MAYER | BROWN

CAPITAL MARKETS KNOW HOW SERIES:

CURRENT TRENDS IN REPO TRANSACTIONS

Structured Repos, Collateralised Repos, Combo Note Structures and Green Repos

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AGENDA

01

CURRENT DEVELOPMENTS

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- Clearing for repos of US Treasuries coming into effect by 30 June 2026
- Digital Asset Annex to the 2011 GMRA published on 19 August 2024
- New German Master Agreement for Repurchase published in 2022
- Growing popularity of Green Repos
- Bilateral and triparty repo transactions using DLT
- Cash settlement with central bank money, e.g. via the Bundesbank's Trigger Solution (see next slide)

CURRENT DEVELOPMENTS (CONT.)

Experiment: Digital bilateral intraday repo transactions

On 22 November 2024, DekaBank and NatWest Markets N.V., together with their technology partner SWIAT, tested the conduct of bilateral intraday repo transactions using the Bundesbank's Trigger Solution for the cash settlement. Concretely, two scenarios were considered: As part of a first simulation, a traditionally issued security was on-ramped to SWIAT's blockchain infrastructure in order to be able to use it in a digitalised form for the repo transaction. In a second simulation, a native digital security was used for the repo transaction. In both cases, DekaBank assumed the role of the market DLT operator and acted as a collateral giver in the repo transaction. NatWest Markets acted as collateral taker in both scenarios. The front and term legs of the repos were executed on the SWIAT blockchain network with same-day settlement. The Trigger Solution was used to initiate the cash bookings on the RTGS accounts of both banks in the T2 UTEST, the test environment of the payment system TARGET.

- Further information on the Trigger Solution can be obtained from the Deutsche Bundesbank's website: https://www.bundesbank.de/en/tasks/payment-systems/trigger-solution/conducted-trials-and-experiments-with-the-trigger-solution-918546

02

OVERVIEW OF STRUCTURED REPOS

OVERVIEW OF STRUCTURED REPOS

- A structured repo is a generic term for a repo transaction which is not standard typically with respect to its term (i.e. greater than 3 months) or in relation to the Purchased Securities that are the subject of the repo (i.e. these may be for esoteric or illiquid assets)
- ICMA published the Master Confirmation Annex on 14 December 2023 which provides a set of standardized terms and confirmations for us with certain non-standard repo trades such as evergreens and extendibles
- For other structured repos, e.g. in respect of esoteric or illiquid assets, these will require bespoke amendments to the terms of the standard repo documentation

ANATOMY OF THE GMRA

- The following are certain key provisions of the GMRA which often need to be amended when dealing with illiquid assets or bespoke financing arrangements:
  - Purchase and Repurchase
  - Price Differential
  - Margining
  - Income payments
  - Voting rights and corporate actions
  - Events of Default and Early Termination mechanics

03

COLLATERALISED REPO / COMBO NOTE

STRUCTURE OF TRANSACTIONS – OVERVIEW

- Seller under the Repo transaction issues own notes (e.g. under its MTN Programme) and retains the notes for the purposes of the Repo transaction (the “Retained Note”)
- Retained Notes are the Purchased Securities under the Repo transaction
- Buyer under the Repo transaction faces correlated credit risk of Seller under the Repo transaction and under the Purchased Securities (wrong-way risk)
- Wrong-way risk is addressed by an additional layer of collateral securing Seller’s obligations on the Repurchase Date under the Repo transaction (i.e. the Repurchase Price, costs and expenses)
- Margining under the Repo transaction usually refers to market value of the collateral (i.e. margin calls in case value of collateral falls below a certain threshold)

BACKGROUND – COMMERCIAL REASONING

- Use of various asset pools for funding purposes, e.g. loan claims (project financings, commercial real estate, export financings, shipping/aviation), registered bonds
- Different assets from different jurisdictions can be used as additional collateral for one transaction
- Diversification of funding sources
- Possibility for Seller to receive funding in foreign currencies
- Potential to reduce funding costs
- Liquidity effects at the Seller
- Secured financing option for the Buyer

