxes, transaction taxes, stamp duties, and others may increase costs and decrease liquidity	Harmonized tax treatment, exemptions and double taxation treaties should be considered for repo market participants
Market infrastructure	Lack of pricing feeds, and linkages / interoperability between securities depositories and settlement systems across the region inhibits transparency and encumbers asset in domestic markets	<ol style="list-style-type: none"> 1. Review electronic platforms (i.e. to improve real-time price discovery access); and 2. Improve interoperability of key market infrastructures, such as linking onshore and offshore repo markets at ICSDs, CSDs, and Securities Settlement Systems to enable cross-border mobilization of assets.

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- Overview of a “classic” repurchase transaction
- Types of repurchase transactions
- Classic repos: Bilateral versus Tri-Party
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 - Currency barriers and exchange rate volatility
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 - Recognition of repo documentation in legal regimes
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- Current market dynamics in some ASEAN + 3 jurisdictions
- Addressing policy and market constraints to developing a regional repo markets

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Section II: Market Conventions and Industry Best Practice across the Repo Trade Lifecycle

Pre-Trade Best Practices

- On-boarding a repo counterparty
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- Counterparty identification
- Communication and messaging standards
- How to quote the price of a repo
- How to quote the Purchase Price
- Fixing the Purchase and Repurchase Dates
- Agreeing interest rates for late payments
- Verifying the terms of transactions
- Recommended delivery size
- Guidance for minimum call / threshold amount
- Margin thresholds and minimum transfer amounts
- Anticipating problems that may be caused by low or negative repo rates
- Calculating floating-rate repo interest payments
- Calculating open repo interest payments
- Settlement instructions

Best Practices Over the Life Cycle of a Repo

- Role of collateral in repo transactions
- Recognizing the transfer of title to collateral
- Managing collateral in repo transactions
- Allocation of collateral in a general collateral (GC) repo
- Agreeing the price of collateral
- Fixing an initial margin or Haircut
- Agreeing rights of substitution
- Mark-to-Market and Margining Conventions
- Margin call timing (for relevant currencies)
- Coupon, dividend and other income payments on collateral
- Exercising agreed rights of substitution
- Confirmation and affirmation of post-trade amendments and updates to the terms of a repo
- The issuance of termination notices to counterparties
- Payment protocols / cut-offs
- Managing repo using tri-party services
- Default Management Procedures
- Failure to Deliver Collateral versus Event of Default
- Accepting Partial Deliveries
- Event of Default protocol
- Exercising a 'mini close-out' in response to a failure to deliver
- Partial Settlement versus Pairing-Offs

Repo Markets Workshop – “Straw Man” Agenda

Day 1 – For Senior regulators, policy-makers and public sector participants

13:35-14:05	Presentation: ABCs of Repo Markets
14:05-14:35	Presentation: Why Repos Matter to the Real Economy
14:35-15:05	Presentation: Roadmap Towards a Deep, Liquid Cross-Border Repo Market in Asia
15:05-16:00	Panel Discussion: Meeting the Liquidity Challenge: Improving the Depth of Regional Local Currency Bond and Repo Markets

Day 2 – In depth look for Industry practitioners and working-level regulators, policy-makers and public sector participants

09:05-09:35	Presentation: Importance of Developing a Deep, Liquid Cross-Border Repo Market in Asia
09:35-10:20	Panel discussion: Enhancing Market Infrastructures to Support Efficient Cross-Border Pricing, Trading, Clearing and Settling of Repo Transactions
10:20-11:05	Panel Discussion: Adopting Operational Best Practices in Cross-Border Repo Markets
11:05-11:30	Tea and coffee break
11:30-12:15	Panel discussion: Risk Management in Repo Transactions
12:15-13:00	Panel Discussion: Collateral Management in the New Regulatory Landscape
13:00-14:00	Lunch
14:00-14:45	Panel Discussion: The Importance of the Legal Architecture of Repo Transactions
14:45-15:30	Panel Discussion: Examining the Impact of the Tax and Accounting Regimes on Repo Market Activity
15:30-16:15	Panel Discussion: Priorities and Recommendations to Develop a Cross-Border Repo Market in ASEAN + 3