Title: CLOs, Reverse Repos and GameStop
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Body:
[TLDR](https://youtu.be/gmKHBQBj77Q):

If asked to explain the significance of Reverse Repurchase Agreements and their relation to GameStop, what would you say? Tough question, right? Until I began some heavy-duty research on the topic a few days ago I'm not even sure how I would've explained the phenomenon. That said, I am here today to break down this complicated topic and share with you what I've learned while in pursuit of a more complete understanding of how the financial markets are currently operating.

Key Definitions:

Collateralized Loan Obligation (CLO):
>"Collateralized loan obligations (CLOs) are a form of securitization where payments from multiple middle sized and large business loans are pooled together and passed on to different classes of owners in various tranches. A CLO is a type of collateralized debt obligation."
[Wikipedia - September 4th, 2021](https://en.m.wikipedia.org/wiki/Collateralized_loan_obligation)

Reverse Repurchase Agreement (RRP):
>"A reverse repurchase agreement conducted by the [Desk](https://www.investopedia.com/terms/t/tradingdesk.asp), also called a "**reverse repo**" or "RRP," **is a transaction in which the Desk sells a security to an eligible counterparty with an agreement to repurchase that same security at a specified price at a specific time in the future**. The difference between the sale price and the repurchase price, together with the length of time between the sale and purchase, implies a rate of interest paid by the Federal Reserve on the transaction." - [New York Federal Reserve - September 24th, 2021](https://www.newyorkfed.org/markets/rrp_faq.html)

Secured Overnight Financing Rate (SOFR):
>"The Secured Overnight Financing Rate (SOFR) **is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities**." - [New York Federal Reserve - September 24th, 2021](https://www.newyorkfed.org/markets/reference-rates/sofr)

London Interbank Exchange Rate (LIBOR):
>"LIBOR… serves as a globally accepted key benchmark interest rate that indicates borrowing costs between banks. The rate is calculated and will continue to be published each day by a Clearinghouse (business name redacted), but due to recent scandals and questions around its validity as a benchmark rate, it is being phased out." - [Investopedia - March 14th, 2021](https://www.investopedia.com/terms/l/libor.asp)

Alternative Reference Rate Committee (ARRC):
>"The ARRC is a group of financial market participants convened to help ensure a successful transition from U.S. dollar LIBOR to a more robust reference rate, its recommended alternative, the Secured Overnight Financing Rate (SOFR)." - [New York Fed - August 27th, 2021](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf)

Background:

In previous posts I have hypothesized that a prime broker, family office and supply-chain finance company were collectively exploiting a legal loophole that allowed them to shield their exposure from other prime brokers and avoid taxation through the use of a [financial instrument](https://www.investopedia.com/terms/l/loan-credit-default-swap.asp) used in conjunction with [syndicated secured loans](https://www.investopedia.com/terms/s/syndicatedloan.asp) targeting distressed companies tracked on an [index](https://www.isda.org/book/bullet-markit-lcdx-untranched-transactions-standard-terms-supplement/) meant specifically for them. These financial instruments are a form of "[Synthetic Collateralized Loan Obligation](https://www.reuters.com/article/clo-synthetic-idUKL1955548120071219)."

When a [50 million-euro term loan](https://www.cdsdeterminationscommittees.org/documents/2021/01/europcar-credit-suisse-facility-agreement.pdf/) was [purchased and restructured](https://www.reuters.com/article/uk-europcar-restructuring-idUKKBN2861US) in November 2019 the downstream impact was an unusual failure of a [bankruptcy auction](https://www.ifre.com/story/2694879/europcar-flop-raises-awkward-questions-for-cds-market-ykllfh4hlw). This auction was triggered by the investors who restructured the loan strategically discontinuing debt payments related to it, thereby intentionally defaulting on the prime broker's loan. Auctions like these exist because companies have [Credit Insurance](https://www.investopedia.com/terms/c/creditinsurance.asp) that pays out pre-determined amounts during [Credit Events](https://www.investopedia.com/terms/credit-event.asp) such as bankruptcies. Simply put, this auction was a classic "[short squeeze](https://www.ft.com/content/69accf15-1ab7-426b-aadc-6f594d24dd65)" that left the prime broker, underwriter of the original 50 million-euro term loan, hodling [the bag](https://www.cdsdeterminationscommittees.org/documents/2021/01/emea-dc-issue-2020120201-europcar-mobility-group-s-a-final-list-11-january-2021.pdf/).

Furthermore, as indicated by the [auction service](https://creditfixings.com/CreditEventAuctions/results.jsp?ticker=EUROPMO) where the short squeeze occurred, the loan was being treated as a syndicated secured one - meaning it was "[tranched](https://www.investopedia.com/ask/answers/what-tranche/). When a loan is tranched it allows 3rd parties the opportunity to also invest in the bankruptcy and expected payout of the underlying Credit Insurance previously purchased by the business. Those who invest in loans that do not pay out in the event of bankruptcy stand to lose a lot of money in such an event - this is an incredibly risky form of investment.

