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Healthy & Resilient

The RBC Investor Services' team offer their perspectives on recent demand drivers in the Canadian securities lending market

RQD* Clearing partners with Provable Markets

Clearing, custody and execution solutions provider RQD* Clearing, has formed a strategic partnership with Provable Markets' cloud-native Aurora ATS.

According to the firm, the collaborations enhance RQD* Clearing's capacity to offer securities lending and borrowing services to its clients.

The firm will use the National Securities Clearing Corporation's (NSCC) clearing infrastructure, the Depository Trust Company's (DTC) settlement functionality, as well as Aurora's trading and lifecycle automation.

By joining NSCC's Securities Financing Transaction (SFT) clearing service, RQD* Clearing hopes to enhance capital efficiency and reduce credit and operational risk exposure in advance of the move to T+1.

Commenting on the partnership, John Vinci, managing director, head of secured funding and collateral management at RQD* Clearing, says: "RQD* Clearing's participation as a member in NSCC's SFT clearing service will enable them to extend the benefits of central clearing to their clients.

"As the industry continues to experience growth in SFTs, it is important that this area of the industry also benefits from the risk management and liquidity capabilities that central clearing provides."

CEO of Provable Markets Matt Cohen adds: "[RQD* Clearing's] participation further enriches our ecosystem and underscores our commitment to providing innovative solutions to the securities lending market."

Inside this issue

EquiLend launches Orbisa data on Bloomberg

EquiLend has released its Orbisa securities lending data on the Bloomberg App Portal.

Orbisa, operated by EquiLend, offers buy-side market participants a view into securities lending market activity, and offers a dataset comprising US$32 trillion of global lendable equity and fixed income securities.

The addition of Orbisa to Bloomberg offers access for buy and sell-side market participants to real-time data, the firms say.

Bloomberg Terminal users can subscribe to the Orbisa app to have a view into all active securities lending markets worldwide, covering a range of securities lending metrics across more than 196,000 individual securities.

Metrics available through Orbisa include financing rates, borrow demand, short interest indicator, availability, and liquidity.

Nancy Allen, global head of Data & Analytics solutions at EquiLend, says: "We are delighted to work with Bloomberg to provide our unique securities lending data and analytics to an even broader global community of market participants who use the Bloomberg Terminal.

“Subscribers will be able to make more informed investment decisions with unprecedented insight into the securities lending market with Orbisa real-time data."

Berenberg selects Kaizen for regulatory reporting

Berenberg, a privately owned German bank, has chosen Kaizen as its regulatory assurance provider.

The agreement between the two entities allows the bank to use Kaizen’s ReportShield Accuracy Testing, which will help Berenberg to meet regulatory requirements for EU and UK MiFIR transaction reporting.

ReportShield Accuracy Testing is an automated, managed solution which tests

the quality of trade and transaction data that is reported to the regulator.

Commenting on the news, Jean-Marie Mamodesen, managing director and head of European sales at Kaizen, says: “It’s a challenging time for firms as they grapple with significant regulatory change including EMIR Refit and the EU’s MiFIR Review.

“The solutions we offer at Kaizen help ensure that firms have the best control framework in place and are better served to deliver the high standards that the regulators have come to expect.”

Stephan Henning, head of TS Clearing & Reporting at Berenberg, adds: “In this way, we can further automate and improve processes in the area of reporting and create significant added value for our customers.”

xCube launches the “UAE’s first” SLB service for retail investors

Dubai-based platform xCube has launched the “UAE’s first” fully automated securities lending and borrowing (SLB) service for retail investors.

The offering allows users to manage all aspects of the SLB process directly through the xCube application, removing the need to engage a broker.

Automated SLB services offer many benefits to lenders, including additional streams of revenue, a streamlined lending process, and the freedom to sell securities at any time.

The firm believes the service will also offer benefits to borrowers, such as one click short selling, and a flexible margin framework, all integrated seamlessly for easy portfolio management.

Hamed Ali, CEO of Dubai Financial Market, says: “We see Automated SLB as another significant stride in accelerating the development of UAE capital markets and cementing Dubai’s position as a global financial hub.”

Saad Chalabi, CEO of xCube, adds: “By offering automated SLB services, xCube enables retail investors to lend their securities to others in exchange for a fee, all while maintaining instant access to their stocks should they want to sell them.”

HQLA^{X} closes Series C funding round led by HSBC

Financial technology firm HQLA^{X} has closed a Series C strategic investment round led by HSBC.

The round includes contributions from existing shareholders such as BNP Paribas, BNY Mellon, Citigroup, Deutsche Börse Group, Goldman Sachs and J.P. Morgan.

HQLA^{X} says the funding will fuel the continued development and expansion of its distributed ledger technology (DLT) platform, and support the growth of its client footprint.

As part of HSBC’s investment in the funding round, Jamie Anderson, head of collateral treasury trading at HSBC, will join the firm’s board of directors.

Anderson comments: “Digital asset innovation is accelerating at pace around the world, which is why I’m looking forward to working closely with HQLA^{X} to enable us to collaboratively build on our strengths as partners, and to optimise liquidity management and collateral management activities.”

HQLA^{X} CEO Guido Stroemer adds: “We are excited to welcome HSBC as a strategic investor. In addition to investing in our company in support of our strategic platform vision, HSBC is also connecting to our platform, both as an agent lender and as a bank borrower.”

The HQLA^{X} platform enables clients to execute frictionless, precise, and real-time transfer of ownership to meet a wide variety of collateral obligations, the firm says.

It aims to help the securities finance industry address collateral fragmentation by extending its connectivity to leading triparty agents, custodians and market participants.

FSB proposals to enhance liquidity preparedness

The Financial Stability Board (FSB) has proposed eight policy recommendations to enhance the liquidity preparedness of non-bank market participants for margin and collateral calls, in centrally and non-centrally cleared derivatives and securities markets.

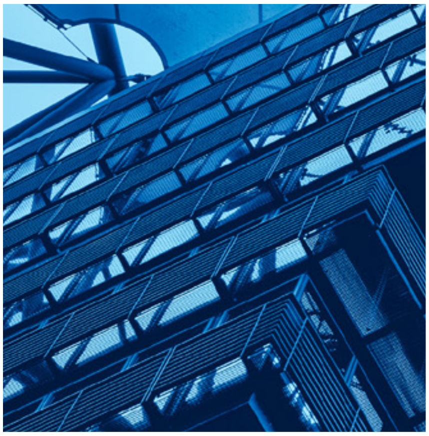
Weaknesses in liquidity risk management and governance by some market participants, were found to be the key causes behind inadequate liquidity preparedness for margin and collateral calls, says the FSB.

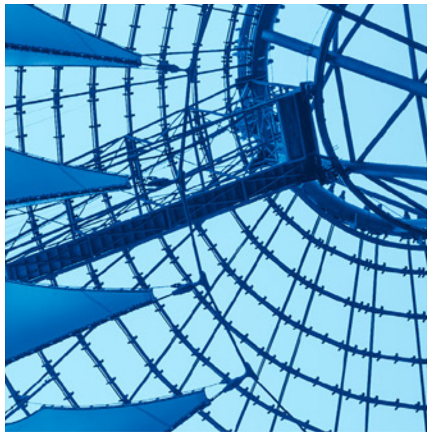
The organisation presented the proposals through a consultation report, which highlights the need for policy adjustments to combat liquidity strains in the non-banking financial institution (NBFI) sector, arising from spikes in margin and collateral calls during times of market stress.

Recent examples of market stress include the March 2020 market turmoil during the pandemic; the collapse of Archegos; and the commodities market turmoil and stress in liability-driven investment (LDI) funds in 2022.

One of the recommendations sets out the need for establishing liquidity risk appetites for margin and collateral calls, as well as contingency funding plans to ensure liquidity needs can be met.

Another proposal calls for liquidity stress tests to cover a range of extreme but plausible scenarios, including both backward-looking and hypothetical. The recommendations cover liquidity






risk management and governance, stress testing and scenario design, and collateral management practices of non-bank market participants, focussing on liquidity risks arising from spikes in margin and collateral calls.

They apply to non-bank market participants that may face margin and collateral calls, including insurance companies, pension funds, hedge funds and family offices.

The report also highlights the need for financial intermediaries in bilateral transactions with non-financial entities, such as commodities traders, to consider assessing their liquidity preparedness for spikes in margin calls and collateral during times of stress.

This consultation forms part of the FSB's work programme on enhancing the resilience of NBFIs. It follows up on the findings of a review of margining practices conducted in 2022 by the Bank for International Settlements' (BCBS) Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

The FSB has invited market participants to provide comments on the consultation report. Responses should be submitted through its online form by 18 June 2024.

ISDA extends Digital Regulatory Reporting to new jurisdictions

The International Swaps and Derivatives Association (ISDA) will extend its Digital Regulatory Reporting (DRR) initiative to several additional jurisdictions.

According to the association, the move will enable firms to implement changes to regulatory requirements cost-effectively and accurately, reducing the risk of regulatory penalties for misreported data.

The extension will cover rule amendments being implemented under the UK

European Market Infrastructure Regulation (EMIR), and by the Australian Securities and Investments Commission, and the Monetary Authority of Singapore.

These rule changes are due to go live in the UK on 30 September 2024, and on 21 October 2024 in Australia and Singapore.

The DRR initiative aims to address cross-border disparities within various rule sets through a golden-source interpretation of each rule set, reviewed and agreed by an industry committee.

The Common Domain Model is used to convert this mutualised interpretation into free, machine-readable code. Firms are able to use the ISDA DRR as the basis for implementation or to validate an independent interpretation of the rules.

ISDA's DRR will be further extended to cover rule changes in Canada and Hong Kong, both due in 2025.

ISDA CEO Scott O'Malia comments: "The ISDA DRR significantly reduces the time and cost needed to implement changes in reporting requirements.

"Rather than interpreting and implementing each set of rules themselves, and then repeating that work as the rules change in future, firms can implement code that has been validated and tested by industry participants and will be updated as rules are amended, enabling resources to be reassigned to other projects."

He adds: "The DRR code for the UK, Australia, Singapore, Canada and Hong Kong will be available well ahead of the rules coming into effect, meaning firms will have plenty of time to implement and test the DRR before using it to report to regulators. Having supported the first phase of the CFTC rule amendments, we're also committed to updating the DRR to include any additional changes when finalised."

NZ Super Fund joins GPFA

The Global Peer Financing Association (GPFA) has announced NZ Super Fund as a new member of its beneficial owner network.

The New Zealand Superannuation Fund is a sovereign wealth fund in New Zealand.

It invests money, on behalf of the New Zealand Government, to help pay for the increased cost of universal pension entitlements in the future.

GPFA brings together beneficial owner members with the goal of encouraging the development of a more effective and transparent marketplace for securities financing activities, as well as liquidity and collateral management.

Members of the GPFA community share a goal to increase and support peer-to-peer securities financing trading activity.

GPFA comments: “Learning from one another and finding ways to collaborate on industry best practices is important to GPFA members and broadening the scope of experience to include the team at NZ Super Fund makes our global community stronger.”

Clearstream to invest in Digital Vault Services

Clearstream has announced its plans to invest in Digital Vault Services (DVS), a fintech offering issuance and safekeeping services for digital bank guarantees and sureties in Europe.

The investment will enable DVS to broaden its offering as a market infrastructure solution for corporates and financial institutions. The mid-term plan will be to integrate DVS’s Guarantee Vault with D7, the digital post-trade platform of Deutsche Börse and its post-trade business Clearstream. This will allow D7 to expand its digital asset product portfolio for the first time.

Jens Hachmeister, head of issuer services and new digital markets at Clearstream, says: “Digital leadership is a central part of Deutsche Börse Group’s Horizon 2026 strategy. The companies’ shared commitment to market innovation makes DVS a perfect fit for Deutsche Börse and Clearstream.”

Jaime Gimeno, co-CEO of Digital Vault Services, adds: “This strategic partnership with Clearstream represents a milestone in our growth journey towards becoming the recognised market infrastructure solution for guarantees in Europe.

“As we move forward, the partnership also positions DVS for exciting new use cases and instruments.”

The investment will be done in exchange for a minority stake. Completion is expected in H2 2024, subject to applicable regulatory approvals and finalisation of legal documentation.

ISLA publishes 2024 netting opinions

The International Securities Lending Association (ISLA) has published the 2024 netting opinions, supporting the title transfer versions of the Global Master Securities Lending Agreement (GMSLA).

All opinions cover companies, banks and securities dealers. Most jurisdictions also cover insurance companies, hedge funds, mutual funds and pension funds as parties to the GMSLA.

Coverage of ISLA's Master Confirmation Annex (MCA), originally published in November 2021, has been further extended to cover an additional five jurisdictions, bringing it to 25 in total.

Opinion coverage has also been extended to include the Thailand annex to the GMSLA 2010, which members can view via the ISLA website.

These opinions are accessible to Association members that subscribe to its nettings opinions service.

Dealing workflows. Digitised.

Left to right: Sophia Rizakos; Kellen Jibb; Kyle Kolasingh and William Yan

A healthy and resilient Canadian market

The RBC Investor Services' team offer their perspectives on recent demand drivers in the Canadian securities lending market, the current regulatory environment and important innovations planned for Canada's market infrastructure

What stood out for you in the first quarter of 2024?

Kyle Kolasingh: In previous first quarters, we have experienced heightened market activity driven by various systemic events. While the first quarter of 2024 was relatively muted, it still carried a significant impact. Q1 saw the S&P 500 achieve its twentieth record high in the span of three months, the NASDAQ 100 hit an all-time high, and the Bank of Japan end its 17-year run of negative interest rates.

Meanwhile, the upcoming transition to T+1 dominated conversations across the industry, as participants continued to take steps to ensure a clear and frictionless path forward. The ongoing integration of environmental, social and governance (ESG) factors into a well-functioning securities lending programme, remained a key requirement for beneficial owners and a mainstay of agent flexibility. After four years of suspended activity, Japan's Government Pension Investment Fund (GPIF) resumed lending in Q1. This bodes well for the sustainability of the financing marketplace, but arguably stimulated much debate and activity in the years following the GPIF suspension decision.

All in all, the RBC Investor Services' (RBCIS) global securities lending desks experienced a productive start to 2024, as we continued our journey of technological modernisation and preparations for T+1. This comes against the backdrop of a healthy and resilient securities lending sector in Canada, the second-largest financing market globally.

How has the North American securities lending market been performing?

Sophia Rizakos: The Canadian securities lending market continues to show strong revenue accretion and compelling portfolio optimisation opportunities for beneficial owners. According to DataLend, revenues were collectively up 15 per cent in 2023, with average fees of 41bps. Approximately 40 per cent of this revenue stemmed from loans garnering more than 500bps.

Canadian equities demonstrated robust performance throughout 2023, generating positive year-over-year increases in revenue, loan balances and asset utilisation. Various sectors, including cannabis, artificial intelligence and crypto, created attractive lending opportunities. On the other hand, dividend reinvestment plan (DRIP) activity softened, with some of the major Canadian financials discontinuing their discount programmes in the face of a diminished need to raise additional capital.

