US Rates Strategy

Joseph Abate, US Rates Strategy joseph.abate@smbcnikko-si.com 1 212 893-1592

October 8, 2025

Overnight funding risk

Cleared repo activity has traditionally had a higher concentration of overnight trades then uncleared activity. As the market shifts to mandated clearing, will a higher concentration of overnight trades make it more vulnerable to shocks in overnight rates?

- Most dealer lending is still uncleared although this is declining as a share of total funding ahead of the SEC's mid-2027 deadline.

- **Roughly 60% of the uncleared funding provided by dealers has an overnight tenor compared to 70% or so in the cleared bilateral market.** Within the uncleared market, the overnight share is higher for general collateral than for specific CUSIPs.

- **Since early August, there has been a sharp increase in the volume of dealer sponsored repo lending**. This has been led by maturities under 30d.

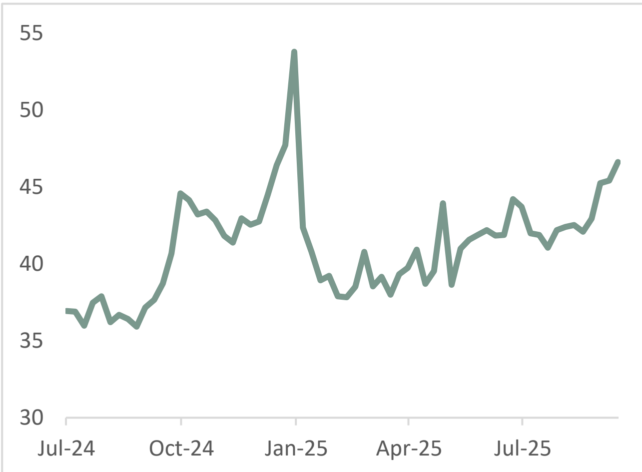
- **We expect the market's sensitivity to overnight repo rates will increase as cleared volumes rise. This could also push term funding rates higher as it is mechanically more difficult to match offsetting end dates across these transactions**. This may increase the importance of the Fed's standing repo facility (SRF) as a rate ceiling.

Overnight funding risk

Traditionally, cleared repo activity has a higher share of overnight trades than the (still) larger uncleared market. We estimate that just under half of dealer-provided financing is currently cleared (Figure 1). **As this goes up ahead of the SEC's mid-2027 deadline, could funding market sensitivity to overnight interest rates increase?**

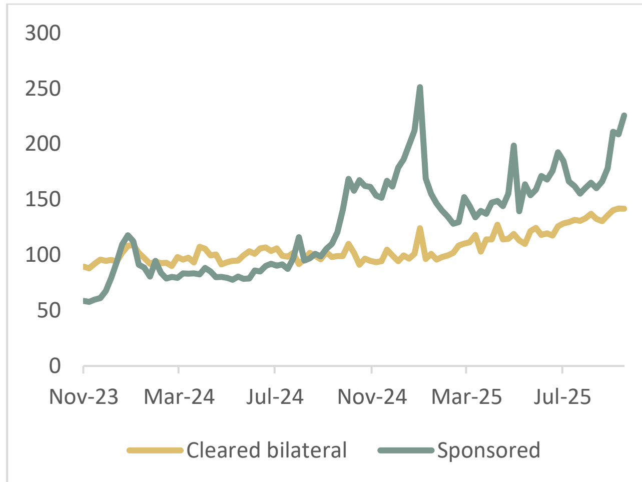
We focus on dealer-provided financing for two reasons. First, dealers largely finance themselves at overnight tenors in the (uncleared) tri-party market. Between 90-95% of this financing is overnight. Centrally clearing these transactions is unlikely to *increase* their exposure to overnight rates. Second, the counterparties that borrow from dealers in repo are less likely to have access to Fed liquidity programs such as the SRF or discount window. **This could make their Treasury positions more sensitive to changes in overnight rates as dealer lending tenors become increasingly overnight**. We use data collected weekly from the Federal Reserve Bank of New York on primary dealer activity.

Figure 1: Cleared activity (% total)



Note: Dealer reverses. Source: Federal Reserve, SMBC Nikko

Figure 2: Cleared activity growth (Dec-23=100)



Note: Cleared bilateral includes general collateral and specials. Source: Federal Reserve, SMBC Nikko

Rising volume…

Although the SEC delayed the mandatory implementation date by a year, the repo market is steadily moving toward clearing all its non-central bank activity. Cleared bilateral and sponsored repo volumes have increased since the SEC mandate was released in December 2023.[1] Volumes are up 40 and 125%, respectively (Figure 2). A recent paper highlights this rapid growth. Between December 2020 and August 2022, the number of sponsored participants in FICC increased by 38. But in the following two years, 555 participants signed up.[2] While both cleared bilateral and sponsored repo are centrally cleared through FICC, sponsored repo gives non-members (such as hedge funds) remote access to clearing. The sponsor guarantees the non-member's transaction to the FICC. The FICC is the counterparty to every trade. And as the dealer faces the same counterparty on all cleared transactions it can net its borrowing against its lending *provided* these offsetting trades have the same end date. Netting shrinks the size of the dealer's exposures and reduces its use of balance sheet capital. A smaller balance sheet footprint gives dealers more intermediation capacity in the repo market. In return, the dealer contributes to the FICC's loss fund and pays VaR margin tied to the maturity of the collateral pledged.[3]

