

July 25, 1997

## **General Collateral Finance (GCF) Repo**

### **Service Summary**

At the request of the Repo Implementation Committee, and in conjunction with the Bank of New York and Chase Manhattan Bank, GSCC has designed a new repo service that will allow our dealer members to freely and actively trade general collateral repos without requiring intraday, trade-for-trade settlement on a DVP basis.

The new service, called the General Collateral Finance (GCF) Repo service, will enable dealers to execute general collateral repos, based on rate and term, throughout the day via eligible brokers. Standardized, generic CUSIPs will be used to specify the acceptable type of underlying collateral. Brokers will submit these repos to GSCC as soon as possible after trade execution and prior to a specified cutoff time. GSCC will guarantee the settlement of GCF Repos upon receipt, and will conduct an afternoon net after the close of the securities Fedwire exclusively for GCF Repo activity, establishing a single net receive or deliver position for dealer members in each generic CUSIP.

The new GCF Repo service will enhance our members' ability to trade general collateral repos by removing the current constraints on collateral notification and allocation, and by ensuring market liquidity across clearing banks. Further, because members will settle on a net basis after the close of the securities Fedwire, they will incur fewer Fedwire charges.

Through netting and novation, GSCC will become the legal counterparty to all GCF repos, thereby eliminating counterparty risk and providing improved balance sheet usage to our members under FIN 41.

GSCC's Repo Implementation Committee has determined that a single generic CUSIP could be used for all general collateral repos backed by U.S. Treasury securities. The service will also encompass mortgage-backed securities; however, the Committee has not yet reviewed the generic CUSIP requirements for these securities.

GSCC is currently working with a sub-committee of the Repo Implementation Committee to further refine business requirements and resolve outstanding issues

for GCF Repo processing. In addition, GSCC will work with the Trading Practices Division of the PSA Funding Division on all relevant issues.

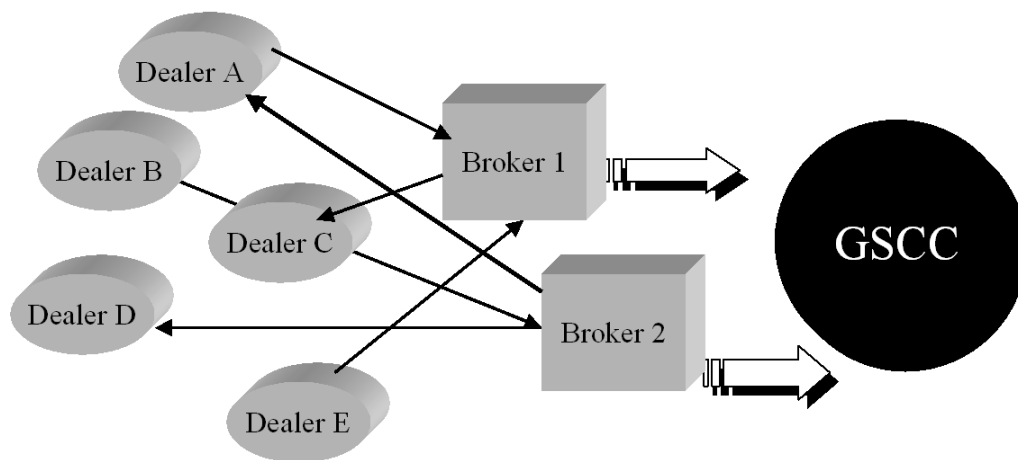
As always, GSCC is interested in the opinions and comments of our members and other industry entities on this initiative. Contact information is included at the end of this bulletin. We will keep you apprised of our progress as we move forward in developing this service.

The remainder of this bulletin provides a processing overview of the new GCF Repo service.

### **Submission and Recording of GCF Repos**

Using the network of eligible brokers, GSCC dealer members will execute GCF Repos throughout the day. Brokers will only execute GCF Repos between dealers that have an existing clearing arrangement with one of GSCC's two clearing banks: the Bank of New York or Chase Manhattan Bank.