In the US equities space, additional activity was attributed to corporate actions, which presented optional lending opportunities for beneficial owners. The most recent of these was an exchange offer with Cummins, which fully split off its remaining interest in Atmus Filtration Technologies. This followed notable events such as the Johnson & Johnson/Kenvue exchange offer, and the AMC conversion of APE shares in 2023.

Corporate action optimisation events continue to be fuelled by demand from arbitrage-seeking funds and, as a result, the US market saw a spike in borrowing fees. Looking further into 2024, we are keen to see how M&A activity develops following a relatively soft 2023, and whether this may translate into lending opportunities on both sides of the border.

Demand for fixed income remains strong, particularly for North American sovereign debt, due to the high interest rate environment coupled with central bank quantitative tightening. In February, the Bank of Canada (BoC) re-introduced the Receiver General auction to provide additional liquidity and align the Canadian Overnight Repo Rate Average (CORRA) closer to its target. The need for liquidity, combined with the search for higher yields, continue to stimulate borrower demand, particularly on an overnight basis. Demand for term lending, while still relatively high, has shown some signs of softening so far this year as structured trades, especially in the Canadian provincial bond space, have rolled off.

William Yan: Collateral flexibility and balance sheet optimisation remain relevant to borrowers and beneficial owners alike. In 2023, RBCIS was the first Canadian agent to accept Canadian pension paper as a standalone form of collateral, providing further flexibility to borrowers and unlocking additional balances for beneficial owners. As we enter Q2 2024, our securities lending desks are seeing demand to pledge an array of collateral, including equities, convertible bonds and corporate bonds.

What is new on the regulatory front for securities lending?

Yan: The BoC's planned introduction of a settlement fail fee on Government of Canada bond and bill trades, underscores the growing emphasis on improving market functionality and efficiency within a low-rate environment. In an approach similar to the implementation of the US Treasury Market Practices Group's fail charges in 2009, the BoC fee aims to incentivise timely and efficient settlement, mitigating systemic risks associated with failed trades. The proposed regime will inevitably aid in promoting optimisation of the borrower settlement process through the introduction of punitive costs, while minimising operational risk. As it stands, the proposed timeframe for the first trial period is set to begin in Q4 2024. While the trial will include fails tracking, fail fees will not be exchanged by participants.

Another notable regulatory update is the Securities and Exchange Commission's (SEC) Rule 10c-1a. The rule, which awaits final guidelines from the Financial Industry Regulatory Authority (FINRA), is intended to enhance transparency and oversight in governing the securities lending market, bolster investor confidence and promote more informed decision making. Based on available information, a beneficial owner using an agency lending model would not have a reporting obligation.

Finally, from a global perspective, the industry continues to assess Basel's revised market risk framework. The Canadian space is well positioned to adopt this updated framework following the implementation of Basel III in Q2 2023.

"As we enter Q2 2024, our securities lending desks are seeing demand to pledge an array of collateral, including equities, convertible bonds and corporate bonds."

William Yan
Associate
RBC Investor Services

What are some of the key innovations planned for the Canadian market infrastructure?

Kolasingh: The transition to a T+1 settlement cycle in Canada and the US, during May 2024, is a milestone event which has driven significant advancements in automated and outsourced technologies. Both lenders and borrowers are currently in various implementation phases of their technology solutions to prepare for the changing settlement landscape, as they look to optimise recall management processes and minimise operational risk.

In Canada, the TMX Group is developing its securities lending recall hub, which is intended to simplify the communication of recall notices for market participants. Similar to the Depository Trust and Clearing Corporation's (DTCC) SMART/Track recall messaging services, the facility provides for interoperability among participants and fintechs — a welcomed enhancement to the financial infrastructure. This additional facility will greatly simplify electronic messaging across multiple fintech and bilateral relationships. As a result, firms will be able to utilise their existing post-trade providers and avoid a patchwork of connectivity, thereby furthering operational efficiencies across the industry.

At RBCIS, we have partnered with our fintech providers to implement a recall service that leverages the TMX facility. This is designed to automate communication of the sending and receipt of recall notifications between agents and borrowers. The streamlined approach will assist in expediting the recall process, increase operational efficiency and reduce timelines.

In tandem with T+1, the TMX Group and Clearstream have launched the Canadian Collateral Management Service (CCMS) — Canada's first domestic triparty capability. CCMS aims to optimise collateral management by enhancing liquidity and minimising exposure risk as market participants navigate increased collateral requirements from regulations, the transition to T+1 and the cessation of bankers acceptances in the Canadian market.

"Similar to securities lending, the foreign exchange world is well prepared for T+1. The USD/CAD FX trade is already on a T+1 standard settlement cycle, and T+0 trading is supported by most market participants."

Kellen Jibb
Associate
RBC Investor Services

Collaboration between stakeholders will continue to be paramount in addressing emerging challenges such as T+1, while seizing opportunities for innovation and growth. Such a spirit of industry-wide cooperation bodes well for market participants, who can continue to operate with confidence.

How are the other market-facing activities being impacted by T+1?

Kellen Jibb: Similar to securities lending, the foreign exchange (FX) world is well prepared for T+1. The USD/CAD FX trade is already on a T+1 standard settlement cycle, and T+0 trading is supported by most market participants. Issues may still arise, particularly in the 'holiday mismatch' scenario, where there is a US holiday but no Canadian holiday (or vice-versa). In this situation, it will be necessary for traders to fund their foreign security purchases on the trade date, to ensure that funds are available to settle security trade purchases. Also, T+0 FX trades cannot be settled via Continuous-Linked Settlement, and this could potentially result in more bilateral trading between the client and counterparty for T+0 trading.

Furthermore, much like securities lending, clients may need to review their trade management and cash projection procedures on the cash and funding side to ensure stakeholder alignment with the shorter settlement cycle. Keeping an additional cash buffer to cover any potential overdrafts might also be necessary, at least until the market is back to a steady state.

How is DEI being integrated into the securities lending sector?

Kolasingh: Over the past 24 months, I have seen a structural change in the securities lending industry, which is increasingly embracing diversity, equity and inclusion (DEI) practices. As chair of the International Securities Lending Association's (ISLA) DEI Steering Group, I work closely with ISLA lead Tina Baker and a group of industry colleagues to further

"The Canadian securities lending market continues to show strong revenue accretion and compelling portfolio optimisation opportunities for beneficial owners."

Sophia Rizakos
Analyst
RBC Investor Services

the association's goals of building and fostering a more diverse securities lending sector. One of our initiatives — ISLA Connects — provides individuals who do not have the opportunity to interact via traditional means, such as industry conferences and working groups, with access to various networking and educational opportunities.

This type of foundational work not only cultivates long-lasting collaboration and inclusivity within the industry, but also encourages change and embraces diversity, ultimately contributing to a successful and sustainable securities financing marketplace. That said, much remains to be done across the industry in raising awareness of our unconscious biases and furthering the appreciation for diversity.

What is RBCIS doing to prepare its securities lending offering for the future?

Kolasingh: The ongoing evolution of global securities financing markets — driven by regulatory change, new markets coming online, expanded forms of collateral management, and the integration of digital assets — makes the need for enhanced automation and a revitalised infrastructure even more important for the business going forward. This is in parallel with increasing demand for greater flexibility in offerings and capabilities from both beneficial owners and borrowers.

As such, RBCIS is continuing to modernise our technology and operational flows. This will enhance trading capabilities, enabling us to optimise client assets and streamline procedures within a compressed settlement infrastructure. In partnership with trusted fintech vendors, our advanced technology architecture and capabilities will future proof the RBCIS securities lending solution. At the end of the day, it is all about ensuring that we continue to meet the needs of our lending clients in today's ever-changing market landscape, generating yield and unlocking the full potential of their investment portfolios.

"The ongoing evolution of global securities financing markets makes the need for enhanced automation and a revitalised infrastructure even more important for the business going forward."

Kyle Kolasingh
Head of Market Services Solutions
RBC Investor Services

Unlocking new levels of efficiency

Justin Lawson catches up with Wematch's co-founders David Raccat and Joseph Seroussi on how the firm's collaboration with Eurex will drive innovation in synthetic securities finance, and the company's long-term vision for the industry

What do you note as the most pressing and current issues facing the securities finance industry?

One of the key challenges we see is the growing need for multiple liquidity channels and alternative platforms, products and venues on securities lending. This is especially critical given the increasing pressure on the sell side to move from physical to synthetic financing due to Basel III risk-weighted assets (RWA) and capital charges, accelerating synergies between physical securities lending and synthetic structures. Another pressing issue is the development of robust pre-trade tools to better optimise trading and inventory allocation.

Regulators are increasingly focusing on transparency and risk management in the securities financing market. How can technology help firms navigate this evolving regulatory landscape?

Our Data & Contribution service helps firms to meet the Fundamental Review of the Trading Book (FRTB) data requirements by providing real, tradable price observations, to pass the Risk Factor Eligibility Test. The service creates a total return swap (TRS) curve, and provides historical and observable data to help with marking books in an opaque OTC market. Working with a data partner like Wematch reduces the time to be FRTB-compliant, with a current run rate of 10,000 quotes received yearly, and more than 700 mids already created. We are soon extending the scope to securities lending with upgrades and downgrades.

Wematch's ongoing notional volume has recently reached a record US$320 billion. To what do you attribute this success, and how does your platform differentiate itself in the market?

Our platform was revamped in 2022 to manage much larger volumes and industrialise the business. We have expanded from niche markets into general collateral flows, which are very volume-intensive. Key differentiators include a powerful collateral optimiser, seamless connectivity and integration, and continuous client-driven innovation on a modern, agile technology stack. We have identified strong growth in securities lending and in the US market, compared to the more mature European TRS market. Our focus is on capturing additional flows in the US and APAC regions for both TRS and securities lending.

It took us less than four years to reach US$100 billion in ongoing notional, two years to grow from US$100 billion to US$200 billion, and just six months to transition from US$200 billion to US$300 billion. This accelerating growth rate is a testament to the value our clients see in our platform and the trust they place in us.

We attribute this success to a few key factors. First, our commitment to innovation — we are constantly pushing the boundaries of what is possible in securities finance, whether it is through our optimisation tools, our expansion into new markets and products, or our strategic partnerships with industry players such as Eurex.

Second, our client-centric approach. Everything we do is driven by a deep understanding of our clients' needs and pain points. We work closely with them to develop solutions that streamline their workflows, reduce their risks, and enhance their profitability. This collaborative approach has helped us build strong, long-lasting relationships with our clients and partners.

Finally, we have very dedicated teams working to make Wematch the go-to platform for securities finance. Their expertise, passion and dedication are the driving force behind our success.

In 2023, Wematch launched several tools. Can you explain how these solutions are helping to revolutionise post-trade processes and your plans for 2024?

The FRM Optimiser is designed to transform financial resource management for banks by simplifying and optimising the recall and substitution process for securities-based lending financing trades. It provides a central marketplace, enhanced trade capture, lifecycle management tools, and a user-rule-driven optimisation tool, ensuring optimal inventory allocation and improved balance sheet management.

The TRS Cash Flow Manager streamlines and automates cash flow management for total return swaps. By leveraging trade data from our TRS modules and corporate actions data, it calculates cash flows. Our Trade Sync feature automates reconciliation, reducing breaks and increasing efficiency.

The Data & Contribution service addresses data challenges in the TRS market, particularly for regulatory requirements such as FRTB. It aims to provide transparent data sharing, enhancing price transparency and standardisation of TRS funding curves. Participants contribute prices, access historical data, and receive customisable reports, therefore improving accuracy and efficiency.

In 2024, we plan to extend the Data & Contribution service globally, introduce digital ISDA confirmations, and enhance the TRS Cash Flow Manager.

Our goal is to be a comprehensive one-stop shop for TRS, and to provide the market with a matching platform on securities lending, revolutionising post-trade processes and becoming the go-to provider for securities finance market participants, who seek to optimise workflows, reduce risks, and enhance capital efficiency.

AI and machine learning are increasingly being applied to securities finance. What potential do you see for these technologies, and how is Wematch incorporating them into its platform?

We recognise the immense potential of AI and machine learning in revolutionising the securities finance industry. As part of our long-term roadmap, we are investing in research and development to responsibly harness these cutting-edge technologies, while maintaining the highest standards of security, privacy, and regulatory compliance.

Our goal is to gradually incorporate AI and machine learning capabilities into our platform, ensuring they complement and enhance our existing offerings. We will keep our clients informed and work closely with them to address their specific requirements and concerns as we make progress in this area.

Wematch recently partnered with Eurex to drive innovation in synthetic securities finance through Basket Total Return Futures (bTRFs). Can you share more details about this collaboration?

Our Eurex partnership, set for a Q3 2024 launch, will enable interoperability between Wematch's TRS module and Eurex's bTRF products. Wematch will provide the GUI for participants to input interests, match trades, and update digital portfolios in real-time via API, allowing for listed bTRF trading alongside OTC TRS.

This collaboration aims to revolutionise the complete end-to-end workflow for bTRF market participants, from basket construction and pricing to trade execution, lifecycle events, and streamlined clearing and settlement. The seamless harmonisation between the two platforms will unlock new levels of efficiency, standardisation, reduced counterparty risk, cash flow management, and capital optimisation for market participants.

The partnership will roll out in strategic phases, with full integration across pricing, execution, and lifecycle management targeted for Q3 2024.

What are your thoughts on DLT and smart contracts, and how do you see these shaping the future of securities finance?

We believe distributed ledger technology (DLT) has immense potential to transform collateral management. Wematch has partnered with HQLA^{X}, Ownera and J.P. Morgan, for repo execution with delivery-versus-payment (DVP) settlement across two different distributed ledgers. DLT can help solve settlement issues and maximise collateral velocity using tokenised securities and digital cash on private blockchains. We have completed all developments to be part of the DLT repo workflow and are eager to see the first trades go through.

Looking ahead, what is your long-term vision for the securities finance industry, and how do you see Wematch contributing to this evolution over the next five to 10 years?

