The Repurchase Agreement (Repo) as a Monetary Policy Instrument

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As Mr Gehrig has already pointed out, the repo is an ideal addition to our range of monetary policy instruments. Before entering into the characteristic features of the new tool, I should briefly like to describe the instruments we are currently using for steering the money market.

In longer-term steering of the market we fulfil the basic liquidity requirements of the banking system by means of foreign exchange swaps. To this end, we buy US dollars in exchange for Swiss francs while at the same time selling the dollars forward. These contracts, limited in time, are usually renewed by us after expiry. While the market for foreign exchange swaps is an extremely liquid market this instrument has the drawbacks that it exposes us to counterparty risks and that the circle of participants is limited. For the short-term steering of liquidity - fine-tuning - we resort to swaps with money market debt register claims or the onward placing in the market of investments held with us by the Confederation. The limited liquidity potential is a disadvantage in the use of these two domestic instruments of the Swiss National Bank (SNB).

What benefits do repos offer the SNB? Repo agreements are a versatile monetary policy instrument suitable both for creating and siphoning off liquidity. They can be used for longer-term and short-term steering of bank liquidity. Moreover, repos offer two considerable advantages, notably compared with foreign exchange swaps:

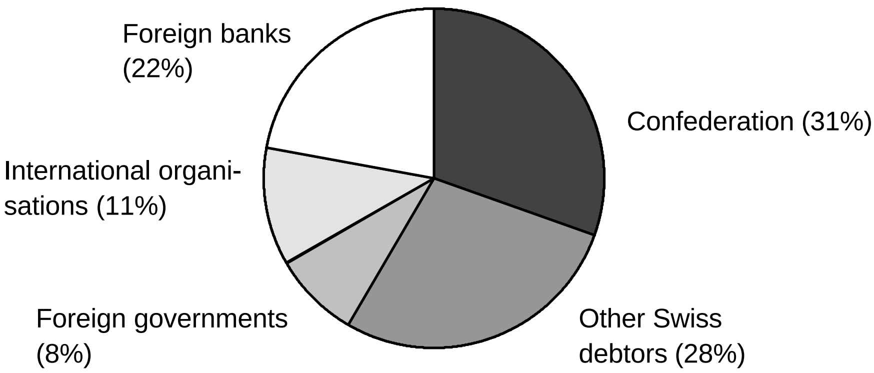
- The circle of counterparties engaging in money market operations with the National Bank will become larger. The prescribed minimum transaction amount for repo agreements will be Sfr 1 million, also giving smaller banks direct access to the SNB.

- Repos are also an ideal monetary policy instrument for risk considerations: the delivery-versus-payment transaction guaranteed by SEGA eliminates the *performance risk,* to which we are particularly exposed in the case of foreign exchange swaps. Moreover, the *market price risk* attaching to the securities serving as collateral is averted by daily margin transfers.

Repos thus meet high demands as regards their possible application, circle of participants and risk.

In order to enter into a repo agreement with the National Bank, the counterparty must have securities eligible as collateral at the SNB. Naturally, the National Bank must require such securities to meet certain standards as regards quality. This leads to a conflict of aims: on the one hand, we are interested in a maximum market potential of securities eligible as collateral at the SNB and, on the other hand, the risks incurred must be minimised to the greatest extent possible. The present solution fulfils both requirements. The basket of securities has been designed to be broad. We also expect it to be suitable for repo agreements between the banks. This should help to prevent a segmentation of the market in the interest of liquidity.

Debtor categories in the SNB's basket of securities



What then are our criteria for securities eligible as collateral for a repo agreement with the National Bank? The basic requirement is that the securities must be denominated in Swiss francs. In addition, certain restrictions apply as regards liquidity, type of security and category of debtor.

Since customer holdings may be included the market potential can be widened substantially. A commercial bank can employ securities borrowed from customers for repurchase agreements with the National Bank. The advantage for the customer lies in the fact that he can increase his earnings through securities lending. The market potential, i.e. the available volume of securities eligible for repurchase agreements should therefore not represent a major restriction.

I come to the end of my remarks. The advantages of repos are self-evident. We are therefore confident that repos will also prove their worth as a major monetary policy instrument in Switzerland. This assessment is supported by the experience gained in other countries. Most European central banks are already using repos as their chief monetary policy instrument today. Repurchase agreements will also play a prominent part at the European Central Bank.