DOCUMENTATION

- Termsheet
- Master Agreement for Repurchase Transactions (GMRA); German Master Agreement for Repos
- Confirmation
- Security Documentation; governed by the laws of jurisdiction where collateral is located
  - Account Control Agreement?
- Legal Opinions
- Valuation Schedules

KEY FEATURES IN THE CONFIRMATION – GENERAL TERMS

- Definition of Eligibility Criteria for the purchased securities
- Payment of Repurchase Price – installments vs. payment at the Repurchase Date
- Additional Early Termination Events in case of certain events relating to additional collateral/Purchased Securities?
- Calculation of Transaction Exposure – market value of Purchased Securities vs. market value of additional collateral
- Margining – separate margining for the transaction vs. margining under the Master Agreement
- Spread step-ups/spread reductions to account for certain events during the lifetime of the transaction
- Make-Whole Events

KEY FEATURES IN THE CONFIRMATION – COLLATERAL TERMS

- General approach – security terms in the confirmation vs. security terms in the security agreement
- Link to Master Agreement; how to treat defaults and ineligibility events relating to collateral
- Confirmation usually contains following provisions:
  - Eligible collateral definition
  - Basic description of Security Agreement
  - Agreed amount and valuation of collateral
  - Consequences of an invalidity event relating to collateral
- Additional terms could also be implemented in the confirmation, e.g:
  - Definition of secured obligation, security interests, enforcement event
  - Replenishment mechanism related to collateral
  - Reps/undertakings/covenants relating to collateral

PRACTICAL CONSIDERATIONS

- Retained Note structure
- New Master Agreement vs. existing Master Agreement; separation of transaction
- Long Form Confirmation
- Asset Due Diligence re. transfer/consent/confidentiality requirements
- Control over the collateral; financial collateral requirements?
- Collection Account
- Haircut and Overcollateralisation
- Replenishment structure
- Reps and warranties
- Structure of security documentation
- Consequences of defaults under the transaction or breach of security terms; enforcement vs. close out

04

GREEN REPOS

OVERVIEW

- Four possible green repo structures:
  1. Repo with green and sustainable collateral
  2. Repo between green and sustainable counterparties
  3. Repo with green and sustainable cash proceeds
  4. Sustainability-Linked (SL) Repo
- The development of a liquid repo market with sustainable collateral can encourage additional supply as repos provide an opportunity to temporarily convert those assets into cash
- A repo with green and sustainable cash proceeds injects additional funding into the sustainable finance ecosystem
- Main driver for engaging in sustainability-related repo transactions are: (i) commitment to sustainability as part of the company's broader strategy, (ii) addressing investor demand and (iii) opening-up additional financing options to support their sustainability objectives

HIGH-LEVEL CATEGORISATION OF GREEN REPO TRANSACTIONS

- ICMA has identified two broader groups of repo transactions with a sustainability element:
  1. Repos with wider sustainability considerations relating to the treatment of collateral and counterparties
  2. Specific repo products providing sustainable financing, such as sustainable "use of proceeds" repo and "sustainability-linked" repos

REPO SUPPORTING SUSTAINABLE FINANCING

Repo against sustainable collateral: A repo transaction in which buyer and seller use sustainable asset(s) as collateral for trade

Repo with sustainable counterparty: A repo transaction that considers the sustainability credentials of the counterparties to the repo transaction, i.e., counterparties that meet certain sustainability criteria

REPO PROVIDING SUSTAINABLE FINANCING

Sustainable Use of Proceeds (UoP) Repo: A repo transaction where the cash is used exclusively to finance or re-finance, in full or in part, new and/or existing eligible sustainable projects or the borrower's sustainable asset portfolio

Sustainability-Linked (SL) Repo: A repo transaction in which the financial and/or structural characteristics of the repo is linked to the seller's performance with respect to a set of predefined Sustainability Key Performance Indicators (KPIs) or Sustainability Performance Targets (SPTs)

