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UNDER PRESSURE

Carmella Haswell speaks to Ernst Dolce, head of liquidity solutions at AXA Investment Managers, on the mounting pressures facing markets and the firm's top priorities

ISLA appoints Ashurst for GMSLA review

The International Securities Lending Association (ISLA) has selected global law firm Ashurst to provide preliminary analysis on the Global Master Securities Lending Agreement (GMSLA) within the digital asset landscape.

The analysis will look at key provisional changes to title transfer and security interest over collateral (pledge) frameworks of the GMSLA that may need to be revised to cater for digital assets including tokenised digital assets, native digital assets and forms of digital cash.

The ISLA Legal Steering Group and ISLA Digital Asset Working Group will conduct detailed legal analysis of the GMSLA frameworks in association with ISLA members and a white paper is likely to be published detailing the results of this analysis.

David Shone, director of market infrastructure and technology at ISLA, says: “Digital assets and tokenisation are areas that are increasingly important to our members; offering new business opportunities, new solutions to locked-up liquidity issues, and new methods of risk reduction.

“The appointment of Ashurst to help chart our way through this landscape ensures that the GMSLA agreements published by ISLA and used for securities lending activity globally, are able to support our membership’s ability to leverage these new opportunities. This is a key component in ISLA’s digital strategy and supports our ongoing mandate to establish standards for the securities finance industry.”

Etay Katz, finance regulatory partner at Ashurst, adds: “This is a momentous junction of change for the industry, and our appointment further solidifies Ashurst’s reputation and standing as the global law firm of choice advising on digital assets transformation in global financial markets.”

Inside this issue

OCC volumes up

Securities lending transaction volumes cleared through OCC have grown 10.0 per cent month-on-month to 172,365 for July 2022.

However, average daily loan value for securities lending trades cleared through the Chicago-based clearing house have contracted 2.95 per cent to US$119.64 billion for July 2022 relative to July 2021.

For options contracts, total average daily volume for all options cleared through OCC has grown 3.6 per cent YoY to 40.60 million year-to-date.

This has been driven particularly by a 48.5 per cent YoY rise in ADV for ETF options to 15.50 million ytd and a 35.9 per cent YoY rise in ADV for index options to 2.58 million ytd.

For equity options, average daily volume has fallen 16.3 per cent to 22.28 million ytd.

Total monthly cleared futures and options volume through OCC has contracted 6.6 per cent to 742.04 million contracts for July 2022 relative to July 2021.

Equity options explained a major share of this decline, with monthly contract volume shrinking 26.8 per cent YoY for July 2022 to 393.92 million.

DTCC's MTU connects to major triparty agents

The Depository Trust & Clearing Corporation (DTCC)'s Margin Transit Utility (MTU) service is now connected with major triparty agents including BNY Mellon, BNP Paribas Securities Services, Clearstream and Euroclear.

MTU enables users to enrich, settle, monitor and report matched collateral calls globally, while connecting to and sharing information with multiple counterparties including automated instructions for triparty agents.

MTU's Triparty Messaging service assists clients in complying with regulatory requirements such as the Basel Committee on Banking Supervision-International Organization of Securities Commission's Uncleared Margin Rules (UMR).

According to DTCC, UMR Phase 6 is anticipated to bring approximately 700 to 900 firms into scope, and building connectivity with multiple triparty agents could prove to be a significant time and resource drain.

MTU's pre-integrated connectivity and standardised settlement messaging for

all major triparty agents aims to deliver a common infrastructure, eliminating the need for direct builds.

In addition, MTU is expected to create efficiencies for triparty agents by eliminating the need to onboard hundreds of clients in preparation for UMR Phase 6.

J.P. Morgan, SIX and State Street have also connected with the MTU service.

Commenting on the milestone, Bob Stewart, executive director of institutional trade processing at DTCC, says: “UMR Phase 6 is right around the corner. The MTU triparty messaging service will create efficiencies for in-scope firms and triparty agents, assisting in compliance with the regulation and delivering a significant win for the industry.

“For many firms caught by UMR Phase 6, the requirement to onboard to a triparty venue in order to receive collateral can be new and unfamiliar. This is where MTU core features and functionalities deliver a turn-key solution to the industry challenge.”

South Korea tightens oversight of short selling

South Korea’s Financial Services Commission (FSC) has announced a package of measures designed to tighten oversight of illegal short selling and to improve the operation of the short-selling system.

In a meeting held between FSC representatives and market participants on 28 July, attendees raised concerns that investor mistrust in the short selling system has continued to build in the face of recent declines in global stock markets, according to a statement from the financial regulator.

The FSC has responded by stating that prompt measures are required to “bolster oversight and punishment over market-disturbing activities in capital markets linked to illegal short selling and short selling-based price rigging”. This must be accompanied by “prompt improvements” to the short-selling system to address the issues raised by investors.

These will focus on measures to strengthen oversight and punishment of illegal short selling activities. This will include wider powers to investigate “unfair transactions linked to short selling”, to monitor naked short selling activities and steps to expand investigation teams at the Korea Exchange and FSC charged with these responsibilities.

As part of this package, the financial authorities will reinforce procedures for identifying "overheated short selling items". A stock will be classed as "overheated" when the proportion of short orders is 30 per cent of issued share capital — even without a major decline in the share price or a significant increase in short sale transaction volume.

Through fast-track investigation procedures established through a joint investigation unit at the Seoul Southern District Prosecutors Office, the financial authorities will have power to impose stronger penalties, including larger fines, when the level of damage caused by malpractice in this area is found to be particularly severe. This will include a requirement for perpetrators to forfeit illegal profits and "concealed properties" secured through illegal short selling.

Significantly, the financial authorities also propose measures to improve short selling opportunities for retail investors. This will include a 20 per cent reduction in the margin requirement applied to individual investors from 140 per cent to 120 per cent.

The FSC will require steps to tighten oversight and to strengthen financial penalties to begin "as soon as possible" in a bid to improve public trust in the short selling system. Enactment of measures that require amendments to existing regulations should commence by the end of 2022.

This reform programme follows a temporary ban on short selling activities imposed by the market authorities in South Korea in March 2020 designed to "help ease market anxieties" with the onset of the COVID-19 pandemic.

The FSC authorised a partial resumption of short sales in stocks falling within the KOSPI 200 and KOSDAQ 150 indices in May 2021.

Securities finance revenues jump 40% YoY in July

Global securities finance revenues have totalled US$1.215 billion, making July 2022 the highest revenue-generating month of the year, according to S&P Global Market Intelligence.


