

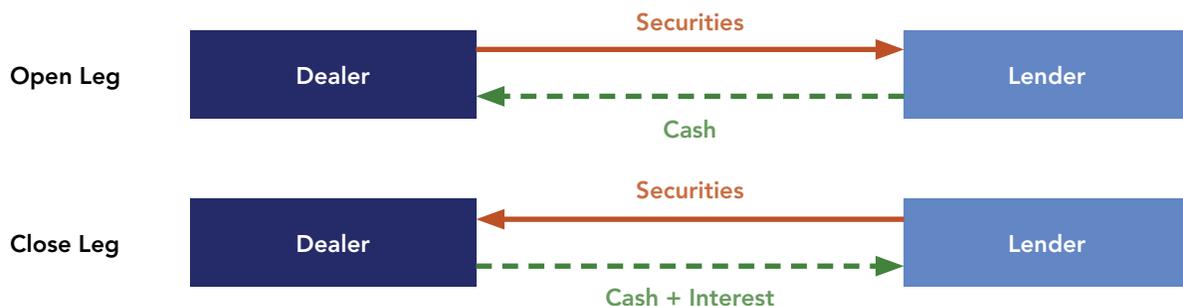
Frequently Asked Questions

This section answers some frequently asked questions about the subjects discussed in this brief. For more details, see Baklanova, V., Copeland, A., and McCaughrin, R., (2015). “Reference guide to U.S. repo and securities lending markets,” Staff Reports 740, Federal Reserve Bank of New York.

What is a repo agreement?

A repurchase (repo) agreement is an agreement to sell a security with the agreement to repurchase the security later, at a pre-arranged price.

Figure 1. A Repo Agreement

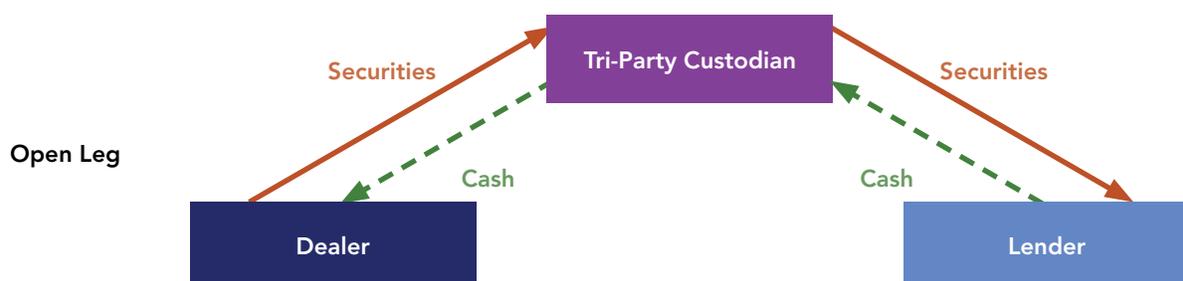


The sale of the security is called the “open leg” of a repo transaction, while the repurchase is the close leg. The difference between the sale price and the repurchase price agreed to, which is generally higher, determines the repo rate. The entity selling the security in the open leg is referred to as a “repo dealer” or “cash borrower” and the entity receiving the security in the close leg is referred to as the “repo lender” or “cash lender”. Since a repo agreement essentially amounts to a collateralized loan, the security being sold and repurchased is known as the “collateral” for the repo agreement.

What are bilateral and tri-party repo?

In a bilateral repo agreement, lenders and dealers trade directly, with collateral generally being transferred to the lender. For some lenders, holding collateral is difficult, so certain repo agreements have custodians who hold collateral on behalf of lenders. In a tri-party repo agreement, the custodian also oversees collateral management on behalf of the dealer, allocating securities that the dealer holds in order to meet the requirements of their various repo contracts. These tri-party agreements are therefore essentially moving cash and collateral between the dealer and the lender’s accounts with tri-party custodians.

Figure 2. A Tri-Party Repo Agreement



What is general collateral repo?

General collateral repo agreements specify a general class of collateral which the lender expects to receive from the borrower rather than a specific security. For instance, a lender might enter a repo agreement that specifies acceptable collateral being all Treasuries with less than ten years and greater than five years to maturity. The repo dealer is then free to decide which Treasury they will sell to the lender within that specified class. In contrast, specific collateral repo agreements specify a particular security that must be delivered from the repo dealer to the lender during the open leg of the contract.

What is central clearing?

Central clearing is a system for the clearing and settlement of securities transactions in a market wherein a single financial institution, known as a central clearing counterparty, guarantees trades between participants in the market. Should one side of a trade default, the loss to the other side of the trade is met through a regular collection of funds from all members of the market known as margin. In centrally cleared markets, the counterparty for the firm is therefore the central clearing counterparty, rather than the other side of the trade. As a result, participants in the market are able to net any offsetting positions they have within the cleared market, which reduces accounting measures of their gross positions.

What is the SOFR?

The Secured Overnight Financing Rate (SOFR) is a reference rate published by the Federal Reserve Bank of New York in cooperation with the Office of Financial Research. It provides a broad measure of the cost of financing Treasury securities overnight. The rate is based on repo transactions in the Bank of New York Mellon's Tri-Party market and the Fixed Income Clearing Corporations GCF and DVP repo services. For more information, see the [Federal Reserve Bank of New York's Additional Information About Reference Rates](#).

What is a securities dealer?

Securities dealers are financial institutions that specialize in securities market transactions. Generally, securities dealers make markets for securities, which is they stand ready to buy or sell securities within a close range of the prevailing market price. As a result, securities dealers often hold large portfolios of different securities that they make markets in, and often fund these portfolios through borrowing and lending in the repo market.

What is a primary dealer?

Primary dealers are certain financial institutions that are trading counterparties of the Federal Reserve Bank of New York. These dealers make markets for transactions with the Federal Reserve Bank of New York and with certain entities who hold accounts with the Federal Reserve. They also are required to bid in auctions of new Treasury securities by the Treasury Department at reasonable prices.