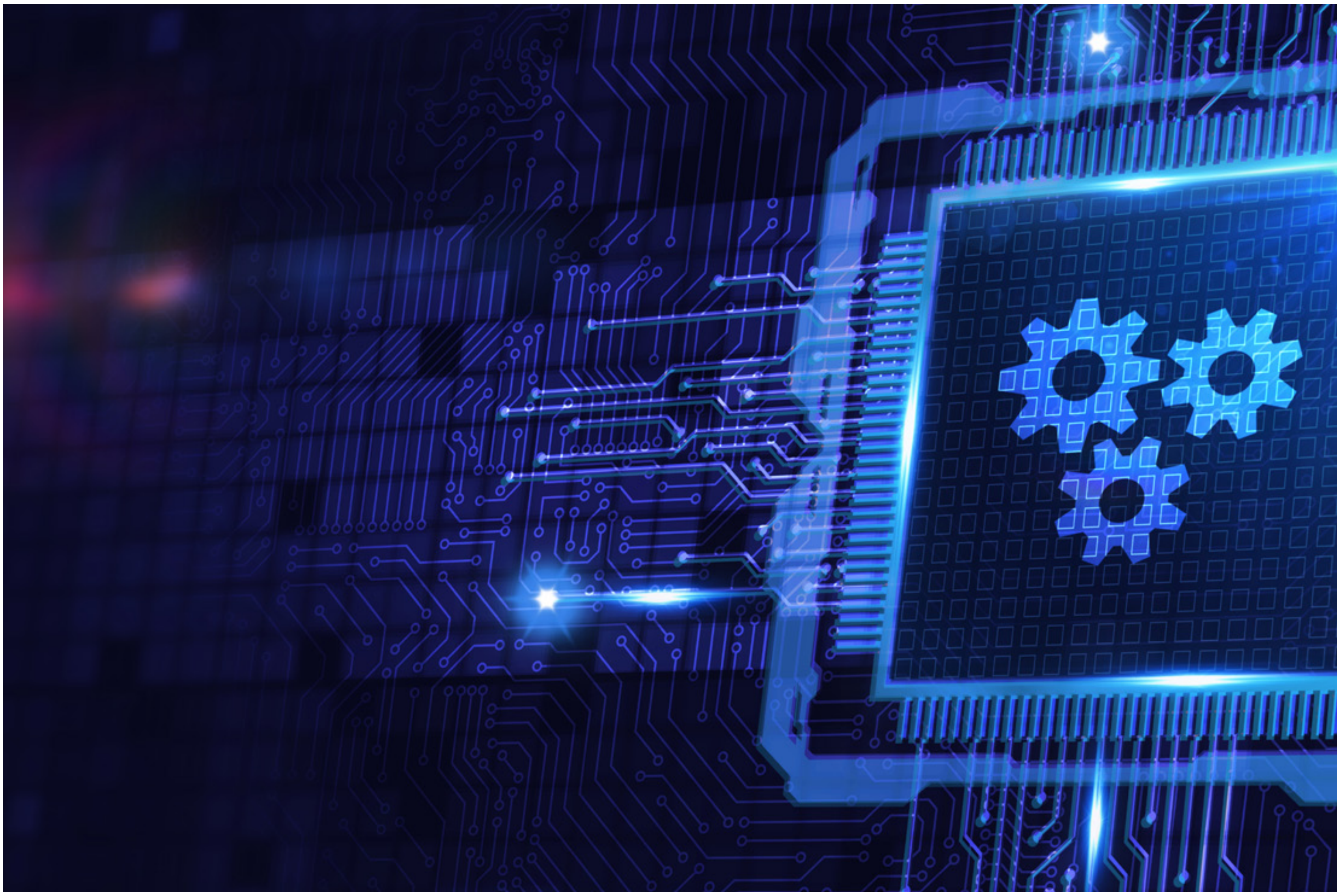
We emphasise the importance of interoperability and a cross-product solution that allows clients to optimise workflows, collateral, and inventory across securities lending, TRS, and bTRFs. Our vision is to become product-agnostic and offer a single-provider solution for maximum efficiency.

Wematch prioritises the development of DLT solutions and plans to release an interoperable solution in late 2024. Wematch envisions a future of accelerated digital efficiency, connecting market participants across asset classes on modern, agile platforms.

We will continue to expand our TRS, securities lending, and financing offerings globally, bringing automation, optimisation and innovation. Wematch is committed to accomplishing its plan of providing market participants with a full suite of securities finance solutions, encompassing securities lending, TRS, bTRFs, and other innovative products. By offering a comprehensive, integrated platform, Wematch aims to become the go-to provider for securities finance market participants seeking to optimise their workflows, reduce operational risks, and enhance capital efficiency.

David Raccat
Co-founder and chief revenue officer
Wematch

Joseph Seroussi
Co-founder and CEO
Wematch



Collateral management: from a product to a service

Over the past 15 years, collateral has become a key facet of the finance industry. In the process, it has changed from being a product that is posted, to being a service that can be optimised. Collateral efficiency is increasingly the primary goal of market participants, say Euroclear's Mike Reece and Olivier Grimonpont

Collateral management has played a pivotal role in enabling industry transformation and innovation, especially since the financial crisis in 2008. It has emerged as a primary solution for institutions navigating a changing regulatory environment.

It shifted to the centre of the finance industry after the financial crisis, and since then it has assumed a key role in ensuring the stability of financial institutions. Collateral management now sits on a unique crossroad at the convergence of front and back offices, sell side and buy side, product and business lines, and different geographical regions.

In response to the 2008 financial crisis, regulators and policy makers made a series of regulatory changes to ensure that critical financial institutions would have adequate access to liquidity and funding, even at times of extreme market stress. This was based on a combination of increased capital and liquidity requirements, and properly secured financing arrangements. Collateral management, and in particular triparty collateral services, were well positioned to help the industry move to fully secured financing.

The pace and scale of regulatory change from 2012 to 2022 was a huge challenge for many institutions. These regulatory changes demanded a new approach to financing, funding and liquidity. Firms initially scrambled resources to comply with requirements like the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Requirements (NSFR). However, it quickly became clear that collateral management is well positioned as a broad solution to meet these standards, and collateral managers saw a significant uptick in activity and balances in response.

Optimisation

As firms have become more adept at meeting regulatory demands, their focus has shifted towards cost efficiency and profitability, through the optimisation of their collateral activity. Clients emphasise the need for flexible and integrated collateral solutions spanning various financing and hedging products, including repos, stock loans, and derivatives. Speed of implementation and time-to-market consistently ranks high among client requirements for collateral solutions.

The demand for scale and efficiency has prompted the entry of new fintech companies and data providers, equipped with innovative technology and data solutions. These entrants have both disrupted and enhanced collateral management solutions. Additionally, societal expectations are pushing collateral providers to offer services and solutions related to ESG criteria.

In 2021 and 2022, other external factors converged, posing significant challenges for triparty providers. These included the final phases of the Uncleared Margin Rules (UMR), new entrants with differing needs from the traditional client base, the pandemic's impact, and the ongoing march of fintech and data providers. This convergence led to increased pressure on triparty providers to maintain high-quality service and client satisfaction.

These challenges have led to some significant changes within the collateral management services market. Firstly, previously disparate parts of the market have now come together. Collaborative arrangements between buy and sell-side firms have become more prevalent as they navigate collateral set-ups.

Post UMR Phase 6, while buy-side firms continue to consider options to future proof their operating models and optimally manage collateral, they benefit from leveraging a well-trodden path by banks and dealers, which are familiar with the efficiency achieved through collateral solutions such as triparty.

Previously siloed collateral products and services, such as equity, fixed income, and derivatives, are now coalescing. Coordination across locations and regions is essential for delivering global solutions. Most notably, front and back-office departments have begun working more closely together, with front-office teams prioritising post-trade cost reduction and savings, with increased focus on collateral efficiency. Ultimately, regulation that drives the industry is often agnostic to pre and post-trade silos, creating requirements and having an impact

"Data and technology will underpin much of the workflow of the future to ensure that both the firm and our clients have the right innovation and information to deliver collateral efficiency."

Mike Reece
Head of Collateral Management Services
Euroclear Bank

throughout the trade lifecycle. Similarly, innovation allows further transparency across different cost centres, while to explore digital and tokenisation solutions, it is essential to understand the full lifecycle of a collateral trade.

"At Euroclear, clients consistently express the need for rapid market and counterparty access, swift and accurate responses, intuitive tools providing access to people and data, and collateral expertise intimately aligned with their business and priorities," says Olivier Grimonpont, head of product management for Market Liquidity at Euroclear. "Their objective is straightforward: to maximise efficiency from our triparty services."

"Remarkably, a vast proportion of collateral liquidity and counterparties operate within the Euroclear ecosystem. Euroclear is, in fact, Europe's largest provider of triparty services"

Olivier Grimonpont
Head of product management for Market Liquidity
Euroclear

To position itself to best serve its clients and maximise collateral efficiency in this expanding and often complex ecosystem, Euroclear has realigned its collateral teams within Euroclear Bank, according to Mike Reece, head of Collateral Management Services at Euroclear Bank.

"In 2023, we created our Collateral Management Services division, which was focused on delivering a seamless client experience, aligning specialist onboarding, client service and operations," Reece adds. "Working closely with our partners in product management, commercial and IT, this team is tasked with delivering Euroclear's broad range of collateral services, maximising potential for our clients' financing and collateral activity."

This change is significant, as Euroclear's Collateral Highway now has "unmatched scale", comprehensive product offerings, and the seamless integration of triparty services with settlement, custody and asset services. "No other entity offers such an integrated service spectrum at the scale that Euroclear does," says Grimonpont. "Remarkably, a vast proportion of collateral liquidity and counterparties operate within the Euroclear ecosystem. Euroclear is, in fact, Europe's largest provider of triparty services."

Euroclear's Collateral Management Services' teams are at the forefront of changes in the dynamic collateral and financing sectors, the firm says, because there are always new client requirements. Whether it is catering to investment banks, or assisting buy-side clients unfamiliar with triparty services, Euroclear's expansive reach helps to provide clients with insights, helping bridge gaps across business lines, products and regions.

"Data and technology will underpin much of the workflow of the future to ensure that both the firm and our clients have the right innovation and information to deliver collateral efficiency, combined with an unwavering focus on speed of set up and fast time to market," Reece concludes. "Nevertheless, the evolving role of collateral and financing at the heart of our industry brings both opportunities for growth and responsibilities for delivering great service to our clients."

Collateral Panel

Securities finance specialists reflect on the transformation of collateral management, from an auxiliary service to a pivotal aspect of the ecosystem, and how the practice is being impacted by key regulatory initiatives

Panellists

David Beatrix, Head of OTC and Collateral Services, Securities Services, **BNP Paribas**

Jérôme Blais, Co-Head of Triparty Collateral Management, Securities Services, **BNP Paribas**

Darren Crowther, Head of Securities Finance and Collateral Management Solutions, **Broadridge**

Sam Edwards, Head of Alpha Collateral Services, EMEA and APAC, **State Street**

Charles Engle, Executive Director, Tri-party and Collateral Management, **J.P. Morgan**

Sabine Farhat, Head of Securities Finance, Product Management, **Murex**

Neil Murphy, Business Manager, triResolve Margin, **OSTTRA**

How has collateral management transformed from being viewed as an auxiliary service to becoming a pivotal aspect of the securities finance ecosystem?

Jérôme Blais: Collateral management has moved from being an almost purely operational concern to being part of the front office strategic decision making process. Firms can no longer afford to treat it with mere collateral operators, but now need to invest in people and a web of systems that can seamlessly manage collateral allocation across their trading activities.

In times of collateral rarefaction, smart and effective collateral management processes allow firms to be able to seize trading opportunities by making the most of their available balance sheet.

Despite the industry's best efforts to create bridges between collateral pools, and make collateral venues more interoperable, front office collateral managers still need, more than ever, to build and operate models that allow them to mobilise collateral that is still moving across these venues on an almost constant basis. The move to T+1 will, more likely than not, put even more emphasis on the necessity to incorporate collateral management into the trading engine of most top-tier firms.

Sam Edwards: Collateral plays a key role in the facilitation of activity in the securities financing ecosystem. Its traditional role as a hedge against counterparty credit risk is well established. In recent years, especially the periods following stressed market conditions, collateral has become an indispensable tool in financing and liquidity management.

Movement in the value of collateral during the term of the transaction provides opportunities for dynamic valuation, and presents opportunities to derive economic benefits, as well as enhancing its traditional role in times of extreme market volatility. It also provides market participants with a reliable source of funding. Collateral can be deployed in two modes.

When collateral is an outright transfer of legal title, as in the case of securities financing transactions, it gives opportunities to the collateral receiver to redeploy it for its own financial activities. Where collateral is pledged and its re-use or rehypothecation is not permitted, as in the case of the Uncleared Margin Rules (UMR), it can be recalled and substituted by the collateral giver. Economic benefits of active collateral management have transformed its importance in equal measure across regulators and market participants.

Furthermore, the current interest rate environment has diminished the attractiveness of cash collateral. As the receiver of cash collateral benefits from reinvesting it. However, some part of the proceeds of reinvestment is rebated back to the collateral giver. With no clear indication on where the interest rate markets are headed, non-cash collateral is starting to replace cash. Collateralisation is a mainstay of financial markets with continuing demand, it has pivoted sharply from an auxiliary service to being a facilitator and enabler of financing transactions for all market participants.

"The move to T+1 will, more likely than not, put even more emphasis on the necessity to incorporate collateral management into the trading engine of most top-tier firms."

Jérôme Blais
Co-Head of Triparty Collateral Management, Securities Services
BNP Paribas

Darren Crowther: Collateral Management has always been core to securities finance since it is an inherently collateralised form of trading. However, the impact of regulation has meant greater attention needs to be paid to the types of collateral accepted. These include factors such as the liquidity of the collateral and the market risk attached to them. Simply having a high credit rating is not enough for assessing the acceptability of collateral these days. Even high quality government bonds have seen increased levels of volatility since interest rates started to rise.

Sabine Farhat: Collateral management and securities finance are always interlinked. Historically, however, they were run by two siloed teams. The successive waves of regulations post crisis — Basel, UMR, T+1 and US Treasury repo clearing, to name a few — have created a unique challenge to collateral management. While the demand for high quality collateral is rising, its availability is suppressed due to capital and liquidity constraints. This mismatch underscores the necessity for increased collateral mobility within the securities finance market.

Meanwhile, market headwinds compel financial institutions to optimise asset usage, explore new revenue streams, and improve operational efficiencies. Adopting a holistic approach to collateral management and securities finance empowers firms to effectively manage inventory and liquidity to reduce funding costs, enhance yield and ensure regulatory compliance. This convergence also leads to optimised operations — it breaks silos and streamlines fragmented and manual processes.

"Collateral is now a parameter fully integrated in the pricing of derivatives, and XVA desks are fully reliant on collateral parameters."

David Beatrix
Head of OTC and Collateral Services,
Securities Services
BNP Paribas

Charles Engle: Collateral management has undergone a profound evolution, transitioning from its former perception as an ancillary service, to assuming a central role within the securities finance ecosystem. This shift is primarily attributed to the multifaceted utilisation of collateral beyond conventional securities financing activities. The expansion of collateral providers and receivers, coupled with the escalating growth in collateral obligations and balances, underscores the pivotal significance of collateral management. Moreover, the triparty infrastructure has been instrumental in facilitating this transformation, offering a robust framework for innovative applications of collateral.

Beyond traditional financing endeavours, collateral management now encompasses diverse functions such as managing uncleared initial margin (IM) for OTC derivatives, administering IM for central counterparties (CCPs), handling variation margin (VM) for OTC derivatives, facilitating structured financing arrangements, and optimising enterprise-wide collateral utilisation.

