

CAPITAL MARKETS
UNITED STATES

Repo market needs clearing certainty

Protocols pioneered for swaps could address challenges presented by the US Treasury clearing mandate



The final phase of the new central clearing requirement by the Securities and Exchange Commission (SEC), introduced in December 2023, is set to have a profound impact on the US Treasury market.

While the initial phases of the mandate, beginning in March 2025 and culminating in December 2025, have focused on US Treasury cash clearing, some of the most significant changes are anticipated during the final mandate period for repo transactions, set to take effect June 30 2026. This phase, focused on enhancing efficiency and transparency in repo transactions, raises important questions about the future of institutional trading in this sector by introducing massive changes to the **\$4.5 trillion** repurchase and reverse repurchase (repo) market, potentially presenting an even more challenging scenario.

Under the new rule, all repo trades, which are collateralised by US Treasury securities – except those between state and local governments and other clearing organisations – will need to be submitted for central clearing after the trade is executed. That's a major change for a market that has historically been relationship-driven, low margin and largely uncleared.

The size and complexity of the repo market, combined with its relatively short-term nature, present unique challenges that are expected to make central clearing

difficult in this space. However, history offers a potential solution: the **electronic pre-trade credit check**. This innovation, pioneered by Tradeweb, played a key role in the successful implementation of central clearing in the post-Dodd-Frank swaps market following the 2008 financial crisis and could similarly help address the challenges facing the repo market today.

Unique challenges

With trillions traded each day, typically over a period of just a few hours and often conducted as part of much larger portfolio trades with very little visibility into individual line items, the repo market has been a go-to source for immediate liquidity for decades. By introducing a clearing mandate, an important part of that value equation -- which is the ability to cost-effectively deploy capital using Treasury holdings as collateral -- will become significantly more complicated.

As the rule is currently written, come June 2026, third-party clearinghouses will extend their reach into that equation, requiring more dealers across more trades, and potentially, more clearinghouses, to put up capital as collateral to ensure that the clearing party is covered on the repo trade. Depending on the clearing model chosen, however, dealers could struggle to allocate balance sheet in a commercially sensible way to support that type of trading at scale.

Currently, the specifics of the individual clearinghouse and netting models that will be used for repo trades are still unknown. The Fixed Income Clearing Corporation (FICC), which currently handles the lion's share of US Treasury clearing, supports a sponsored access model, whereby members bundle clearing and execution with the sponsoring bank or dealer in what is colloquially called a "done with" trade. However, FICC is also reportedly exploring an alternative model, which is based on an agency clearing model, whereby buy-side firms trade with an executing broker who underwrites the client's exposure to

the clearinghouse, similar to the **models proposed by CME Group and ICE**. This approach, which is widely used in derivatives markets, is commonly referred to as "done away" trading. LCH has yet to propose its strategy at this stage. Wherever the clearing houses land, it is safe to assume that any incremental capital required will be challenging under current constructs.

In fact, many market participants have already started to raise caution around the challenges central clearing will create, with some suggesting that it will introduce a **concentration of risk**. Meanwhile, others are projecting that the move will **modernise the repo market**, making it more efficient. However, the jury is still out on how exactly a centrally cleared repo market will work.

Introducing a Pre-trade Credit Check

As mentioned above, one potential solution that would work particularly smoothly in the agency clearing model involves taking a page from the clearing mandates introduced in the post Dodd-Frank swaps market, where the concerns were very similar. Market participants at the time believed that mandated central clearing would crush liquidity, cause an untenable buildup of risk at the clearinghouses and increase trading costs.

These worst-case scenarios, of course, did not materialise.

Instead, electronic derivatives trading volumes actually grew following the mandates. From 2012 to 2015, electronic swaps volumes on the Tradeweb platform grew substantially, reaching more than \$5.49 trillion in notional volume by 2015. This growth continued in the years to come; in 2023, electronic swaps volumes on the Tradeweb platform reached \$63 trillion in notional volume, an increase of 74% year-over-year.

A big part of that had to do with operational adjustments made behind the scenes, which ended up improving workflows and streamlining the trading

process. One important innovation that helped make that possible was the electronic pre-trade credit check, which acted as a sort of litmus test for good swaps transactions.

Here's how it works. Before a swaps trade is initiated, both parties to the trade and the clearinghouse assure that the trade will clear through a futures commission merchant (FCM). In a centrally cleared environment, institutional investors need a clearing member to extend credit in order for their trade to clear. There are several paths to achieving this certainty of clearing, all of which require some type of pre-trade credit check to ensure that clearing members will extend sufficient credit. This pre-trade credit-check procedure can occur at the clearinghouse, through an industry vendor or hub, or at a swap execution facility (SEF), where the trades are actually executed.

Innovation is key

The pre-trade credit check capability, for which Tradeweb was awarded a **U.S. Patent in 2017**, made it possible for dealers to bring a third-party clearing member into the mix, with guarantees that the trade will be covered, but without necessarily putting up all of the collateral themselves. Ultimately, the workflow follows the same underlying logic as a traditional repo trade, but by introducing a system of automated checks and balances into the process, it meets the risk management challenges posed by the regulation without compromising speed and liquidity.

While there are still several months of planning ahead for repo market participants, trading venues and clearinghouses, it is important to start working now on solutions that can address the specialised challenges associated with this new set of requirements.



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