International
Capital
Market
Association

ICMA

EUROPEAN REPO COMMITTEE

For the information of repo market participants

Harmonisation of GMRA mini close-out provisions and ICMA buy-in rules

At its meeting on November 9, 2007, the European Repo Council resolved to amend the Repo Trading Practice Guidelines of August 20, 2003, promulgated by the ERC so as to align differences between the timing of the mini close-out provisions contained in paragraphs 10(g) and (h) of the GMRA (2000 version), and the buy-in rules contained in Section 450 of ICMA's Rules and Recommendations and also to require the seller to accept a partial delivery in a mini close-out situation.

In order to address these issues the revised Repo Trading Practices Guidelines recommend that parties should agree the following:

- the seller should serve a notice by 10 a.m. London time on the date of the fail notifying the buyer that if the buyer has not delivered equivalent securities by noon London time it will serve a mini close-out notice on that day; and
- the seller must accept a partial delivery of the relevant securities.

The amended version of the Repo Trading Practice Guidelines will be published on ICMA's website in due course.

An explanatory note by external counsel is attached.

Godfried De Vidts
Chairman European Repo Committee and Council

INTERNATIONAL CAPITAL MARKET ASSOCIATION

HARMONISATION OF GMRA MINI CLOSE-OUT PROVISIONS AND ICMA BUY-IN RULES

1. INTRODUCTION

1.1 The ERC has identified that in some circumstances the interaction between the mini close-out provisions contained in paragraphs 10(g) and (h) of the Global Master Repurchase Agreement (2000 version) (the ***GMRA***), which apply to repo transactions and are referred to in this note as the ***mini close-out provisions***, and the buy-in provisions contained in Section 450 of ICMA's rules and recommendations, which apply to cash transactions and are referred to in this note as the ***buy-in rules***, results in discrepancies in timing and valuation which can result in differences in the amount recoverable under each provision. These discrepancies have a particular impact in transactions involving high yield, emerging market and other illiquid securities.

1.2 Where the repo seller fails to deliver purchased securities on the purchase date, the seller is required to pay to the buyer an amount equal to accrued repo interest but is not required to compensate the buyer for any increase in value of the purchased securities.

1.3 Where the repo buyer fails to deliver equivalent securities on the repurchase date, the provisions operate as follows –

Day	**Buy-in rules**	**Mini close-out**
Date of fail (F)	Serve buy-in pre-advice notice by 10 a.m. London time[1]	Serve notice that will close out if fail not settled within 24 hours[2].
F+1		Serve mini close-out notice (no time limit)
F+2	Serve buy-in notice by 10 a.m. London time	
F+5	Buy-in agent appointed and buy-in executed. Buy-in agent purchases bonds in the "best available market for guaranteed delivery"	
F+6		Default Valuation Time. Securities valued on the basis of purchase in the market, dealer quotes or determination of fair market value at any time up to the default valuation time, or a combination of the three.

1 If the notice is served after this time, it is deemed to take effect on the following day which would extend the process.

2 This is not required by the GMRA but is a recommendation from the ERC.

1.4 There are four situations where the interaction of the mini close-out provisions and the buy-in rules is relevant –

(a) where the seller fails to deliver purchased securities on the purchase date as a result of a fail on a cash trade;

(b) where the failure by the seller to deliver purchased securities on the purchase date causes the buyer to fail on a cash trade;

(c) where the buyer fails to deliver equivalent securities on the repurchase date as a result of a fail on a cash trade;

(d) where failure by the buyer to deliver equivalent securities on the repurchase date causes the seller to fail on a cash trade.

1.5 The interaction is also relevant where participants are in a chain of transactions which involves repo and cash transactions.

2. THE DIFFERENCES

2.1 The potential differences between the two procedures arise as follows.

(a) Under the GMRA, the buyer has no right to receive any compensation for an increase in value in the purchased securities if the seller fails on the purchase date, while under the buy-in rules the buyer is entitled to receive the difference between the price at which the buy-in is executed and the original purchase price.

(b) Under the GMRA, the seller can close out the transaction as soon as the fail occurs on the repurchase date and is not required to serve a notice warning the buyer that it intends to close out the transaction (although the ERC has issued a recommendation that the seller gives one business day's notice of its intention to serve a mini close-out notice). If the seller does not close out the transaction immediately but serves a warning notice, the mini close-out process may take one business day longer than the buy-in process.

(c) Under the buy-in rules, the amount payable by the defaulting party is the difference between the price at which the buy-in is executed and the original purchase price. The buy-in contract is executed on the fifth business day after the fail. Under the mini close-out provisions, the seller may value the securities at any time between the close-out and the default valuation time, which is usually five business days after the close-out. The seller may value the securities by using the price at which it purchases the securities in the market, dealer quotes or determination of fair market value, or a combination of the three. Accordingly, depending on how and when the seller determines the default market value of the securities, there may be a discrepancy between the buy-in price and the default market value.

(d) Under the buy-in rules, a non-defaulting party is required to accept a partial delivery of securities. Under the mini close-out provisions, it is not.

2.2 Although the buy-in rules and the mini close-out procedures are capable of operating consistently where the failure occurs on the repurchase date of a repo, the differences explained above mean that it is not possible to guarantee that they will always do so.

2.3 Where the party who is subject to a buy-in on the cash trade is the non-defaulting party under the repo transaction, it can invoke and control the mini close-out procedures. In principle, therefore, it can ensure that it times the notices and determines the default market value of the securities to coincide with the buy-in that is exercised against it.

2.4 Where the party who can exercise a buy-in on the cash trade is the defaulting party under the repo, it cannot control the mini close-out process and therefore there is a risk that the differences outlined in paragraph 2.1(c) above will arise and cause a difference in timing and valuation.

3. THE SOLUTION

3.1 In order to prevent the risk of some of these differences arising in practice, the ERC has resolved that the Repo Trading Practice Guidelines promulgated by the ERC should be amended so as to align the timing of the mini close-out provisions and the buy-in rules and to require the seller to accept a partial delivery in a mini close-out situation.

3.2 This means that the parties should agree the following –

(a) the seller should serve a notice by 10 a.m. London time on the date of the fail notifying the buyer that it the buyer has not delivered equivalent securities by noon London time it will serve a mini close-out notice on that day; and

(b) the seller must accept a partial delivery of the relevant securities.

Freshfields Bruckhaus Deringer
(MIR)
7th January 2008