

Could Direct Repo be the next big thing?

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We met with Jeff Kidwell and Aaron Stearns at IMN's Beneficial Asset Holder conference in Arizona this week. Both work at AVM Solutions, which is offering a new product they call Direct Repo. The premise is simple: match up repo providers with cash providers in a principal transaction with AVM acting as broker. It gets a bit more complicated from there but the basic question is, does Direct Repo provide a needed solution to the market for cash investors and repo providers alike?

Readers of Securities Finance Monitor know the backdrop well: banks are reducing balance sheet exposure and pushing down on repo credit lines; the ROA isn't there. What's more, banks are offering less treasury and agency repo right when cash investors (US 2a-7 funds, cash collateral investors, money markets) want more of the stuff. Supply is down and demand is up. This leaves a pretty big hole in the market and has cash investors suffering for return.

Enter Direct Repo. By acting as a broker without using a bank's balance sheet, Direct Repo connects repo buyers and sellers in an agency transaction. The two counterparties become principals to the trade with all the risk and operational hurdles that entails. While these matters need to get sorted out before Direct Repo can become a mass market product, the basic framework has been established and customers are buying. In truth, there is no validation like the reality of a client putting on a trade.

We think that Direct Repo is a great idea. Banks don't want to provide repo to the market but the market is hungry, even maybe starving, for high quality repo product. Leave aside the fact that Direct Repo looks to match up buyers and sellers at the midpoint of the market. Just focus on the demand for product at any price. This sure beats losing money in your money market fund. Our bet is that Direct Repo is a product that will mature with interesting variations in the months and years ahead.

Here's a [related article](#) on counterparty and liquidation risk in Direct Repo on our buy-side site, [AssetOpsandStrategy.com](#).