These versatile applications not only enhance risk mitigation but also unlock liquidity and mobilise assets across the securities finance landscape. Consequently, collateral management has emerged as a linchpin in fostering efficiency, resilience, alpha generation, cost savings, and liquidity within the securities finance ecosystem, marking a fundamental paradigm shift in its strategic importance.

What significant changes in collateral management practices have been observed since the global financial crisis of 2008, and how have these adaptations improved the resilience of the financial market?

David Beatrix: The changes have been massive. Firstly from a regulatory standpoint for OTC derivatives with the introduction of mandatory central clearing, then Uncleared Margin rules (variation and initial margins), or FINRA 4210 for the To-Be-Announced (TBA) market. Collateral is now a parameter fully integrated in the pricing of derivatives, and XVA desks are fully reliant on collateral parameters.

From an operations standpoint, the implicit problem was to cope with a complex landscape, while maximising efficiency with the smallest operational risk possible. There have been many initiatives of standardisation like the Clearing Connectivity Standard, and promotion of electronic platforms between participants to negotiate agreements, exchange data, agree margin calls etc. Some of them emerged as key for the overall resilience of collateral exchanges. The International Swaps and Derivatives Association (ISDA) is leading the data standardisation effort, jointly with the International Securities Lending Association (ISLA) and the European Repo Council (ERC), with the Common Domain Model initiative aiming to facilitate systems interoperably across different assets (derivatives, repo, securities lending).

From a liquidity perspective however, certain areas of the market are still facing challenges when it comes to mobilisation of liquidity, which triggered ‘dash for cash’ scenarios like in 2022 with the UK gilt crisis, which attracted the attention of regulators. The industry is not finished with regulations, with the possible introduction of US Treasury repo clearing in 2026, which will likely bring its own challenges to the repo market.

Farhat: The financial crisis and resulting regulations have fundamentally transformed how institutions manage collateral. This transformation has three key aspects:

Centralised collateral management — firms are now consolidating collateral management across different business units in order to bring transparency, meet increased margin pressures, unlock unused inventory, improve liquidity access and strengthen risk management practices. This enhances collateral mobility and increases liquidity in the whole market.

Rise of collateral utilities — centralised counterparty clearing houses (CCPs) and triparty services are becoming increasingly common. These utilities mitigate counterparty risk and reduce operational risks and costs. They contribute to a more stable financial system.

Standardisation, automation and electronification — the industry is moving toward greater standardisation, automation and electronic processes. Market participants are able to manage collateral more effectively by reducing legal and operational costs, ultimately leading to a more robust, transparent and efficient financial market.

Neil Murphy: The introduction of new global margin rules since 2016 has concentrated the attention of front office and collateral managers alike. For some, the focus has been narrow, with firms prioritising delivery against new IM requirements only (calculation, exchange and segregation of IM). In contrast, other firms have taken the opportunity to review their entire front-to-back margin process.

The distinction being, that these latter firms have been able to transform processes for VM, as well as IM, and in some cases have leveraged these synergies to support and improve processing for additional asset classes — including cleared, repo and exchange traded derivatives (ETD). These changes have been characterised by a move towards increased use of industry standards — such as reconciliation, calculation and documentation — and a wider adoption of automation and straight-through processing (STP), such as with electronic messaging and SWIFT.

Engle: Due to the evolving regulatory landscape and increased collateral demand since 2008, significant changes have reshaped collateral management practices, enhancing the resilience of the financial market. Notably, there has been a marked shift towards centralised data strategy, as well as automation and optimisation across various aspects of collateral management.

Centralised collateral data strategy has become the focus for sell and buy side firms across multiple dimensions, including instrument and market data, agreement and collateral eligibility, positions and transactions, and trade or collateral obligations. A siloed approach could work for individual businesses or desks, but treasurers and financial resource managers will be challenged in identifying and executing on optimisation opportunities or, more importantly, meeting regulatory requirements as regulators continue to focus on collateral as part of resolution planning, liquidity stress testing and other areas where firm-wide collateral data is critical.

The increased regulatory requirements and collateral demand has also been driving the need for holistic, scalable solutions. This includes the automation of repo processes, exemplified by the expansion of triparty programmes to support diverse trade activities and the introduction of new functionalities like real-time instruction management and workflow automation. Additionally, J.P. Morgan has expanded its triparty collateral management reach to include the buy side, with buy side firms increasingly relying on holistic solutions provided by custodians and collateral agents to navigate uncleared margin rules.

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Head of Securities Finance, Product Management
Murex

Moreover, the evolution and regulation of fully paid lending programmes has necessitated scalable and compliant collateral operating models, with a focus on safeguarding collateral through third-party custodians. These adaptations, to name a few, have bolstered the efficiency, transparency, and risk management capabilities of collateral management practices, contributing to the overall resilience of the financial market. Through automation, enhanced connectivity, compliance measures, and the surrounding data strategy, collateral management has played a crucial role in mitigating systemic risks and strengthening the robustness of the financial ecosystem in the post-crisis landscape.

Crowther: There has been a combination of initiatives that were already in progress before the global financial crisis, but were accelerated by it, as well as those that were driven by the wave of regulation that followed the crisis.

Greater consolidation of collateral management functions and technology across asset classes began before the global financial crisis, but has been sped up due to the challenges associated with obtaining a consolidated view of counterparty risk. The consensus is that increased use of clearing, standardisation of IM, standardisation of risk-weighted asset (RWA) calculations, standardisation of CSAs, processes, the Common Domain Model (CDM), and automation, along with a more holistic approach to collateral management, have contributed to enhanced resilience.

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Darren Crowther
Head of Securities Finance and Collateral Management Solutions
Broadridge

However, many firms have struggled with integrating collateral management across asset classes and legal entities. They have been held back by a combination of issues. These include technology, divergent practices between asset classes, organisational structure, and static data.

Edwards: In a bid to match the demand created by regulatory reforms, key standards and operational practices have been implemented across the globe to standardise the legal and operational frameworks underpinning collateral management. A key impediment to efficient use of collateral is lack of visibility and mobilisation in a timely and cost effective manner. In addition, standard eligibility criteria and haircuts have also been adopted to reduce friction regarding valuation and eligibility schedules.

Collateral transformation or 'upgrades' have become instrumental in easing the pressure on high-quality collateral. Typically, equities or corporate bonds do not meet all of the eligibility criteria of regulatory standards. These securities can be transformed to eligible collateral through repo or securities lending transactions.

In the same period, operational processes have improved across the board. In the decade before the financial crisis, more often than not, collateral management was back office activity which usually ran on spreadsheets. Exposures were frequently over collateralised to avoid daily movement of collateral between counterparties, particularly in the OTC markets. In the last decade, medium to large size firms have established robust technology and processes to manage end-to-end collateral flows. In addition, the industry has established best operational practices and benchmarks to enable standardisation and effective use of technology.

Can you discuss the evolving role of collateral diversification and its impact on the collateral management landscape?

Crowther: For years following the global financial crisis, central banks were accumulating various high-quality collateral as part of their quantitative easing policies. There was also an increased use of cash due to significantly lower interest rates. We also saw greater use of cash because of the much lower interest rates. As interest rates have increased and we have seen quantitative easing, the range of collateral available has increased and opportunity costs of different types have changed.

However, the primary driver of collateral diversification has come from the realisation that it is not just about the credit quality of issuers — it is about the market risk attached to different securities. The UK LDI crisis serves as a striking example of this shift, along with significant price fluctuations in various long-dated high quality government bonds.

Murphy: The combination of rising interest rates and new regulations have seen firms expand the types of collateral they pledge, requiring many to exchange non-cash collateral for the first time. For those with some prior experience in using these assets (for example where they have a sizeable repo or cleared book) the change has been simpler and has been more about increasing funding only. However, for others, the broadening of assets has required wider changes to systems; documentation and onboarding with triparty agents; connectivity to market infrastructure (SWIFT) etc. In turn, this diversification also increases the focus on collateral funding, leading firms to prioritise collateral optimisation as a way to minimise overall costs.

Edwards: Regulatory obligations have created a tight market for high-quality liquid assets (HQLA). Assets are considered HQLA if they are liquid and maintain their value in stress conditions. Another measure of liquidity is through the ease of sale or repo of the asset. Collateral diversification is key to mitigating market risk. Overexposure to a borrower, currency, sector, or asset class, creates concentration risk. Collateral's ultimate goal is to protect the non-defaulting counterparty. In the event of counterparty default or market event, diversification helps to reduce liquidation costs for concentrated pools of collateral.

On the other hand, a less diversified pool may prove challenging to liquidate, or may need to be substantially discounted to liquidate. However, achieving diversity is not easy. It requires ongoing monitoring and review of collateral valuations, and making necessary adjustments to the pool. Operationally, the legal entity, physical locations of collateral and supporting market infrastructure are important elements in diversification considerations.

In addition, an important factor in driving changes in eligible collateral schedules (ECS) is the changing rates and profit margin environments. As lenders search for increased yield, their risk appetite has broadened during periods of low rates and stable markets, while the re-introduction of risk to the market over the past five years has led to a retrenchment of this approach as returns increased and risk aversion returned.

Engle: Collateral diversification plays a pivotal role in shaping the collateral management landscape, fostering resilience and enhancing market efficiency. As financial markets evolve, institutions seek to broaden their collateral horizons, tapping into new markets and asset classes to optimise their financing and derivatives activities. This shift towards diversification is exemplified by initiatives like J.P. Morgan Tri-party's expansion into new markets (eg Poland) and within existing markets (eg Japan, China Stock Connect, Korea, Taiwan), enabling clients to leverage a wider array of assets for collateral purposes.

By embracing diverse collateral options, institutions mitigate concentration risk, enhance liquidity, and unlock new opportunities for asset mobilisation. Furthermore, collateral diversification promotes market stability by reducing reliance on specific asset types or regions, therefore bolstering the overall resilience of the financial system. As the demand for collateral diversification continues to grow, collaboration between market participants and innovative solutions will further shape the collateral management landscape, ensuring its adaptability to evolving market dynamics.

"As financial markets evolve, institutions seek to broaden their collateral horizons, tapping into new markets and asset classes to optimise their financing and derivatives activities."

Charles Engle
Executive Director,
Tri-party and Collateral Management
J.P. Morgan

Farhat: Traditionally, cash and government bonds are major forms of collateral. However, post-crisis regulations and challenging market dynamics increase collateral scarcity, liquidity pressure and concentration risk. To explore alternative, acceptable forms of collateral, optimise capital and liquidity, enhance returns and mitigate risk, firms tap more and more into a wider pool of collateral, including equities, corporate bonds or even alternative assets such as commodities, digital assets and structured products.

This brings several challenges to collateral management. First, managing a broad range of collateral requires robust processes to assess and represent asset eligibility in the collateral schedule, value collateral accurately and efficiently handle margin calls.

Second, it multiplies monitoring and optimisation of global collateral inventory complexity. Third, diversifying collateral holdings might also introduce more counterparty risk, which requires careful valuation and management. To cope with these challenges, the collateral management industry demands sophisticated systems capable of evaluating, monitoring and processing wide and evolving types of collateral in a centralised framework.

How do regulatory initiatives such as accelerated settlement and central clearing affect collateral management practices, and what measures are firms taking to enhance efficiency in compliance with these standards?

Edwards: The move to T+1 in the US and the upcoming changes to US Treasury clearing are continuing to drive the move towards automated, STP-based collateral and inventory management solutions. Our clients are well positioned to further develop their optimisation capabilities, as the use of intelligent solutions and frictionless environments such as State Street triparty enable the next level of alpha generation for their shareholders.

"The combination of rising interest rates and new regulations have seen firms expand the types of collateral they pledge, requiring many to exchange non-cash collateral for the first time."

Neil Murphy
Business Manager, triResolve Margin
OSTTRA

The disadvantage of this continued regulatory focus on transparency and risk reintermediation is that we will see costs increase for buy side firms in particular. The barriers to entry, along with the increase in liquidity buffer, and initial process friction, will not be appealing given the increased requirements placed on them in recent years, through requirements such as the UMR.

Farhat: Regulatory initiatives such as accelerated settlement and central clearing have profound effects on collateral management practices. A shortened settlement cycle requires firms to post collateral more quickly to fulfil transaction obligations. This places greater pressure to efficiently allocate and mobilise collateral in a timely manner. Mandates for the central clearing of derivatives, and soon, US Treasury and US Treasury repos, might increase margin requirements due to an increase in clearing activity and margin segregation requirements. It also shifts collateral management responsibilities toward managing relationships with CCPs and ensuring compliance with their margin requirements.

To optimise collateral allocation and ensure compliance, firms are centralising collateral management functions to achieve better control and visibility across business lines. This is facilitated by adopting a multi-function and multi-asset system that natively integrates collateral management functions with trading, risk management and settlement. Firms are also investing in advanced technology and automation, to streamline collateral operations from margin calculation and margin call management down to settlement and regulatory reporting.

Engle: Regulatory initiatives such as accelerated settlement and central clearing significantly impact collateral management practices, prompting firms to adopt measures aimed at enhancing efficiency and compliance with these standards. The transition from a T+2 to a T+1 settlement cycle in the US, effective 28 May 2024, necessitates swift adjustments to systems and processes to mitigate settlement risk and enhance capital efficiency. Firms face challenges in re-prioritising initiatives to align with the accelerated timeline, particularly in securities lending programmes where recall time frames must be condensed and processes realigned to prevent settlement fails.

Borrowers and lending agents are urged to adapt their procedures to ensure timely recalls and collateral returns. Triparty agents offer a streamlined and highly STP solution for managing non-cash collateral, minimising the operational hurdles associated with bilateral management. Additionally, central clearing mandates, especially for derivatives, compel firms to optimise collateral usage and explore end-to-end solutions. Buy side firms are increasingly outsourcing collateral processing to leverage expertise and reduce operational risk.

Collaborating with collateral managers facilitates holistic management, allowing firms to focus on strategic objectives while ensuring compliance with regulatory standards. These measures underscore the industry's commitment to adaptability and efficiency amid evolving regulatory landscapes.

Beatrix: Many regulations have direct or indirect effects on collateral. Reducing settlement cycles for example, implies reduced substitution cycles, in cases like the sale of a posted asset, which makes the recall a bigger challenge especially under a bilateral collateral setup. Together with the introduction of the Central Securities Depositories Regulation (CSDR) and settlement fail penalties, the impacts for firms can be substantial.

On another point, central clearing implies that cash is king for VM, which is a challenge for structurally cash-poor institutions like pension schemes hedging their liabilities with cleared swaps, and whose clearing exemption ended in June 2023. They have to maintain a structural cash ladder based on adverse market scenarios, while still achieving yield and remain as invested as possible.

The IM rules introduced completely new processes, with a significant adoption of triparty and the particular aspects of threshold monitoring, implying the need for the front office to monitor their trading levels with each counterparty carefully.

