Repo growth and innovation in uncertain markets

Eurex's Frank Gast, global head of repo sales, and Carsten Hiller, head of repo sales Europe, discuss what is behind the firm's recent growth in repo volumes, the core initiatives the company is working on, and where Eurex Repo is heading next

Eurex continues to see strong growth in its repo markets following an extremely busy 2023, with volumes in the first four months of 2024 up by almost 25 per cent year-on-year across the repo markets.

What is driving the year-on-year growth in volumes across Eurex Repo?

Frank Gast: A lot of clients have reactivated over the past two years. We have more than 160 clients across our repo markets, and many firms have returned to being active in GC Pooling. We have a great diversity of clients across commercial banks, debt management offices (DMOs), central banks, supranationals and buy side firms. This diversity ensures that we have cash providers and collateral providers, and that is what is fueling our strong volume growth.

How have you seen firms re-engage with Eurex Repo and what is their core motivation for this decision?

Gast: On the buy side, it is a case of firms looking to use all of the available tools in the market. They must follow the Uncleared Margin Rules (UMR) and fulfil certain cash or securities requirements. If there is stress in the market, the buy side needs access to all of the available levers it can pull to source liquidity. In addition to triparty and bilateral markets, CCP markets are another source of liquidity for the buy side to have in place.

For the banks, we see a lot of second-tier firms and supranationals who were not necessarily active in repo in the past, and are now using repo because of the current rate levels and depth of our liquidity tool. Since rates are where they are today, they now need to be part of the repo market in a way that they were not when rates were lower.

Thirdly, the motivation for hedge funds is to be wherever they can to leverage all of the opportunities offered by the current interest rate levels. For hedge funds, not tapping into all repo markets is a missed opportunity that will impact their returns.

Carsten Hiller: We now see investment opportunities in the market and opportunities to manage short cash and short liquidity. Cleared repo offers an advantage from a risk perspective, which is attractive to firms looking to join the cleared repo market. But also, when it comes to handling counterparties, firms have access to more than 160 counterparties without needing individual bilateral agreements.

Therefore, firms that have historically placed excess cash and liquidity with the central bank are now looking at the repo market to increase returns.

Where are you noting the largest points of growth across the platform?

Gast: Most of the growth is in GC Pooling, which is our cash-driven market. The reduction of excess liquidity and interest rate levels are certainly playing a crucial role. But Eurex is also known for term business, where we see significant growth. Eurex is unique in offering term repo — you cannot get term rates up to two years out in any other repo market apart from Eurex. The benefits of netting across our market segments are an important driver for the term business we see.

Hiller: We also see the large international banks shifting business in the short-end over to Eurex, and providing more quotes in the order book. Currently, there are additional quotes in the order book in French, Spanish, Belgian and Austrian government bonds. The overall number of tickets increased, attracting other participants who saw the quotes from Eurex on their screens. The more liquidity we generate on our platform, the more it encourages people to trade on Eurex.

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From your understanding, how is the macro environment impacting the market?

Hiller: Looking at the overall market environment and what has happened over the previous 18 months, we have seen a shift from collateral scarcity into collateral abundance. Going back two years, we saw extreme special rates in German bunds. The demand for bunds was substantial, while the available inventory fell short of meeting that demand. This was driven by external factors such as the war in Ukraine, but also by hedge funds positioning for the European Central Bank (ECB) to hike rates, which meant that they were going short on the bund and had to borrow it back in the repo market. This was all driving and further increasing the demand for bunds, which also resulted in the expensive special rates.

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Today, the demand for bunds has decreased by around 30 per cent in the first quarter in terms of traded volumes, and the rate at which bunds are trading is almost at the level where every bund is comparable to the GC Pooling levels. Significantly, while traded volume in the bund has declined, we have been able to compensate for that through higher trading activity in other European government bonds, especially in French, Italian and Spanish government bonds. Here, clients are actively shifting over business into Eurex, especially for term repo.

Eurex recently expanded its GC Pooling offering by adding another green bond basket. What was the motivation behind this decision?

Gast: We are always innovating. We started with GC Green bond baskets three years ago and are now entering the next phase with more features, such as automatic substitution and allocation. We have a lot of issuers of green bonds as clients, such as finance agencies, development banks and the major regional European banks. They have an interest in a liquid secondary market. More than 20 clients are interested in the basket and are set up for the launch. When you see this number of clients showing interest in trading a basket on either side, you know there is demand for the offering.

The new GC Pooling basket provides additional features such as collateral forecast reports, automated allocation and automated substitution of collateral to make the handling for traders more convenient. We will keep innovating and bringing new offerings to the market.

Hiller: Back in 2020, when we first launched our Green Bond GC Basket, we intended to kick off the discussion about green collateral in the repo market. In our markets, we look at Green Bonds as collateral in repo transactions, which means the repo does not directly have an additional sustainability impact. However, we are supporting the overall ecosystem of the green bond segment, and our main goal is to contribute to developing an efficient and transparent market for sustainable finance by supporting the funding and liquidity of sustainable assets.

Increasing issuance activity in the primary market is necessary to achieve the overall goal of green transitions. Still, the primary market cannot grow without a liquid secondary market for cash bonds and the repo market.

Another Eurex initiative shows the firm including repo in cross-product margining. How is this advancement currently developing?

Gast: Currently, our Prisma model offers cross-margining between listed and OTC derivatives, but repo has not been added yet. We will implement it stepwise this year. Next, we will allow repo to be part of the cross-product margining. This will bring huge benefits to our clients, particularly to buy side firms coming on board.

We are also growing our offering among the hedge fund community. These firms trade huge positions, for example in bund futures. If they can achieve synergies between the listed, OTC, and repo markets on margins, rather than looking at repo in isolation, it will be of significant added value to them.

How strong is the adoption of cleared repo among the buy side?

Gast: Our key strategic focus has been attracting more buy side firms to cleared repo. For years, we have had our ISA Direct offering for pension funds, insurance companies and corporates, who are contributing around 10 per cent of our total volumes today and are the fastest growing segment in our market.

Now, we are extending the buy side access with an indemnified model to hedge funds, and the first of these are currently onboarding with a view to having the first pilot clients ready in the second half of the year. It is similar to the US FICC model, which we are bringing to Europe to broaden the ecosystem. We want to provide optionality to the market, giving them different ways to access funding.

Cleared repo is key because of the netting benefits. Banks, as the counterparties of hedge funds, can net their positions in cleared markets, which they cannot do in bilateral or triparty markets. This multilateral netting balance sheet netting is a driving factor in adoption.

Looking ahead, what is next for Eurex Repo?

The European Collateral Management System (ECMS) is coming in November 2024. This ECB project harmonises collateral infrastructure across Europe and integrates local central banks. Eurex is planning to launch additional partnerships to promote the benefits of re-using collateral in the context of the ECMS.

For example, the expansion in the use of collateral from our pan-European, cash-driven liquidity pool, GC Pooling, will enable refinancing opportunities with local central banks. Furthermore, we also plan to roll out cross-product margining in various steps as previously mentioned. Eurex Repo is going to have a busy year ahead.

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