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This represents a 40 per cent YoY rise in securities finance revenues for the month of July, driven by strong demand for equities lending.

Looking month-on-month, securities finance revenues have risen 6 per cent relative to June 2022.

American equity revenues for the month of July skyrocketed, rising 103 per cent YoY to US$605 million.

Global equity revenues increased 44 per cent YoY, and 8 per cent month-on-month, making July the highest revenue-generating month so far for the individual asset class.

S&P Global Market Intelligence also announced that EMEA equities experienced a 12 per cent decrease in fees YoY despite an increase of 54 per cent in utilisation.

Exchange-traded products (19 per cent), government (7 per cent) and corporate bonds (77 per cent) all saw increases in revenues YoY.

American depository receipts (ADRs) continued to experience a decline in revenues YoY, although ADR lending revenues for July were up 40 per cent relative to June.

The top five revenue-generating Americas equities for July 2022 include Gamestop Corp (GME), Beyond Meat Inc (BYND), Lucid Group Inc (LCID), Faraday Future Intelligent Electric Inc (FFIE), and Dutch Bros Inc (BROS).

CME Clearing widens collateral eligibility

CME Clearing has widened its collateral eligibility to accept short-term US treasury ETFs as initial margin.

By extending the range of collateral that it will receive as IM, the clearing house aims to extend the flexibility of funding solutions offered to market participants with IM requirements. CME Clearing claims that it accepts the widest range of collateral of any major clearing entity.

These short-term exchange-traded funds invest in US treasuries with less than 12 months to maturity. CME Clearing managing director and global head of clearing and post-trade services Suzanne Sprague indicates that the clearing house has worked closely with ETF sponsors to ensure that accepting short-term UST ETFs as collateral meets with its risk management standards, while offering a broader choice of collateral that users can post to the CCP.

Goldman Sachs Asset Management global head of ETFs Mike Crinieri says: “Treasury ETFs such as the Goldman Sachs Treasury 0-1 Year ETF are a useful form of collateral that may benefit clients that have challenges managing the roll of US Treasury Bill portfolio, or who simply wish to outsource treasury management. We are [working] with CME Clearing to deliver the operational efficiency of the ETF wrapper for collateral purposes.”

Carolyn Weinburg, BlackRock’s global head of product for ETF and index investments, says: “iShares launched the first four-bond ETF 20 years ago, believing they would modernise fixed income markets by increasing transparency and liquidity while unlocking sophisticated portfolio and trading capabilities for our clients.

“Margin and collateral are a new use case for bond ETFs like SGOV and SHV, which further demonstrates how they are useful, resilient investment tools that can improve outcomes for individuals and large institutions alike.”

Global PSSL welcomes SSE as observer

The Global Principles for Sustainable Securities Lending (Global PSSL) has welcomed the Sustainable Stock Exchanges Initiative (SSE) as its third observer.

The voluntary and neutral engagement will grant SSE regular access to certain meetings and roundtables that shape Global PSSL’s initiative.

Global PSSL is an independent, not-for-profit community interest company tasked with encouraging standardisation and adoption of environmental, social and governance (ESG) principles within the global securities lending market.

The Netherlands Authority for the Financial Markets (AFM) became the second regulatory observer for the organisation in January.

Global securities lending industry hits $939m in revenue

The global securities finance industry generated US$939 million in revenue for lenders in July 2022, a 24 per cent increase on July 2021, according to DataLend.

Compared to the previous month, the July 2022 figures represent a 5 per cent increase from the US$897 million generated in June 2022.

Global broker-to-broker activity, where broker-dealers lend and borrow securities from each other, totalled an additional US$262 million in revenue in July, a 34 per cent rise from 2021.

According to DataLend, the increase in lender-to-broker revenue over 2021 was driven primarily by North American equities, where average fees increased by 57 per cent, resulting in a 51 per cent increase in revenue generated.

In the Asia Pacific region, equities saw a decline in revenue of 15 per cent due to a decrease in average fee of 12 per cent.

Europe, Middle East and Africa equities remained relatively flat year-over-year with a 1 per cent increase in revenue over 2021.

The market data service of fintech EquiLend also reveals fixed income markets experienced revenue increases across both government debt, up 4 per cent, and corporate debt, up 88 per cent, compared to July 2021.

The rise in corporate debt revenue was driven primarily by average fees rising by 74 per cent.

The top five earners in July 2022 were Gamestop Corporation (GME), Beyond Meat (BYND), Lucid Group (LCID), Faraday Future (FFIE) and Dutch Bros (BROS). The five securities in total generated over US$154 million in revenue in the month.

