

Whitepaper

**Eurex's GC Pooling<sup>®</sup>**  
**repo service takes repo  
funding management  
efficiencies to a new level**



# Executive summary

- Tightening liquidity conditions in the Eurozone, following a prolonged period of excess liquidity, is driving banks to reevaluate their funding liquidity sources.
- The features of the Eurex's GC Pooling<sup>®</sup> repo markets offer banks unmatched efficiencies in the management of scarce financial resources, compared to bilateral and tri-party repo markets.
- The power of multilateral netting and the preferential risk-weights afforded to qualifying central counterparties (QCCPs) brings capital management benefits across all the key measures, including RWAs, leverage ratio and GSIB (global systemically important banks) requirements.
- The exemption of QCCPs from regulatory limits together with preferential risk-weights, gives GC Pooling<sup>®</sup> a significant edge over bilateral and tri-party repo markets when managing under the revised large exposures regime.
- Eurex's application of the evergreen trading terms to the GC Pooling<sup>®</sup> product, alongside the collateral substitution feature and broad set of eligible securities makes GC Pooling<sup>®</sup> a highly efficient solution in the management of Net Stable Funding Ratio ("NSFR") and Liquidity Coverage Ratio ("LCR").



# Introduction

The market for repurchase agreements ('repo') plays a central role in redistributing cash liquidity and collateral between banks, and between banks and non-bank financial institutions (e.g. Pension Funds, Insurers, Hedge Funds). The European repo markets are some of the most complex in the world. While the Eurozone's common currency, the Euro, is shared by several (but not all) countries within the European Union, government bond markets of the underlying countries are diverse in terms of issuance, liquidity and credit quality. In addition, there are active markets in non-Euro repo trading, including USD, GBP and CHF cash funding markets. The European repo markets comprise bilateral, tri-party, and centrally cleared transactions. In addition, the markets can be further segmented into cash-driven funding markets, or markets focused on the financing and sourcing of specific securities.

Eurex's repo trading and clearing service is a leading European marketplace for international secured funding and financing. Since its establishment in 2001, it has been a cornerstone of innovation in the European repo market with a comprehensive offering that has evolved with changing market conditions. Eurex's flagship product for repo is GC Pooling<sup>®</sup>, a visionary cash-driven funding tool that has been a reliable refuge for market participants in periods of extreme market instability.

The Russian invasion of Ukraine, and its aftermath (sanctions, energy market instability etc.), caused a re-assessment of the inflation outlook and subsequent monetary policy tightening in the Eurozone beginning in July 2022. Following a prolonged period of unprecedented levels of excess liquidity in the banking system, the new monetary policy regime is expected to result in tighter liquidity conditions, particularly with the TLTRO redemptions and the beginning of quantitative tightening. As a result, many European banks are scrambling to review their funding liquidity sources, leading several banks to return to the GC Pooling<sup>®</sup> market. The deep funding liquidity that GC Pooling<sup>®</sup> offers is well documented in a variety of Eurex whitepapers, industry publications and academic research.

Perhaps less appreciated are the significant efficiencies that GC Pooling<sup>®</sup> offers from a business and regulatory perspective. This paper highlights advantages in a range of areas including capital management, large exposures, liquidity coverage and stable funding.<sup>1</sup>

<sup>1</sup> This whitepaper does not constitute accounting or regulatory advice or guidance. Customers should consider the accounting and regulatory requirements in the jurisdictions relevant to them before using the Eurex Repo GC Pooling<sup>®</sup> and related products or services.