Crowther: One of the major side effects of central clearing has been to enforce a high degree of standardisation around both trading and collateral practices. Additionally, margin calls from the CCP must be promptly collateralised, regardless of whether participants agree or dispute the values reported by the CCPs. Both of these factors help to reduce friction and inefficiency in collateral management, even though some may miss the previous flexibility.

The transfer of collateral, as well as securities finance transactions, typically settle more quickly than transactions in the cash securities markets. However, the challenge arises when providers of collateral need securities back quickly, in order to settle any sales they make of those securities. This can lead to an increase in fails. While there are markets that settle on T+1, or have no tolerance for fails, these are not always the largest markets. If reduced settlement cycles cause more friction, larger markets will need to adapt and learn from them.

How does triparty collateral management support the transition to central clearing, and what role does it play in enhancing liquidity and efficiency in the collateral market?

Engle: J.P. Morgan Tri-party collateral management facilitates the transition to central clearing by offering the CCP Margin Exchange (CCPMx) solution, enhancing liquidity and operational efficiency for clearing members. By aligning with CCPs' preference for bilateral collateral delivery, CCPMx combines Tri-party's optimisation and eligibility engines with bilateral market movements. This approach simplifies collateral delivery and return processes, including intraday recalls, while optimising collateral selection and reducing operational burdens. J.P. Morgan Tri-party's role extends to managing collateral against margin obligations across multiple CCPs, streamlining connectivity and providing clients with a consolidated view of global collateral obligations across their securities financing and derivatives collateral activity. Through partnerships like with Baton Systems (Core Collateral), J.P. Morgan has connectivity to major CCPs globally, further enhancing liquidity and efficiency in the collateral market while simplifying collateral management for market participants.

Farhat: Triparty collateral management (TCM) bridges traditional bilateral collateral and central clearing. It facilitates collateral segregation and movement to and from the CCP. When a market participant pledges collateral directly with a third-party agent, this collateral is segregated from other assets and can then be used to fulfil margin requirements for centrally cleared transactions. TCM also reduces operational burden and simplifies compliance with CCP for clearing members by automating collateral operations, centralising record keeping, and standardising documentations and processes.

TCM plays a vital role in enhancing liquidity and efficiency in the collateral market. It enables efficient allocation and utilisation of collateral assets across multiple transactions and counterparties, ensuring that collateral is available when and where it is needed most. This improves overall liquidity in the market, mitigates counterparty risk and increases market resilience. TCM also contributes to a more efficient collateral landscape by accelerating collateral movements, reducing errors and minimising processing costs via automation and streamlining.

Edwards: As a triparty service provider, and through our Collateral+ solution, evolving market regulation offers us the chance to enable enhanced technology solutions to our clients with a view to gaining more returns from their inventory, reducing overall capital requirements and gaining access to a greater diversity of liquidity sources. Triparty can play a key role in this, supported by the continuing development of the interoperability approach, by reducing physical settlement requirements and enabling 'round the clock' collateral mobility.

As our clients step up to driving value creation throughout the end-to-end trade cycle, State Street Triparty has a key role to play in both the traditional and digital landscape.

What role does technology, particularly AI and blockchain, play in innovating collateral management processes, and how can firms ensure successful integration and adoption of such technologies?

Crowther: Collateral still exists in silos and there are still the associated costs and frictions of managing collateral on a global basis. Broadridge has used DLT to help make it easier to mobilise collateral and is developing AI solutions that help deal with the frictions that occur in the post-trade processes.

Successful adoption and integration of technologies, such as artificial intelligence and blockchain, ultimately depend on being laser focused on the problem that needs to be Solved, as well as picking the right tool for the job. This is the approach Broadridge has taken, and it has helped to get our new products into production at multiple clients.

Murphy: The collateral management process has historically been resource-intensive, demanding significant time and financial investment for daily operations. Consequently, it stands to benefit greatly from technological advancements that can streamline processes, reduce costs, mitigate risks, and minimise manual intervention. Recent advancements in technology, particularly in margin call messaging and reconciliation, have centred around the adoption of standardised industry platforms, enhancing connectivity for all market participants.

To ensure widespread adoption, future innovations — including the adoption of AI and blockchain — should follow a similar approach. They should aim to minimise barriers to adoption, offer cost-effective solutions, and deliver clear and demonstrable benefits. Given the bilateral nature of collateral management, improvements must cater to firms of all sizes, not just the largest players, ensuring accessibility and usability across the industry.

Farhat: Technology, including AI and blockchain, is transforming collateral management by offering greater efficiency, cost reduction and risk mitigations. AI has the potential to automate decision making processes, such as collateral optimisation and risk management, and perform predictive analysis on future collateral requirements. Blockchain can enhance efficiency by improving transparency and traceability of collateral records, reducing intermediaries, and increasing liquidity and accessibility of collateral assets.

To ensure successful integration and adoption of such technologies, firms must invest in robust, scalable and modern infrastructure and technology platforms. These investments lay a solid foundation — they enable centralisation, automation and digitalisation, and allow firms to adapt swiftly to new technological advancements. Collaboration with technology vendors and industry partners is also crucial to facilitate the integration of technology innovations.

Engle: Technology, particularly AI and blockchain, is revolutionising collateral management processes by enabling optimisation, cost reduction, and asset mobilisation. AI aids in optimising collateral on a broader scale, while blockchain technology facilitates the tokenisation of assets, unlocking their value and streamlining their mobilisation. For instance, J.P. Morgan's Tokenized Collateral Network (TCN) leverages blockchain to enable near-instantaneous settlement of collateral transactions, enhancing liquidity and efficiency.

Tokenisation enables the release of 'trapped' assets and adds utility to — and removes mobility friction from — highly liquid assets. For example, BlackRock and Barclays used TCN to deliver money market fund (MMF) collateral for an OTC derivatives trade. This solution transformed the usage of an asset class that was nearly impossible to mobilise as collateral to a near-instantaneous transfer of MMFs at the time of the margin call.

Successful integration and adoption of these technologies require firms to prioritise interoperability, ensuring seamless connectivity with existing systems and platforms. Moreover, firms should invest in robust cybersecurity measures to safeguard sensitive data and build trust in these innovative solutions. Collaborating with industry partners and regulatory bodies can also facilitate standardisation and promote widespread adoption, driving further innovation in collateral management practices. By embracing cutting edge technologies and fostering collaboration, firms can navigate the evolving landscape of collateral management with agility and efficiency.

Edwards: The technology evolution is not slowing down, and all financial services firms are technology firms in one shape or form. The adoption of AI and distributed ledger technologies (DLT) is taking place in differing ways. While some firms have been looking at revolutionary approaches, at State Street, we see the best results coming through market alignment via evolutionary methods. The use case for DLTs to enhance collateral mobility and globalisation of domestic asset liquidity is clear. Combining this with our triparty platforms brings the next level of inventory efficiency for our clients.

While the initial process developments for AI are to enable greater responsiveness and effectiveness in resolution of the remaining manual processes in the collateral chain, such as enhanced dispute management and client reporting. An innovation mindset is key for us at State Street, as we help our clients to adapt to a landscape where the pace of change continues to accelerate.

How are firms addressing recent liquidity stresses in the market, and what innovative solutions are being offered to provide clients with greater flexibility in managing liquidity needs?

Edwards: Market stress events throughout 2020, 2021 and 2022, have caused market participants to think more carefully about their liquidity needs and associated management. Historically, many buy side market participants have fulfilled their collateral obligations by sourcing inventory against exposures on a like-for-like basis across accounts within the same legal entity, or by running cumbersome internal processes to aggregate inventory into one account to cover all exposures under that legal entity.

Increasingly, market participants are turning to robust optimisation engines to allow them to specify algorithmic rules for sourcing inventory across their account range into centralised collateral inventory accounts or long boxes. The inventory in these long boxes is then used to facilitate settlement against counterparty exposures according to client configured rules. Clients are able to configure the allocation of inventory from their accounts to the long boxes and from the long boxes to counterparties as best suits the needs of their trading relationships.

Settlement of inventory between client custody accounts, long boxes and counterparties, is automated by the optimisation engine to improve process efficiency. These solutions enable market participants to deploy inventory from multiple sources in the most optimal manner possible across their trading agreements, and allows them to improve the efficiency of their portfolios, reduce liquidity risk, and help facilitate the deployment of more inventory towards higher value activities.

Beatrix: The implied cost of collateral in derivatives pricing means that cash remains somehow king on the OTC market. In fact, there is no other option on centrally-cleared OTCs, while the latest ISDA surveys show that cash remains favoured on non-cleared OTCs — despite a slight decrease in the use of cash versus securities compared with two years ago.

"Increasingly, market participants are turning to robust optimisation engines to allow them to specify algorithmic rules for sourcing inventory across their account range into centralised collateral inventory accounts or long boxes."

Sam Edwards,
Head of Alpha Collateral Services, EMEA and APAC
State Street

Repo facilities can be an option to ease the sourcing of cash for cash-poor players, as these offer an option to source cash at a cost possibly cheaper than the funding cost implied in the derivatives price assuming securities collateral.

Besides, there have been moves recently to facilitate the eligibility of tokenised assets as collateral, such as the Tokenized Collateral Model Provisions in the ISDA Credit Support Annex (CSA), or the Luxembourg Blockchain III Law. However, the gains observed on tokenisation so far at proof-of-concept level are still limited, especially with regards to the collateral traps they could create versus the rest of the market (assuming adoption remains limited and DLT networks are not interoperable).

Blais: In times of collateral stress, one can look at utilising non-traditional pools of liquidity, such as assets traditionally held and kept in local markets, as a start.

Indeed, as some markets require segregated account structure, beneficial ownership records come with other local requirements that usually make it too difficult to use these assets as collateral in triparty. By exploring the ability to leverage domestic pools of collateral in segregated or emerging markets, firms can find alternative ways to bring additional supply into their global collateral inventory.

Another way to minimise the impact of liquidity stress is to ensure that collateral is mobilised with a near 100 per cent efficiency rate. To do so, either via triparty modules, or through their own models, trading firms should test collateral allocation and eligibility prior to moving inventory, and even before committing to trades. This allows front office collateral managers to anticipate funding needs, avoid collateral shortfalls when possible, and reduce operational costs by guaranteeing eligibility prior to committing collateral pools.

Engle: J.P. Morgan Tri-party has been working with clients on various innovative solutions that support greater flexibility in managing liquidity needs. One approach involves mobilising assets that are traditionally hard to finance or post as collateral. J.P. Morgan has been collaborating with triparty clients to support structured financing and unlock the value of assets like restricted shares, loans, and MMFs for financing activity. By leveraging J.P. Morgan Tri-party's capabilities to un-trap and optimise assets, firms can realise the value of these assets to support overall market liquidity, and generate incremental returns while managing collateral to meet capital and other binding constraints.

J.P. Morgan Tri-party also continues to invest in enhanced inventory management capabilities including reuse, multisource longbox, triparty interoperability and collateral transport. Reuse, multisource longbox and triparty interoperability (J.P. Morgan Tri-party and Euroclear) enable clients to seamlessly move assets across global entities, counterparties and triparty agents (ie J.P. Morgan Tri-party and Euroclear) without the limitations of settlement friction or market cut-off times. Collateral Transport orchestrates asset mobilisation across custody, lending and triparty through the J.P. Morgan Agency Securities Finance platform, enabling assets to be transported swiftly between custodians and triparty agents for lending and fulfilling margin obligations.

By leveraging these innovative solutions, firms can adapt to changing market conditions and better meet their clients' liquidity needs with increased flexibility and efficiency.

Farhat: Firms are managing recent liquidity stresses through a multifaceted approach, which includes:

Diversification of payoffs and strategies. Financial institutions seek balance sheet optimisation by reducing capital charges or lowering funding costs. This can be achieved through new payoffs like evergreen and triparty trades, as well as alternative cash exchange strategies, such as synthetic repo, fully funded swaps, synthetic margin lending and margin loans.

Emergence of central funding units. Fixed income and equity desks are collaborating to optimise the firm-wide securities inventory, empowering traders to make informed decisions on cash and collateral allocation promptly.

Growth of agency lending and prime finance business. These activities enable banks to earn income on capital and generate returns on idle securities holdings, thereby strengthening their balance sheet and mitigating various risks.

To leverage these strategies, firms need advanced technology that offers a rich and evolving library of payoffs across assets, centralise inventory and liquidity management across the organisation, and streamline operations front-to-back-to-risk.

Crowther: For the last few years, there has been a trend towards converging operational cash management and liquidity management, typically performed by a trading desk or treasury. Market movements over the last year have accelerated this.

Periods of extreme market volatility drive more intraday margin calls by CCPs. That means greater need for intraday liquidity. Part of the solution provided by systems is the ability to have a more real-time view on liquidity. Another aspect is the creation of tools that support intraday funding. Broadridge, for example, has introduced tools that support intraday repo transactions.

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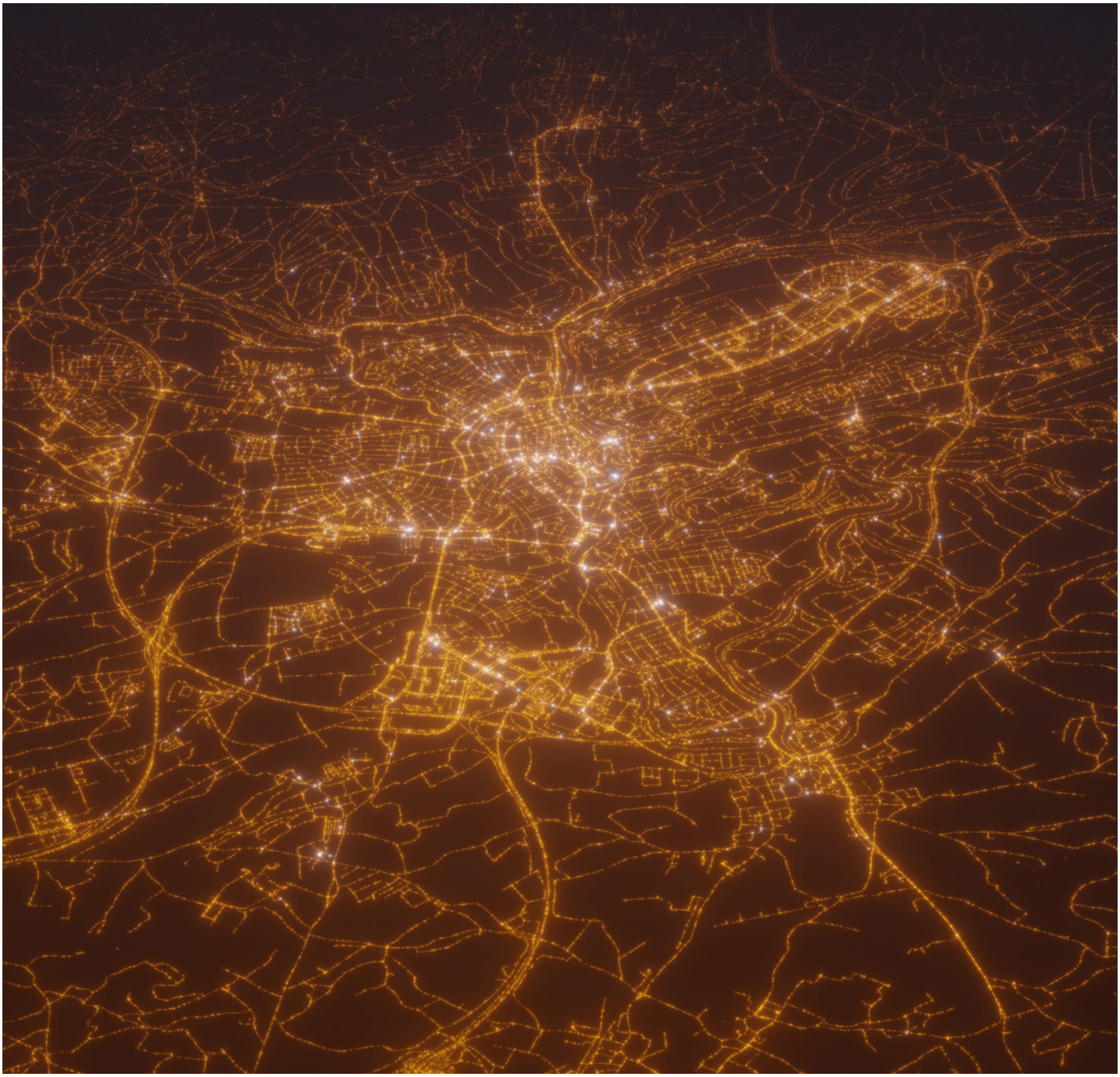


Clearstream adds central bank money settlement for triparty repo

Clearstream's Christian Rossler and James Cherry speak to Bob Currie about the introduction of central bank money settlement for its uncleared triparty repo service

Clearstream has added a central bank money (CeBM) settlement facility to supplement its long established non-cleared triparty collateral management service, thereby providing CeBM settlement for both cleared GC Pooling and Special Repo segments, and its uncleared triparty repo (TPR) service.

