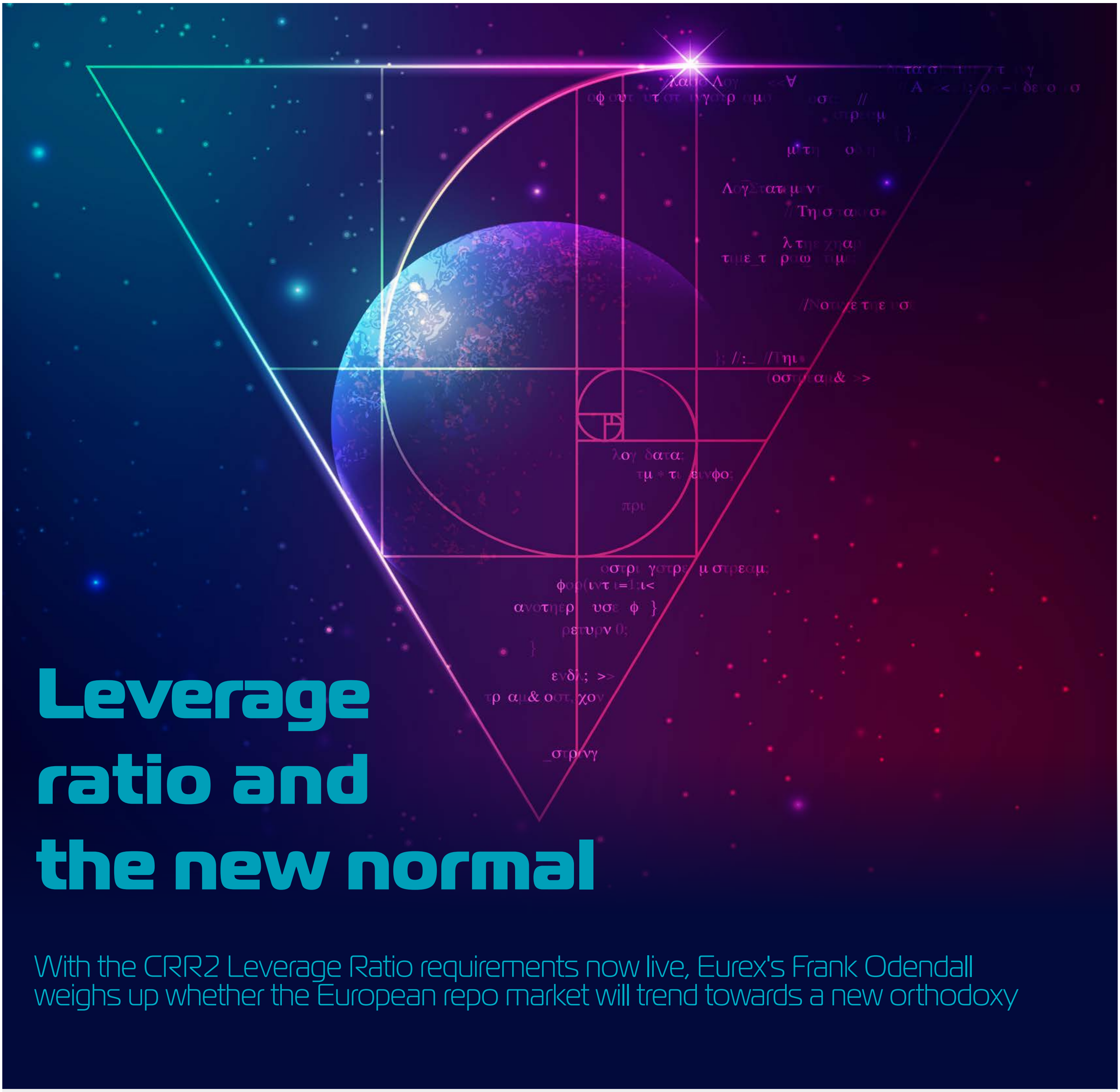
securitiesfinancetimes

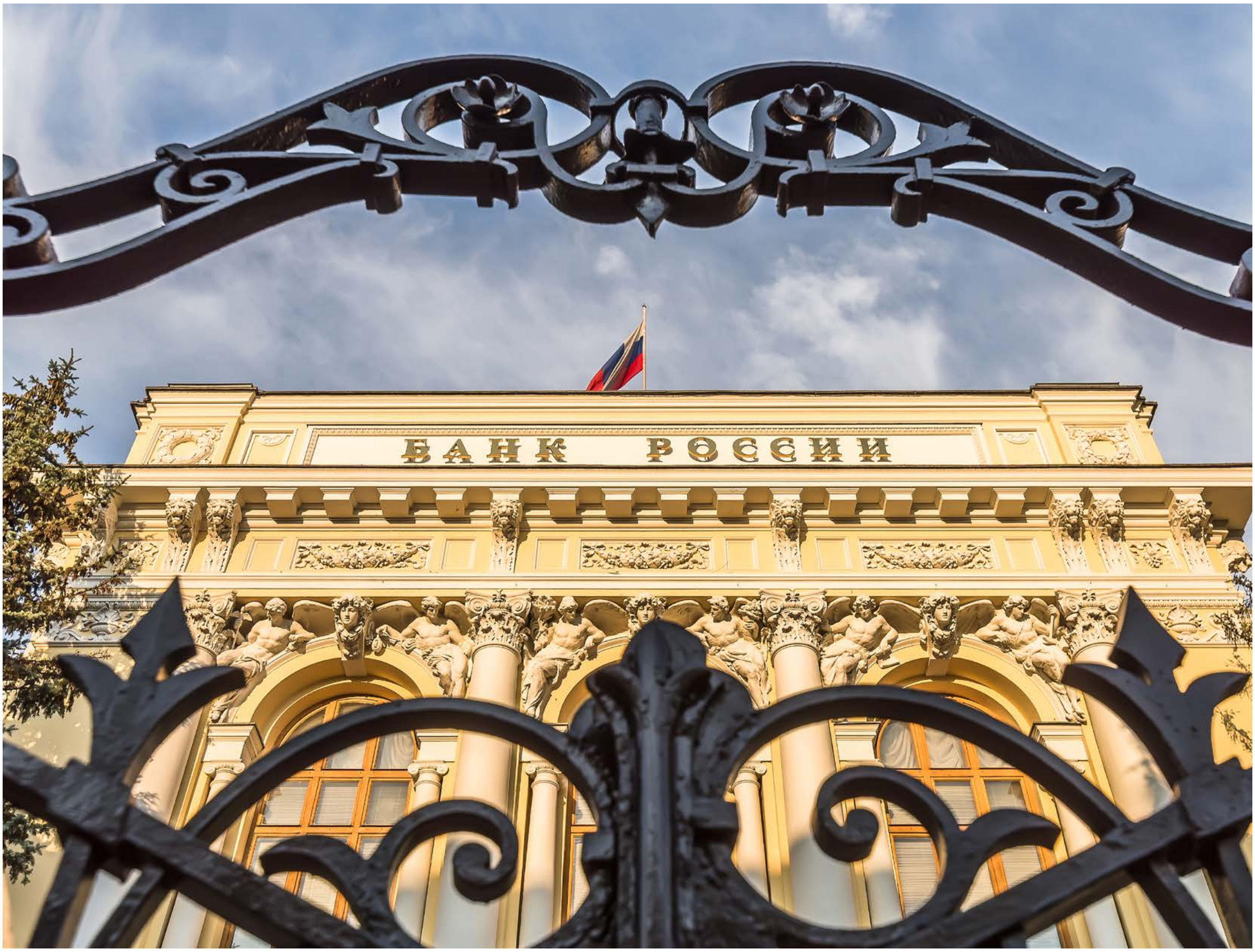
The primary source of global securities finance news and analysis

