PUBLIC EXPOSURE DRAFT SEPTEMBER 20, 2004

Update No. 2004-2

Restated Repo Trading Practice Guidelines

A. Introduction

Set forth below is a public exposure draft (“Exposure Draft”) containing additional clarifications to the Association’s August 1, 1996 Restated Repo Trading Practices Guidelines (“1996 Guidelines”) that is designed to facilitate, where appropriate, negative rate repo trading between Bond Market Association (“Association”) members in FedWire eligible book-entry securities (“Government Securities”).

B. Discussion

The Association’s Funding Division Executive Committee has recommended publishing this Exposure Draft to allow market forces (as reflected in special collateral repo rates) to better facilitate the resolution of situations where a particular Government Security is experiencing an extraordinary level of settlement fails such as that occurring last fall in the May 2013 U.S. Treasury 10-Year Note.

While negative rate repo trades already occur occasionally, including on a “guaranteed delivery” basis, the Association is today adding a new Section Q. to the 1996 Guidelines clarifying what constitutes a “prompt delivery” trade. The Association is publishing this Exposure Draft to ensure that there is a mechanism whereby firms that are holding a particular Government Security have adequate incentives for making such securities available to dealers and other market participants that need to use these securities to cover a short position or otherwise make delivery to a third-party.

The Association hopes that these changes to the 1996 Guidelines will improve the overall functioning of the repo markets for Government Securities by eliminating any perceived barriers to the monetization of the scarcity premium for a security that is trading special in the repo markets. By establishing a clearer set of trading conventions that can be agreed upon between market participants when a security is trading special, the Association hopes to promote greater liquidity and facilitate a more efficient price discovery process in the repo markets.

These recommendations are intended to further clarify the meaning and usage of the term “prompt delivery” in the context of DVP repo transactions in Government Securities between member firms.
C. **Recommendations Only**

These Repo Trading Practice Guidelines are recommendations only and are intended for the Association’s member firms in order to promote the smooth functioning of the repo market for Government Securities. The recommendation does not and should not restrict the flexibility of counterparties to negotiate the specific terms of any particular repo transaction, including additional stipulations or conditions.

As with other Association trading practice guidelines, these proposed guidelines are merely recommended, voluntary standards. The Association recognizes, however, that many of its guidelines are widely observed, also on a voluntary basis, by a variety of other market participants. As a result, consistent with the Association’s approach to its other standard-setting initiatives, the Association welcomes receiving comments from various market participants that are not members of the Association including non-dealer counterparties.

It is anticipated that these guidelines might be used by non-members for the same reasons that motivate the Association’s members: namely, the greater market efficiency that results from the broad application and common adherence to set of standards or best practices. As with all of the Association’s trading practice recommendations, the Association intends to continue to reassess from time-to-time the validity and appropriateness of these guidelines.

D. **Legal Status under the MRA**

While a fail to deliver on the start-leg or close-leg of a repo transaction is an event of default under the Association’s Master Repurchase Agreement (MRA), market participants may choose not to trigger an event of default for fails which occur in the ordinary course of business. Dealers, inter-dealer brokers, electronic trading platforms, and other market participants interested in facilitating repo trading under these guidelines should consult with their own attorneys regarding how to make these voluntary guidelines legally enforceable with their counterparties or users.

E. **Amendments to the 1996 Guidelines**

The 1996 Guidelines are hereby amended to read as follows:

Q. **Prompt Delivery**

1. **Definition of “Prompt Delivery”** All “prompt delivery” repo trades, will be cash trades with the seller required to make delivery to the buyer within 15 minutes of the trade being executed.

2. **Assumptions for “Prompt Delivery” Trades:** When two parties to a repo trade agree that the trade is to be done on a “prompt delivery” basis, the buyer assumes the risk that the seller will not be able to make the delivery on the start-leg within the fifteen (15) minute time frame specified above. Consequently, if the seller fails to
make timely delivery, the seller has no risk and incurs no obligation to the buyer. Likewise, unless otherwise agreed between the parties, a “prompt delivery” repo transaction does not mean that the buyer is agreeing to any additional representations with respect to its ability to make delivery on the close-leg of the transaction. At the time of the trade the relevant inter-dealer broker (“IDB”) for a “prompt delivery” trade shall disclose to each counterparty the name of the other counterparty (name give-up).

3. Additional Screen Guidelines for Prompt Delivery Trades

The intent of parties to enter into a “prompt delivery” repo transaction should be clearly signified on the IDB screen by placing a “PD” before the transaction on the screen. The repo rate of a repo transaction (including “negative rate” repo transactions) should not be relied upon to determine whether the parties intend to enter into a “prompt delivery” repo transaction.

F. Public Comment Period

The deadline for submitting comments on this Exposure Draft is Monday September 27, 2004. Persons wishing to comment on Public Exposure Draft should send their comments to either Eric L. Foster, Vice President and Associate General Counsel, or Robert B. Toomey, Vice President and Assistant General Counsel, at the address listed below. Comments may also be sent via email to: efoster@bondmarkets.com or rtoomey@bondmarkets.com.

Eric L. Foster/Robert B. Toomey
The Bond Market Association
360 Madison Avenue, 18th Floor
New York, N.Y. 10017
646-637-9222
Fax 646-637-9122

www.bondmarkets.com