According to the Luxembourg-based market infrastructure group, it is the only triparty agent to offer uncleared triparty repo with CeBM settlement.

"We think this is a really important development for the repo market," says James Cherry, director, head of business development for Collateral, Lending and Liquidity Solutions at Clearstream. "Commercial bank money settlement involves the liability of a commercial bank, and credit exposure to that institution, whereas settlement in central bank money involves the discharge of settlement obligations on the books of the central bank directly — this is viewed enormously positively by large risk averse organisations."

For Christian Rossler, vice president of business development for Collateral, Lending and Liquidity Solutions at Clearstream, this is a perfect time to add additional surety and choice to its secured financing programme. Clearstream has seen a surge in activity across both its centrally cleared and uncleared repo products through 2023 and into 2024.

After an extended period of low interest rates, successive European Central Bank (ECB) rate rises and earlier-than-expected repayment of targeted longer-term refinancing operations (TLTROs) led to an increase in the cost of funding on the capital market.

Excess liquidity has fallen from record highs of almost €4.7 trillion in 2022, to just over €3.5 trillion in Q1 2024, predominantly due to TLTRO tranches maturing and market participants making early repayments of their TLTRO holdings.

For the period 1 November 2023 to 30 January 2024, TLTRO III outstanding amount contracted by €37.3 billion as a result of the non-reinvestment of maturing TLTRO funding, along with early repayment of €61.7 billion in TLTRO funds in December.

The ECB's adjustment of the remuneration cap for non-bank deposits has also provided a stimulus for trading activity throughout European repo markets. Non-banks and new customers have contributed more liquidity to the repo markets since the ECB, acting through the national central banks, has offered a rate of only €STR-20bps on non-bank cash deposits since May 2023.

In addition, Deutsche Bundesbank has stopped paying interest on domestic government deposits since 1 October 2023. This development led to a further step up in the use of CCP repo on the part of public authorities, with large amounts of public funds also finding their way into Clearstream's TPR facility.

More broadly, the ECB continues to reduce the size of its asset purchase programme (APP), with Eurosystem central banks having ceased the reinvestment of principal payments from maturing APP securities since July 2023.

Cleared and uncleared repo

Clearstream's uncleared triparty repo for the euro segment applies a similar structure for settling the cash leg of the repurchase agreement trade to that applied for GC Pooling. This enables the cash provider to settle the transaction in central bank money via the Eurosystem's real-time gross settlement payments platform TARGET2 (T2). To access the T2 payments system, the cash provider will need to position the required funds in its direct cash account (DCA) with the national central bank.

"This is a game changer — enabling triparty repo transactions conducted via the Clearstream ICSD now to settle in central bank money," explains Rossler. While Clearstream has offered a TPR facility to customers since 1992, this has previously settled in commercial bank money on the books of the ICSD. "We are now the only TPR provider for uncleared repos to offer settlement in both central bank and commercial bank money," he says.

This change brings additional surety and confidence to the cash provider, in cases where the securities (ie collateral) leg of the delivery-versus-payment (DvP) repo trade fails to settle, either in part or in full. In this situation, the cash provider has a credit exposure to the triparty agent for the time that the trade remains partially open. "Reluctant to have cash sitting overnight on the balance sheet of the triparty agent, the cash provider may previously have opted to cancel the trade," says Cherry. However, with this overnight exposure now being against the central bank in a CeBM settlement environment, it mitigates this credit risk and largely removes the incentive for the cash giver to cancel when the trade remains partially open.

In providing the option to settle in CeBM, Clearstream, as a triparty agent, also handles a large part of the operational and administrative overhead associated with the settlement process.

By outsourcing these obligations to the triparty agent, for repo market participants, it eliminates the cost and burden of establishing and managing their own collateral management operation. Consequently, uncleared repo via Clearstream's triparty service, as well as CCP-cleared repo via GC Pooling and special repo, have been attractive venues for a wide range of cash providers, including central banks, sovereign institutions and supranationals, along with commercial banks, buy-side firms and corporates.

To settle in CeBM, the cash receiver is required to deposit collateral in a commercial bank money (CoBM) account in its name at Clearstream's ICSD, Clearstream Banking Luxembourg. Clearstream will then move this collateral into an intermediate account, prior to transferring it into a securities account at Clearstream Banking Frankfurt (CBF), the German CSD, for CeBM settlement via the TARGET2-Securities (T2S) platform. In delivering DvP settlement finality, these securities will be then transferred into the collateral receiver's account at CBF against transfer of cash.

Clearstream's triparty solution also simplifies the contractual and documentation overhead when compared with managing bilateral funding relationships with multiple counterparties. Clearstream has established a centralised agreement called the Clearstream Repurchase Conditions (CRC), which provides funding and financing customers with access to a wide range of counterparties that have signed up to the CRC agreement.

Alongside this facility, counterparties have the option to trade under the terms of a standard Global Master Repurchase Agreement (GMRA), or to employ a Global Collateral Management Service Agreement (GCMSA) which provides flexibility for the collateral to settle in either the Clearstream ICSD or in CBF.

The early repayment of TLTRO obligations, and the steps to unwind central bank asset purchase programmes, has resulted in the release of a wide range of assets back into the market which were previously pledged to the central bank against emergency support programme funding.

Some of this collateral is HQLA, but some is also lower-grade collateral which is harder to finance. Clearstream's uncleared TPR solution, supported by its collateral optimisation solution, somewhat offsets this constraint, helping counterparties to find suitable cash providers that may be willing to lend against a wider range of non-cash collateral.

As a result, triparty repo has provided a natural home for repo trades collateralised with equity and corporate bonds. While Deutsche Börse's GC Pooling cleared repo programme offers financing against standardised collateral baskets, the triparty repo service enables counterparties to collateralise trades using individual ISINs or a pooled basket of ISINs.

Trade proposition

Over a number of years, Clearstream has established a Marriage Broking model, whereby dedicated specialists at Clearstream evaluate counterparty eligibility profiles to identify new potential financing or securities lending counterparties that align with a firm's credit risk profile, its collateral eligibility criteria, and its trading preferences.

Drawing on its collaboration with Intelli-Select, Clearstream is also developing opportunities to bring greater technical power to the Marriage Broker service using its AI-based own Selection Criteria with Automate Reasoning (OSCAR) module for tailoring bespoke collateral baskets and identifying wider opportunities for counterparty matching.

Significantly, the TPR programme provides flexibility to support intraday financing. While GC Pooling provides lending against fixed repo tenors, Cherry explains that the TPR programme offers flexibility for repo counterparties to negotiate shorter or longer bespoke financing terms, including the ability to raise same-day liquidity and diversify collateral sets to meet specific needs.

Since Deutsche Bundesbank, under the ECB's guidance, has reduced the yield paid on cash deposits, this has motivated European finance agencies and state treasuries in particular to seek higher rates of return through secured financing markets, resulting in a sharp upturn in volumes through GC Pooling and higher trade volumes for clients seeking the additional flexibility offered by TPR. "Our message to cash providers is that they are receiving the best of both worlds," says Rossler. "They can achieve yields on their cash balances comparable to what they can access elsewhere in the money markets, but with the additional safety offered through being able to settle in central bank money.

"Clearstream also offers counterparty diversification via the triparty programme, and the potential to identify new trading opportunities against a range of collateral types by drawing market leading expertise and the introduction of new technologies such as OSCAR." This is supported by daily mark-to-market and opportunity for the collateral taker to re-use collateral posted against the repo transaction.

For cash takers, the programme offers opportunities to diversify their funding sources and to finance securities held in inventory against a deep pool of cash providers — including debt management offices, supranationals and sovereign entities — while extending flexibility of funding terms and collateral eligibility.

Release schedule

Clearstream has now completed testing with early adopters for the CeBM-settled triparty repo services and this has been available for use since December 2023.

Rossler indicates that the company is eager to welcome other early adopters that are interested to begin production testing.

"We are a seasoned agent for CeBM settlement, having provided this for the GC Pooling service, offered by Eurex Repo and Clearstream, for more than 15 years," says Rossler. "We have a detailed knowledge of how this works and how to offer this efficiently to clients."

The funding and financing marketplace has been redefined by a shift in the monetary policy environment and the decision of national central banks no longer to pay attractive remuneration on central bank deposits. This has forced cash providers to seek alternative avenues in the money markets to generate yield on their cash in a secure environment.

"Excess liquidity in the range of billions seeks to return to the money market securely, to be placed securely, but without any increase in operational risk or credit exposure," concludes Rossler.

"Clearstream's triparty repo service — in concert with the GC Pooling and Special Repo service offered in partnership with Eurex Clearing — is well positioned to meet this requirement."

James Cherry
Director, head of business development for Collateral, Lending and Liquidity Solutions
Clearstream

Christian Rossler
Vice president of business development for Collateral, Lending and Liquidity Solutions
Clearstream

Unlocking the world of tokenisation

Ownera has been working to bring the industry together to open up distribution for the world of tokenisation, says Anthony Woolley, head of business development and marketing. He speaks to Carmella Haswell about the firm's open approach to realise this future

Technology firm Ownera is pushing the industry towards what it calls an "open approach", as it attempts to unlock and digitise the world's largest markets, enabling connection between different providers, and allowing businesses to scale.

"You can move faster alone, but further together," believes Anthony Woolley, head of business development and marketing at Ownera. He implies that to be able to collateralise against markets such as real estate, and the highly-manual offline markets of private equity or private debt, the industry must favour the open approach.

He states: "Firms can have people build unilateral solutions, and they can achieve a level of success with that, but they will only ever go so far."

The ability to scale

Ownera launched in 2020, and has been moving "at quite a pace" since its formation. The firm has been working to bring the industry together to solve the global problem of distribution for the world of tokenisation for finance, a task that is "no trivial matter".

According to Woolley, the firm spent the best part of 2020 bringing together more than 80 institutions to develop an open peer-to-peer (P2P) protocol called FinP2P, that enables distribution rails to unlock tokenisation. In parallel, the team has been working with these participants to develop this protocol and form the underlying technology for its practical application.

"As a firm, we knew that industry participants were excited about tokenisation, it was a popular topic of discussion and institutions understood its potential to transform the industry," Woolley confirms. "However, we were also aware that as these tokenisation solutions came to market, organisations would run into the problem of achieving distribution at scale."

The tokenisation platforms coming to market at this time had assets and investors, as well as custody and payment solutions. However, these aspects were "sitting as islands" — that is to say, they were vertically integrated solutions — therefore causing distribution issues.

While the team at Ownera continued to develop the underlying technology to tackle this challenge and create its open standard — subsequently incorporating this technology into the proof of concepts and pilots of other large institutions — the real challenge for the firm has been taking this project to production. This has been the company's priority throughout 2023 and 2024.

Woolley adds: "Currently, we have many projects going into production, and we see this scaling exponentially over the next year as we enable distribution for this world of tokenisation."

Referring to Ownera's own ability to scale, Woolley says the firm has worked to prove that the FinP2P protocol and the company's distribution rails would be supported by the industry. Ownera received backing from several institutions, including J.P. Morgan and US Bancorp, which led to a Series A funding round totalling US$20 million.

Ownera has also identified an "evolution" on the demand side — where wealth managers, digital exchanges and private banks, which the company was targeting, are now working with Ownera. Woolley says: "That is the key to connecting supply and demand. Where two or three years ago people were still experimenting with the technology, now it is all going to production."

Connecting industry players

For any firm wanting to become more interoperable, there is an underlying risk of creating further fragmentation across the market. Ownera is working to ensure its approach is complementary to other industry standards.

Its core objective is to enable interoperability for tokenised assets so that platforms can interconnect. He adds that the firm's projects are not just about "the technical interoperability of connecting technology platforms" — when referring to interoperability, the firm speaks of connecting industry players.

Ownera provides routers to different types of industry players so that they can connect P2P to unlock distribution, and done so "in a way that the regulated financial services industry understands". In avoiding fragmentation, the firm says it does not sit in the financial transaction, or introduce new regulatory structures or regulatory ambiguity.

Woolley explains: "Effectively, our routers enable institutions to connect pools of liquidity and connect to different market participants. This is the right balance to bring parties together. We are operating with our software routers to enable institutions to interconnect, our P2P approach is what is enabling the industry to consolidate at a global level."

The firm's efforts to connect to different industry parties is evident through its 18 month long collaboration with Wematch.live, J.P. Morgan and HQLA^X. This collection of firms are currently developing a "novel solution" that will enable the execution of repo transactions, executed on the Wematch platform with delivery-versus-payment (DvP) settlement across two different distributed ledgers.

Speaking to Securities Finance Times, Guido Stroemer, co-founder and CEO of HQLA^X, says: "As we build out the ecosystem of distributed ledger technology (DLT) platforms, we do not want to re-create the fragmentation of legacy securities settlement infrastructure.

"Interoperation across DLT platforms is paramount for the overall success of the global DLT ecosystem, and the collaboration across HQLA^x, J.P. Morgan's Onyx platform, Wematch, and Ownera, is an excellent example of an important interoperability use case."