Broker-Assisted Processing will replace the traditional matched comparison process for GCF Repos. That means that both the repo and reverse sides of the transaction will be processed based upon broker input, without requiring the submission and matching of corresponding trade details from the dealer members, as illustrated below.



By using input from a single, approved submission source (i.e., the brokers) to process the GCF Repos, the intrinsic limitations and processing delays associated with two-sided comparison are avoided. This is especially important in order to effectively net each dealer's GCF Repo activity in the afternoon, much earlier than netting is currently performed for regular buy/sell and repo activity.

Brokers should submit GCF Repos to GSCC throughout the day as the trades occur using screen-based or multibatch electronic input.

Because the specific collateral for the repo is not determined at the point of trade, members will submit all GCF Repos to GSCC using generic general collateral CUSIPs that denote the underlying product. For example, one generic CUSIP could be used to denote all U.S. Treasury securities, another generic CUSIP(s) could be used to denote mortgage-backed securities, and so forth.

GSCC will establish a submission cutoff time for transactions to be included in the current day's processing. The cutoff time must be after the close of the securities Fedwire, but prior to the close of the funds Fedwire. GSCC is therefore contemplating a 3:00 p.m. cutoff time. This will provide GSCC with sufficient time to capture, net, and report on GCF Repos and make a single funds movement between the two clearing banks prior to the close of the funds Fedwire.

Transactions submitted after the cutoff will not be eligible for intraday net settlement; however, next-day and forward settling activity will be captured for GSCC's overnight processing cycle.

### **Guarantee of GCF Repos**

GSCC's settlement guarantee for GCF repos will go into effect as soon as GSCC receives and processes trade data submitted by brokers. That means that GSCC will become the legal counterparty to all GCF repos, thereby eliminating our netting dealer members' counterparty risk and providing improved balance sheet usage for members under FIN 41. (Note: A preliminary review by Price Waterhouse of the concepts set forth in this document suggests that GCF Repo processing, as proposed, seems to meet FIN 41 requirements.)

### **Netting GCF Repos**

GSCC will net all of the GCF Repos intra-day for each dealer into a single net settlement position per generic general collateral CUSIP submitted. (Upon initial implementation there may be only one generic CUSIP.) This position represents

the aggregate net dollar amount borrowed by the repo dealer or loaned by the reverse dealer.

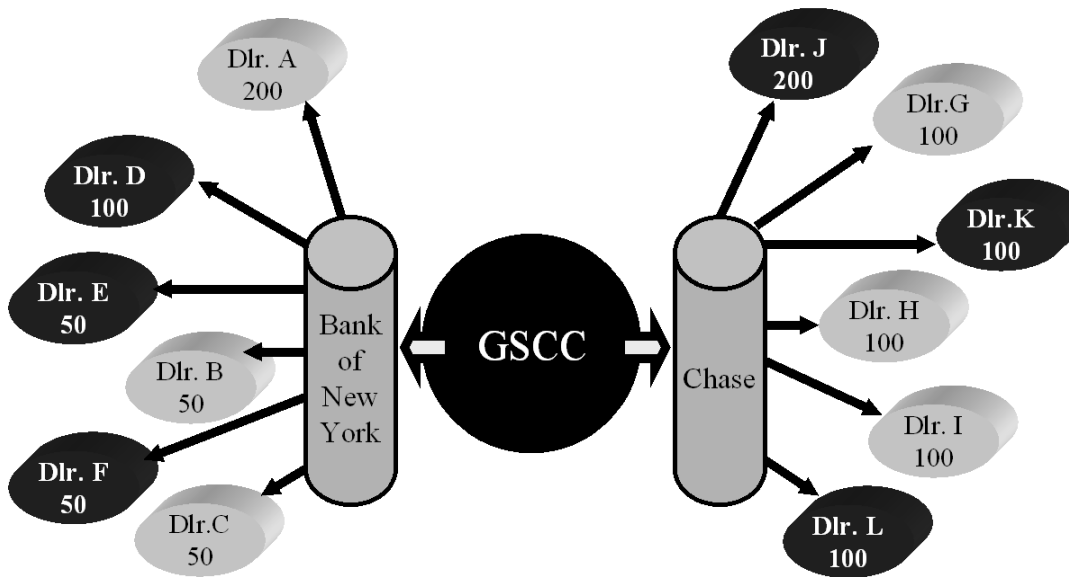
GCF Repo netting will consist of adding all of the carryover activity for term GCF Repos together with the current day's activity (i.e., positions associated with term repos would be re-netted each day with the dealer's current activity).