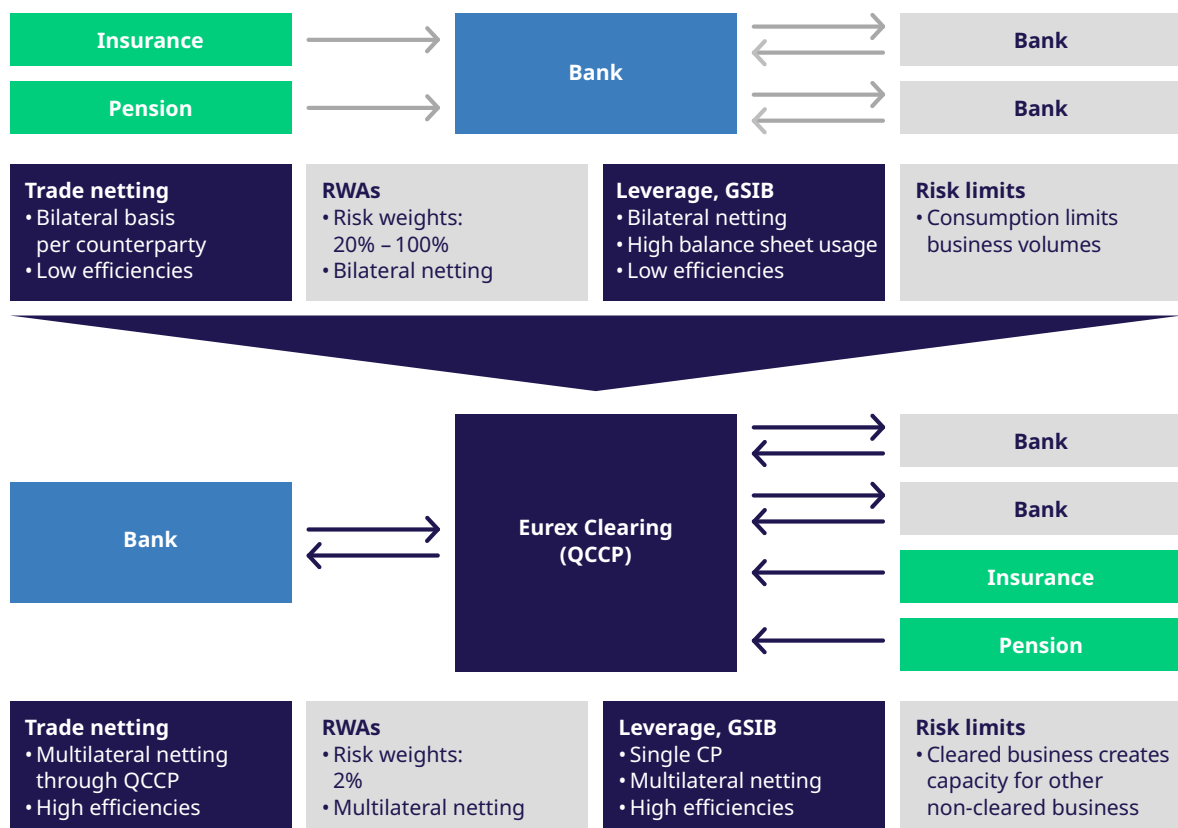
# Capital management

Banks are subject to capital constraints across a number of dimensions, and different banks can be constrained by different dimensions (e.g. RWAs or leverage exposure) at different times. Repo and reverse repo transactions give rise to RWA requirements to the extent that lending is under-collateralized or excess collateral is posted, especially after the application of regulatory haircuts. In a GC Pooling<sup>®</sup> transaction, the counterparty is Eurex Clearing – a qualifying central counterparty (QCCP). Exposures to QCCPs qualify for a 2% risk weight, which effectively reduces RWAs to de-minimis levels when compared with bilateral exposures to banks. Banks can also be constrained by the leverage ratio or other balance sheet-based regulatory measures such as global systemically important banks (GSIB). Unlike RWAs, these measures do not afford any preferential treatment to QCCPs. However, these measures permit the application of balance sheet netting where long (cash taker) and short (cash provider) positions can be offset subject to certain conditions being met, including but not

limited to: same counterparty; same maturity; same currency and same settlement location/mechanism. In the bilateral repo funding markets, banks are trading with multiple counterparties, which significantly reduces the opportunities for balance sheet netting. In cleared repo markets, banks access liquidity from multiple counterparties, but ultimately face the CCP and effectively achieve balance sheet netting on multilateral basis.