Issue 297 01 March 2022



Leverage ratio and the new normal

With the CRR2 Leverage Ratio requirements now live, Eurex's Frank Odendall weighs up whether the European repo market will trend towards a new orthodoxy



Russia’s central bank restricts short selling

The Bank of Russia has imposed a ban on short selling that came into effect at 11:00 Moscow time (9:00 CET) on Thursday 24 February.

This ban is open ended and will continue until further instructions are received from the central bank.

In a statement, the Bank of Russia says: “Given the current situation in the financial market and to protect the rights and legitimate interests of investors in financial markets, mitigate risks and curb excessive volatility, the Bank of Russia has instructed brokers to suspend short sales in the exchange until the said instruction is cancelled.”

Stocks that make up the MOEX index have been subject to high volatility, with the Index losing 44 per cent of its value in sliding to its low point during Thursday trading.

Trading Economics notes that the MOEX Russia Index climbed 20 per cent in Friday early trading, partially recovering from a 33 per cent plunge in the preceding session.

The Bank of Russia has taken further action as sanctions have started to bite. Among other measures, it has raised its key interest rate from 9.5 to 20 per cent and has ordered Russian exporting companies to sell 80 per cent of their forex revenues on the market in moves to support the ruble.

Inside this issue

NGX targets digital transformation

The Nigerian Stock Exchange will focus on the continued development of its technology ecosystem, along with the advance of its exchange-traded derivatives and securities lending markets, according to its 2022 Market Outlook, presented on 23 February.

Securities lending activity grew 440 per cent by value to N513 million (US$1.2 million) in 2021, up from N95 million in 2020 and N340, 000 in 2019.

NGX completed its demutualisation in March 2021, establishing a non-operating holding company, the Nigerian Exchange Group (NGX Group) which has three operating subsidiaries, its operating exchange (Nigerian Exchange Limited, NGX), its regulatory arm NGX Regulation Limited (NGX RegCo), and its real estate company NGX Real Estate Limited (NGX RelCo).

The exchange has registered seven derivatives contracts with the Nigerian Securities and Exchange Commission in advance of the launch of its exchange-traded derivatives service.

It has now completed user acceptance testing for its derivatives instrument set up and trading systems and recently completed integration with the central counterparty clearing service offered by NG Clearing.

More broadly, NGX announces that its 2022 roadmap will promote a digital transformation agenda that will focus on building end-to-end digital platforms, drawing on partnerships with market intermediaries, to enhance the distribution of capital market products and services that support financial inclusion.

In line with this proposal, NGX has released a framework for the launch of an ESG board designed to attract impact investments to the exchange.

FinClear utilises Broadridge to expand securities finance business

FinClear, an Australian-based wealth management infrastructure provider, has enlisted Broadridge to expand its securities finance business.

Broadridge's Securities Finance and Collateral Management (SFCM) FastStart solution provides FinClear and its clients

with enhanced functionalities in this area of the business.

SFCM is a front-to-back Software as a Service solution for securities finance, used across the buy and sell-side stock lending, repo, and collateral trading markets.

Clients can gain access to SFCM via the SFCM FastStart programme, which provides a securities finance foundation at a low price and with a minimal initial integration requirement.

The programme is designed for a phased expansion of integration and automation as business grows, according to Broadridge.

Darren Crowther, general manager of Broadridge's SFCM, comments: "In the ever changing landscape of securities finance, financial institutions need to react quickly in order to trade new products, access new streams of revenue, and service an ever expanding customer base.

"At its core, SFCM FastStart promotes simplification and streamlining of securities finance, allowing our clients to benefit from effortless integration and automation, with the ability to grow and scale while meeting increased market and regulatory requirements."

Andrea Marani, COO at FinClear, adds: "Securities finance is an important hedging, liquidity, and revenue enhancement tool for many FinClear clients. Broadridge SFCM allows us to offer additional functionalities and enhanced processes, delivering a greater experience for our customers."

DTCC targets data transparency for repo markets

The Depository Trust and Clearing Corporation (DTCC) has launched a new service that provides access to trade data for US treasury securities in a bid to extend transparency in repo markets.

This solution, named DTCC Treasury Kinetics, will access US treasury transaction data held by the government securities division of the Fixed Income Clearing Corporation (FICC), DTCC's subsidiary that provides trade comparison, netting and settlement for government fixed income securities.

On average, FICC provides matching, netting and settlement for more than US$3 trillion per day.

DTCC indicates that this new service will provide a daily summary of aggregated, anonymised trade data, including the number of transactions, USD amounts and rates for delivery-versus payment (DvP) repo. This will provide historical data going back to 2011, enabling users to back-test current repo trade data against past events.

DTCC plans to make DTCC Treasury Kinetics and its other data services available on cloud-based markets, starting with Snowflake Data Marketplace which is scheduled to be live before the end of Q1.

Commenting on the new service, managing director of DTCC Data Services Tim Lind says: "DTCC Treasury Kinetics delivers one of the most comprehensive views of the repo markets available today, providing increased transparency for investors and intermediaries. This new service meets a critical industry need: access to a single, comprehensive data source that provides greater insight into the US repo markets."

As repo markets have continued to evolve, DTCC believes that rising volatility in the sector underpins the requirement for repo market participants to have access to data that provides greater transparency and understanding of valuation, rates and liquidity.

In October, DTCC published a white paper promoting the case for extension of central clearing for US treasury securities. FICC currently provides a range of client clearing models for US treasury cash securities and repo transactions, including correspondent clearing, prime broker clearing and sponsored clearing via the FICC sponsored-clearing service.

Adenza to automate AIB's regulatory reporting

Adenza, the merger of Calypso Technology and AxiomSL, has announced its selection by the Allied Irish Banks (AIB) to support the bank's credit risk, securitisation, leverage ratio and large exposure risk reporting throughout Europe and the UK.

Adenza's AxiomSL risk solutions will aid AIB in delivering an automated approach to capital and credit calculations, data management and analytics.

The solution enables banks to manage a range of global regulatory risk requirements. These include global and cross-regional compliance with the rules developed by the Basel Committee on Banking Supervision (BCBS) such as internal ratings-based approaches (IRB) and standardised approach for counterparty credit risk (SA-CCR).

