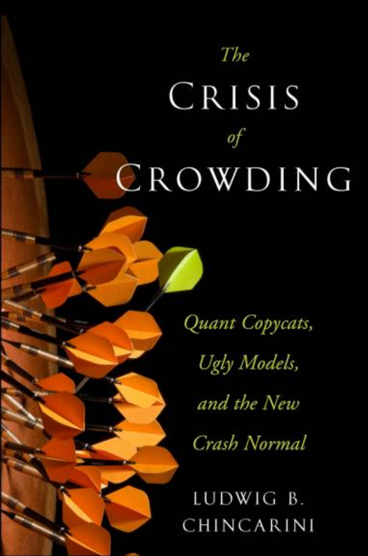

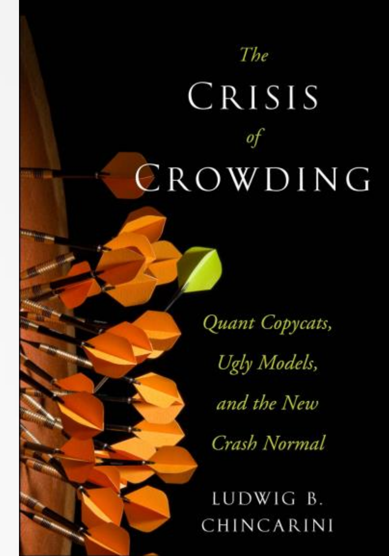

Optimal Intervention on Strategic Fails in Repo Markets

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June 27, 2021

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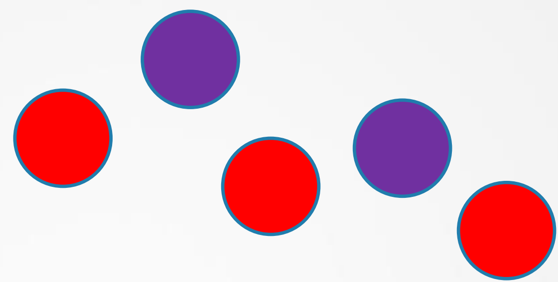
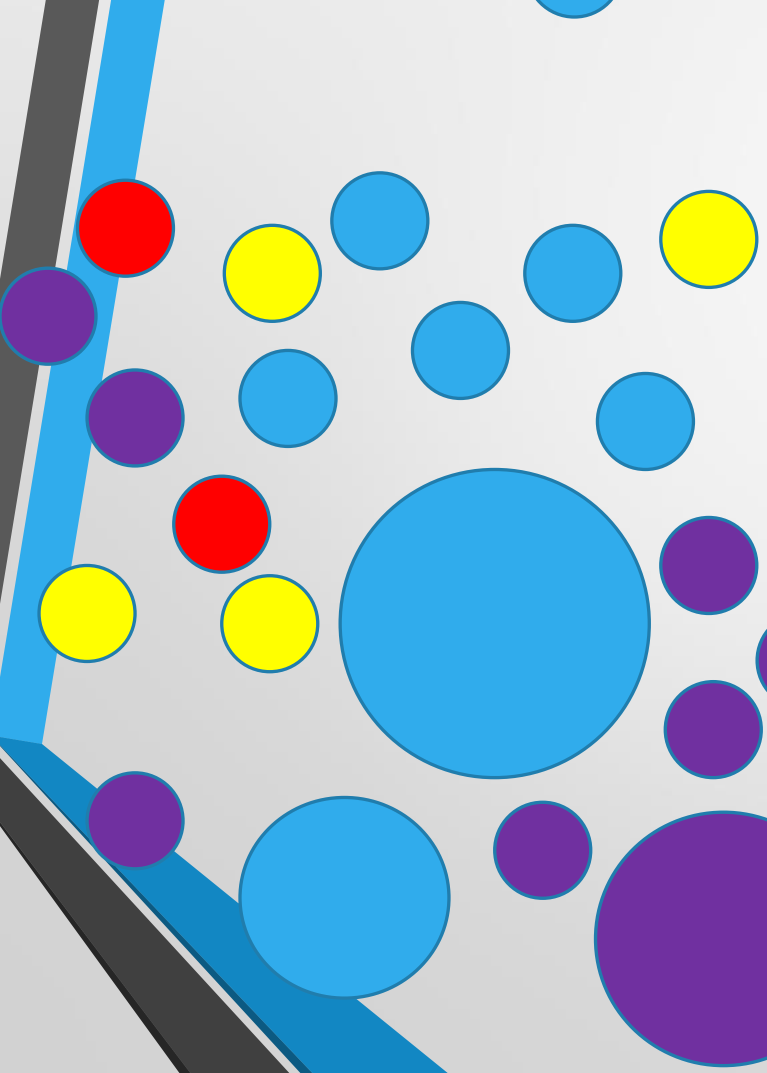
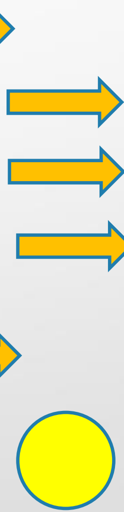
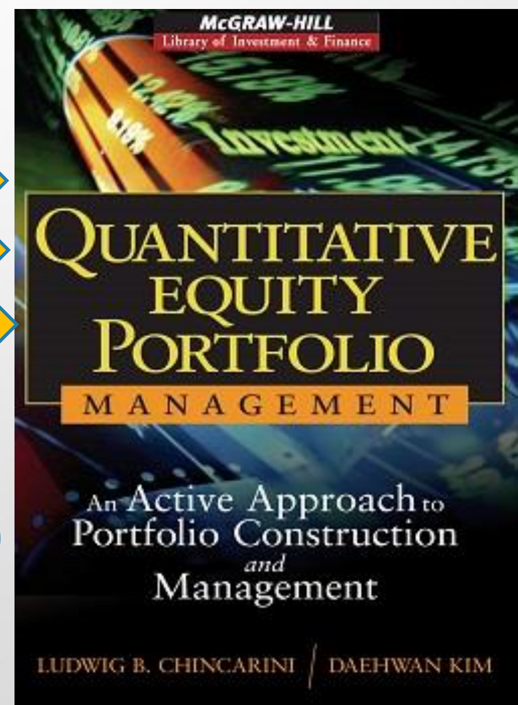


