A repo ("sale and repurchase agreement") is a financial product where you sell an asset and simultaneously agree to buy it back at a later date. A reverse repo is the opposite: here you buy an asset with an agreement to sell it back later.

Repos are typically used to:
- raise liquidity;
- cover a short position in an asset

In a repo, the legal ownership of the asset transfers to the buyer. If the seller does not repay the borrowed liquidity at expiry, the buyer becomes the final owner of the asset. The buyer is thus secured both through the seller's creditworthiness and the value of the underlying asset.

Types of repos

There are typically two types of repos.

Classic repo
In a classic repo, the legal ownership of the asset is transferred to the buyer, while the financial ownership remains with the seller. This means that coupon payments formally accrue to the buyer, but the amount is immediately passed on to the seller.

Sell/buy-back (buy/sell-back)
In a sell/buy-back, coupon payments also accrue to the buyer. Unlike a classic repo, however, the coupon payment is not passed on to the seller. Instead, the price of the asset is adjusted on expiry of the repo to account for the coupon payment.

Collateral and margin

The market value of the asset pledged as collateral is typically calculated daily (mark-to-market).

This means:
- If the value of the asset falls, the buyer can demand additional collateral (margin call)
- The buyer can require a haircut, where the value of the asset is set lower than its market value

A haircut means that the seller must provide more assets as collateral, protecting the buyer against market fluctuations.

Opportunities offered by a repo

A repo can be used for several purposes. For example, you can use a repo to:
- raise liquidity at lower costs than for an unsecured loan;
- cover a short position in an asset; and
- exchange assets during the term of the repo

1. Benefits and drawbacks of repos

Benefits	Drawbacks
Ability to borrow liquidity at lower cost by pledging assets as collateral.	If the seller wants to sell the asset in the market during the term of the repo, the asset must be borrowed in the market to be delivered back.
The buyer has lower credit risk, as both the counterparty and the asset serve as collateral.	This can make it more difficult for the seller to sell the asset during the term of the repo.
The seller typically has the option to exchange assets during the term of the repo.	Asset exchanges can be administratively burdensome for the buyer, who typically does not benefit from the exchange.

2. Return

A repo is typically traded at a fixed interest rate.

For the seller (who receives liquidity):
- If interest rates fall during the term, the liquidity is borrowed at a relatively high rate
- If interest rates rise, the liquidity is borrowed at a relatively low rate

For the buyer (who provides liquidity), the opposite applies.

3. About risk

The buyer is secured both through the seller's creditworthiness and the credit quality of the underlying asset.

Risk arises if the seller goes bankrupt and the buyer cannot realise the asset at the repo's nominal value. Therefore, the buyer will typically prefer assets with:
- low duration;
- low volatility in case of interest rate changes;

A haircut is often used as additional protection against market movements. For example, an asset may be valued at 95% of its market value, making the buyer less sensitive to price fluctuations.

4. What you should know before trading

When trading derivative financial products with the Bank, you may be required to enter into a framework agreement. The framework agreement outlines how the Bank monitors the risk you assume.

The framework agreement entitles the Bank to:
- terminate the contract;
- require additional collateral

This may happen if the market value of the contract moves in a negative direction and exceeds the agreed credit limits.

To trade repos, a suitability assessment must be conducted. The Bank evaluates, among other things:
- the purpose of the transaction;
- the time horizon;
- your financial strength;
- your risk appetite; and
- your knowledge of and experience with the product

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If you seek individual advice in connection with the establishment and ongoing management of repos, please contact your adviser.

Tax
We only provide general tax advice. The applicable tax rules depend on how you invest - whether as a private individual, a personal business, a company or through pension savings. For specific advice, you should consult an accountant.

Costs
Trading repos involves costs, which depend on the specific agreement and the assets pledged as collateral.

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