The benefits for the leverage ratio, GSIB and even RWAs from multilateral netting, a feature unique to cleared repo markets such as GC Pooling<sup>®</sup>, are very material. GC Pooling<sup>®</sup> can be used to fund Specials trading in a balance sheet efficient manner. Further, the ongoing scarcity of collateral, winding down of monetary policy measures, and the uneven distribution of HQLA in the Eurozone is creating opportunities for spread trading, collateral upgrade/downgrade trades, and collateral swaps. Eurex Repo has made remarkable gains in the single ISIN and GC markets. If such trading can be funded using GC Pooling<sup>®</sup>, it can

**Figure 1. Capital benefits when moving from bilateral to centrally cleared repo**



bring balance sheet efficiencies which dramatically improve the profitability of such activities. Further balance sheet efficiencies arise from GC Pooling® collateral re-use which can be applied for: Eurex Clearing initial and intraday margin requirements for repos, derivatives and equities; ECB/Bundesbank/Banque Centrale de Luxembourg operations; and the GC Pooling® market.

To fully appreciate the benefits of cleared repo, one must look in the context of the broader business objectives. By leveraging cleared repo opportunities to fullest extent possible, it creates capacity (and releases credit lines) for other business lines, and trading activities that remain bilateral.

# Large exposures

The third iteration of the EU Capital Requirements Regulation introduced new requirements for collateralized exposures such as repo. In the calculation of large exposures measures, banks must report the collateralized portion of the exposures towards the collateral issuer, rather than the counterparty. This is a form of exposure “substitution”. While this certainly adds to the complexity of reporting obligations, there are also real economic implications for the repo business if these complex rules result in banks breaching large exposures limits to collateral issuers. The “substitution approach” also has requirements which stipulate that if the collateral issuer is risk-weighted higher (i.e. worse) than the counterparty, the effect of the collateral is ignored, and the bank reports the exposure against the counterparty as if it was unsecured. While we are not aware of any deliberate policy intention to afford QCCPs with preferential treatment under the substitution approach, careful analysis shows that there are comparative advantages for centrally cleared repo transactions, such as GC Pooling®.

To understand the drivers, it is worth highlighting two salient facts about QCCPs, namely that they are: i) risk-weighted at 2%; and ii) exempt from large exposures limits. As an example, consider a hypothetical GC Pooling® basket containing European government bonds risk weighted at 0% and commercial bank bonds risk weighted at 20%. The European government bonds are risk-weighted better than the QCCP (counterparty), so the collateral is permitted to reduce the credit exposure to the QCCP. However, the collateralized portion of the exposure is re-pointed to the

respective individual European government bond issuers. This in itself is not a problem, because European government bonds risk-weighted at 0% are typically exempted from large exposures limits. In the case of the commercial bank bonds, these are risk weighted worse than the QCCP. Hence the portion of the credit exposure collateralized by this bond is still reported against the QCCP, as if it were unsecured. This is also not a problem because QCCPs are exempted from large exposures limits.

The large exposures regulation under the new substitution requirements is likely to present significant challenges for banks (especially banks with small capital bases) trading bilateral or tri-party repo. However, the use of cleared repo products, such as GC Pooling®, allows banks to carry out their secured funding activities without ever falling foul of regulatory large exposures limits.