OSTTRA collaborates with LCH SwapAgent

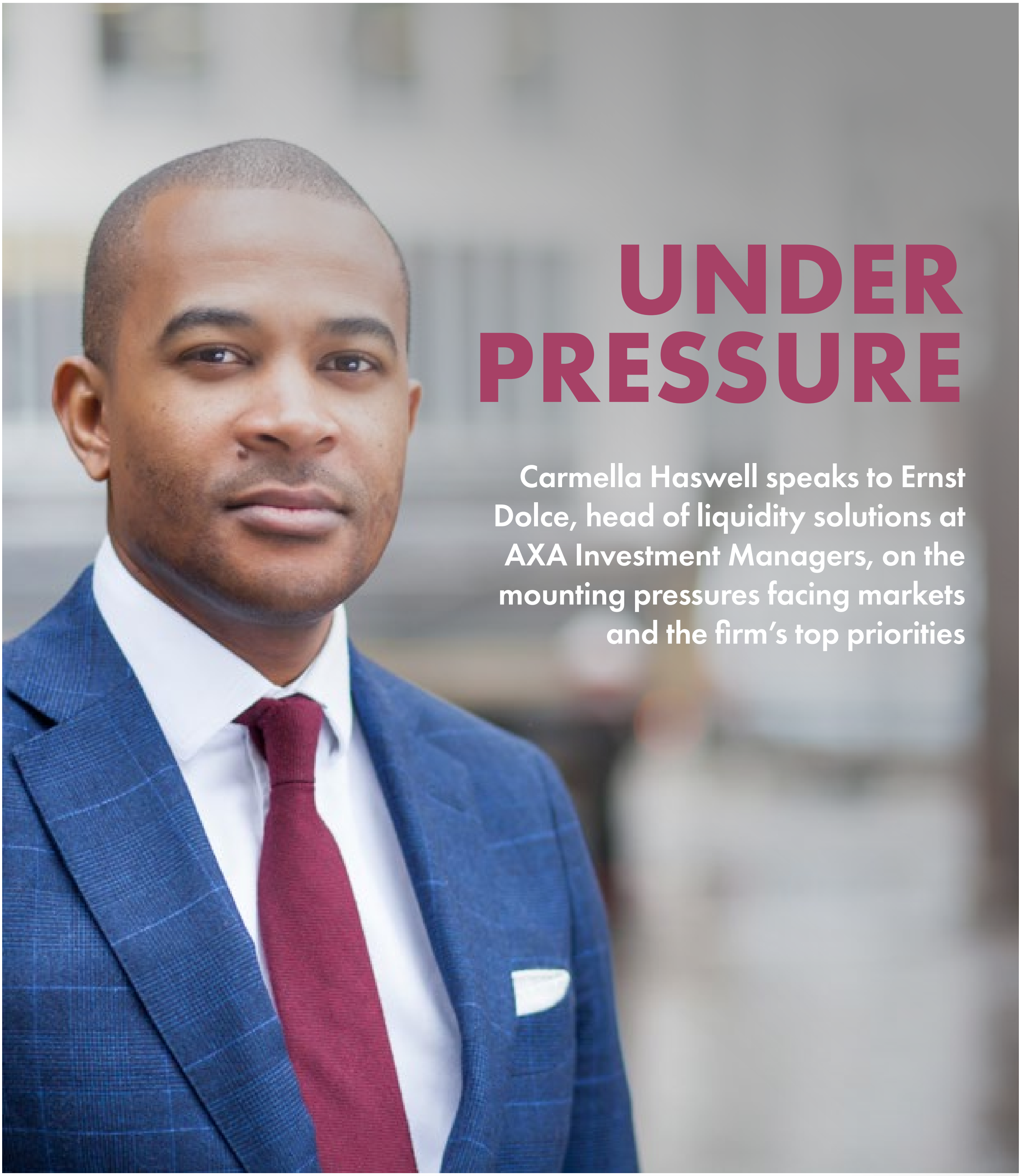
OSTTRA, a global post-trade solutions company, will collaborate with LCH SwapAgent to reconcile bilateral over-the-counter (OTC) trade data.

The collaboration will see OSTTRA use its portfolio reconciliation service, OSTTRA triResolve, to actively reconcile data received from LCH SwapAgent, a part of the London Stock Exchange Group.

LCH SwapAgent is a service designed to standardise and simplify the valuation and settlement of non-cleared OTC derivatives.

Market participants can authorise SwapAgent to send their data directly to OSTTRA triResolve to reconcile all their holdings versus counterparties in one place – at the required regulatory frequency for total portfolio size.

OSTTRA says this will enable participants to use one coherent reconciliation process that takes advantage of OSTTRA triResolve's workflow tools to help investigate and resolve differences.



UNDER PRESSURE

Carmella Haswell speaks to Ernst Dolce, head of liquidity solutions at AXA Investment Managers, on the mounting pressures facing markets and the firm's top priorities

Changes in the market and the regulatory landscape are putting pressure on the global demand for high-quality liquid assets (HQLA) collateral, according to Ernst Dolce.

Currently, the market is facing high inflation pressures as the consumer price index (CPI) reached 9 per cent for the US and UK, 6.1 per cent for France, 7.5 per cent for Germany and 10 per cent for Spain in July. The market is also facing interest rate hikes, or an anticipation of future interest rate hikes, explains Dolce, and an increase of year-to-date market volatility.

Dolce indicates: “Some market participants, due to the decrease of the value of the assets usually used as collateral, and an increase in their margin calls, are facing more pressure than others to post more collateral for derivatives, repo, securities lending transactions, or to manage their regulatory solvency ratio or liquidity ratio — short and long term.”

The introduction of the requirement to post initial margin for uncleared derivatives has contributed to a reduction in the inventory of collateral available. With Phase 6 of the Uncleared Margin Rules (UMR) to go live in September 2022, an increasing number of asset managers — not captured by Phase 5 of the UMR regulation — will have to deal with the reduction of the available collateral pool.

“The combined effect of the changes in the markets and the regulatory requirements are pushing market participants to quickly modify their cash management, liquidity sourcing, optimise their collateral management and increase the monetisation of any excess of liquidity, where feasible.” Dolce explains.

He adds: “We expect the high demand for HQLA and corporate bonds to prevail this year due to market conditions and the regulatory landscape, as well as an increasing interest from clients for securities financing.”

To understand the drivers of growth and demand for a firm's securities financing programme, it is necessary to look at the mismatch between the supply and demand for liquidity, changes in the markets, and the impact of the regulatory landscape.

The mismatch between the supply and demand for liquidity can be illustrated by the injection of liquidity in the markets by the central banks to cope with potential financial impacts of the COVID crisis — which has contributed to an abundance of liquidity in the market, according to Dolce. European Central Bank excess liquidity reached €4.4 trillion as of 3 August 2022, compared to €1.6 trillion on 1 January 2020. However, this excess liquidity is available only to banks or institutions with market-making commitment.

Further evidence of this mismatch could be illustrated by the fact that the liquidity available within the Undertakings for the Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) remains underused or inaccessible without the ‘middle-man’ role of banks, broker-dealers and agent lenders for some market participants with liquidity needs.

The European Fund and Asset Management Association registered €20.8 trillion of net assets of investment within the UCITs and AIFs domiciled in Europe in the third quarter of 2021.

Building blocks

Dolce indicates that securities finance is a tool for AXA IM to create liquidity solutions, optimise collateral management across derivatives, repo, reverse repo and securities lending, reduce counterparty exposure, in addition to source funding and generate income. “Our strategy is to look at these building blocks to provide better liquidity management to our clients,” says Dolce.

> *"Automation allows AXA IM to reduce the cost of implementing securities lending and to reduce pressure on collateral management"*

He adds: “We are continually adapting this tool to address the needs and constraints of our clients. The way we apply this tool to UCITS, alternative investment funds, pension funds, insurance companies, and the client’s balance sheet is highly driven by regulatory and client requirements.”

Increasing automation and improving operational and legal frameworks has become a top priority for AXA IM. The finance industry has been journeying toward the implementation of automation, with AXA IM being no exception as the firm pinpoints securities financing transactions and collateral management as a main focus for automation.

Automation allows AXA IM to reduce the cost of implementing securities lending and to reduce pressure on collateral management. “We are trying to automate our strategy to capture more trades in the market. We strongly believe that a significant part of the general collateral transactions — e.g., open and term transactions — should be executed on platforms,” says Dolce.