Adenza's risk calculation engine is part of the AxiomSL ControllerView data integrity, data lineage and control platform, which allows institutions to ingest external model results, add source data and transform disparate data points into a Basel-driven data dictionary.

Jim Smyth, head of regulatory reporting at AIB, comments: "Adenza's AxiomSL centralised and scalable approach to standard and advanced credit risk calculations, enables AIB to meet risk calculations and reporting requirements without the need to reinvent and rebuild new technology each time regulatory obligations change. We felt it was important to work with a firm that can deliver high powered reporting solutions across the regulatory reporting suite for today and in the future."

HSBC selects Proxymity's Shareholder ID solution for SRD II compliance

HSBC has selected Proxymity's Shareholder ID solution in an effort to meet the compliance requirements for the EU's Shareholder Rights Directive II (SDR II) Directive.

The solution automates shareholder ID requests in industry compliant formats, eliminating the need for manual intervention.

Implementing the solution will ensure that all HSBC disclosure services are compliant with the directive which is being implemented to reduce short termism and excessive risk taking by companies.

Following the successful rollout of Proxymity Shareholder ID in the UK and Europe, HSBC plans to introduce the solution to clients in Asia in the coming weeks.

HSBC also plans to deploy Proxymity's Vote Connect proxy voting solution later this year to enhance the accuracy, timeliness and transparency of both meeting announcements and votes.

Proxymity's solutions ensure that investors receive "golden source" meeting announcements in real-time and are able to vote up until the market deadline.

Joe Mernagh, senior product manager at HSBC, comments: "Our collaboration with Proxymity on shareholder disclosures ensures a best practice process for our clients. We look forward to working with Proxymity to enhance our disclosure and proxy voting services over the course of 2022."

Sharegain accelerates growth with Series B funding

Sharegain, a capital markets infrastructure finance technology company, has raised US$64 million in Series B round funding.

The funding led by WestCap has been joined by Citi, EJF Capital LLC and Optiver PSI. Participating existing investors include Maverick Ventures Israel, Blumberg Capital, SixThirty, Rhodium, and the Kessler family office.

In line with its mission to democratise the US$3 trillion securities lending industry, Sharegain says it has defined a new market category with its Securities Lending as a Service (SLaaS) solution.

Sharegain enables online brokers, private banks, asset managers and custodians to benefit from an end-to-end offering and generate additional income on their assets.

The firm also announced that WestCap partner Scott C. Ganeles, the former CEO of Ipreo and board member of Tradweb and NYDIG, will join the Sharegain board.

Boaz Yaari, founder and CEO of Sharegain, says: “We are thrilled that WestCap, Citi, EJF Capital LLC and Optiver PSI are joining our existing shareholders on our mission to democratise securities lending. We believe that lending your stocks, bonds and exchange-traded funds is a basic ownership right that should be made available to all.

“As private investor participation increases in capital markets, we are levelling the playing field so that private investors, through their brokers and banks, can benefit from income-generating solutions that have been restricted to big financial institutions. This partnership enables us to accelerate our global growth plans and scale, expand our offering faster and realise our vision of opening up securities lending to every investor worldwide.”

Dan Fischer, head of investments for Europe, the Middle East and Africa at WestCap, adds: “We see an opportunity for Sharegain to improve access to a critical financial service while benefiting both retail consumers and institutions. We look forward to forging a close partnership with Boaz and the team to support Sharegain’s global commercialisation.”

Basel III monitoring reveals improved bank liquidity through H1 2021

Banks’ risk-based capital ratios remained roughly constant during the first half of 2021, despite continuing economic disruption created by the COVID-19 pandemic, according to the latest Basel III monitoring data released on 21 February by the Basel Committee on Banking Standards (BCBS).

Average Common Equity Tier 1 (CET1) capital ratio under the initial Basel III framework remained unchanged at 13.2 per cent for Group 1 banks over this timeframe.

For Group 2 banks, the CET1 capital ratio fell from 16.3 to 16.2 per cent for the six months to 30 June 2021.

Group 1 banks, under the BCBS reporting methodology, are banks that are internationally active and have Tier 1 capital of more than €3 billion. Group 2 banks have Tier 1 capital below €3 billion or are not active internationally.

Banks’ liquidity ratios strengthened during H1 2021, with the liquidity coverage ratio (LCR) for Group 1 banks improving from 142.8 to 143.8 per cent, according to the survey.

For Group 2 banks, LCR improved from 208.3 per cent to 224.6 per cent. This reflects the minimum stock of high-quality liquid assets that a bank must hold as liquidity reserves to cover net cash outflows under a 30-day stress scenario.

BCBS reports that seven Group 1 banks had an LCR of less than 100 per cent during this reporting period, which was largely the result of banks drawing on their LCR reserves during the COVID-19 pandemic. All Group 2 banks had an LCR well above the minimum 100 per cent ratio for the period.

Net stable funding ratios (NSFR) improved over the same period from 123.0 to 124.5 per cent for Group 1 banks and 125.7 to 129.6 per cent for Group 2 banks.

In contrast to LCR, which measures liquidity coverage according to a 30-day stress scenario, the NSFR indicates a bank’s ability to withstand funding risk over a longer time horizon.

Target capital shortfalls under the fully phased-in final Basel III framework contracted from 6.1 per cent to 2.3 per cent for Group 1 banks for the H1 2021 period. For Group 2 banks, the capital shortfall also declined, from 1.8 to 1.3 per cent.

Bank leverage under the fully phased-in final Basel III framework increased for the Group 1 bank sample over the period, with the leverage ratio — which reflects a bank’s capital (typically Tier 1 capital) relative to its exposure — dipping 0.3 per cent to 6.2 per cent. The largest reduction, of 1.1 per cent, was evident in the Americas. This, the report states, results from a significant increase in the leverage ratio exposure measure — reflecting the end of temporary exclusions from the leverage ratio exposure measure applied by some jurisdictions during the pandemic.

This latest Basel III monitoring exercise found that three global systemically-important banks (G-SIBs) reported a total loss-absorbing capacity (TLAC) shortfall of €24.2 billion. This metric reflects the ability of a G-SIB to withstand losses without falling below regulatory minimum requirements and requiring recapitalisation or resolution procedures.

The Basel III monitoring exercise is conducted by the BCBS on a semiannual basis, gathering data to support risk-based capital ratio, leverage ratio and liquidity metrics utilising a representative sample of institutions in each country.

Data for the H1 2021 reporting period was supplied for 172 banks. This includes 110 large and internationally active banks (classified as the Group 1 bank sample), of which 30 are G-SIBs, and 62 other banks (classified as Group 2 banks).