Figure 2. Clearing can help manage against tightened large exposures limits

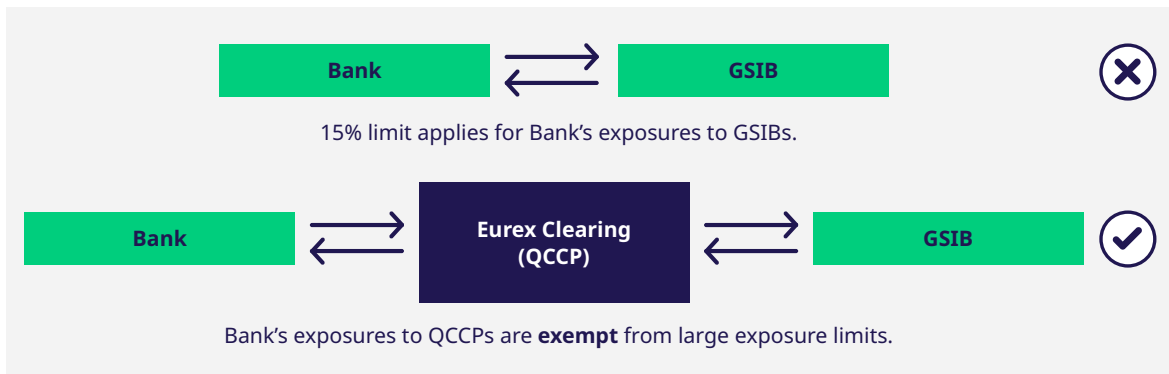
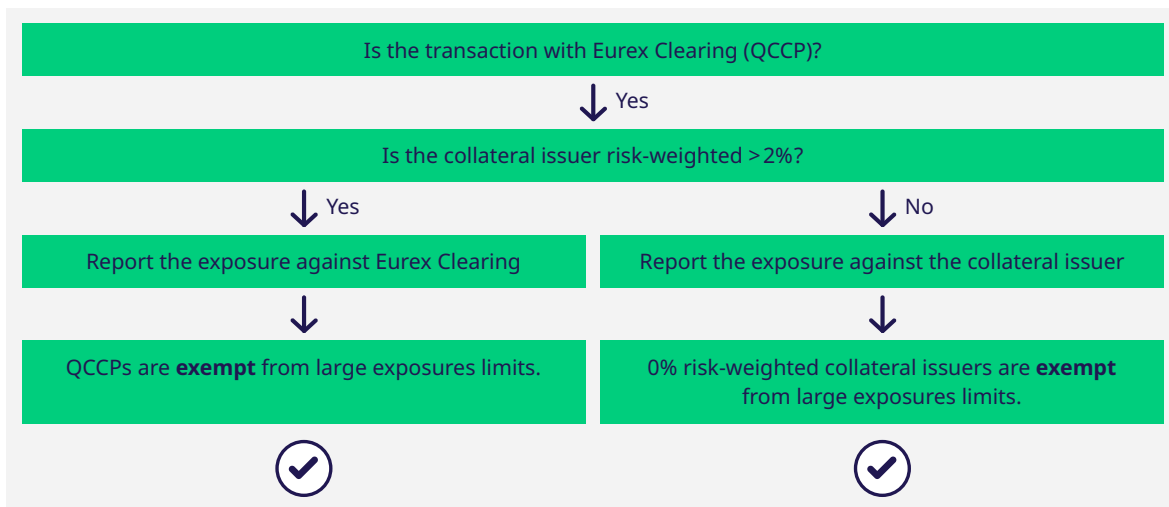


Figure 3. Cleared repo business is unaffected by large exposures collateral issuer substitution rules



# Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR)

Since its initial proposal as part of the Basel III reforms, NSFR has been one of the most contentiously debated pieces of regulation and had one of the longest lead times before its implementation in the EU in 2021. However, the NSFR regulation was an anticlimax in many respects, with the vast majority of banks carrying very healthy buffers when comparing against the regulatory minimum. While not downplaying the potentially significant

funding optimization efforts undertaken by banks to prepare for the regulation, the healthy buffers suggests that banks simply realigned their funding profiles to very conservative levels. Given that funding costs touch the economics of every product and service of a bank, the question is how long this can continue until competitive pressures force banks to innovate. At Eurex we have adopted the "evergreen repo" concept for the GC Pooling®