> *"A more standardised onboarding process at triparty agents will benefit market participants, accelerate the onboarding process as well as enhancing our ability to serve our clients"*

In terms of improving its operational and legal frameworks, the firm will implement two main plans of action. Firstly, AXA IM is expected to set up additional triparty agent services as principal and agent lenders to manage the collateral. The firm will also be working hand-in-hand with triparty agents to accelerate the Know Your Customer (KYC) onboarding process. “We believe that a more standardised onboarding process at triparty agents will benefit the market participants, accelerate the onboarding process as well as accelerating our ability to serve our clients,” explains Dolce.

Secondly, AXA IM will encourage increased connectivity between third-party vendor applications and the development of APIs by these vendors. The securities financing market infrastructure will evolve through to higher demand from all market participants for cloud-based solutions and API connectivity.

Voting rights

Speaking to SFT, Dolce touches upon AXA IM’s relationship with environmental, social and governance (ESG) principles, a topic that has become an integral part of discussion for firms. “We want to continue to perform the securities financing activity with a robust responsible investment policy and maintain our stewardship in the industry,” Dolce projects. This includes complying with the set of clients and internal ESG guidelines: voting rights, screening of collateral, and restriction on assets lent out.

Regarding voting rights when performing securities lending, AXA IM’s policy is to use all commercially reasonable efforts to recall all positions on loan when there is an opportunity to vote.

Beyond exercising their voting rights, AXA IM acknowledges that clients may seek to implement additional ESG guidelines on both legs of the securities lending transaction. For example, restrictions on assets lent out could be implemented by putting guidelines on the lendable assets and restricting the eligible collateral.

Dolce adds: “It is fair to say that the screening of the collateral received requires new tools or the adaption of existing ones in order to capture the ESG guidelines of clients. This is an operational issue that could be fixed by all market participants and not a challenge specific to ESG.

“ESG and securities financing are compatible and we all — clients, regulators and market participants — have a role to play to ensure strong stewardship and a commitment to responsible investments, clarity in the regulatory framework and building the infrastructure to support and shape securities financing collateral management.”

Next steps

Looking ahead, AXA IM’s focus over the coming 12 months will remain on optimising collateral management across derivatives, repo, reverse repo and securities lending transactions. Dolce indicates a substantial added value for clients, including lower collateral management cost and an increase in income generation, when using securities financing techniques and designing liquidity solutions.

Additional next steps for the firm include increasing the automation of trading activity, such as increasing the volume of low touch transactions, and building intelligent tools and data analytics to better serve AXA IM clients. ■

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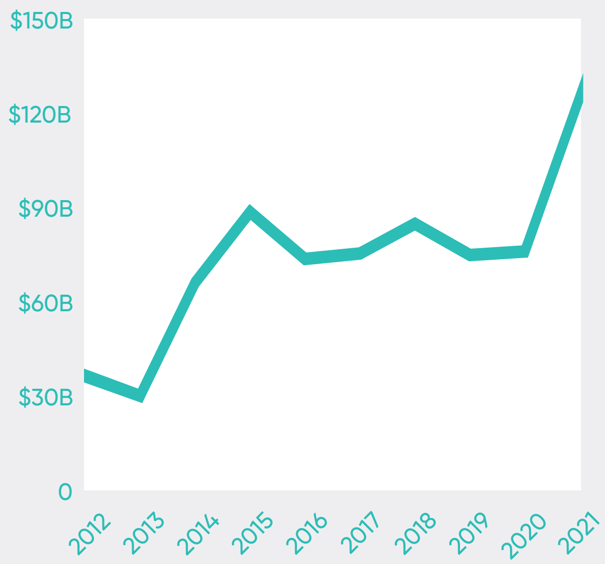
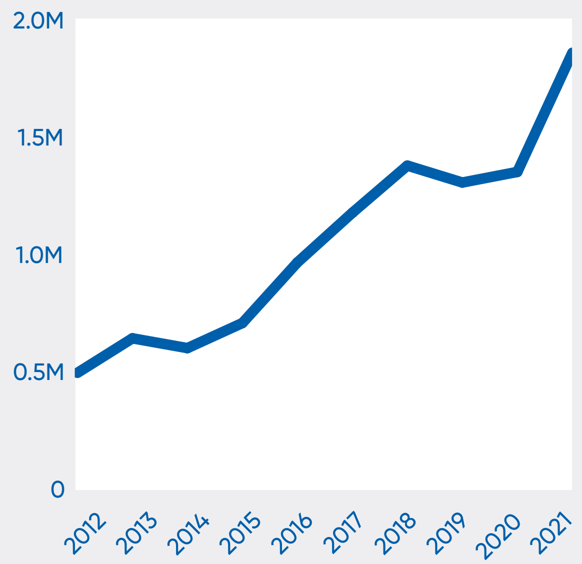


Annual New Loan Transactions



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ECB Opinion Paper recommends dropping CSDR mandatory buy-ins

Bob Currie gauges industry reaction to recent dialogue on CSDR settlement discipline and assesses how well market participants have adapted to the cash penalties regime

The European Central Bank has recommended that the mandatory buy-in (MBI) component of the Central Securities Depositories Regulation (CSDR) should be dropped from the CSDR settlement discipline regime.

This follows an announcement in June from the European Securities and Markets Authority (ESMA) that application of the MBI element of CSDR will be postponed for a further three years.

The MBI rules refer to a mandatory obligation for settlement parties to execute buy-ins against counterparties that fail to settle their trades within a required period.

ESMA's decision to postpone the MBI was intended to give co-legislators, the European Parliament and EU Council, additional time to determine the best course of action to improve settlement efficiency while avoiding duplicative implementation costs for market participants — pre-empting the cost and inconvenience to market participants should the MBI regime be introduced and then be subject to multiple amendments.

In a proposal released in March 2022 (amending Regulation [EU] No 909/2014), the European Commission put forward a "two step approach" to finalising CSDR settlement discipline provision, combining steps to clarify settlement discipline rules and to revise the timeline for implementation of mandatory buy-in provisions.

In this proposal, the Commission indicated that the implementation of MBIs will be dependent on the progress of efforts to reduce settlement fail rates in the EU. It did so in the expectation that cash penalties would "incentivise improvements in settlement efficiency" without endangering market stability and liquidity. After assessing the impact of cash penalties, it intends, in step two, to evaluate how best to apply the MBI regime in light of the progress that has been made in improving settlement efficiency.