It just so happens that, per a [legal report](https://www.credit-suisse.com/media/assets/corporate/docs/about-us/investor-relations/financial-disclosures/results/csg-special-committee-bod-report-archegos.pdf) published by the bag-hodling prime broker, the family office they had been working with preferred the exact type of [financial instrument](https://www.lexology.com/library/detail.aspx?g=4ba2f5cc-0b27-4bd5-bb09-ed6222a3521f) that pays out in the event of bankruptcy-related events. Due to the family office's preference for these inherently risky, non-cancelable, high "[tenor](https://www.investopedia.com/terms/t/tenor.asp)" financial instruments that were "[invented](https://www.lexology.com/library/detail.aspx?g=4ba2f5cc-0b27-4bd5-bb09-ed6222a3521f)" in 2010, their exposure was the highest of all the prime broker's clients. Worth noting **the average tenor of the family office's contracts was 24 months**, so when the bankruptcy auction "failed" in January 2021 and the prime broker's insurer [froze](https://www.reuters.com/article/britain-greensill-credit-suisse-idCNL1N2L80T5) a $10bil policy that underwrote the supply-chain finance company, it's not like these contracts became invalidated or were immediately executed on the open market - they're non-cancelable, remember? So what happened to them?

The understanding I have come to is that these contracts were auctioned off by a Clearinghouse-owned [service](https://www.cdsdeterminationscommittees.org/lcds-management/) and were purchased by prime brokers who in this context function as [clearing brokers](https://www.investopedia.com/terms/c/clearingbroker.asp). The clearing brokers then participated in [securities lending](https://www.investopedia.com/terms/s/securitieslending.asp) alongside hedge funds in attempt to reduce exposure (e.g. encourage selling in order to find "hard-to-borrow" shares) of the auctioned-off assets. These hedge funds then opened [short positions](https://www.reddit.com/r/Superstonk/comments/pcb39f/gabe_is_this_legal/) in companies the over-leveraged family office was long on, seemingly under the expectation the family office would experience a liquidation event in the near future, which did in fact occur during March 2021.

Astonishingly, these same hedge funds appear to have been granted the non-public privilege of concealing certain positions from financial disclosures out of concern they were being "targeted by Retail

Investors” on social media. This has and continues to strike me as a [false narrative](https://www.reddit.com/r/Superstonk/comments/pam30m/the_melvin_capital_misdirection/) invented by these hedge funds seeking permissions that would not be available to them otherwise.

Hypothesis:

Ok, so by now you might be wondering, how does this connect? What does this background have to do with CLOs, Reverse Repos and GameStop? Well my friends, it’s quite simple - this background is an explanation for how the CLO market silently cultivated a Credit Insurance [bubble](https://www.bloomberg.com/news/articles/2021-08-30/is-bitcoin-a-good-investment-billionaire-paulson-says-crypto-worthless-bubble). The historic Reverse Repo amounts now observed on a daily basis are further evidence of this bubble given their date-driven relation to a transition away from LIBOR (which was being maintained by the Clearinghouse that owns the bankruptcy auction service) to SOFR which was [formally recommended](https://www.newyorkfed.org/arrc/sofr-transition) by the New York Federal Reserve on July 29th, 2021. SOFR simply provides a benchmark for interest rates based on the amount of money being housed overnight via Reverse Repos.

This transition is an amazing change for the financial markets and is forcing CLO funds to operate in the daylight instead of behind closed doors through legal loopholes.

The transition to transparency is also a possible explanation for why August 2021 saw the “[most active](https://finance.yahoo.com/finance/news/august-most-active-month-ever-115901816.html)” CLO market in history.

A few other points of interest that I discovered during my CLO research:
1. The SOFR chart had an [unusual spike](https://fred.stlouisfed.org/series/RRPONTSYD) on the final day of the family office’s liquidation event on March 26th, 2021
2. CLOs were historically priced off [three-month LIBOR](https://www.bloomberg.com/news/articles/2021-05-14/structured-weekly-clo-refinancing-burst-seen-ahead-of-libor-end), which helps to explain the volatility other popular DD writers have attempted to explain through Total Return Swaps.
3. 2020 had the [highest number](https://ihsmarkit.com/research-analysis/2020--highest-credit-default-events-since-2009--what-about-202.html) of defaults since 2009, which means those invested in the CLO market likely made big bucks last year. Curious considering friends of the family office saw [record inflows](https://www.institutionalinvestor.com/article/b1q6hth4vqp7dg/Ten-fold-Growth-and-a-740-Percent-Stock-Gain-Cathie-Wood-s-Breakout-Year-by-the-Numbers) during the same period of time.

Conclusion:

Thanks for reading! Remember, I’m just a Retail Investor who is sharing publicly available information, not a financial advisor.

Happy Earnings Week!