

# A Focus on Execution

Update on U.S. Tri-Party Repo Reforms

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Earlier this year, the private sector task force sponsored by the NY Federal Reserve Bank and charged with substantial reform in the U.S. Tri-Party Repo markets was disbanded – an act that was widely covered in the media. J.P. Morgan’s Mark Trivedi, who is close to the action as the co-chair of the Operational Arrangements Working Group, provides an insider’s point of view plus a preview of upcoming milestones on J.P. Morgan’s road to reform.

*“The Task Force served its purpose really well,” says Mark Trivedi. “With the end state defined, now it’s time to channel that time and energy into execution.”*

The change in the role of the Task Force was by design – a fact that’s often overlooked. When the Task Force first convened in September 2009, its members focused on identifying the risks and developing recommendations. Those recommendations resulted in significant changes to the market structure last summer that cut the duration of intraday credit extended by the clearing banks by three quarters, dramatically improved the transparency of the market and set the stage for final elements of the reform agenda.

Now that all market participants have agreed on an End State and are well on the way to implementing the final set of recommendations, the governance structure to oversee execution has evolved accordingly. The need for a Task Force comprised of dozens of market participants has diminished. Rather, the time is better spent on execution.

In this systemically important market, it’s critical to make the right changes and implement them well and in a thoughtful manner in order to avoid market disruption. As each of the clearing banks has its own path to achieving the Phase Two Target End State, and dealers and cash investors face substantial operational challenges, the NY Federal Reserve Bank has assumed a larger role in monitoring execution and providing governance and oversight.

## Execution – J.P. Morgan’s key focus for 2012 and 2013

We continue to pursue our own aggressive development agenda, building on the accomplishments of the last two years to finalize the remaining improvements to achieve the Phase Two Target End State before year-end 2013.

Specifically, that means the practical elimination of intraday credit extended by the clearing banks, and the removal of term and non maturing open trades from the daily unwind. Key building blocks were introduced in 2011, including J.P. Morgan’s award-winning Auto

## 7 milestones on J.P. Morgan’s Road to Reform

According to Michael Albanese, Global Head of Clearance, the following steps are needed to achieve the Phase Two Target End State:

1. Eliminate non-maturing trades from the daily unwind. Currently, these account for about 40% of each day’s activity. In the new market model, they will not unwind.
2. Change the operating model to accommodate a newly-created settlement batch process that expedites the return of cash for maturing trades.
3. Allow algorithmic settlement, with a clear and unambiguous process based on collateral type that is transparent to all market participants.
4. Streamline the optimization and allocation algorithm to expedite the settlement process.
5. Allow for simultaneous exchange of cash and collateral, in an ‘operational moment in time’ that keeps transactions fully collateralized.
6. Adjust the unwind for GCF collateral, postponing it to 3:30 p.m. to synch up with unwinding transactions.
7. Introduce J.P. Morgan’s secure committed clearance advance facility, as the final step of the target state, to facilitate repo maturation on fully transparent terms.

Substitution product; new technology that supported three-way trade confirmation; and new reporting that provided greater transparency to cash investors. In a series of shifts that resulted in the gradual delay of the daily unwind from early morning to late afternoon, the duration of intraday credit was trimmed from a full business day to 1 ½ - 2 ½ hours. While the amount of credit extended was not reduced, the shortened tenor has dramatically reduced that exposure.

#### Getting it Done by ‘Doing it Right’

To reach the end state by year end 2013 requires a concerted effort from all parties, notes Jason Paltrowitz, Americas Markets Executive for Banks and Broker Dealers at J.P. Morgan. “Market participants will experience additional, significant changes to current operating models,” he comments. “Collectively, we’ve already made substantial changes to a decades-old market that is worth trillions of dollars each day, is crucial to maintaining market stability, and is an important financing mechanism for the industry.”

Last year, hundreds of market participants modified the way they operate, and more transformation is on the way. It’s important to carefully assess and identify the impact of these reforms, to coordinate change, and take the time to “do it right” to ensure there are no unintended consequences, Paltrowitz says. “We’ve achieved a great deal in a very compressed timeframe without causing any negative impact to the market. The steps taken to date have laid the foundation for upcoming initiatives, and we will take the same careful approach and work closely with all our clients to achieve the Phase Two Target End State.” By year-end 2013, J.P. Morgan will have achieved that goal – credit risk to the clearing bank will be limited and, overall, risk will be more appropriately aligned between the counterparties. ■

*“By year-end 2013, J.P. Morgan will have achieved the Phase Two Target End State,” says Jason Paltrowitz.*

For the most up-to-date information on J.P. Morgan’s approach to U.S. Tri-Party Repo Market Reform, visit [www.jpmorgan.com/visit/US\\_TPR\\_Reforms](http://www.jpmorgan.com/visit/US_TPR_Reforms)

#### Recent Awards

- J.P. Morgan was named Broker / Dealer Custody & Clearing Provider of the Year by Custody Risk Americas (2012)
- J.P. Morgan Auto Substitution was named Best Clearing and Settlement Initiative by *FTF Technology News* (2012), and was Highly Rated for Innovation in Clearing and Settlement Technology in *The Banker’s Innovation in Banking Technology Awards* (2011)
- J.P. Morgan received the #1 ranking in the Americas in the annual *Global Investor/ISF* Tri-Party Repo Survey (2012) based on client feedback
- J.P. Morgan received more Top Rated and Best in Class Awards in the *Global Custodian* Tri-Party Repo Survey than any other collateral agent (2012). The survey highlighted the firm’s “leadership in [U.S.] tri-party reform”, with particular mention of operational innovations such as securities-for-securities Auto Substitution and the three-way trade matching engine

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