Repurchase Agreements (repos) - An Innovation in the Swiss Financial Centre

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Ladies and Gentlemen

On behalf of the Swiss National Bank - and also of Swiss Securities Clearing Corporation (SEGA) and the Swiss Bankers' Association - I should like to welcome you to today's press conference. The focus of this gathering is on repurchase agreements (repos) - an innovation in the Swiss franc money market. In cooperation with the banks and the Swiss National Bank, SEGA has worked out a solution which we would like to present to you today. After my opening remarks, Mr Spörndli of the National Bank will introduce you to repos as a monetary policy instrument. Mr Füglister, representing the Swiss Bankers' Association, will then explain the significance of the repo as a financial market instrument. Finally, Mr Häberli will sketch the services which SEGA will provide based on the existing infrastructure. The various contributions also include legal and technical aspects as these are considered to be valuable additional information. At the end of the presentation, we and a number of other experts will answer any questions you may have.

What exactly is meant by a repurchase agreement? In a money market transaction known as repo the cash taker sells his own or borrowed securities to the cash provider. At the same time, it is agreed that the cash taker will repurchase paper of the same type and quantity from the cash provider at a later date. From an economic point of view, a repo is considered to be a secured loan, and the cash taker thus pays repo interest to the cash provider during the term of the agreement. To ensure cover in the event of price fluctuations, any deviations are compensated by daily margin transfers. Repos thus replace unsecured money market advances by secured forms of financing.

The introduction of repurchase agreements fulfils a common need of the banks and the National Bank. The advantage to the banks is that unsecured money market investments are replaced by an attractive securities-backed operation. And for the Swiss National Bank repos are an ideal addition to the existing range of monetary policy instruments.

The institutional framework is conducive to a successful launching of the new financial instrument: fiscal aspects, capital adequacy requirements, the technical processing infrastructure and the amendments to the National Bank Law.

- At the beginning of 1997 the Federal Department of Finance clarified the scope of federal stamp duty by confirming that repos are in principle not subject to this tax. The reason is that - economically speaking - repos are to be regarded as secured loans and not as purchases or sales of securities.

- Capital adequacy rules are another aspect that make repos attractive from a cost point of view. As secured loans repos are not subject to capital adequacy requirements. The lender is only required to provide adequate capital for that part of the loan which may not be covered. This helps to save on equity costs, notably when compared with traditional unsecured interbank advances.

- As far as processing is concerned, SEGA has provided an infrastructure which represents a safe and efficient solution with a minimum of processing risks. Moreover, the Swiss Stock Exchange has decided to provide a platform for repos on the basis of its electronic trading infrastructure.

- Finally, a further precondition was fulfilled when the revised National Bank Law became effective in November 1997. Article 14 now explicitly authorises the National Bank to enter into repurchase agreements.

While favourable conditions are of the essence for the success of the venture, they are not sufficient in themselves. The attractiveness of the new instrument depends very much on how it is structured. In a combined effort a marketable product has been developed. Let me briefly describe three main features:

- The trading concept provides for standardised and non-standardised agreements. In over-the-phone trading both types of transactions may be concluded. Standardised agreements have the advantage of being more liquid, which in turn renders pricing more transparent. An electronic trading platform at the Swiss Stock Exchange would further enhance the efficiency of this instrument.

- A second important prerequisite for success, in view of the size of our securities markets, is to be seen in the structure of repos, which is designed to conserve market liquidity. The securities lodged with the cash provider as collateral are not blocked in a closed custody account and thus withheld from the market for the entire duration of the repo. The opposite is the case: the cash provider can dispose of the securities at any time. While the possibility thus provided for a multiple use of the securities enhances market liquidity, it also makes higher demands on portfolio management by cash providers. The technical prerequisites for efficacious risk control, however, fully exist. We are convinced that the liquidity of the Swiss franc bond market will not be adversely affected by repo operations but, on the contrary, will probably be improved by them.

- Repos, moreover, require a secure legal basis, making it possible, in the event of disruptions, to claim ownership rights with respect to the securities. The Swiss standard agreement on a multilateral basis adequately meets this requirement.

Given the favourable environment, the attractive structuring and the cost-effective processing mode, we are confident that interbank trading will establish itself on a broad basis, which will also permit smaller banks to participate. Not only the individual participants stand to benefit from this new instrument. The replacement of unsecured credit relationships by secured loans as well as the step-by-step processing guaranteed by SEGA will heighten the safety of the entire system and thus strengthen the financial sector as a whole.

The new financial market instrument is to be introduced gradually. On 20 April we will start with RepoLight, a simplified preliminary version with a limited circle of participants, which will replace our traditional swaps with federal money market debt register claims (MMDRCs). The full project is to be launched at the end of September 1998.