Significantly, in advancing this proposal, the Commission rejected the option to suspend the MBI framework entirely. It highlighted that settlement fails in the EU remain "consistently higher than those in other major financial markets" and that MBIs may still have a role to play in reducing this settlement inefficiency.

The European Central Bank's (ECB's) recent 'Opinion' paper marks a departure from this proposal, recommending that the MBI component of CSDR should be removed since, in the ECB's view, the introduction of MBIs would lead to "significant interference in the execution of securities transactions and the functioning of securities markets".

The ECB has also recommended that, should MBIs come into force, securities financing transactions should be excluded from coverage under the MBI regime. In the ECB's words:

"An SFT does not generate an outright open position between the trading parties such as to justify a buy-in against the failing party. Consequently, this would not align with the EU legislator's intention to reduce the number of settlement fails through mandatory buy-ins" (ECB 'Opinion', July 2022, parg 1.6).

Going into more detail, the ECB indicates that it welcomes the EU legislators' intention to create a more targeted scope for the CSDR settlement discipline regime — one that tackles the market behaviour that perpetuates settlement inefficiency, but without penalising every individual settlement fail regardless of the context and the parties involved.

With this in mind, the ECB advises that the settlement discipline regime should not apply to all securities settlement fails, but only when this has negative financial impact for the settlement counterparties of the failing party (parg 1.1)

The ECB has also recommended that, should MBIs come into force, securities financing transactions should be excluded from coverage under the MBI regime.

Joint Associations letters

A number of these ECB recommendations will resonate with industry trade associations that have highlighted their concerns about provisions in the CSDR settlement discipline regime, and explicitly the mandatory buy-in component, that they believe may have negative implications for market liquidity and may entail duplicative costs. In January 2020 and March 2021, an alliance of 14 trade bodies wrote to the European Commission and ESMA to share their views.

The Joint Associations indicated that they remain fully supportive of the Capital Markets Union project and steps to improve settlement efficiency in Europe. However, this must be done in a way that protects market liquidity, that does not increase costs for issuers and investors, and does not place European capital markets at a competitive disadvantage.

Following on the back of a targeted consultation process by the European Commission, which ran from December 2020 to February 2021, and publication of its interim report (released on 30 June 2021), the Joint Trade Associations again wrote to the European Commission and ESMA in July 2021 regarding the implementation schedule for mandatory buy-in rules.

Among other recommendations, the associations advised policymakers in this letter against enforcing a set of MBI rules and then revising them at a later point. This, they say, would "risk damaging the competitiveness of EU capital markets and increasing cost for investors, but would also lead to a duplication of efforts and significant unnecessary disruption for market participants". The letter highlighted that a considerable number of open questions about the MBI regime were still under consideration and these would need to be addressed well in advance of implementation, giving market participants sufficient time to make alterations to their systems, processes and contractual arrangements.

ECB Opinion

Expanding on ISLA's current position and its reaction to the ECB 'Opinion', ISLA's head of regulation, digital and market practice Adrian Dale says that ISLA supports the advice of the ECB to exclude securities financing transactions, which are a recognised mechanism to enhance settlement efficiency and provide much needed liquidity. "It is important to remember the considerable differences in economic profile between SFTs and outright sales and purchases," says Dale. "Securities lending is a well-documented tool for reducing settlement failure, with potential fails being avoided through short term borrowing."

> *"It is still too early to comment on the final outcome as the CSDR review discussions are still ongoing. However, the latest developments certainly provide grounds for optimism"*

ICMA continues to engage with the co-legislators on the proposed revisions to the CSDR MBI regime. In particular, ICMA is recommending greater flexibility in the assessment process for the "two-step" approach, including the possibility to recalibrate penalties. It also recommends excluding SFTs from the scope of MBIs and, in the event that MBIs are applied, implementing this through market regulation rather than CSDR.

Elaborating on these points, ICMA director of market practice and regulatory policy Alexander Westphal says that the Association welcomed the Commission proposals back in February, especially the proposal for a revised MBI framework which took on board a number of concerns previously raised by ICMA and the wider industry. "This is certainly a major improvement compared to the previous version of the rules," he says. In particular, the "two-step approach" on MBIs proposed by the Commission is important as it recognises the potentially disruptive impact [of MBIs] on the market, as well as allowing for more proportionate and targeted initiatives to improve settlement efficiency rates (including the CSDR penalty regime) to be implemented first.

This said, Westphal believes there is definitely scope for further improvements and, with this in mind, ICMA submitted detailed comments on the proposals back in May. "The ball is now in the court of the European Parliament and the EU Council which have both started their respective discussions based on the Commission proposals,' he says. As a result, each will adopt their own position on the CSDR review. "The discussions are still at a very early stage and will only properly kick-off after summer, but we are certainly keen to engage with policymakers on both sides to support the discussions and share our perspective on the proposals," says Westphal.

Gilbert Scherff, senior product manager for securities finance at Broadridge, observes that market participants already have a toolkit in place to address settlement fails for securities financing transactions, given the existing provisions of the Global Master Repurchase Agreement (GMRA) and Global Master Securities Lending Agreement (GMSLA) documentation along with wider market best practice for SFTs. Against this background, he believes that MBIs could have a negative impact on liquidity such that the possible consequences, and unforeseen effects, may go far beyond what the regulator initially intended. "In this context it is encouraging to see a reconsideration of the MBI," says Scherff.

Specifically, given the nature of SFTs and the associated collateral, Scherff believes it would make sense to exclude these transactions from the MBI, especially given the instances where a securities finance transaction is often employed to remedy an operational or liquidity issue.

Flexibility in MBI application

The European Central Bank has recommended that the mandatory buy-in component of the Central Securities Depositories Regulation should be dropped from the CSDR settlement discipline regime.

In the event that an MBI regime does come into force, however, the ECB proposes that legislators should consider an approach where, rather than legislation prescribing the exact method of executing the buy-ins, this should provide greater flexibility to the counterparties to contractually agree on buy-in details among themselves. This might include an option where the non-failing party can decide whether or not the buy-in process would be triggered (ECB, July 2022, parg 1.5).

Asked whether ISLA would be supportive of a regime that offers this discretion to the non-failing party, ISLA's director of regulation and sustainability Farrah Mahmood points out that ISLA's GMSLA has contained contractual remedies for many years that provide the non-failing party with this optionality. "We support the right of trading parties to execute their own buy-ins, based on their underlying contractual requirements, which provides flexibility to act in the best economic interest of the failed-to party," she says. "This allows for loan termination and replaces the delivery obligations with payment obligations — a process commonly referred to as a 'mini close-out'."

