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Abstract

We examine how market structure, market power, and systemic risk respond to close and intense lending relationships between financial conglomerates (FCs) in non-centrally cleared bilateral repo. Using transaction-level data from Mexico, we document persistent and stable funding relationships between FC-affiliated banks and funds with two distinctive features: first, funding transactions are two-way, that is, a given pair of rival FCs provide lending to one another on the same day; second, two-way transactions are executed at lower average rates than one-way transactions. We show that two-way lending between FCs favours both market concentration and market power of FC-affiliated funds, and worsens the terms of trade of independent banks' and funds' lending. Furthermore, we find that the bank-level contribution to systemic risk increases with two-way lending.