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Repurchase Agreements (Repo)

Repo Definition

Paragraph 10 of International Accounting Standard 39 "Financial Instruments: Recognition and Measurement" defines *"repurchase agreement (Repo) as an agreement to transfer a financial asset to another party in exchange for cash or other consideration and a concurrent obligation to reacquire the financial asset at a future date for an amount equal to the cash or other consideration exchanged plus interest".*

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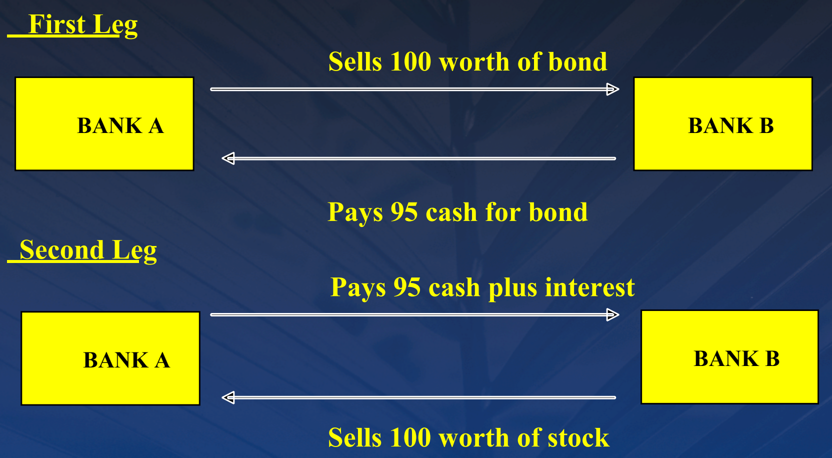
Classic Repo



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Margin

- An initial margin is given to the supplier of cash in the transaction. The market value of the collateral is reduced (or given a “haircut”) by the amount of margin when determining the value of cash lent out
- Size of the margin depends upon the credit quality of the counterparty, term of the repo, duration and quality of the collateral

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IFRS Implications (IAS 39, AG 51 (a))

- If the financial asset is sold under a repurchase agreement, it cannot be derecognised from the books as the transferor retains substantially all the risks and rewards of ownership.
- On-balance sheet: An accounting entry appears as secured loan and not as a “sell” transaction. Bonds given as collateral remain on the balance sheet; corresponding liability is repo cash (opposite for the buyer)
- Profit & loss account: Repo interest is treated as payment of interest on accrual basis.

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IFRS Implications (IAS 39, AG 51 (a))

- In the books of the borrower, the bonds will be shown as an asset and the cash received from the lender would be shown under the liability side as a “Borrowing under repurchase agreement”

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IFRS Implications for the Counterparty

In the books of the lender the bonds purchased subject to commitment to resell them at a future date are not recognised. The amount paid are recognised as deposits/loans and advances to customers/banks. These are shown as assets collateralised by security.

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Capital Adequacy Treatment - Borrower

Banking Book

- The Bank will continue to risk-weight the assets under credit risk rules.
- The amount of margin / haircut is subject to counterparty credit risk.
- Following approaches are available for the calculation of counterparty risk:
    1. Comprehensive Approach under Credit Risk Mitigation
    2. VaR Models under Credit Risk Mitigation
    3. Expected Positive Exposure under the Internal Models Methods
- Counterparty risk on different assets with the same party may be calculated on a net basis

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Capital Adequacy Treatment - Borrower

Trading Book

- General Market Risk and Specific Risk will be provided under Market Risk rules
- Counterparty risk: Same as Banking Book

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Capital Adequacy Treatment - Lender

- If the counterparty in the Repo is a Bank, it should treat the loan as a "collateralised loan" under normal rules applicable to Banking / Trading Book

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