Woolley exclaims that it "has proved to be one of the most exciting projects" for the firm. "Our approach with our routers is completely agnostic to the type of asset, the type of security, and the use case," he continues. "This technology is applied much more broadly than just the world of securities finance. But within securities finance, we found our technology could be provided and applied to a strong business case and demand that was out there."

Ownera says, through its routers, it has solved how to orchestrate between different environments — in this case, between technology platform HQLA^X and J.P. Morgan's Onyx team. HQLA^X works to unlock digital collateral, holding digital records of collateral with trusted third parties, which can begin to mobilise the collateral within that context. J.P. Morgan meanwhile, presents digital cash solutions through its tokenised deposit solutions.

Ownera provided a router to HQLA^X to connect to its digital collateral platform, and a router to J.P. Morgan to connect to its blockchain deposit account platform. Ownera's routers orchestrate DVP transactions between those two different environments. That is then exposed to the market through the trading platform, which is the third party in that financial transaction.

Wematch provides a user interface to the trading parties to manage their on-chain asset balances — cash and collateral — and to negotiate and agree to repo transactions.

This business case, Woolley highlights, "starts to unlock the intraday repo market for true management of intraday liquidity", whereas in the past people have been subject to overnight interest rates. As participants wait for the platform's release in 2024, the collaborators will now focus on meeting legal and regulatory obligations to ensure the group "productionise" it properly.

Woolley predicts: "Over time, we see this expanding so that we can connect between different providers of digital collateral, or providers of digital cash. Everybody understands that it benefits the industry as a whole to be able to unlock, effectively securities finance, this intraday mobility of collateral at an industry-wide level."

A bright new future

As a number of institutions strive for tokenisation, the market is also seeing pushback against its advancement. One of the largest points of concern surrounding this is the practicality of integrating tokenisation into the existing infrastructure.

While the industry has the complexity of myriad systems and processes, built over many years, Woolley asks, "if somebody is building a tokenisation solution in isolation, how will that integrate, and how do we get from where we are today to this bright new future?".

Woolley believes Ownera has a solution which will enable participants to move incrementally towards that tokenised future. He insists: "While the pushback relates to how you make the old work with the new, that is something we feel that we tackle well. We can enable existing investors and trading platforms to interface into this new world, without having to worry about bits and bytes and blockchains, they just need a router."

Ownera routers are designed to enable orchestration using existing settlement processes. It can settle against existing payment rails, or the firm can provide the ability to orchestrate instant settlement with various forms of digital cash, the company says.

Another key concern for industry members refers to regulatory ambiguity — some participants believe that regulation may not be ready for tokenisation. Woolley argues that technology is not regulated, it is the business cases and the implementations that are.

Woolley reassures that Ownera is here to address all of those concerns, so that firms can "see a path to not just where they are today, but what they do tomorrow, next month and next year to realise that future".

A deep dive on data

Performance measurement is a crucial component of securities lending programmes. Sophie Downes explores why

Performance measurement.

For many of us, it might prompt fearful recollections of exam halls and school grades; in the securities lending sphere, it has become a vital component of the way the market operates.

Its nature has also transformed irrevocably. With the advent of the digital age came the shift from human number crunching to computer programming. Data is now collated more quickly, and with greater breadth; results are aggregated at the click of a button, and the human counterpart has more insight than ever before.

By measuring performance, market participants can use their financial resources to more efficiently benefit both their clients and the broader financial system.

So whether it involves the launching of a new product, or adjusting pricing and risk strategies, performance measurement is a business imperative.

The players

Data measurement is a necessary component of the securities finance space. It is also profitable. Dominated by a handful of industry giants, a competitive spirit marks the discourse between data intelligence firms.

S&P Global Market Intelligence is a veteran in this arena. Covering approximately US$36 trillion in global securities, from more than 20,000 institutional funds, the firm holds 17 years worth of daily historical data. It also provides insights into the repo market through its Repo Data Analytics product. For Matt Chessum, director of securities finance at S&P Global Market Intelligence, both data sets are essential tools for market participants “to make informed decisions about lending activities, pricing strategies and risk management”.

Another contender on the performance measurement stage is DataLend, the securities finance data division of parent company EquiLend. Similar to S&P Global Market Intelligence, DataLend sources its data directly from industry practitioners, including prime brokers, custodians, asset managers and hedge funds, with the advantage of pulling insights from EquiLend’s own trading platform.

While S&P Global publishes blog posts and its Insight weekly newsletter, DataLend publishes a quarterly research publication called ‘The Purple’. Aptly named given “it provides an editorial view of industry trends and market colour”, says DataLend’s global head of Data & Analytics Solutions, Nancy Allen.

“Combined, DataLend and The Purple have democratised transparency in the securities lending market,” declares Allen.

In context

Regardless of which firm you might choose to provide your insights, the role of data is invaluable. Within the context of securities lending, performance measurement covers a number of areas, including revenue generation, risk adjusted returns, and borrower demand and dynamics, to name a few.

Data is fundamental to this process as it allows market participants to directly compare their programmes with those of their peers — an exercise that Chessum believes participants should be engaging in on a regular basis. “Performance measurement remains a critical exercise for beneficial owners,” he argues. “It enables them to generate the optimum level of returns within an understood risk framework.”

As to what analytics are of most interest to firms, Chessum responds measuredly. For the securities lending market, the greatest focus is on borrower demand, market trends, lending fees and income.

"Performance measurement remains a critical exercise for beneficial owners. It enables them to generate the optimum level of returns within an understood risk framework."

Matt Chessum
Director of securities finance
S&P Global Market Intelligence

On a more granular level, he notes that different market participants focus their attention on a number of more specific metrics. A hedge fund may focus on borrowing fees, short squeeze scores and stability of supply, while agent lenders may focus on days to cover, market share, and changes to fees that are being captured through intraday feeds.

“Each market participant will use the data in a different way, to both capture additional revenues and monitor their market risk and exposure,” Chessum explains.

An industry standard

With this amount of data, naturally a need arises for standardisation and a set of best practices. Here, the Securities Lending Performance Measurement (SLPM) guidelines represent the industry standard.

Introduced by the International Securities Lending Association (ISLA) in 2020, agent lenders can choose to follow the guidelines to ensure that their data is provided in the same manner and format.

Farrah Mahmood, director of regulatory affairs at ISLA, discusses why it was necessary to implement an industry standard: "There was a mutual feeling from beneficial owners that the data being provided to them by aggregators was inconsistent." She explains that, due to the variations in the way data was being presented, it was harder for beneficial owners to effectively assess their performance against one another.

Enter the SLPM guidelines.

Besides improving transparency and enabling beneficial owners to make more informed decisions about strategy, Mahmood highlights how these standards create a level playing field, particularly as inconsistent reporting can distort performance results.

"In short," Mahmood summarises, "measuring agent lender performance empowers beneficial owners to be proactive managers of their securities lending activity, ensuring it delivers optimal value."

The guidelines are divided into three main areas: inventory data, transaction data and static data. As Chessum notes with pride: "S&P Global Market Intelligence is the only data provider across the industry to both meet, and exceed these industry standards."

Data evolution

The mechanisms of measuring performance have evolved considerably over time.

Historically, beneficial owners relied on their agents to provide data. Performance measurement would be focused on general market trends or comparative year-over-year performance, and was usually conducted on a quarterly or semi-annual basis. This meant that collecting data, and producing insights from it, was a largely manual process for the agents.

Today, Allen tells me, clients want direct access to more detailed and standardised reporting that can be accessed ad-hoc, and without the need for significant manual analysis. Emphasising the impact of this evolution, she suggests that the demand for performance insights has grown "more than ever before".

Indeed, the improvements in technology have resulted in an increased appetite for independent data among beneficial owners. Gone are the days of outsourcing data to custodians or external investment managers. Rather, Allen believes, owners are preferring to take a more "hands-on approach" with their investment teams.

"The majority of our clients not only leverage our standard product offering, but also work with our product specialists to design more bespoke analytics to monitor their lending programmes and help add value," she explains.

Chessum also acknowledges the impact of access as performance measurement evolves. "Having the ability to access the data through either a portal, API, or data aggregator, has increased the ability of end users to use the data in different ways." The result is a more "tailored to" situation, where owners can individualise their data needs.

The tools

As the use of data has grown, securities lending markets have become more sophisticated. Securities lenders can now manage risk in real time. Alerts can be triggered and actions can be corrected, all at a much quicker pace. "Automation has created more streamlined processes, faster decision making and improved client service levels," reports Chessum.

This can be seen through the vast array of S&P Global Market Intelligence's product solutions, all of which depend heavily on access to data. One clear example is the firm's exchange traded fund (ETF) collateral lists, where the underlying components of ETFs can be identified to match admissible assets and markets within an individual collateral schedule. The firm also provides an onboarding accelerator tool, which analyses inventory to review the quality and level of demand of assets in a lending programme.

"Both examples use data to generate efficiencies in either the optimisation of asset pools or the unlocking of liquidity within the market, improving the allocation of financial resources throughout the lending chain," explains Chessum.

He continues to describe the 'holistic perspective' provided by aggregated data, highlighting how it can identify broader trends that might not otherwise be apparent if looking at individual data points. But, ultimately, the strength of data lies in its simplicity — "It reduces noise by providing clearer underlying trends and patterns."

Like S&P, DataLend also uses programmatic tools to offer a near real-time view into lending programme performance. Allen describes the firm's CPR and Portfolio offerings as "relative to a like-for-like peer group". "These tools offer a multitude of ways to slice and dice your data, all without the need for any manual input," she enthuses.

The opportunities posed by these tools are significant.

DataLend Portfolio, for example, automates traditionally complex revenue attribution analysis. Aimed at beneficial owners, it allows them to view the data within the context of liquidity, credit, market and structuring risk.

"In addition to helping them understand what happened with their programme during a given period, access to data also helps them to understand what could have happened, in order to gauge the performance of their portfolio and its managers," Allen explains. This insight is unparalleled, and it is changing the way investors engage with their portfolios.

AI in action

Having already undergone dramatic change, how much more can we expect performance measurement programmes to develop?

One obvious factor is the use of artificial intelligence (AI). While the term gets thrown around in industry discussions rather casually, Allen predicts the implementation of AI is imminent, if not incorporated already.

"The feasibility of deploying such a technology is much more realistic today than even five years ago," she observes. "Not just because of the advances in AI, but because the securities lending industry has collectively moved towards transaction automation and data standardisation.

"That is the ethos by which EquiLend was formed, so it's natural to consider the potential for AI as a further extension of our mission and vision."

Meanwhile, S&P Global Market intelligence has already started to implement AI into a number of its metrics. One notable example is a model that uses machine learning to calculate the likelihood of a short squeeze taking place.

"The feasibility of deploying such a technology is much more realistic today than even five years ago. Not just because of the advances in AI, but because the securities lending industry has collectively moved towards transaction automation and data standardisation."

As machines adapt, these processes are set to become more sophisticated. Chessum sees this firsthand in his company's use of AI: "As the model consumes the data, it continues to learn — increasing its level of accuracy as the data consumption grows." It is clear from talking to both Chessum and Allen, that the exponential growth of technology and data generation is rapidly transforming the way in which businesses operate across the industry.

With effective tools in place, beneficial owners are best placed to deploy their assets within an ever-evolving lending market. Evidently, the potential is limitless.

Tonic insights: adapting to market volatility

Following on from his recent appointment as the head of Americas at The Tonic Consultancy, Jor Molchan sits down with Justin Lawson to discuss the current hot topics facing securities financing

Congratulations on your recent appointment at Tonic — can you tell us about your new role?

In my role as the head of Americas, I lead our North American client relations, delivery and people — all with the support of an excellent team. I am responsible for helping our Americas clients execute their critical business goals, via Tonic's expertise-led model.

What led to your decision to join the team at Tonic?

I joined because the Tonic story is an impressive one that I wanted to be part of. The depth of expertise, the company's service model that puts clients first, the variety of transformational capabilities and Tonic's impressive client list, all made this an attractive opportunity from the beginning.

Add to this the firm's commitment to excellence, a great culture and a stellar team of specialists, the decision to join was an easy one.

How does your previous experience in the industry support your role as Tonic head of Americas?

I believe this role ties together my varied career in financial services. My early years included securities finance, asset servicing and global custody — all key domains for Tonic. After that I moved into financial services consulting, where I led capital markets advisory programmes, oversaw delivery and managed a book of client accounts. I have lived through a varied set of domains, firms and consulting rigour that matches Tonic's model well.

My approach to success in previous roles has been focused on team-oriented problem solving. Turning large groups of people into organised and self-actualised teams is the best way I know to achieve more. I expect to leverage the same approach at Tonic, helping clients reach further success.

Can you describe Tonic's service model and what it brings to the industry?

Tonic is a Capital Markets consultancy that does things differently, which was part of the appeal for me. As I have previously said, Tonic is expertise-led, which ultimately means we protect and accelerate our clients' business goals in all areas, including regulatory, commercial and resilience.

Our consultants are a hand-picked set of practitioners, who all have the deep domain and transformation expertise required to deliver on Tonic's service model. They have all 'been there and done it', with strong views on industry best practice. This is backed by the firm's client-first service model, which focuses on integrity throughout.

We build long-term, trusted partnerships with a global set of clients, across the UK, Europe, Americas and APAC. High-focus domains such as collateral, post-trade, treasury, risk and digital are our foundation, but we are continually adding more areas to the mix, based on our clients' evolving needs.

We provide the same suite of services across all our domains, including advisory, transformation, educate, and operate.

Currently, what are the key focus areas for your clients?

Hot topics are always driven by the current climate. The longer-term market volatility we are now used to has increasingly focused our clients on profit protection and growth — both cost savings and revenue building — as well as staying resilient within a period of higher uncertainty.

Inevitably, regulatory transformation remains a key focus, but firms are looking more creatively at how to get compliant in ways that protect profits and resilience in the long-run.

Some of the key things for our clients right now include Basel Endgame, US Treasury Clearing and a raft of resilience regulations.

For many of our clients, this includes steps towards real-time inventory management, resilience target operating models, new capital and liquidity solutions within securities finance, collateral optimisation and analytics, data target state infrastructure and a pathway to digital solutions, such as tokenisation and distributed ledger technology (DLT) settlement.

Amid the volatile climate, what are the current securities finance trends that firms are being exposed to?

One that really sticks out here are the record-breaking securities finance revenues of US$10.7 billion in 2023, growing almost 10 per cent year-on-year. This can mainly be attributed to the heightened interest rates, increased volatility in the equities market, and the demand for specials. The volume surge means firms are increasingly investing in scalable and resilient capabilities across trading and operations, to maximise future profits.

Another key trend is a renewed focus on efficient use of balance sheet and capital, with Basel Endgame and other regulations further eroding the profit base across the market. A number of firms are now focused on joining or building new capital-efficient service models, including derivatives synthetic models, peer-to-peer, sponsored clearing, triparty and more.

