

# Best Practices - Intraday and Overnight Tri-party Dealer Financing

Issue	Questions	Points for Discussion
<b>Limits</b>	Should dealer financing be limited? How? Who should set limits?	Aggregate dealer repo financing via clearing banks, as well as mix between liquid and less liquid collateral, should be subject to limitations based on each dealer's capital base and funding profile (short term vs. long term funding). Limits should be set by regulators as part of dealer leverage restrictions. Clearing banks should limit intraday financing risk by increasing margin based on volume. Regulators, clearing banks, dealers and investors should cooperate to determine aggregate level of financing via tri-party repos.
<b>Margin</b>	How should the margin be set? Who should set margin requirements? Should the margin be established against assets at a more granular level? What volatility standards and liquidation timeframe should be used to calculate the margin? Should a floor on margin be established?	Margin should be proportional to the risk of the collateral. Dealer financing (intraday and overnight financing by clearing banks and overnight repo financing by tri-party investors) should be sufficiently margined to cover the potential price decline of securities held as collateral during their expected liquidation time. Margin should be applied to collateral types at a level granular enough to distinguish their risk, taking into account the price volatility and the liquidity of each security. Regulators should work with the industry to set standards for margining with one option to consider a margin floor.
<b>Collateral Eligibility</b>	Which types of collateral should be accepted? Who should define collateral eligibility? How? Should minimum concentration or diversification standards be set?	Collateral eligibility should be based on careful analysis conducted by both tri-party investors and clearing banks of the quality and liquidity of securities being pledged to them by dealers. Acceptable collateral should be defined along with appropriate margin requirements. Maximum concentration and minimum diversification standards should be set by tri-party investors and clearing banks. The Fed discount window's collateral eligibility, based on security types, ratings, and maturities, should be considered as a guideline for tri-party repo collateral eligibility.
<b>Collateral Valuation</b>	How should collateral be valued or priced? How should the valuation for illiquid/not traded securities be handled? Should there be pricing methodology flags indicating how prices are set?	Collateral valuation should be transparent and reliable. Clearing banks and investors should know and be satisfied with the reliability of the sources used to price collateral, whether based on bids/quotes from market participants or pricing models, or sourced by vendors or by multiple or single dealers. Pricing methodology flags should be used to indicate how price was set. Consideration should be given for adjusting margins to take into account the source and methodology used to derive security prices. Securities that are not traded should not be assigned any collateral value.

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<b>Risk Reduction</b>	How can the risk faced by clearing banks on intraday and overnight repo financing be reduced? Can the daily unwind and intraday risk be avoided? How?	Dealers should inform clearing banks as early as possible if they are unable to arrange sufficient end of day repo financing from investors and anticipate the need for overnight financing from the clearing bank so that the clearing bank knows earlier what may happen at the end of the day, including how much overnight financing it may need to provide if the dealer cannot find additional repo financing or another source of funds. Daily repo unwinds and resulting intraday financing by clearing banks can be avoided if clearing banks allow intraday DVP collateral substitutions required by dealers and end of day DVP settlement of tri-party repos between investors and dealers only at final maturity. This requires a significant change in the tri-party industry model and could only happen if there are incentives encouraging term repos.
<b>Tracking/Monitoring</b>	Should dealer intraday financing risk be tracked and monitored? How?	Intraday financing, collateral (at an appropriate level of detail), and margin should be tracked and reported real-time by clearing banks' systems.
<b>Contingency Funding</b>	Should dealers have a plan to cope with a reduction in investor overnight financing? Should dealers have a plan to cope with systems and other disruptions? Should clearing banks have a plan to cope with increased overnight repos?	Dealer contingency funding plans are critical. Alternate sources of dealer liquidity should be available to cover reductions in repo investor funding. Dealer capabilities to cover outages must be robust and tested. Clearing banks should have a plan to cover liquidity needs if they need to replace tri-party investors providing overnight repo financing. The Fed primary dealer secured credit facility implemented in mid-March has played a critical role in reducing dealers' funding/liquidity risk.
<b>Fed Role</b>	What role should the Fed play? How can best practices be adopted across the market?	The Fed should continue playing a key role as a liquidity provider. The Fed should be an active participant in the process to set new market standards and guidelines that are critical to implement these best practices across all market participants.