OCC Stock Loan Programs

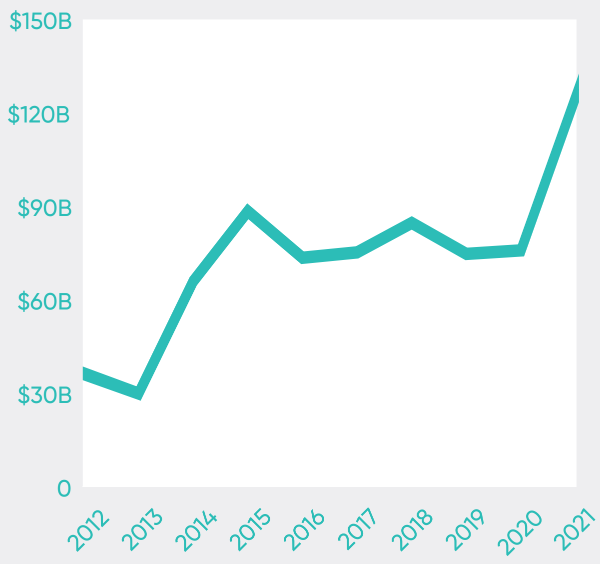
Key Benefits

- Counterparty disintermediation
- Expanded credit and trading allowances for cleared activity
- Risk weighted asset savings of approx. 95% compared to uncleared stock loans
- Margin offset
- Automation and streamlined operations

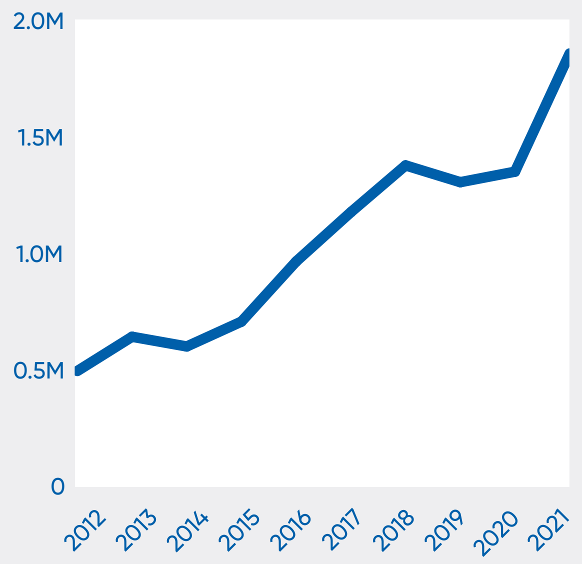
79
HEDGE LOAN PROGRAM MEMBERS

125B
AVERAGE DAILY LOAN VALUE AT YEAR END 2021

Annual Notional Value of Loans



Annual New Loan Transactions



For more information about OCC Stock Loan Programs, visit theocc.com

10c-1 reporting: SEC reopens consultation

In the second of two articles, Bob Currie evaluates the SEC's 10c-1 proposal to promote transparency in US securities lending

In late November, the US Securities and Exchange Commission (SEC) announced a new US trade reporting regime that it expects to bring greater transparency for the securities lending industry.

The proposals, which were unveiled by the SEC under Exchange Act Rule 10c-1, require lenders to report the material terms of securities lending transactions to a registered national securities association (RNSA), along with details of securities on loan and available for loan.

The **first part of this article**, published two weeks ago in SFT 296, provides detail of the proposed 10c-1 reporting framework and the reaction of the industry during public consultation, which closed on 7 January.

It is noteworthy, as we go to press with this issue, that the SEC has voted to reopen public consultation, providing respondents with additional time to share their recommendations on the design of the Proposed Rule. This additional consultation window will extend until 1 April (or 30 days from its publication in the Federal Register, whichever is later), giving respondents roughly one month to file their comments.

This is broadly equivalent to the first round of public consultation, when the SEC put forward 97 questions in its consultation document but gave the industry just 30 days to respond. The decision on Friday to open a second consultation window is indicative of the strong body of feedback received during the first consultation period and the weight of unanswered questions raised by the initial 10c-1 design.

Under the proposed new rule, any person that loans a security on behalf of itself or another person will be deemed to be a "lender", including banks, insurance companies and pension plans, and thereby required to report.

To track the transaction, the RNSA will be required to assign a unique transaction identifier to each reported securities lending trade. Under this Proposal, the RNSA will publish selected data relating to each transaction, along with any subsequent modifications. It will also publish aggregated data providing details of on-loan securities and securities that are available to loan.

Scope and (extra)territoriality

Respondents to the SEC consultation highlight that further clarification is needed regarding the territorial scope of the 10c-1 reporting obligation and, also, which transactions should be reportable.

Although the Proposed Rule states that '(a)ny person that loans a security on behalf of itself or another person' has a reporting obligation, the Rule in its current form does not identify clearly whether it is the lender's domicile, the security itself or a combination which brings a transaction into scope of the reporting regime.

By comparison, under the Securities Financing Transactions Regulation (SFTR) regimes in the EU and UK it is primarily the domicile of the transacting entities which determines the reporting obligations, such that an EU entity, or an EU based branch of a non-EU entity, is required to report (or the equivalent for UK application).

According to Adrian Dale, head of regulation, digital and market practice at the International Securities Lending Association (ISLA), ISLA was advised that up to 18 per cent of lender transactions in the US market are provided by funds outside of the US. This statistic implies that a considerable volume of activity may not be captured by the proposed regulation, pending clarity on scope and extraterritoriality.

When a regulator is driving for greater transparency, as the SEC is doing with 10c-1, ISLA indicates that it is important, as far as possible, that these regulatory provisions are fit for purpose worldwide. This demands co-operation and agreement between national supervisors. Without this, inconsistencies are likely to develop in how markets are regulated at national level which could create arbitrage opportunities and impair efforts to harmonise around common global standards.

Thomas Tesauro, president of Fidelity Capital Market — speaking on his company's behalf as a principal lender, borrower, prime broker, lending agent and securities lending data provider — shares concerns that the extraterritorial scope of the Proposed Rule is not clear.

He also indicates that the Proposed Rule does not define accurately what it means to "loan a security". Fidelity is one of a number of respondents to the 10c-1 consultation that urges the SEC to provide clear definition of when a securities loan is deemed to be "effected", pointing out that in the marketplace a loan is not typically considered to be effected until the loan has been contractually booked and settled, which may be end-of-day or on T+1.

Lessons from SFTR

In 2013, the FSB published a report, Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, that set out recommendations to address financial stability risks relating to securities financing transactions (SFTs). These included recommendations for national supervisory authorities to improve data collection for SFTs, strengthening their ability to detect financial stability risks and to develop policy responses.

Given that the EU has implemented a trade reporting regime for SFTs through a phased implementation during 2020 and 2021, it is useful to explore whether the SEC can learn valuable lessons from the design, testing and implementation process for SFTR.

Speaking to SFT, ISLA's Adrian Dale indicates that had there been a market standard data representation of securities lending prior to that regulation, SFTR's implementation would have been significantly faster, it would not have required years of consultations and clarifications, and would not have demanded as much development effort by market participants. At the same time, it would have offered regulators a clean view of the relevant SFT markets.