$$\text{GCF Repo Net Position} = \text{Carryover Activity} + \text{Current Day's Activity}$$

GSCC will be responsible for maintaining a database of the financial data for the repos, for monitoring the terms and end dates of repos carried on its books, and for insuring the appropriate interest is passed from the repo dealers to the reverse dealers.

GSCC will provide netting results to the clearing banks and our netting dealer members. Clearing banks will be responsible for notifying their members regarding the settlement of GCF Repo positions, and for making all money and securities movements.

The figure below provides an example of how netting results will be communicated to dealer members. The example, with simplified netting results to illustrate the fundamental concepts, is further expanded in the next section of this document, entitled "Funds and Securities Transfer."



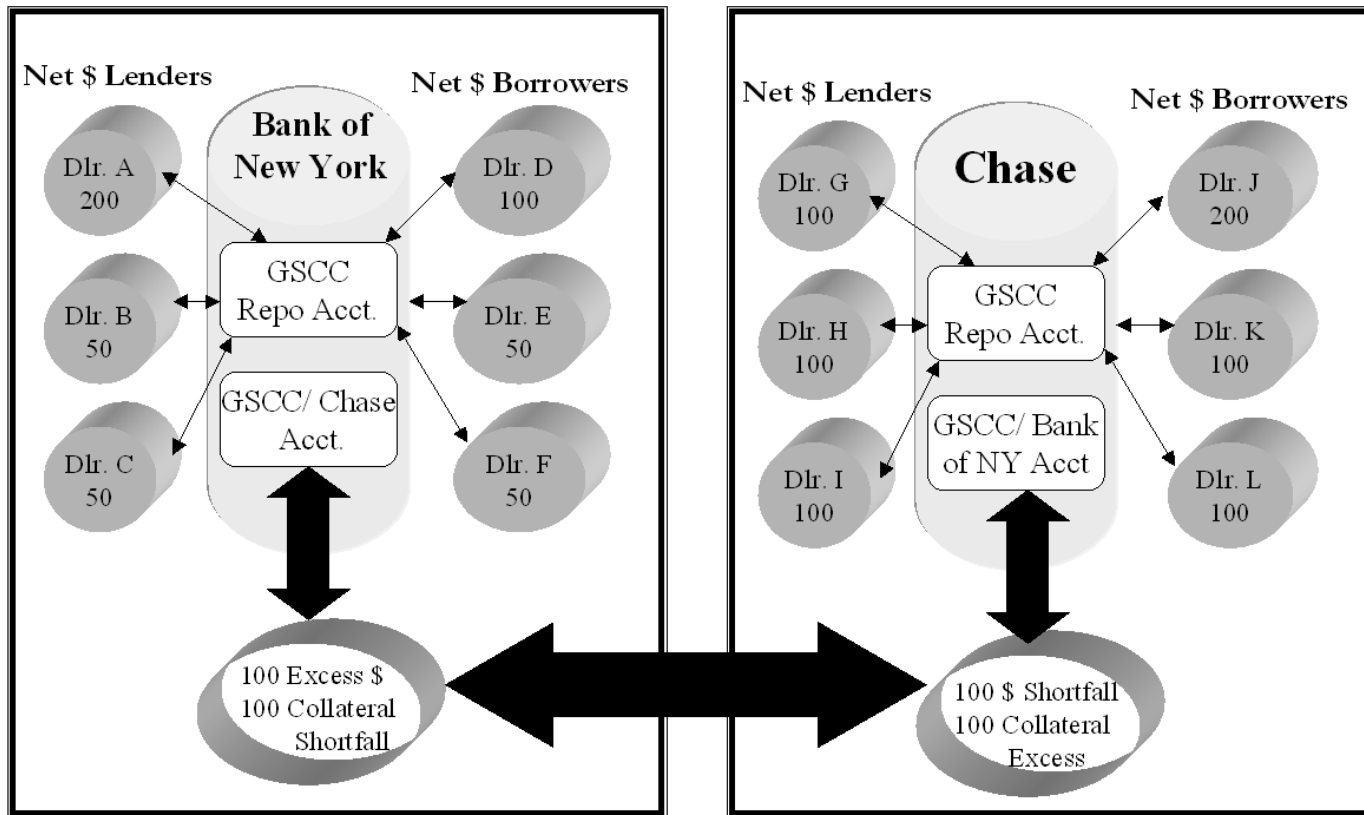
(Note: The dealers in the darker-shaded ovals are the net borrowers, while the dealers in the lighter-shaded ovals are the net lenders.)