Thank you for coming.





New Edition of QEPM will be released in 2021. Please look out for it. ;)



Good for teaching students in quant finance.

1. Summary of Work

- Attempts to model and understand "strategic" fails in REPO agreements
- Constructs a simple model
- Claims that one of the provisions for failed delivery is not socially optimal

2. General Comments

- This is not my area of research and I did not go through every proof of the model.
- My goal is to suggest things that will make the paper better given my limited knowledge.

2. General Comments

1. I would give reader more on the background. In fact, maybe have a section entitled background describing the REPO rules and even the paper by Fleming & Garbade.

2. General Comments

- https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateral-markets/icma-ercc-publications/frequently-asked-questions-on-repo/25-what-happens-if-a-party-fails-to-deliver-collateral-in-a-repo/
- Also talk about Fleming's work in more detail. Note: I didn't see anything too unusual in the link above (e.g. zero interest rate).

2. General Comments

2. For example, describe and express the problem that you are addressing. Also, get some empirical evidence on how frequent it is.

2. General Comments

2. How big of a problem is strategic “fail to deliver” and is it really static incentive or something else. For example in Fleming and Garbade [Ref. 8 in your paper], they mainly discuss failures around problem events, rather than firms behaving according to some “optimal incentive” problem – this is very different than the way your model approaches it.

2. General Comments

3. Why can’t people buy insurance against failures?
4. Related to above, it would help to connect your theory to reality – i.e. what are types of situations (real) where people would fail to deliver.
5. I know your paper is a draft, but weave in RELATED LITERATURE and ORGANIZATION, rather than name them as sections.

2. General Comments

6. You consider many scenarios in your theoretical model, I would do a table which says how each on is different and also how it relates to the real world.
7. You argue seller must be interest to borrower, but on that links on the first page, it seems a little different. Also, if they are going to "violate", why not just bag the contract entirely?

2. General Comments

8. In your model, everyone agrees on value, what if that is not true. In Chapter 12 of my book The Crisis of Crowding, parties differed greatly on what they thought about the value of Swap Contracts.
9. You mention that the “fails charge” would be equal to x. But is there anyway to know what x is? If so, let us know, otherwise, it’s hard to go from theory to policy.

2. General Comments

10. Your model says that optimal reset rate NOT EQUAL to 0. It would be nice if you put in some parameters and let us know how far from that it is. For example, I can see cases, where x=y=(yh-yl)/2, sigma=2, what would r* be? I think looking at various parameters based on real evidence and looking at how badly zero would be could be interesting.

2. General Comments

11. Your extensions need more justification and organization to them. I would spend time on this.
12. Conclusion – Perhaps spend some time on the POLICY IMPLICATIONS. What would your model say one should do in practice to alleviate the problem?

Summary

- There are delivery failures on REPOs. Fleming and Garbade (reference in paper) have some good articles on the problem.
- This paper builds a theoretical model to understand what causes failures.
- Interesting paper, but I think more needs to be done to tie it to empirical problem, both ex-ante (explaining to users why an incentive model is the right model – rather than a crisis model) and ex-post, how this model helps guide policy to some improvement in this market.

Thank you

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