ISLA recommends that the support of a market-derived data set should be considered, both to facilitate transparency proposals and to assist the market in its future development. The Association has been working with its members, and with the International Swaps and Derivatives Association (ISDA) and the International Capital Markets Association (ICMA), to create a consensus-derived market data standard, the Common Domain Model (CDM), which has been widely discussed elsewhere in SFT. Dale indicates that ISLA has made itself available to the SEC to discuss any of these points, including development and wider application of the CDM.

The 10c-1 Proposed Rule appears to envisage a much 'leaner' reporting framework than SFTR, with 12 reporting fields in the current 10c-1 design, compared with 155 for SFTR.

SFT asked Fran Garritt, RMA director of securities lending and market risk, whether this 'lean' 10c-1 reporting template is suitable for meeting the SEC's transparency objectives — and whether additional fields may need to be added to provide a more accurate picture in terms of pricing transparency (see further on p 36 in this issue).

Garritt responds that RMA does not favour adding additional fields to the 10c-1 template. "We believe the SEC will be able to capture all the pertinent information related to pricing transparency with the current proposal," he says. "From RMA's perspective, excess data fields add limited benefit considering the additional cost of sourcing and transmitting the additional fields." In making this point, Garritt reminds us that the scope of 10c-1 and SFTR are quite different. "10c-1 would implement statutory authority for rulemaking with respect to securities lending specifically," he says, "while SFTR covers other kinds of transactions."

For ISLA's Adrian Dale, it seems highly likely that the SEC will need to add additional fields during implementation to achieve the full objectives that it intends through the reporting regime.

"Experience [from SFTR implementation] illustrated that the initial field template advanced by regulators to support the reporting process is unlikely, in practice, to be sufficient — and typically it will be necessary to add extra fields during the testing and implementation to capture any missing elements," says Dale. As an example, additional fields may need to be added to capture ESG and sustainability considerations in lending strategy and collateral transfers.

With this in mind, ISLA has continued to host meetings since SFTR went live to find solutions to data issues. For example, its members continue to encounter issues with fields and events such as timestamps, settlement failure, trading venue, maturity date, fees and Legal Entity Identifiers (LEIs). Questions may also be driven by conflicts between primary regulation, subsequent regulatory clarifications, and market practice.

As illustration, Dale notes that SFTR only has one currency field, for example, even though there may potentially be different currencies for valuation, collateral, and billing, and this consequently requires some workarounds to communicate the required information. Although currency fields are not a good example for the US market, Dale indicates that this does highlight the potential drawbacks inherent in the historical approach to regulatory reporting.

Ed Blount, in his capacity as executive director of Advanced Securities Consulting, proposes an alternative to the SEC's proposed 10c-1 design that will allow asset managers to report loans to an RNSA via a registry using a copy of the custodian's records (fig 1).

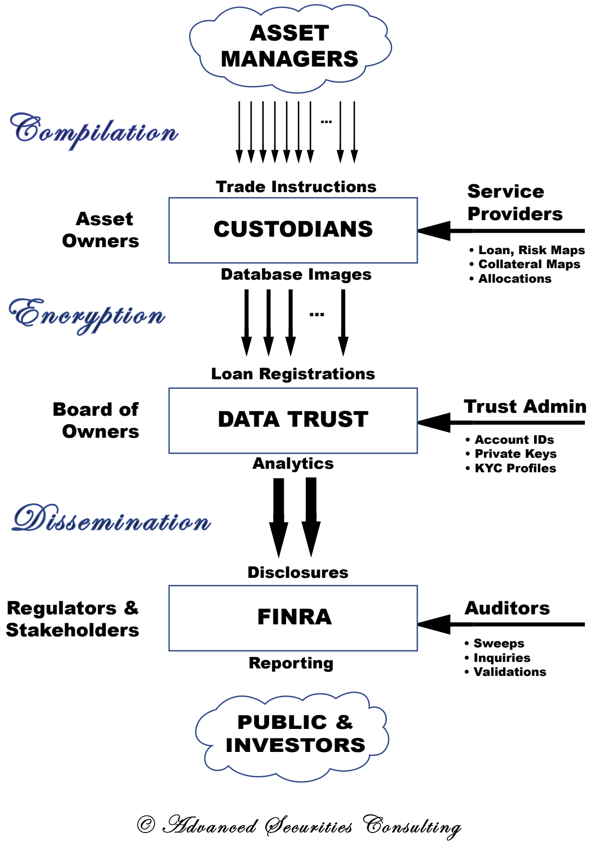
Speaking to SFT, he advises allowing lenders to report from their own data trust — a database that could be serviced by custodians on behalf of lenders and which, potentially, could be managed on a permissioned blockchain.

Under the data trust arrangement (box on p 20), asset managers will submit trade reports to the beneficial owners' custodians and carrying brokers; and agent lenders will submit loan transaction details or delivery orders to the custodian, as they do currently. The custodian will then send a copy of designated master files to the data trust registry, marking this with a unique transaction identifier (UTI) generated by the custodian's systems.

If, as a 10c-1 requirement, the SEC continues to require data on loan availability (see box on p 20), Blount believes this can be captured accurately by the data trust from the portfolio custodian's master files. However, some beneficial owners are likely to insist on their LEIs being

Figure 1

10c-1 Securities Finance Disclosure Regime Using a Data Trust



encrypted and inventory aggregated to avoid providing information that might tempt predatory traders.

Corrections and modifications to reported loans — as well as data on 'locates' — could also be reported from the custodian's master files in the data trust.

According to Blount, at least US$100 million could be saved from the estimated US$375 million in projected start-up costs for 10c-1 reporting, given that custodians are connected to the lending agents and asset managers through a number of utility networks. Instead of the 409 data input pipelines to FINRA, as estimated in the proposal, Blount says that only two would be needed for lenders of participating asset managers.

In developing an effective reporting regime, ISLA's Dale emphasises that it is important for financial regulators to keep a watchful eye on the opportunities extended by new technology and harmonisation.

From a technology standpoint, he suggests that a reporting system based on distributed ledger technology (DLT) may deliver a more effective solution than the current SEC 10c-1 design. In a DLT-based environment, trade and collateral data may be reconciled instantly by trading parties (or their reporting agents), providing financial regulators with a transparent, consolidated view of market pricing in near to real time in accordance with the goals of 10c-1.

In implementing this solution, ISLA believes it is advisable to migrate to a DLT-based data repository, rather than adopting an intermediate solution — such as the SEC 10c-1 Proposal — that will consume resources and will potentially delay the adoption of an innovative DLT-based solution.

Delegated reporting

The SEC's 10c-1 Proposal envisages a single-sided reporting regime that makes provision for reporting to be delegated to broker-dealers by lenders, subject to a written agreement. This currently appears to be the only form of delegated reporting permitted by the proposed rule. Beneficial owners that do not employ a lending agent or enter into a written agreement with a reporting agent would be responsible for complying with the requirements of the proposed rule themselves.