Net GCF Repo positions will be included in GSCC's Clearing Fund margin calculations, and a daily mark-to-market for the repo rate will be performed each day for forward-settling and term GCF Repos.

### Funds and Securities Transfer

Because some dealers clear at the Bank of New York, while other dealers clear at Chase, the net borrow (repo) and loan (reverse) positions will most likely not balance within clearing banks. However, the total net borrow amount will equal the total net loan amount across the clearing banks.

The figure below illustrates this concept.



Dealers A – F have clearance arrangements with the Bank of New York, while Dealers G – L have clearance arrangements through Chase Manhattan Bank.

Throughout the day, all twelve dealers would trade with one another indirectly through eligible brokers. For this example, the dealers would have the net positions shown above after netting.

As shown in the figure, the sum of the net loan (reverse) positions at the Bank of New York is \$300 million, while the sum of the net borrow (repo) positions is only \$200 million. Once all possible deliveries are made internally, the Bank of New York has a remaining \$100 million in excess dollars to loan, and requires an additional \$100 million in securities as collateral (i.e., positions move flat).

Conversely, at Chase, the net borrow (repo) position is \$400 million, while the net loan (reverse) position is \$300 million. Therefore, after all possible deliveries are made internally, Chase has remaining collateral valued at \$100 million, but requires an additional \$100 million in cash to meet its borrowing requirements.

The Bank of New York would therefore send the additional \$100 million in cash over the funds Fedwire to Chase through a GSCC account. Chase would simultaneously deliver the \$100 million in excess securities to a joint GSCC/Bank of New York account established at Chase exclusively for this purpose.

The next day, the clearing banks would return collateral to the appropriate parties (i.e., the repo dealers and the other clearing bank). The clearing banks would also return the money borrowed, plus the repo interest, to the appropriate parties (i.e., the reverse dealers and the other clearing bank). These cash and security movements would also be processed through the GSCC account at the Clearing Bank.

### **Open Issues**

GSCC and the Repo Implementation Committee are currently reviewing a number of open issues related to GCF Repo processing. Some of the issues being reviewed are listed below (i.e., this is not intended to be a comprehensive list).

1. The need to establish standardized pricing between the two clearing banks.
2. The review of the clearing banks' existing tri-party agreements to ensure consistency with this process.
3. The assessment of the impact of GCF Repo service implementation on those dealers that do not currently clear at one of GSCC's two clearing banks.
4. The development of an alternative method for trade capture and comparison if GCF Repo processing services are required in a dealer-to-dealer market.
5. The provision of preliminary net positions for GCF Repo activity to dealer members one half hour prior to the submission cutoff to allow for adjustments.
6. The review of appropriate cutoff times.
7. The determination of the appropriate CUSIP breakdown for mortgage-backed securities.
8. The potential incorporation of other Federal Reserve Bank eligible book-entry securities into this service.

### **Contact Information**

#### Operations Issues:

Joe Grima, Managing Director

(212) 412-8566

Legal Issues:

Jeff Ingber, General Counsel and Managing Director

(212) 412-8637

Written comments should be addressed to Sandy Manata, Managing Director,  
GSCC Planning, (or sent by facsimile transmission to (212) 363-4607.)

Thomas F. Costa

Managing Director