EBA Q&A on LCR Calculation and Triparty
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Final

Legal Act: Regulation (EU) No 575/2013 (CRR)
Topic: Liquidity risk
Contact: International Capital Market Association
COM Delegated or Implementing Acts/RTS/ITS/GLS/Recommendations: N/A
Subject matter: Reuse of collateral in a repo transaction with collateral substitution rights

Question:

Can a bank record an inflow for a reverse repo with a residual maturity of up to 30 days under the LCR, where collateral is being funded in a repo with a residual maturity of more than 30 days, where collateral is allocated on an automated basis and managed by a third party (ie triparty repo), and where the repo has automatic rights of substitution for collateral of the same or better HQLA classification?

Background on the question:

Base FAQ 27 -d406 (now Basel CF LCR40.79) Paragraph 146 states that there is an inflow rate of 0% when collateral received through a secured lending transaction is reused to cover a short position, including matched repo books where the collateral reuse transaction has a longer maturity than the secured lending transaction. This rule reflects the risk that it may not be possible to roll-over the shorter-term transaction at maturity in order to continue borrowing the collateral reused in the longer-term transaction.

The rule overlooks the fact that, in the case of a triparty allocation, the triparty agent would automatically substitute the collateral being reused in the longer-term transaction were it no longer available to the party reusing it (because the short-term transaction supplying the collateral had not been rolled over). This substitution involves no action by either counterparty to the triparty transaction. Furthermore, triparty allocation logic cannot distinguish between long-term and short-term sources or uses, so inadvertently creates inflow reuse (such reuse can be prevented where collateral can be directed bilaterally). Any such reuse is automatically resolved by the triparty agent upon the unwind of short-dated transactions.

Take, for example, a scenario whereby a counterparty enters into a one-week reverse repo (say in ISIN A) and a three-month reverse repo (ISIN B). They also enter into a one-week triparty repo and a three-month triparty repo, where the eligible collateral is allocated automatically by a third party and is continuously substitutable. In the case that both ISIN A and B are eligible under the triparty transactions, it is equally possible that either ISIN A or B, or a combination of both, could be allocated to either triparty repo. In the case that ISIN A (the shorter-term reversed collateral) is allocated under the three-month triparty repo, CF LCR40.79 would measure the three-month repo as a zero inflow for the purpose of LCR. This is despite the fact that at the end of the one-week reverse transaction in ISIN A (when it is no longer available for allocation in any triparty repo), it will automatically be substituted with ISIN B or another available, eligible ISIN. This highlights the seamless fungibility of ISINs A and B in this scenario.

It could be argued that if in this scenario the counterparty ensured that ISIN A was allocated under the shorter-term triparty repo and ISIN B under the longer-term triparty repo, then CF LCR40.79 would record an LCR inflow for the longer-term reverse. However, it is important to recognize that in the case of triparty, specific collateral positions cannot be directed to a specific term-matched use because triparty allocations are solely based on an instrument's eligibility to a given basket. All collateral positions held at triparty are fully fungible and allocated based solely on their eligibility and availability at a point in time. They may be substituted in a later cycle with another available eligible position if they need to be withdrawn from triparty to satisfy a bilateral delivery obligation. The sole constraint is on availability of eligible collateral, not on the availability of any specific instrument.

Hence CF LCR40.79 potentially overlooks the inherent fungibility of collateral in the case of triparty funding transactions.

Proposed answer:

Where the collateral given in a reverse repo with a residual maturity of up to 30 days is being funded in a repo with a residual maturity of more than 30 days, and where the collateral is allocated on an automated basis and managed by a third-party agent, the bank can report an inflow in respect of the reverse repo for the purpose of LCR, so long as the repo has automatic rights of substitution for collateral of the same or better HQLA classification.