From a buy-side perspective, the Investment Company Institute (ICI) urges the SEC not to limit permitted lending agents to banks,

Data trust

Ed Blount and David Schwartz, from the Centre for the Study of Financial Market Evolution, outline the case for a data trust to support securities lending reporting

A data trust is an evolving mechanism for individuals to take the data rights that are set out in law (or the beneficial interest in those rights) and to pool these into an organisation, a trust, in which trustees would exercise the data rights conferred by the law on behalf of the trust's beneficiaries. The central organising principle for every data trust is that the trustees are instructed to use the data assets for the owners' exclusive benefit. The key features of a data trust are ownership and control.

Blount and Schwartz recommend that the 10c-1 reporting system outlined in the SEC's proposal should be adapted to accommodate a data trust formed by beneficial owners in the securities lending industry. Although a data trust for securities lenders and borrowers would be an original application of the concept, Truata, the European Mastercard data trust, may provide a useful precedent. Truata was formed to anonymise customer transaction data for analysis and compliance with the EU's consumer privacy regulations. Truata's beneficiaries are competitors, just like securities finance market participants, so they rely on robust usage and encryption policies that make it difficult for owners to use the data as a weapon against one another.

If lenders were permitted to join together to form a data trust, Blount and Schwartz believe they could pool not just the information required by 10c-1, but also Know your Customer (KYC), proxy voting, ESG and other transaction data for their own benefit.

This would offer potential to produce all the publicly available data envisaged by the SEC, as well as a privileged dataset of highly confidential, shared analytics for the reporting lenders, who are expected to pay for the 10c-1 disclosure system.

Data vendors and fintechs would bid to service the registry database, enabling beneficial owners to benefit from the analytics provided by these vendors, as they do currently. Contractors would reformat records and facilitate 10c-1 reporting to the regulatory transaction repository, as today. The creation of a new, wider pool of data would also stimulate competition among data vendors – which is another SEC goal.

clearing agencies, brokers or dealers for the purpose of meeting 10c-1 reporting. It should instead permit any lending agent that serves as an intermediary to a securities loan transaction to report on behalf of a beneficial owner, providing that it is able to satisfy the requirements defined by the Proposed Rule. "We believe that expanding the Rule in this manner would facilitate reporting by beneficial owners that prefer to use non-broker-dealer lending agents to report their securities loans," say ICI's associate general counsel Sarah Bessin, and Susan Olson, general counsel.

A broad set of reporting agents are supporting the SFTR reporting process in the EU and the UK — some of which are data or technology vendors and do not meet the SEC's 10c-1 requirement of being a bank, agent lender or broker-dealer. Consequently, the SEC may wish to broaden its set of approved reporting agents, recognising that some lenders with international activities may prefer to utilise the same agents to manage their 10c-1 reporting in the US.

For Sharegain's CEO Boaz Yaari, it does not follow that, just by virtue of being a broker-dealer, an entity will have the technological capabilities to meet the reporting challenges under the Proposed Rule. Therefore, where such technology capabilities exist, allowing Qualifying Technology Agents to act as reporting agents under Rule 10c-1 would ease the burden on broker-dealers and avoid concentrating the reporting services market.

Pirum indicates in its consultation response that the proposal to allow reporting to be delegated via a registered broker-dealer may create potential confidentiality and conflict of interest issues, as often the lenders subject to the reporting requirements will be engaged in securities lending with the same broker-dealers that they also use for transactions in the cash markets.

Without an alternative, Pirum believes, beneficial owners would either be forced to build their own direct reporting to RNSAs to mitigate these concerns, thereby significantly increasing their costs, or to exit the market entirely, thereby reducing overall liquidity.

Available-for-loan securities

SFTR in the EU and the UK requires two-sided reporting of SFT transactions with the objective of strengthening regulators' and market participants' ability to monitor risk across securities lending and financing activities.

However, in driving for greater transparency in securities lending markets, the SEC's 10c-1 proposal requires that lenders report details of securities lending transactions on a trade-by-trade basis, and also provide additional information on securities that are on loan or available to loan.

As discussed more fully in part 1 of this article, this data for securities on loan and available for loan must be submitted to the RNSA by the end of each business day.

A number of respondents to the SEC consultation argue that the requirement to report available-to-lend securities should be removed from the reporting process.

The Risk Management Association states, for example, that requiring lenders to report securities that are available to lend "would provide little or no significant benefit for the securities lending market" — and this may potentially discourage lending and use of reporting agents.

RMA's Fran Garritt and Mark Whipple, chair of the RMA's Council on Securities Lending, point out that other securities finance transaction reporting regimes, particularly SFTR, do not require lenders to report data on available-to-lend securities. They propose that, in the case of 10c-1, more accurate estimates of loan supply could be extrapolated from fluctuations in trading volumes and fees that will also be available to the SEC through data that it aims to collect through the 10c-1 reporting regime.

Other observers note that the Proposed Rule mandates reporting of total on-loan balances, securities available to loan and the utilisation rate, but does so without regard to whether the lender has self-imposed restrictions on the number of securities or percentage readily available to loan. In this case, disclosing loan balances and utilisation rate, but without accounting for lender restrictions, is unlikely to provide a useful benchmark of availability.

Respondents from buy-side trade associations also raise concerns that the proposed 10c-1 reporting regime may reveal confidential information about members' trading strategies.

Jennifer W Han, chief counsel and hedge of regulatory affairs at the Managed Fund Association (MFA), says that the MFA is "strongly concerned" that transaction-by-transaction financing data, even in anonymised form, would "provide the market with sufficiently detailed information to allow market participants to reconstruct or reverse-engineer investment and trading strategies, leading to situations similar to the GameStop and AMC market events."

Jirí Król, deputy CEO and global head of government affairs at the Alternative Investment Management Association (AIMA), explains that even in anonymised form, these disclosures, specifically regarding the fee or rate and the class of borrower, would reveal a significant amount about the actions of individual market participants.

AIMA members tend to borrow from a limited number of broker-dealers, which are publicly disclosed in Form ADV, says Król. "The publication of this data would be valuable to market participants looking to front run or short squeeze market participants building a short position or reverse engineer the strategies of firms taking short positions, particularly when the long positions of firms are publicly available via Form 13F," he adds.

More broadly, MFA's Jennifer Han urges the SEC, in its efforts to provide near intraday pricing transparency for securities lending markets, to provide a clear delineation between reporting for wholesale and retail segments of the securities lending market. MFA members are designated as "retail market", she notes, because they are reliant on their broker-dealers to borrow securities, under the umbrella of their brokerage account agreements, to facilitate settlement obligations for short sales. The SEC is misguided, she believes, in its attempt to develop a consolidated tape for two very different types of securities lending activities — the "wholesale market" and the "retail market" — which are governed by different contractual frameworks.

AIMA raises a similar point in its response to the SEC, noting that while the wholesale market lends itself to a standardised transparency regime, the retail market consists of complex transactions that are part of bespoke relationships with nuanced interrelated contractual terms — for example collateral, counterparty and term — that are often not finalised until end of day or later. "As a result, retail market transaction data would lead to non-comparable and often misleading data reported and disseminated publicly," AIMA states.