REPO WITH SUSTAINABLE COLLATERAL

- Limited direct sustainability impact and does not represent an increase in the supply of sustainable financing
- However, indirect contribution to sustainability by these repo transactions helps channel financing and collateral through the sustainable ecosystem
- Two groups of sustainable collateral
  - Green Bonds (ICMA GBS or EU GBS)
  - Collateral based on other predefined ESG criteria, e.g. ESG ratings or internal methodologies (“sustainability- screened” collateral)
- Risks to use collateral as a green metric as there are currently no agreed marked standards for ESG ratings (ESG Ratings Regulation does not yet apply)

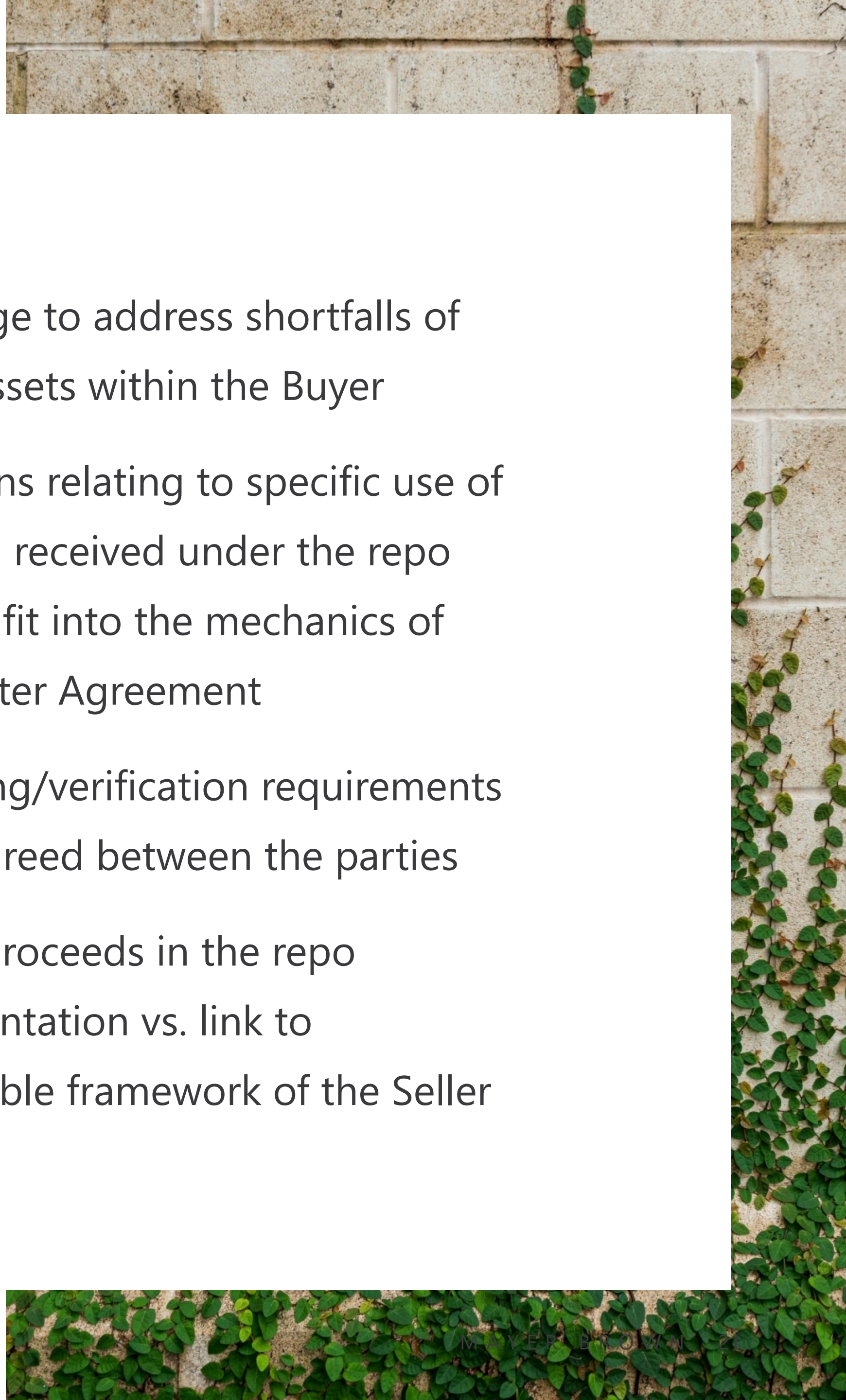
REPO WITH SUSTAINABLE COUNTERPARTIES

- Strict counterparty selection:
  - Based on external ESG ratings, but also PAI principles pursuant to SFDR may be used
  - Focus only on sustainable and ESG-aligned counterparties (“pure play”)
  - Based on internal assessment of the counterparties' ESG credentials or internal ESG rating criteria
  - Combination of above approaches
- No guarantee that proceeds are invested in sustainable activities
- Current data on ESG performance of companies not yet standardised
- CSRD, EU Taxonomy and ESG Ratings Regulation as potential solution for standardised and reliable ESG ratings and metrics

SUSTAINABLE USE OF PROCEEDS REPOS

- Cash received under the repo is exclusively used to finance or re-finance new or existing eligible projects or a sustainable asset portfolio of the Seller
- Allocation of the cash proceeds usually follow established market practices for bonds (ICMA Principles and Guidelines) and could also be used in accordance with the new EuGB
- Use of proceeds can be combined with use of sustainable collateral, exclusion of non-sustainable (brown) collateral or the DNSH principle on the securities leg
- Tenors are usually longer-term (6 months and more) to better match long-term sustainability objectives; short-term tenors may be used for bridge or opex/capex financings

- Challenge to address shortfalls of green assets within the Buyer
- Provisions relating to specific use of the cash received under the repo need to fit into the mechanics of the Master Agreement
- Reporting/verification requirements to be agreed between the parties
- Use of proceeds in the repo documentation vs. link to sustainable framework of the Seller



SUSTAINABILITY-LINKED REPO

