A Primer on Repurchase Agreements

BY ALLSPRING GLOBAL LIQUIDITY SOLUTIONS TEAM

Repurchase agreements (repos) are a type of short-term investment widely used by money market fund portfolio managers and shareholders. One reason for this is that money market funds are required to maintain at least 25% of their assets in daily liquid assets, which can include overnight repos. Over 85% of the $3.7 trillion tri-party repo market consists of U.S. Treasury or agency debt collateral,[1] according to the Federal Reserve Bank of New York.

What is a repo?

01 A repo is the sale of one or more securities with a simultaneous commitment by the seller to repurchase the security from the buyer at a future date at a predetermined price. This transaction allows one party (the seller) to obtain financing from another party (the buyer). The security is held as collateral, protecting the buyer against the risk that the seller is unable to repurchase the security as designated. In this way, a repo transaction may be thought of as a collateralized loan to the seller of the repo.

A tri-party repo

02 Repos may be executed as bilateral repos, whereby repo sellers and buyers settle the trade directly with each other. Another option is tri-party repos, in which a clearing bank handles settlement and operational issues.

03 Tri-party repos are popular among money market funds because of their operational efficiency. For example, when a money market fund is the buyer or lender of cash and a broker-dealer is the seller of collateral, or borrower of cash, the collateral and loan flow through one of two custodial banks specializing in these transactions. These banks provide clearing services to the tri-party repo market, are responsible for trade settlement and collateral pricing, and help facilitate collateral substitution (see Table 1 below).

04 Most of the tri-party repo market is transacted with an overnight maturity, which means the collateral is sold back to the broker-dealer the next business day and qualifies as an overnight investment in portfolios. There are also term repos, in which the collateral is sold back to the dealer after two or more business days.

TABLE 1: The tri-party repo process Traditional versus nontraditional collateral

1. As of April 9, 2024.

STEP 1	STEP 2	STEP 3	STEP 4
The repo transaction takes place between the money market fund, or buyer, and broker-dealer, or seller. The amount and terms of the trade are mutually agreed upon.	The money market fund delivers cash to the clearing bank, while the broker-dealer delivers securities from their account to the money market fund's account at the same clearing bank.	The clearing bank moves cash to the seller at the same time the collateral is moved to the buyer.	At maturity, the clearing bank unwinds the repo, sending cash plus accrued interest to the money market fund and returning the securities that were held as collateral to the broker-dealer.

The Securities and Exchange Commission (SEC) categorizes repos according to the type of collateral, either as Treasury repos, government agency repos, or other repos. Repos collateralized with Treasury and government agency securities are sometimes referred to as traditional repos and are fairly self-explanatory, but other repos—sometimes referred to as nontraditional repos—are akin to checking none of the above. Nontraditional repos can include a wide array of investment types used as collateral, including both investment-grade and non-investment-grade fixed income securities; asset-backed securities, structured securities, corporate bonds, and municipal bonds; money market securities; and equities and exchange-traded funds. Repos backed by nontraditional collateral are a small part of the tri-party repo market but vary widely in credit quality and liquidity.

Investors are protected by both the creditworthiness of the dealer counterparty—a measure of the likelihood that the seller will be able to repurchase the security on the agreed-upon repurchase date—and the value of the collateral. Repos are generally over-collateralized, meaning the value of the collateral will exceed the amount of the loan, and the amount of over-collateralization is called the margin or haircut. Investors need to be sure that the value of the collateral is sufficient to cover the total amount of their investment in the event of a default by the borrower. Because different types of securities are more volatile than others and may take longer to liquidate, the margin that investors require for those types of securities will be higher—as will the yield on the repo itself.

Allspring Money Market Funds are managed with a consistent investment process and philosophy that focus on liquidity and high-quality investments. As part of the firm's overall risk management, our Money Market team employs a rigorous credit analysis process. Prior to entering into a repo, the team must complete two important steps—assess the counterparty risk and evaluate the repo collateral.

Assessing counterparty risk

SEC Rule 2a-7 requires that money market funds determine that the repurchase counterparty "presents minimal credit risk," which has been a fundamental part of our process throughout our 37-year history of managing money market funds. For short-term investments, our credit team analyzes the soundness or creditworthiness of a counterparty and assigns an internal credit score for each counterparty when it is placed on the approved issuer list—a list composed of issuers we believe present minimal credit risk.

Evaluating repo collateral

During the evaluation process, we carefully consider the following four factors:

05 The type of collateral, including its potential price volatility and expected market liquidity in a time of stress, helps establish haircuts.

06 It is important to consider the availability of prices used for valuing the security and to check that the required margin is sufficient. We prefer collateral that has a reliable source of transaction-based market prices. While the maturity of a repo may be for a specified term, collateral can be freely substituted by the dealer, so margins must be checked daily.

07 Our ability to liquidate a given collateral type over a reasonable time horizon, unless we have the ability to own the

collateral directly in our money market funds, requires we employ traders who are experts in the security type, and the market must be deep enough to provide for the amount of collateral we could take on from the borrower.

08 The ability to negotiate a margin level and yield that we believe is commensurate with the transaction is essential in order to execute the repo transaction.

We allow a limited number of repo collateral types in the Allspring Money Market Funds, including U.S. Treasury securities (excluding Separate Trading of Registered Interest and Principal of Securities, or STRIPS, maturing in more than 10 years); U.S. government agency securities and plain agency mortgage-backed securities; and high-quality 2a-7 eligible commercial paper and certificates of deposit (also known as money market securities). While these may not represent the highest-yielding sectors of the repo market, they meet our criteria for safety and liquidity. In addition, we continue to evaluate other types of collateral against our criteria to ensure that we have access to all available supply—if and when it should meet our criteria.

Keeping our money market fund investors whole

The repo market is essential to money market fund investors. With a $3.4 trillion market size, the bulk of which is represented by high-quality, liquid collateral, we believe we are able to identify safe, liquid investment opportunities. We recognize, however, that not all repos are equal, and we are committed to thoroughly investigating the collateral types behind each one prior to transacting. The Allspring Money Market Funds invest in U.S. Treasury and government-backed traditional repos as well as certain types of nontraditional collateral that meet our criteria. Our funds' nontraditional repo holdings include high-quality money market fund–eligible securities such as commercial paper and certificates of deposit. We do not invest in any other types of repos collateralized by nontraditional securities.

To learn more

We want to help clients build for successful outcomes, defend portfolios against uncertainty, and create long-term financial well-being. To learn more, investment professionals can contact us.

For more information, please contact:

- Institutional Sales Desk: **1-888-253-6584**
- Website: **allspringglobal.com**

If you're an institutional investor, when you visit the website, click on your location and select your role on the welcome screen as "Institutional Cash Investor."

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For retail money market funds: You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon sale of your shares. An investment in the Fund is not bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor is not required to reimburse the Fund for losses, and you should not expect that the sponsor will provide financial support to the Fund at any time, including during periods of market stress.

For floating NAV money market funds: You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon sale of your shares. An investment in the Fund is not a bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor is not required to reimburse the Fund for losses, and you should not expect that the sponsor will provide financial support to the Fund at any time, including during periods of market stress. For government money market funds: You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not a bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor is not required to reimburse the Fund for losses, and you should not expect that the sponsor will provide financial support to the Fund at any time, including during periods of market stress.

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