> *"Had there been a market standard data representation of securities lending prior to SFTR, implementation would have been faster, it would not have required years of consultations, and would not have demanded as much development effort by market participants"*

Closing thoughts

In the two parts of this article, SFT has evaluated a cross-section of the potential benefits offered by the SEC's proposed 10c-1 reporting regime and the industry's recommendations for amendments to this trade reporting model.

Given the weight of open questions, it seemed likely that the SEC would need to reopen some points for further consultation — and this was confirmed on Friday 25 February, just a business day before SFT 297 is published, when the regulator said that respondents would have a further one month to share their comments. In the same breath, it also put forward a new proposal under Exchange Act Rule 13f-2 that aims to provide greater visibility, through aggregated short sale data, regarding the behaviour of "large short sellers".

In refining the 10c-1 design, it seems likely that the SEC will need to give consideration to whether it should approve additional RNSAs. A number of respondents to the SEC consultation have questioned whether it is appropriate that FINRA should serve as sole RNSA for the 10c-1 reporting process.

Another possible option is that lending participants could report trades directly to the SEC, given the capability that the regulator has in place to receive EDGAR filings and to provide public dissemination of this data.

For reasons discussed, It is also likely that the SEC may extend the range of reporting agents that it will approve to support 10c-1 reporting.

In designing its 10c-1 reporting regime, the SEC aims to strengthen its ability to monitor systemic risk and the buildup of stress in the market. This involves building greater visibility across the lifecycle of a securities loan transaction, including transactions passing through key service intermediaries such as prime brokers and lending agents.

In doing so, the SEC's proposal recognises that a broker-dealer may borrow as principal, but then makes an onward loan either to the end client (for example, a hedge fund) or internally to a trading desk within the bank — recording this activity in its stock record-based accounting systems and tracking its P&L across each step in this chain of transactions.

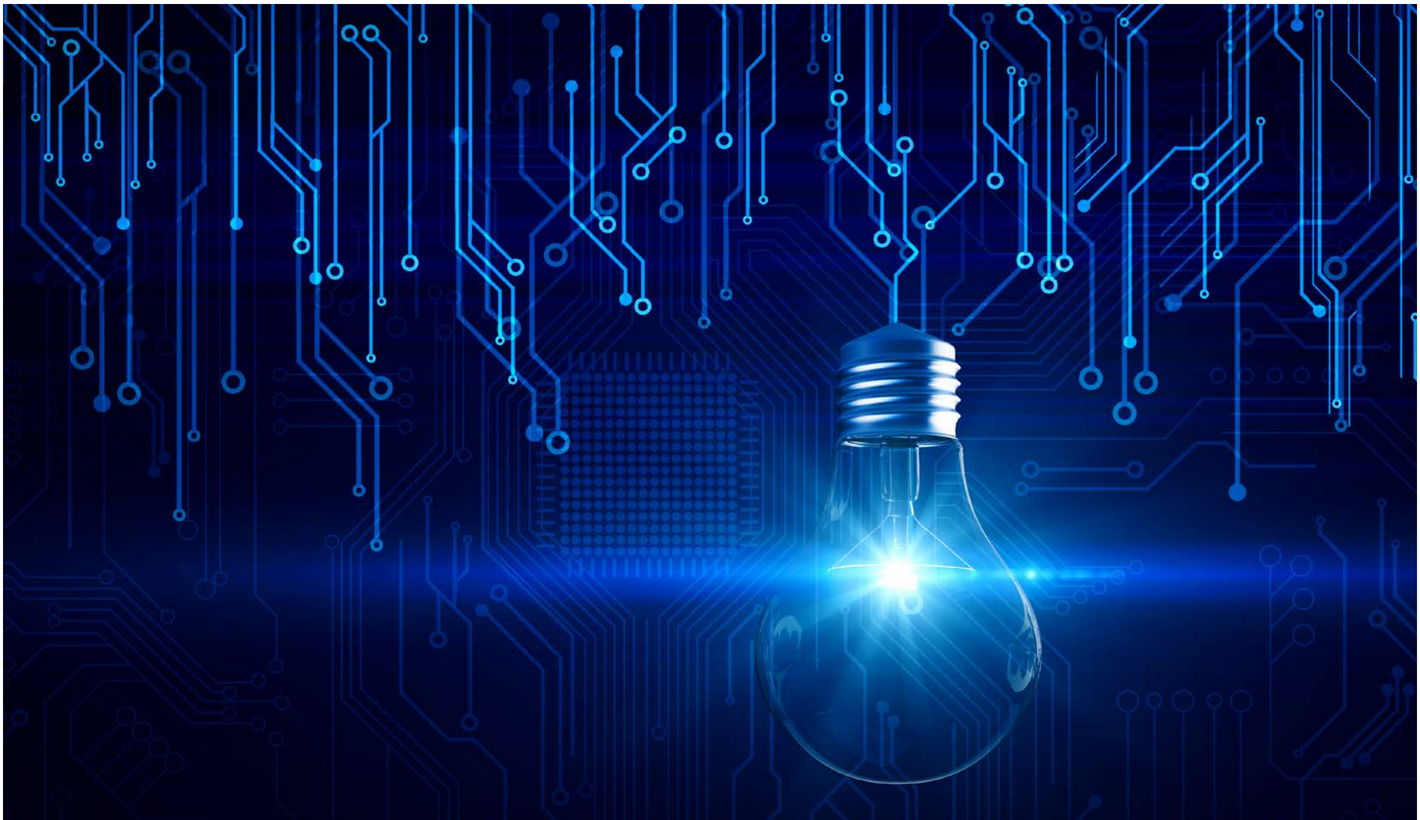
By identifying the prime broker as a lender as well as a borrower — and therefore requiring the PB to report its securities lending transactions, securities on loan and available for loan — this will potentially give the SEC greater visibility across PB lending activity and how these loans are used. For CSFME's Ed Blount, this is a major step forward.

In advancing this proposal, the SEC applies an important requirement — stated in a footnote in the proposal document — that 'each lender must know its borrower'. This, Blount believes, will help the SEC to monitor whether the loan is used for legitimate purposes — a Reg T purpose — and will provide early indication of illegal practices such as cum-ex trades. An overarching objective for the SEC, he notes, is to encourage firms that borrow and lend as principal to have a detailed understanding of their risk and to know their borrowers. This, he says, will be an important step to ensuring that the industry is clean and that risk, at enterprise and systemic level, within this sector is monitored and managed effectively.