If all transactions had the same maturity end date, then every cleared repo trade would theoretically net automatically. Of course, while there is robust demand for overnight financing, some borrowers prefer to lock in their financing to protect against temporary rate shocks. Mechanically, it is easier to match the demand and supply of short-maturity funding (largely overnight but up to 7d). **Coordinating end dates for longer maturities is complicated because cash lenders such as money funds face liquidity**

---

[1] Most (~80%) of the activity in cleared bilateral repo is against CUSIP-specific collateral

[2] See "The Rise of Sponsored Service for Clearing Repo", A. Copeland and R. Jay Kahn, Liberty Street Economics, Federal Reserve Bank of New York, October 8, 2025.

[3] Their margin is also sensitive to the direction and concentration of their trades and collateral.

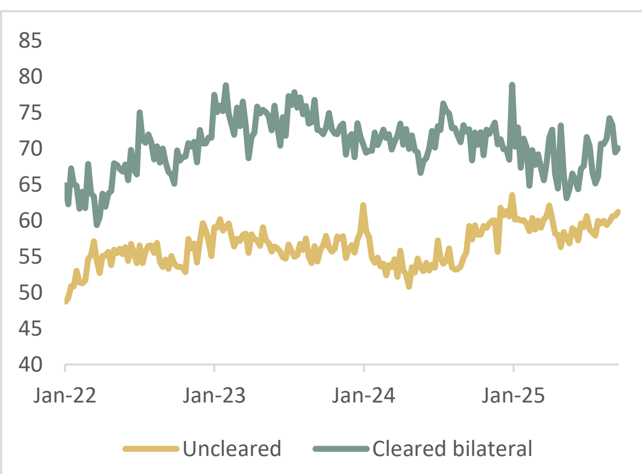
regulations that limit the tenors of their lending and these often do not match those looking for term financing.

…but overnight activity will grow

Overnight lending has been a bigger share of dealer-provided financing in the cleared repo market than for uncleared transactions. **Roughly 60% of uncleared funding provided by dealers has an overnight tenor compared to 70% or so in the cleared bilateral market** (Figure 3). Daily uncleared funding from dealers is about $1.5trn. Thus, as these transactions shift into the cleared market, their tenors will tilt more toward overnights. We estimate this might increase dealer funding at overnight tenors by about 20% or $150-200bn. Of course, nearly $900bn of this overnight activity is currently not cleared, so in *aggregate*, overnight cleared activity might climb to $1.8trn by the mid-2027 deadline.

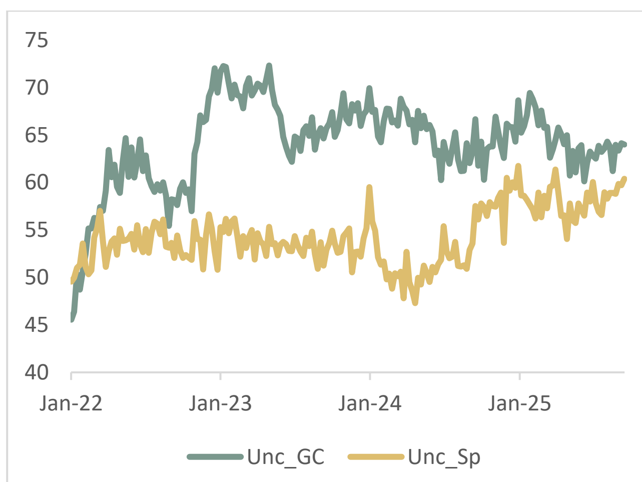
We made no distinction between the types and tenors of the collateral that dealers are now financing in the uncleared market. **However, the overnight share is higher for general collateral than for specific CUSIPs** (Figure 4). This likely reflects the type of activity that dealers are intermediating. In the uncleared general collateral market, dealers are passing along financing raised in tri-party from money market funds and other cash lenders. The borrower is merely looking for funding. By contrast, in the uncleared market for specific collateral, borrowers may be looking for the equivalent of a left sock to match the right one. Generally, once they have located the right "sock", they may need to hold onto it for more than a day – for example, to deliver into a futures contract. As a result, securing *term* financing may be more important to these investors.

