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How do you distinguish a repurchase transaction from a buy/sell-back from a securities loan?

This is a question that has come up in discussions about the construction of the common domain models (CDM) which are supposed to provide digital representations of repo and securities lending. The question arises because a CDM is supposed to infer the nature of a transaction or instrument from its economic terms rather than having to rely on parties themselves naming what they think they have transacted.

Repurchase transaction versus buy/sell-back

The first problem is how to distinguish, at the point of execution, a repurchase transaction from a buy/sell-back. The only substantive difference between the two types of repo is what happens when income is paid on the underlying collateral. In the case of a repurchase transaction, an income payment on collateral should trigger an equivalent manufactured payment from the buyer to the seller. In the case of a buy/sell-back, there is no manufactured payment to the seller. Instead, the seller is compensated by means of a pre-agreed reduction in the repurchase price.

The problem for the repo CDM is that manufactured payments are a post-trade event, so cannot be used to infer the nature of a repo at the point of execution. One cannot point to whether the parties have signed the GMRA Buy/Sell-Back Annex as this is not an economic term and some parties trade buy/sell-backs but do not sign the Annex. Moreover, under the GMRA, repurchase transactions can be switched from manufactured payment to adjustment of the repurchase price in the event of a failure by the buyer to make a manufactured payment.

While the repurchase price of a buy/sell-back against collateral with a term over an income payment date will be lower than buy/sell-backs of the same term against similar collateral, so will the repurchase prices of specials.

One could identify future income payments from collateral data and check whether the repurchase price of a transaction has been adjusted by an amount similar to the expected income (the exact adjustment also depends on the interest rate used to compensate for the fact that the repurchase date --- when the seller gets the benefit of the income --- is later than the income payment date --- when the seller would have got the manufactured payment). But this is not an economic term and looks cumbersome.

The best solution might be to simply de-emphasise the buy/sell-back structure. The difference with repurchase transactions was significant historically, when most buy/sell-backs were undocumented, but that is no longer the case. What remains is the post-trade operational difference which does not fundamentally change the character of the transaction. Why don’t we just call everything a repo and accept that some will use manufactured payments and some will not? (This is also a solution that should be applied to SFTR as well.)

Repo versus securities lending

The next problem for CDM is created by parties either documenting repos under securities lending agreements as cash-collateralized loans (eg reverse stock loans) or documenting cash-collateralized securities lending under repo agreements.

The fundamental difference between repo and securities lending is that, while both transfer title to the securities, the former does so by means of a sale and the latter by means of a loan. This should have significant consequences where collateral fails to be delivered (a repo starts regardless but a loan would be postponed until delivery). However, this is ignored in the case of repos under securities lending agreements. The difference in practice is that the cash principal amount of a repo documented as a securities loan is not changed by margining, as it would be for true cash-collateralised securities loans (although the picture is blurred where margining is done on a net basis).

Once again, the obstacle to inferring the type of transaction is that the key difference is a post-trade event. SFT CDMs could look for a contractual term which rules out cash margin for SFTs under securities lending agreements that are cash-collateralised but that once again takes us beyond the economic terms of the transaction.

Answers on a postcard please.