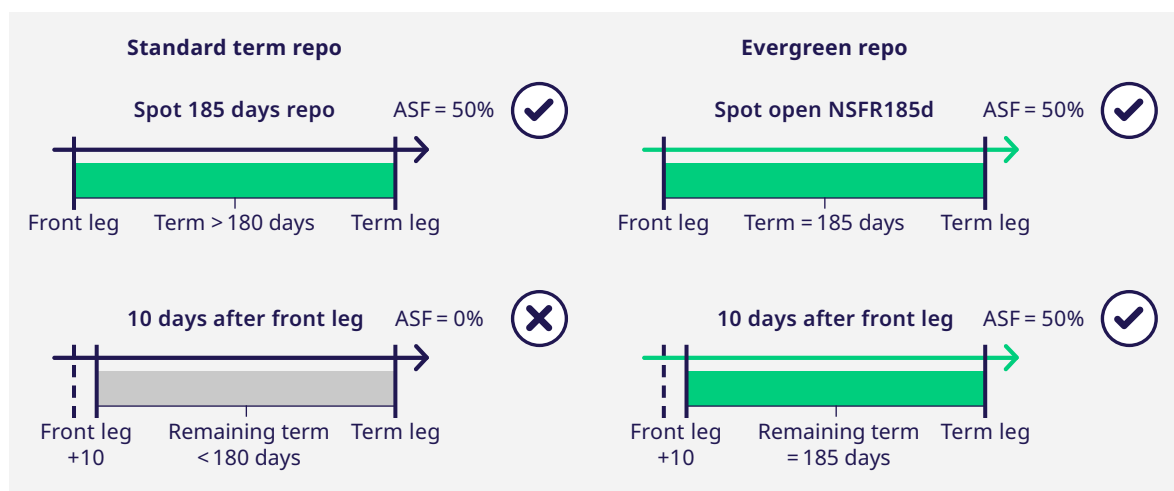
product suite, with maturity terms flexibly aligned with the maturity buckets specified in the NSFR regulation (e.g. 185 days and 370 days). The evergreen repo concept is the perfect management tool for NSFR as it addresses the cliff effects associated with standard term repo, where material stable funding benefits are lost as the maturity rolls down.

The real power of GC Pooling® in the management of NSFR is the ability to substitute collateral over the life of the funding transaction in combination with the large array of eligible securities. In single ISIN repo and GC repo transactions, collateral

posted is committed for the life of the trade which removes the option to recall that collateral for more productive uses as market conditions change and opportunities arise. With GC Pooling®, the ability to substitute provides full flexibility to recall and redeploy collateral for more productive uses without terminating the trade and losing NSFR benefits (provided that the substituted collateral is of the same or better HQLA designation).

Evergreen repo terms are also available (LCR30d) which align with the 30-day Liquidity Coverage Ratio (LCR) requirement, enabling efficient management under the regulation.

**Figure 4. Evergreen terms on GC Pooling® transactions brings efficiency to NSFR management**



# Summary

Tightening liquidity conditions in the Eurozone, following a prolonged period of excess liquidity, is driving banks to reevaluate their funding liquidity sources. The features of Eurex's GC Pooling® repo markets offer banks unmatched efficiencies in the management of scarce financial resources, compared to bilateral and tri-party repo markets.

The power of multilateral netting and the preferential risk-weights afforded to QCCPs brings capital management benefits across all the key measures, including RWAs, leverage ratio and GSIB requirements. The exemption of QCCPs from regulatory limits together with preferential risk-weights,

gives GC Pooling® a significant edge over bilateral and tri-party repo markets when managing under the revised large exposures regime. Further, by leveraging cleared repo opportunities to fullest extent possible, it creates capacity (and releases credit lines) for other business lines, and trading activities that remain bilateral.

Eurex's application of the evergreen repo trading terms to the GC Pooling® product, alongside the collateral substitution feature, makes GC Pooling® a highly efficient solution in the management of NSFR and LCR.

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