Figure 3: Overnight activity (% total)



Note: Dealer reverses; general collateral and specials. Source: Federal Reserve, SMBC Nikko

Figure 4: Overnight uncleared activity (% total)



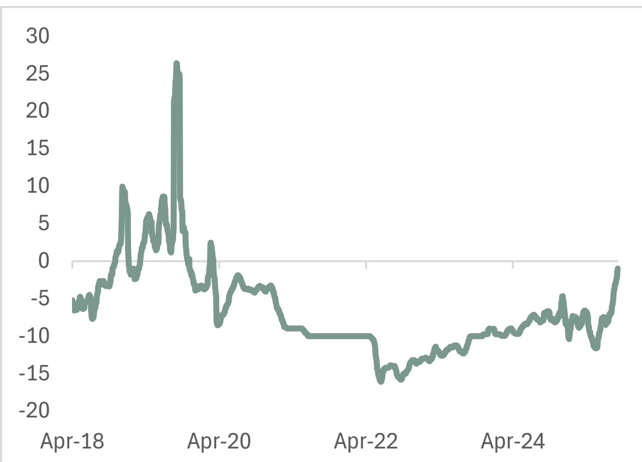
Note: Dealer reverses. Source: Federal Reserve, SMBC Nikko

Higher term funding rates?

We think the shift toward clearing has so far not caused a spike in funding rates for two reasons. First, bank reserves have remained ample to abundant. This has kept tri-party rates comfortably below IORB although recently the spread has started to narrow (Figure 5). Second, demand for funding has been relatively balanced between overnight and term. This has kept the overnight shares in the cleared bilateral and sponsored markets relatively stable (see Figure 3).

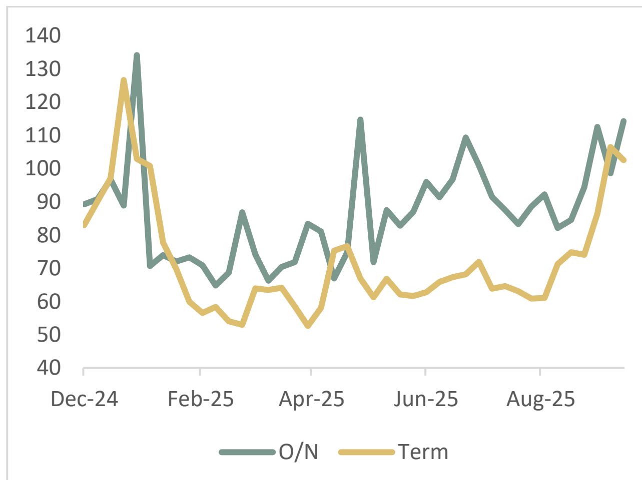
But recently, the demand for term funding has risen. In figure 6, we index dealer sponsored lending to December 2024 to gauge growth in funding demand this year. Beginning in early August there was a sharp increase in the volume of dealer sponsored lending – led by tenors shorter than 30d. While it is too soon to know if this a temporary shift related to uncertainty around funding rates at quarter-end and the effect of the Treasury's cash restocking, we think it highlights a key potential issue in the market. An increase in the demand for term funding could push these term rates higher as they are harder to fit into a "nettable package" even within a larger cleared market. That is, while the trade will still be centrally cleared, the dealer may struggle to find an offsetting term trade that allows it to net down its balance sheet. Instead, it may be easier for the dealer and the borrower to roll overnight financing day-by-day. **But that leaves both exposed to swings in overnight interest rates**.

Figure 5: Tri-party less IORB (bp)



Source: Federal Reserve, SMBC Nikko

Figure 6: Term sponsored funding (Dec-24=100)



Note: Dealer reverses. Source: Federal Reserve, SMBC Nikko

Disclaimers

This document is provided by SMBC Group (including, collectively or individually, Sumitomo Mitsui Banking Corporation, SMBC Nikko Securities America, Inc., and their affiliates, as applicable) for informational purposes only, solely for use by the client(s) or potential client(s) to whom such document is directly addressed and delivered. This document was prepared by SMBC Group's economist(s). The views, statements, assumptions, and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Group. This document does not constitute an offer or solicitation of the sale or purchase of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Group and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by SMBC Group's economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals, and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Group does not accept any liability or responsibility for any results in connection with the use of the information. Recipients are responsible for making final investment decisions and should do so at their own discretion following their own independent analysis and assessment of the merits of any transaction prior to execution, after conducting a careful examination of all documentation delivered, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents. Financial instruments discussed in this document may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views, statements, assumptions, and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Group. The trading desks of SMBC Group trade or may trade as principal in financial instruments that are the subject of this document, and the author(s) of this document may have consulted with the trading desks while preparing the document. The proprietary interests of SMBC Group may conflict with those of the recipient. SMBC Group may seek to do business with companies mentioned in this material and the trading desks may accumulate, be in the process of accumulating or have accumulated, long or short positions in financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This document is not a research report, and neither the document nor its author(s) is subject to policies and procedures that apply to the globally branded research reports and research analysts of SMBC Group or to legal requirements designed to promote the independence of investment research. This document is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that SMBC Group, and its directors, representatives, or employees, may have a long or short position in any of financial instruments mentioned in this document and may make a market or trade in financial instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent, at any time.

No part of the author's compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of the author(s) may differ from one another.

This document is the property of SMBC Group, subject to copyright. Any reproduction of this document, in whole or in part, is prohibited and you may not release this document to any person, except to your advisors and professionals to assist you in evaluating the document, provided that they are obligated by law or agreement to keep the document confidential. Distribution, possession or delivery of this document in, to, or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.

© 2025 SMBC Group. All rights reserved.

.