We see a parallel focus on profit and capital analytics, to leverage pre-trade costs within the trade execution process, plus collateral optimisation techniques — both pre-trade and post trade — to minimise costs once the trade has been executed. The move towards real-time, holistic inventory management, is also a connected trend throughout the industry. More firms are now signing up to digital solutions, via tokenisation and DLT use cases, for resilience and optimisation drivers.

Another area to highlight is the US Treasury clearing regulation — a game changer for the clearing of US Treasury cash and repo transactions. Many firms have started to define their new front-to-back operating models, to ensure they are ready to execute from late 2025 onwards. Minimised profit impact is the goal here, based on the net-new collateral and funding requirements that come into play. Clearly, this provides opportunities for service providers to expand their clearing offerings, with new clearinghouses and agents also 'joining the party'. It is definitely one to keep an eye on, that will drive a new industry model for us all.

How does Tonic help its clients meet these challenges?

When faced with complex or heavy challenges, a client wants to depend on a company that has ‘been there and done that’.

At Tonic, it is the group expertise pool that brings real value to our clients, with a collective relevant experience spanning hundreds of years, all for our clients to tap into. That also comes with a great network of industry participants, vendors and service providers, to protect and accelerate our clients’ decisions.

Tonic specialises across the full suite of advisory, transformation and implementation services, so we can help our clients wherever they need the most support. Some clients initially focus on the advisory services, such as strategy, vision, benchmarking, training and content creation.

Tonic’s Health Check service, for example, is a powerful vehicle for firms to gain accelerated, targeted recommendations on their key pain points. In turn, our clients can then quickly move into tailored solutions and execution. Our health checks are used by clients across all manner of use cases, with the Securities Finance Resilience Health Check our latest module.

Most clients then leverage Tonic’s Transformation suite to accelerate their target state. This includes regulatory solutions, target operating models, vendor selection, data strategy and programme governance. Implementation services are then available as needed, to protect key goals such as regulatory compliance, platform integration, testing, data readiness and more.

Tonic has seen impressive amounts of growth in recent times. What is the story here, and how has your domain coverage evolved over the last few years?

It is no secret that Tonic has grown significantly since its inception in 2018, especially post-Covid.

The growth has come in several forms. Expansion of our client base, domain coverage, and growth in our people — both our specialist practitioners and our senior management team.

A huge checkpoint in the growth story came in 2022 when ‘Margin Tonic’ became ‘Tonic’. In truth, it seems Tonic had grown beyond our ‘Margin’ roots long before then, as clients asked us to apply our expertise-led model to a wider set of domains.

Tonic has since replicated the expertise within our collateral practice — where today we have over 270 years combined experience — to our wider set of domains, including post-trade, risk, treasury, and digital. As an example, we now have over 225 years of post-trade experience, 100 years of risk experience and more than 50 years of treasury experience, with more uplift to come.

Tonic’s fun, dynamic and hard-working ethos has no doubt played a big part in our success, by providing a healthy, collaborative workplace, with lots of room for everyone to grow.

What is the motivation behind expanding in the Americas and what is your strategy to achieve this?

This actually started with Covid, which was a turbulent period for all of us. During that time, geography mattered less and our Americas clients wanted the best expertise available from Tonic, regardless of where they sat.

Our Americas clients have been asking Tonic for a while if we can do more for them in the US and Canada, via the same expertise-led model. Tonic’s Americas client relationships are very strong, so we are focused on getting closer and delivering more value to them.

Today we have a growing Tonic Americas footprint, but we want to demonstrate our commitment to our Americas clients by investing more, helping them to hit their key goals.

Going forwards we will provide our Americas clients with a more scalable and flexible service model, underpinned by the same deep expertise. We will cover all of our core domains, and some new ones.

Considering Tonic’s continued growth, what heights do you see Tonic reaching in the next two years?

We are on a good course, but there is lots more we want to do. The consistent goal is to help our clients hit more of their key business goals, in an increasingly complex market environment.

In the coming years we will expand our domains where synergies are strongest. We will grow our team size, scale, flexibility, and the value we bring to our clients. We will also continue to bring the most relevant capabilities to clients — whether service, region or others — driven by their best interests.

An upward trajectory: Q1 2024 securities lending market revenues

Matthew Chessum, director of securities finance at S&P Global Market Intelligence, evaluates the performance of the market during Q1 2024, and how geopolitical tension, as well as the US presidential elections, could set the future of the global economy

Resilient fourth quarter corporate earnings, a continuation of AI exuberance, and further dovish tones from central bankers encouraged global equity markets to continue their upward trajectory during the first three months of the year. The S&P 500 experienced its strongest opening three months since 2019, after gaining just more than 10 per cent over the period. The Eurostoxx 600 also hit an all-time high, as momentum generated by blowout Q4 US technology company earnings helped to push global indices to new highs. A tentative turnaround in Chinese equities was also seen.

Over the period, the general deflationary trend continued, despite a few bumps in the road. Central banks have consistently warned that the final stages in getting inflation back to target would be the toughest, and while the latest decreases have been less pronounced than previous readings, its retrenchment into low single figures has continued.

Markets took confidence from the fact that it does appear to be under control, which helped to boost valuations. The fact that higher interest rates have been able to tame inflation without damaging economic growth has also extended further confidence to investors.

Although investors may be rejoicing over the recent surge in valuations worldwide, and the decline in inflation, it is crucial to acknowledge and evaluate the significant risks that do persist. One of the most major of these, comes in the form of geopolitical uncertainty.

Tensions grow as wars in the Middle East and Ukraine continue, and as the year proceeds, focus will move to the US presidential elections — voters face a choice between two very different candidates, who offer different perspectives on the future of the global economy. This is having an impact on commodity prices which may in turn have an impact upon inflation. In short, it is increasingly becoming a stock pickers market, which is positive news for the securities lending landscape as volatility starts to edge back in.

A breakdown of performance

In the securities finance markets, revenues continued to cool throughout the quarter, as Q1 produced US$2.75 billion. This represents a 20 per cent decrease year-on-year (YoY) but a slight uptick quarter-on-quarter (QoQ). The securities lending markets faced a number of headwinds during the period. Short loan interest fell to its lowest level in a decade across EMEA equities, with revenues during January and February falling to all-time lows. Revenues derived from specials activity declined during the period across all regions, and further headwinds in Asia in the form of short sale bans and ongoing weakness across the Chinese economy, held revenues back.

Cash reinvestment revenues also fell during Q1 for the first time in six quarters. It appears that the high tide for interest rates may well have passed, as most central banks are now at least considering reducing borrowing costs. The pace of easing looks less likely to mirror the aggressive speed at which tightening first took hold, and the lag in transmission means easing effects are taking more time to feed through across the globe. Expectations of rate cuts have now fed through to reinvestment pools however, which is reflected in the revenue declines.

Equity lending generated just over US$2 billion during the quarter. This represents a decline of 20 per cent YoY. The largest contributor to these revenues continued to be Americas equities, which generated just over US$1.07 billion (53 per cent). US equities generated US$959 million during the period, which represents a 26 per cent reduction YoY. From the other markets that make up this region, Canadian equities performed well over the quarter as average fees continued to increase YoY.

Average fees in Canada topped 74bps — an eight per cent increase YoY. Canada was the only market to experience a single-digit decline in revenues across the region. Elsewhere, revenues declined by 12 per cent YoY in Brazil, 37 per cent YoY in Mexico, and 23 per cent YoY across American depository receipts (ADRs). Balances did increase across the South American markets, however, as did lendable value.

Across EMEA, securities lending revenues suffered further substantial declines, pushing the quarterly total down 40 per cent YoY. This follows a YoY reduction of 47 per cent during Q4. Balances declined by 30 per cent and utilisation fell by 36 per cent.

The region suffered from a lack of demand and specials trading. Short interest fell to its lowest level in a decade during Q1, but it started to increase towards the beginning of April. All the top 10 revenue generating European markets experienced double-digit declines in revenues YoY, with the UK, France and Germany, all seeing YoY revenue dips of over 40 per cent. Average fees are a different picture however, with YoY increases seen across Germany, France, and the Netherlands.

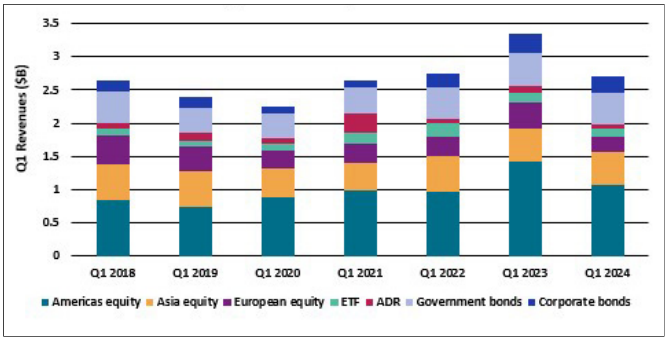
APAC equities generated US$490 million during the quarter, with Japan, Taiwan and Malaysia, leading the charge. Japan generated US$186 million in revenues, which is an eight per cent increase YoY, the market also experienced a two per cent YoY increase in balances and a six per cent increase in average fees. This was against a backdrop of an equity market that continued to hit record highs during the period.

The region did continue to see a strong degree of divergence during Q1 however, with Hong Kong and Singapore experiencing declines in revenues of 31 per cent and 36 per cent respectively. South Korea also experienced a 34 per cent YoY decrease in average fees, while Hong Kong experienced a slight two per cent increase.

In the fixed income markets, Q1 saw a significant shift in the landscape of inflation and interest rates. Most central banks proceeded with caution, avoiding any further moves to interest rates, with only a couple making any changes during the quarter. The Bank of Japan moved rates back into positive territory during the quarter for the first time in 17 years, signalling an end to negative rate policy, and the National Bank of Switzerland surprised markets with a 25bps rate cut.

Global economic data remained strong, and the US economy continued to perform well. A recovery also took hold across China, although the property sector continued to face issues. This improvement in data led to a rise in government bond yields during the quarter, with increases seen across UK, German and US 10-year issues. In the securities lending markets, government bond revenues increased by two per cent YoY to US$173.4 million. Average fees declined by nine per cent YoY to 17bps, but balances increased by three per cent.

Figure 1. Q1 revenues by asset class



Corporate bond performance stayed strong over the quarter, with revenues remaining robust. Despite Q1 revenues declining by 20 per cent YoY, they only fell two per cent QoQ, which may point towards the beginning of a stabilisation in returns. Looking at Q1 revenues in comparison to other Q1 periods, they remain elevated, and corporate bonds continue to perform well. Q1 2024 produced the second highest Q1 revenues over the last six-year period.

In conclusion, revenues have continued to cool across most asset classes during Q1, but it is important to remember that the market had been firing on all cylinders during 2023, generating some of the best returns ever experienced — any YoY comparisons and declines in revenues must be kept in context.

Looking ahead to Q2

General market conditions were not very supportive for securities lending activity during the previous quarter, with low volatility, low short loan interest and continually rising asset prices. Given the momentum that has been building throughout Q1, the second quarter is likely to focus more on company fundamentals, to see whether they can catch up with market moves. If not, and investors become complacent, Q2 could see a more volatile trading environment than has been experienced since the beginning of the year.

There was positive momentum in IPOs, with new companies coming to market. Corporate events such as the Cummins spin off have also been positive for securities lending participants. With valuations and interest rates at recent highs, we expect to see more corporate activity in the coming months as firms look for cheaper financing options.

Heading into Q2 and Q3, investors are also likely to become increasingly reactive to central bank decision making, as expectations of multiple rate cuts have already been priced into market valuations. As the rhetoric surrounding the impending presidential election in the US starts to increase, given the stark difference in economic outlook from the two candidates, investors will also become increasingly responsive to moves in voter sentiment.

Regarding securities lending revenues, a general improvement across most asset classes and regions has started to emerge during the first few weeks of Q2. Volatility is starting to creep back into markets, and some of the blind AI exuberance seen during Q1 seems to be coming to an end.

Q2 is going to be a good barometer for securities lending activity, as the higher for longer narrative takes hold in the US and central bank divergence starts to take place. S&P Global Market Intelligence believes that revenues will remain strong but below those achieved last year. There is still a lot to play for, and when compared to any year other than 2023, 2024 appears to be off to a good start.

Matthew Chessum
Director of securities finance
S&P Global Market Intelligence

Pirum selects Jennis

Pirum has welcomed Mark Jennis to its US team, heading up business development for CollateralConnect in North America.

Jennis brings more than three decades of collateral management experience, including within strategy, business and product development, and execution.

He joins the post-trade services fintech from Morgan Stanley, where he served in a number of senior roles, including within business unit risk management. During his two stints with Morgan Stanley, Jennis held a 14-year tenure with the firm.

Previously, he led strategy and strategic partnerships at Transcend, between 2019 and 2023.

In addition, he developed blockchain use cases and solutions for PeerNova; he was executive chairman at DTCC-Euroclear GlobalCollateral, spearheading the Margin Transit Unit; and held a number of senior positions at Banker Trust between 1987 and 1999.

FIS appoints Tenggren

FIS Global Transfer Agency Services has appointed Peter Tenggren as senior director of product management.

He joins forces with vice president, Lisa Shea, as part of the firm's solution management leadership team.

Tenggren brings extensive experience in fund servicing. Prior to joining FIS, he held a 12-year tenure at BNY Mellon, where most recently he served as senior principal of product management.

Before this, he was a senior vice president and managing director at PNC Global Investment Servicing, between 2007-2010.

Commenting on the appointment via LinkedIn, Shea says: "Together, we will drive innovation and help steer FIS towards greater heights."

Vincent joins StoneX group

Lee Vincent has joined StoneX Group as commercial treasurer.

Vincent brings extensive experience in prime brokerage and securities finance, particularly relating to trading, pricing and financial resource management.

Previously, he spent 11 months at an industry consulting firm, where he was a senior consultant.

Earlier in his career, Vincent held roles at Scotiabank, Goldman Sachs and Morgan Stanley.

Wematch.live hires Culshaw

Wematch.live has appointed David Culshaw as global head of fixed income.

Based in London, he will be responsible for driving the growth strategy for the firm’s fixed income business, as well as developing its product offerings to meet the evolving needs of the market.

Culshaw joins Wematch.live from Brevan Howard spinout, SigTech, where he served as global head of business development.

Prior to this, he spent four years at BrokerTec, where he led the commercial development of their dealer-to-client RFQ repo platform across EMEA and North America.

intellimation.ai adds Joshi

Chetan Joshi has joined intellimation.ai as director of pre and post-trade products.

Based in London, he will work with clients, partners and the industry to develop next generation Vertical AI products.

Joshi brings more than 25 years of industry experience to the role, specialising in operations, technology and trading.

Prior to joining the fintech company, Joshi was chief operating officer of consultancy firm Margin Reform, which he founded in 2019.

Earlier in his career, he held collateral roles across a handful of banks including Barclays, JPMorgan Chase and Royal Bank of Scotland.

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