AVM SOLUTIONS

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The biggest news today, at least in the Repo & Securities Lending market, is that the Federal Reserve Bank of NY has made good on their proposal to the FOMC (released in the FOMC minutes of July just 2 weeks ago) and will begin the new Reverse Repo Facility with 140 non-primary dealer cash providers (per the list approved by them in 2010) on Monday, 9/23/2013, far sooner than most market participants thought (most estimates were in 2015, when participants believed the Fed would start a tighter monetary policy). In the FOMC minutes of July, they talked about an unlimited, fixed-rate repo facility which would augment their primary dealer counterparty list (currently at 21) and include some GSEs, money market funds/investment managers, and some large international and domestic banks (including some securities lending agents and custodial banks). During the preliminary operations the Fed wants to gauge demand without affecting markets so the "unlimited" part is not yet operational. Essentially, this sets a floor for General Collateral (GC) Repo, although it does not set a floor for Specials Repo, or Repo on individual securities. The main points from the release are:

- The operation will be open to all eligible counterparties (now 140)
- Initial Overnight fixed rate will be 0.01% and they will test rates between 0.01%-0.05%)
- The collateral that the Federal Reserve will offer will be US Treasuries initially, not Agency MBS pools
- Max allotment will be set at $500mm per counterparty (but may be expanded to $1billion), which would be initially a total of $70billion
- The Reverse Repo Facility will be open from 9/23/13 to 1/29/14 (although markets expect the Facility to continue after that end date)

Here is the actual release http://www.newyorkfed.org/markets/opolicy/operating_policy_130920.html This has the potential to be a game-changer for the Repo & Securities Lending market. From my perspective, it reinforces what we have been saying for the last 5 years (having the Federal Reserve now link up with non-traditional repo counterparties and disintermediating the primary dealers) about the need for cash providers and collateral providers to explore their own linkages through Direct Repo™ (in addition to the normal pipeline to the broker/dealers). While it may be good news for Direct Repo™ and for supply for some cash providers, it may cause some shocks to other segments of the Repo market. Some non-primary broker/dealers, municipalities, pension funds, insurance companies, corporations, and banks who were not included as new Fed counterparties may be impacted, especially if they are investing in Treasury Repo or are not receiving IOER (0.25% interest on excess reserves). Primary dealers, who have enjoyed their exclusive relationship with the Federal Reserve for many years, may wind up having to reduce balance sheet or at least increase bid/offer spreads and collateral spreads, in order to compete with the Federal Reserve for these cash providers, particularly if the collateral types used by the Fed expands or the total size increases. Other collateral providers (insurance companies, asset managers, mortgage bankers, and mREITs) may feel a knock-on impact of these potentially rising bid/offer spreads and cost of balance sheet. The front-end of the curve, up from the lack of Taper talk/reprieve by the FOMC at Wednesday's meeting, was initially getting hit on this release.

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