Similarly, ICMA's Westphal indicates that this is an important point that ICMA fully supports. This, he suggests, would be fully in line with current market practice and the ICMA buy-in rules which are applied in the OTC bond market. Under the ICMA rules, buy-ins are triggered at the discretion of the failed-to counterparty. "The fact that the [CSDR] MBI provisions do not provide this level of flexibility has always been one of our key concerns," says Westphal.

ICMA and ISLA has been active alongside other industry associations — through the Joint Associations' letters of March 2020, January 2021 and July 2021, and through wider canvassing — in calling for amendments to the original provisions of the CSDR settlement discipline regime, particularly relating to MBIs. SFT asked these associations how far they believe that their concerns and recommendations have been addressed in responses so far from policymakers.

For ICMA's Alex Westphal, the fact that the implementation of MBIs has been suspended and the topic is currently being reconsidered as part of the ongoing CSDR review is already a major achievement and shows that policymakers have taken the concerns that ICMA and other stakeholders have raised very seriously. "We appreciate that it was not easy to get to this point and required a lot of flexibility and pragmatism from both the Commission and ESMA," he says.

ICMA notes that although the ECB does not have a decision-making role in the ongoing legislative discussions in the Council and the European Parliament, the opinion is a positive and important step that it hopes will be influential among co-legislators.

According to Adrian Dale, ISLA is pleased that its concerns have been recognised and it strongly welcomes the corresponding recommendations of the ECB. However, while raising concerns is an appropriate first step, he believes this must be quickly followed by pragmatic and practical solutions on how to address the fundamental objective of the regulation, to improve settlement rates.

Although regulators can in some ways formalise this challenge, Dale suggests that market participants should also consider the plethora of available solutions that facilitate settlement, including distributed ledger technology. "On considering available technologies, many firms agree that distributed ledgers, with their instant communication of an undisputed ledger, will undoubtedly form a large part of the solution," says Dale.

Westphal reminds us that it is still too early to comment on the final outcome as the CSDR review discussions are still ongoing. However, he suggests that the latest developments certainly provide grounds for optimism. "In our view, there are more effective and less disruptive means than MBIs to improve settlement efficiency and there are a number of meaningful industry initiatives under way, for example ICMA's guidance related to settlement optimisation tools which we published both for repo and cash bonds," says Westphal.

Cash penalties

SFT asked ICMA's Westphal how effectively market participants have adapted to the introduction of the settlement fails reporting and cash penalties regimes that were enacted in February, and how much impact these changes have had in promoting improvements in settlement efficiency for securities financing transactions (SFT).

The roll-out of the penalty regime has not been an easy exercise, responds Westphal. ICMA is monitoring feedback from members and there are still some ongoing challenges with CSD and custodian reports and underlying data quality. But members are observing a steady improvement in accuracy and the reconciliation process.

In the aftermath of the go-live, Westphal notes that there has been a high degree of coordination across the relevant trade associations, and with the CSDs, to address the initial issues. ICMA has established a separate workstream to help tackle key challenges and provide some further clarity through detailed Q&As and best practices which are available on the Association's website.

Similarly, ISLA has dedicated considerable effort to preparing for CSDR penalties, particularly in identifying the causes of settlement failures and developing best practices to ensure market alignment. This initial work generated two papers that evaluate the causes of settlement inefficiency and a range of proposed solutions (available on ISLA's website). Farrah Mahmood indicates that the Association's work is continuing on topics such as sale notification, auto and manual partial delivery, and auto-borrowing. "Preparations within member firms have resulted in improved monitoring and management of settlements, which we see mirrored in feedback at ISLA working groups," says Mahmood.

On the basis of evidence from ISLA's working groups, Adrian Dale indicates that there was evidence of a discernible improvement in settlement rates during the first half of 2022 but, with the cyclical increase in volumes, those rates have declined somewhat as we move into the busiest period of the year.

> *"There was evidence of a discernible improvement in settlement rates during the first half of 2022 but, with the cyclical increase in volumes, those rates have declined as we move into the busiest period of the year"*

For ICMA's Alex Westphal, the impact that the CSDR fails reporting and cash penalties regime has had on settlement efficiency rates is not easy to evaluate, given that data on settlement efficiency is very limited — especially when it comes to granular information, and for SFTs specifically which are currently not even distinguishable from cash bonds at CSD level. "From what we have seen so far, there has not been a significant uptick in settlement efficiency rates since February," he says. "However, it is still relatively early days as the new regime takes time to fully bed in. In addition, it is not easy to disentangle any direct effects of cash penalties from the impact of the general market conditions which, of course, have not been easy either."

Broadridge observes that clients are starting to mine data with regards to CSDR penalties and to find ways to translate these findings into improvements in how they conduct their business. Gilbert Scherff notes that this may include reviewing matching and settlement fail rates to the specific trades and analysing return on investment by considering both operational and reputational cost and risk. "We expect this will be a catalyst for innovation and improvement with regards to post-trade processes, for SFTs and more broadly," he says. "We are already observing this through combining management information (MI) from the Securities Financing Transactions Regulation and the CSDR regime."

Nonetheless, feedback from Broadridge clients has identified some challenges with regards to data quality, reconciliation and timeliness of the fines and penalties process. Scherff indicates that there is certainly a lengthy road ahead to ensure that the basic processes mature and that clients can take appropriate action to address settlement inefficiency — the rationale which underpins the implementation of the CSDR fines and penalties regime in the first place.

Recognising this complexity, it is heartening to note provisions in the Commission's March 2022 proposal (op.cit., referenced above) that indicate that it is listening to at least some of the industry's recommendations and seeking ways to streamline application of the MBI regime, should this be implemented.

One noteworthy development is the proposed inclusion of a 'pass-on mechanism'. Under a new paragraph 3a in Article 7 of CSDR, the Commission proposes enabling each participant in a chain of transactions to pass-on a buy-in notification to the participant failing to them — with this being passed along the chain of transactions until this reaches the "original failing participant" (European Commission, March 2022, parg 6, p 210). This pass-on mechanism is designed to prevent a cascade of failed settlements, each requiring a separate buy-in process, by enabling one single buy-in to resolve the full chain of settlements.

Green shoots for securities finance in the depths of a crypto winter

FIS' Ted Allen charts his journey into distributed ledger, detailing the benefits this can deliver to securities finance and the challenges of adapting to the institutional market

I have spent the past few months of my life looking at all things blockchain and distributed ledger – and it has been quite an unusual trip. I started off this journey in blissful ignorance of the world of cryptocurrencies and digital assets, and wondering what, if anything, this might have to do with securities finance.