- In this kind of transaction the repo rate is linked to the Seller’s performance based on a set of predefined Sustainability Key Performance Indicators (KPIs) or Sustainability Performance Targets (SPTs)
- SLB Principles provide a good starting point on transparency, selection, verification and reporting of KPIs/SPTs; KPIs should be meaningful and measurable
- Level of discount/penalty on the repo rate is important to demonstrate a robust incentive for the Buyer to adhere to agreed KPIs/SPTs (currently limited guidance in this respect)
- Longer terms (above 1 year) preferable to achieve progress on the sustainability goals
- Potential adjustments of the repo rate must be appropriately reflected in the documentation
- KPI in repo transactions should be consistent with KPIs used for other instruments
- Use of sustainable collateral or exclusion of non-sustainable (brown) collateral?

RISKS AND CHALLENGES

- Matching short-term repo with long-term sustainable financing
- Lack of standardisation (no best practices or industry guidelines)
- Greenwashing risk; unclear ESG default scenarios and treatment
- No regulatory guidance, requirements or incentives (GAR as accelerator?)
- Limited number of ESG collateral baskets at triparty agents
- Quality and availability of data on sustainable assets
- Additional costs for management of green assets (screening, labelling, disclosure)

PRACTICAL IMPLICATIONS

- Consequences of failure to satisfy the sustainability obligations (EoD vs. early terminations event); alignment with existing mechanisms in the Master Agreement (breach of obligation)
- Provisions for substitution of sustainable collateral
- Additional undertakings
- Avoid double-counting
- Consider agreement dealing with who is entitled to claim the "green value"

A LOOK AHEAD

- Incentives through regulatory treatment and monetary policy (e.g. capital relief, favourable conditions for financing/refinancing)
- Introduction of standardised sustainable baskets by Triparty agents
- Development of green repo market best practices and industry guidelines (e.g. Green Annex to the GMRA)

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The team consists of experienced lawyers as well as young, ambitious and inquisitive talents. This also makes it clear to the clients how important it is to the partners to provide well founded training for the up and coming talent. In addition, all team members are incredibly friendly, so working together is a lot of fun, even beyond the technical side

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