There were a few triggers that got me started; the press coverage about 'risk free' interest rates of 20 per cent, improbable sounding growth rates and market capitalisations, and excited remonstrations from colleagues asking if a crypto lending module for the FIS Securities Finance Suite was in plan. In the wider context of FIS, I became aware of the launch of new solutions and partnerships for crypto and digital assets that connect our broader base of FIS clients to the world of crypto and digital assets.

I have spoken to several people who are at an early stage in their understanding of crypto, who have concerns about a lack of fundamentals and reservations about devoting country-level resources to mining internet money. The volatility in crypto markets that has happened over the past few months is, of course, driving those concerns. There was the terror of the Luna collapse, in which US$60 billion evaporated, and Celsius, with apparently US$11 billion in AUM and offering 17 per cent interest on balances, which crashed into insolvency.

Looking at coinmarketcap.com, you will find nearly 300 exchanges listed that are dealing in around 10,000 currencies. As with many industries, there is a handful of big players and an extremely long tail, and no doubt those numbers will be quickly whittled down as the icy fingers of the crypto winter tighten their grip.

There may be a flight to quality, with investors preferring to accept more realistic returns for the perceived safety of regulated firms with a balance sheet and a credit rating. The large traditional custodians are setting up crypto custody services – and now, even the most prestigious and traditional private banks in the world are adopting new solutions for crypto trading, custody and staking programmes to offer a one-stop shop for crypto and traditional asset investments. There are also regulations coming in all the major jurisdictions that will curb the excess of enthusiasm and prevent further implosions.

Disruptive initiatives

What I found as I dug a little deeper is that distributed ledgers or blockchains are not the same thing as crypto, and that just because people such as Warren Buffet and Jamie Dimon seem to not like bitcoin, it doesn't mean they don't like blockchains. Digital assets and crypto currencies are not the same thing and pretty much any kind of asset can be represented as a token on a blockchain.

In fact, as I started to understand more about the technology underpinning the crypto and digital asset expansion and stopped being distracted by arguments about whether DeFi is better than CeFi, I realised that there is something very interesting here that really does have the potential to transform our financial world.

Put aside the questions around crypto currencies, the ethics of them, the theoretical valuations, whether they are a security or not, and whether algorithmic stablecoins can ever avoid death-spiralling. Take a look instead at how blockchain technology can be applied to existing markets and, potentially, solve some of the fundamental inefficiencies that exist in the system.

There are some very interesting disruptive initiatives in the securities finance market that seem to offer tangible benefits to the adopters, while solving the problems of adapting digital ledger technology to the institutional market. One of those problems is that anonymity is a tenet of the crypto trading world – but surely a pension fund is never going to be able to lend on a market where there is no visibility of the other side of the trade.

I enjoyed a simple analogy I heard that compared distributed ledgers to user-protected websites on the internet: just because the internet is public and open, that doesn't mean you can get into everything without the right credentials. Similarly, not all blockchains are public, and you can solve the KYC problem on a private, permissioned blockchain.

This permissioned approach can make the benefits of the technology adaptable to the securities finance markets if you take your securities positions, tokenise them, and trade them that way. A loan of a position now doesn't need to involve settlement and settlement lags and it doesn't need to be constrained by trading hours. That has made intraday trades a possibility, which means lower reserves for intraday liquidity, less regulatory capital and lower settlement costs. Individual stocks can be borrowed for the time they are needed, not just by the day.

With the right legal, technical and regulatory structures, there are numerous trading and capital benefits to be gained. Likewise, much post-trade inefficiency can be removed once you remove the worry about bilateral reconciliations, settlement fails, margin calls processing, corporate actions and so on.

The securities finance industry can be a slow and clumsy beast, and it will take time for these changes to be adopted widely – but as the recent crypto winter curbs some participants' enthusiasm for all types of crypto currencies, focus can shift onto the more interesting developments in this space. My view is that the potential these technologies show will inevitably win out in the same way that electronic securities did over paper. We have an exciting few years ahead. ■

Latest industry appointments at PASLA, SmartStream and CloudMargin

BNY Mellon has appointed Paul Bradford as director of cross product trading solutions at the firm's London office.

Bradford brings almost 30 years of experience in the financial sector to the role, having previously held the role of European head of equities, securities lending and repo trading at ING.

He joined ING in 2007 and served a 15-year term with the company before moving to BNY Mellon.

Prior to this, Bradford worked for 12 years with Merrill Lynch between 1995 and 2007.

CloudMargin has appointed Richard Gomm as director of product management and Michelle Burridge as director of sales for EMEA.

Based in London, Gomm will report to CloudMargin's head of product Helen Nicol.

Gomm joins the collateral management platform after departing from a six-year term at VERMEG in July 2020.

At VERMEG, Gomm held a number of senior positions between 2014 and 2020, including head of Europe, Middle East and Africa collateral management and head of COLLINE business solutions.

Prior to this, Gomm was assistant vice president of collateral management and client clearing at Deutsche Bank from 2011 to 2014.

In this role, Gomm was responsible for the day-to-day management of multiple teams within the Bank including repo, structured, collateral management and client clearing Europe.

Burridge, also based in London, will report to David White, chief commercial officer at CloudMargin.

Burridge brings 13 years of experience within securities finance to the sales role, joining the firm from a seven-year term with FIS as a senior business analyst.

Prior to this, she held a number of analyst roles within collateral management across BNP Paribas, HSBC and J.P. Morgan.

Ben Burns to chair PASLA

The Pan-Asia Securities Lending Association (PASLA) has announced that Ben Burns will chair the Association with immediate effect, as former chair Stuart Jones relinquishes his position.

Burns, a member of the PASLA executive committee, has been a director of the Association for more than three years, as well as a key member of multiple working groups.

In his new role, Burns will continue to focus PASLA efforts on promoting open, transparent and efficient securities lending practices across Asia-Pacific.

In addition, he will play a key position in the recruitment of an appropriate CEO for PASLA.

Representatives of the Association comment: "We would like to take this opportunity to thank Stuart for his outstanding contribution as a PASLA director for over 10 years and chair for 5 years.

"He has been instrumental in integrating our franchise with the securities lending industry and we wish him well in his future endeavours."

Commenting on the appointment, Burridge says: “I am excited to join such a dynamic company and to work with a product that can genuinely drive new levels of efficiency for the industry.”

SmartStream has expanded its collateral management team with the hire of Nick Dominy, who has been appointed business development director for the firm’s Transaction Lifecycle Management (TLM) solution.

Based in London, Dominy will introduce the solution — which aims to lower operational risks for collateral management programmes — to prospective partners and clients.

He brings more than 25 years of experience in financial technology and banking to the development role, where he will report to Jason Ang, programme manager for TLM Collateral Management at SmartStream.

Dominy joined SmartStream after a six-year term at FIS, where he worked in sales and was responsible for collateral, securities and derivatives processing solutions.

Prior to this, Dominy worked at Torstone Technology where he sold back-office solutions to the sell side, and held various collateral management roles within the industry with companies including Citibank and Omgeo.

Commenting on the new appointment, Dominy says: “SmartStream has invested heavily in their collateral management solution. I am looking forward to rolling out the latest version, helping clients address industry regulatory issues and making better use of their collateral inventory — which is a particularly important first step towards realising the effectiveness and modernisation for greater efficiency gains.

“Integration to the rest of SmartStream’s ecosystem is also key and we will be offering a unique solution in the collateral marketplace — this together with strategic partnerships will give clients greater control over their post-trade operations”.

Ang adds: “Hiring Nick further emphasises our determination to manage the continuous growth and interest in TLM Collateral Management. Our product has been developed year-on-year, and my goal is to have a highly experienced team wherever and whenever needed to service our clients with the best solution and advice”.

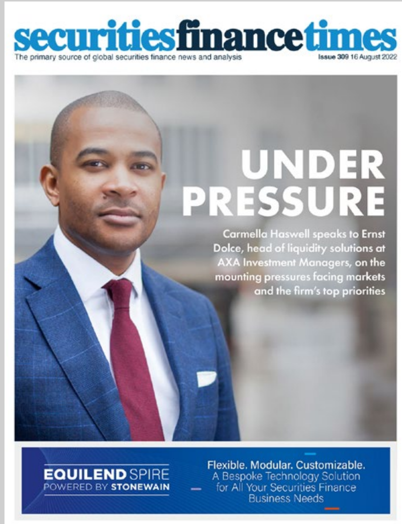
Tomi Adu has announced her departure from Scotiabank after five years at the bank's London office.

Leaving her post as director of collateral trading and co-chair of diversity and inclusion, Adu originally joined the bank in 2017, providing client capital management and funding.

Prior to joining Scotiabank, Adu worked in product management at Sungard, in addition to collateral trading at USB Investment Bank.

Speaking on the announcement via a LinkedIn post, Adu says: “I am grateful and proud of my experiences and accomplishments over the last five years at Scotiabank, broadening our secured funding trading and collateral optimisation capabilities, and co-leading DE&I efforts in Europe.

“I am excited to take the next step in my professional journey at Morgan Stanley in August.”



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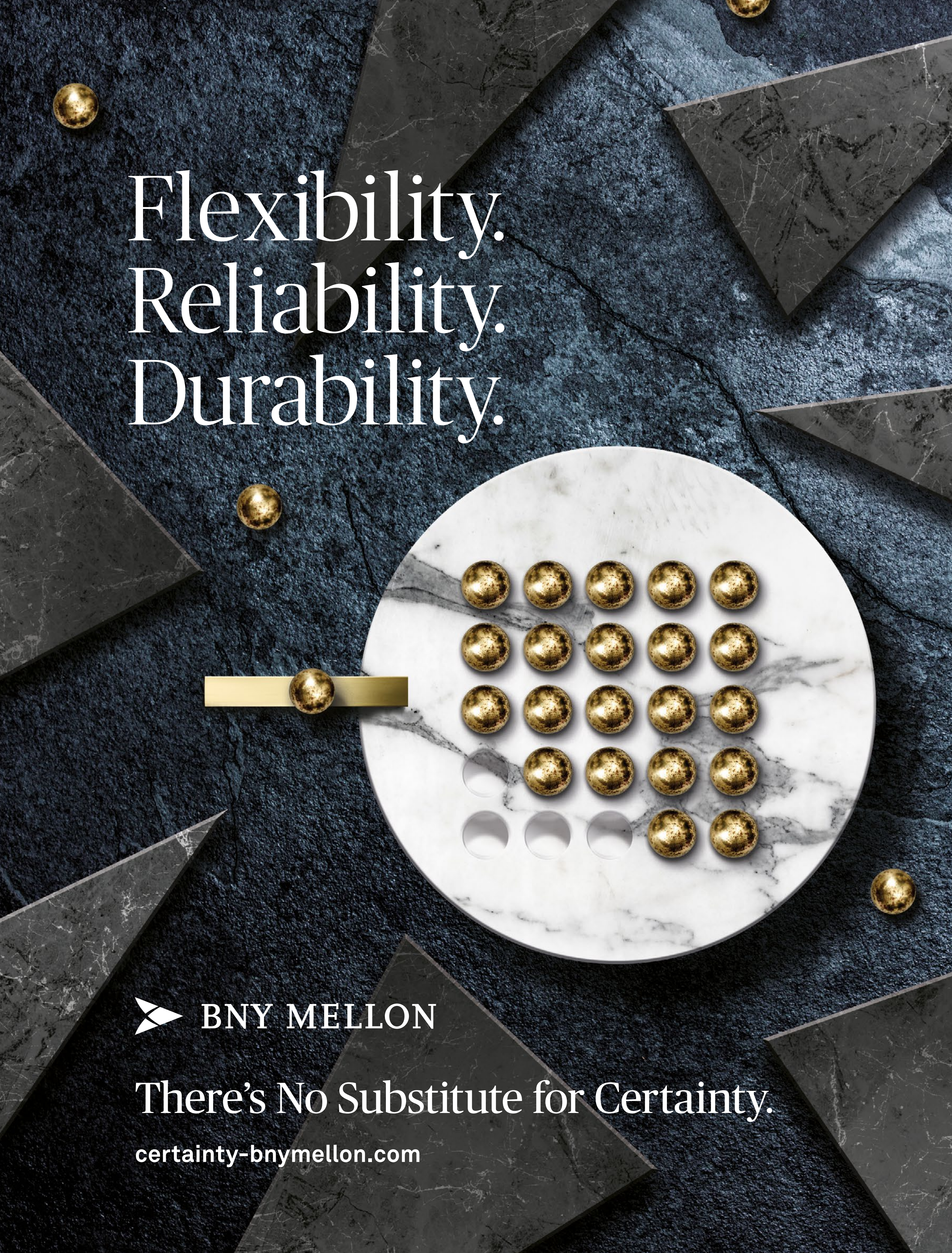
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