COLLINE© Cloud

A cost-efficient end to end collateral management service via SaaS

- Scalable, low-cost modular cross product cloud-based enterprise collateral management platform
- Complete web based regulatory compliant solution covering Cleared & Uncleared Margin Rules (UMR) across OTC, repo, and Securities Lending products (including FINRA 4210)
- A mature, highly available, certified, cloud based SaaS with flexible sizing and configuration
- Improved customer experience with quicker onboarding and out of the box connectivity
- Enhanced Inventory transparency to improve asset utilization and liquidity
- Agility and scalability to comply with changing industry standards and grow your business
- Award winning software, expertise and service from the market leading collateral management system



Collateral management: Solutions for the next generation

Industry experts address the priorities facing collateral managers during 2022 and beyond, reflecting on collateral flexibility, technology, ESG and regulatory drivers

Panellists

Staffan Ahlner, global head of Collateral+, **State Street**

Ted Allen, director of business development, securities finance and collateral, **FIS**

Mike Cardieri Jr, head of agency securities finance, corporate and investment bank, **J.P. Morgan**

Wassel Dammak, director, collateral management product, **VERMEG**

Martin Walker, head of product management SFCM, **Broadridge**

For several decades, the industry has been tackling fragmentation of collateral across product silos and geographical locations. How advanced is the industry in its ability to provide centralised collateral management and enterprise-wide optimisation of the collateral inventory?

And where do primary points of inefficiency remain?

Staffan Ahlner: The industry has moved to centralised resource management and some firms have progressed further than others. There is, however, still room for improvement. Some firms continue to have challenges with harmonisation of real-time data across desks, divisions and entities. It is also interesting to see the difference between the buy side and the sell side. The integration comes more naturally on the buy side, although they manage to a different set of criteria.

We do see more buy-side firms establishing collateral and liquidity centres on the buy side. Buy-side firms tend to be more regional than those on the sell side, so this presents a lesser challenge when compared to sell-side firms that have run global organisations for a long time. Some firms do still struggle with basic metrics to define opportunity cost and where to deploy scarce resources most effectively — be that capital, assets, opportunity cost or liquidity. The optimisation challenge depends on how a firm defines their optimal outcome — which differs between organisations — as well as the tools, resources and expertise available to execute on their strategy.

Ted Allen: Many firms still operate in multiple silos and, of course, each entity and each desk is motivated to maximise their own return on assets. But what is best for one desk is not always best for the firm as a whole. The consequences of not centralising the sources and uses of inventory are that costs of collateral are higher, securities finance returns are lower and balance sheet costs may be greater.

The first place to start is with gathering the inventory, enabling you to answer a set of simple questions. What assets do I have available to me at this time across the whole firm that could be deployed? Where are these assets and when can they be moved? How long do I have these assets for? Where are they eligible to be used and what will they be worth? Real-time global inventory management and collateral optimisation are two sides of the same coin.

Wassel Dammak: We have seen that collateral management consolidation is one of the major drivers for allocating budgets to collateral technology over the last few years. That trend will continue to accelerate as financial institutions look strategically to collateral management across multiple trading business lines, whether financial institutions are acting as 'principal' or 'agent' in their trading activities. Building the business cases is both difficult and urgent because it involves multiple departments: Risk, Operations, Front Office and Treasury in certain cases. Reaching a consensus is not easy — especially because, historically, those business lines were managed in silo with different people, processes and technologies.

Collateral optimisation is a more complex topic because there may be mismatches in the objectives that departments are looking to achieve. Operations are generally interested in the optimal collateral from a cost perspective — for example, the cheapest to deliver. Treasurers are more concerned with preserving high quality liquid assets to control their liquidity metrics, while trading desks are tempted to keep the assets that could generate highest revenues.

Many banks have mandated SMEs to study the feasibility of a centralised optimisation service. One of the major difficulties they have to tackle is the fragmentation of inventories and a lack of transparency when it comes to establishing a global view of the assets across business lines. They have also struggled with the cost-benefit analysis to prove that the investment is worth it. In many cases, firms opted to retain excel sheets because they could not justify the funding for a project deemed to be 'non-urgent' — and ultimately the project was postponed.

Mike Cardieri: There has been considerable focus on this concept across the industry for many years. This has centred specifically on sell-side firms centralising functions internally, as well as service providers partnering with those firms to support their collateral centralisation and optimisation journeys. J.P. Morgan, as a tri-party agent, has seen many of our clients making organisational changes to centralise functions across their firm and they have also implemented technology solutions to consolidate, provide an integrated view across their collateral holdings, and to optimise how this collateral is posted. Though we have seen a tremendous focus on this front, we believe this is a continuous journey given that optimisation of collateral goes beyond the centralisation or consolidation of inventory and obligations.

There is still work to do as an industry. While seamlessly mobilising collateral is a critical component of optimisation, it can be challenging from a practical perspective. This requires involvement from the various players in the collateral management ecosystem, not just the counterparties posting and receiving collateral. For example, as a tri-party agent, J.P. Morgan is focusing on the convergence of the capabilities of tri-party such as eligibility testing and collateral optimisation with bilateral market settlement functionality.

In 2021, our Collateral Services group developed such a solution and this is now actively delivering efficiencies for sizeable initial margin (IM) requirements at a major CCP. This allows the broker-dealer to consolidate collateral inventory in a single location using the tri-party engine to allocate in the tri-party books itself — and then systematically to deliver the collateral bilaterally when that is required outside of the tri-party ecosystem.

Martin Walker: The industry is fairly mature, with vendor solutions available which are sophisticated enough to cope with multi-jurisdictional and siloed organisations.

Consolidating real-time inventory, pricing and settlement information on cash, bonds and equities across multiple systems and time zones is an essential first step. SFCM has Real-time Global Inventory Management at its core. Initial and variation margin requirements must either be calculated or imported. Credit support annex (CSA) requirements, eligibility rules, concentration limits and haircut requirements must also be integrated. As these requirements are common for all clients, they are also well defined.

However, as client collateral optimisation goals vary (i.e. to minimise funding costs, maximise cash balances, reduce balance sheet risk) fintech solutions must include flexibility for defining the algorithm applied, defining best to worst, substitution rules, and so on. SFCM's Collateral Optimizer was designed with these needs in mind.

Moving collateral from point to point has always been a costly and inefficient process. Recent developments in the distributed ledger technology (DLT) space are attempting to address this by tokenising and therefore immobilising collateral, which in theory should save on time and costs.

What trends have you noted over the past 12 months in terms of the collateral that lenders will accept against their securities lending activity?

Cardieri: Over the past 12 months, we have observed two key trends in this space. The first has been that, in certain markets, trades versus cash collateral outpaced non-cash collateral trades. This reversed a long-term trend of growth in non-cash collateral trades.

Another trend evident in 2021 was the willingness of lenders to look at opportunities to broaden their collateral set. In an oversupplied market with no limits in demand, collateral flexibility is key to utilise assets. Regulations introduced post-financial crisis, such as Basel III and the introduction of the Supplementary Leverage Ratio (SLR), Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), have placed counterparty balance sheets under greater pressure, and under increased scrutiny, through tougher restrictions on capital, leverage and liquidity.

This has resulted in scarcer balance sheet resources being allocated internally to counterparties, causing them to place greater focus on balance sheet optimisation and driving interest from counterparties to un-trap and fund a widening range of non-cash assets. Borrowers are constrained by their balance sheets and need to optimise borrows to reduce costs and grow. Collateral flexibility allows the lender to take

"We have a lot to learn from the retail industry. As private individuals, we expect to have the ability to trade, settle and safekeep in one application, but for some reasons we accept the fragmentation when we look at the institutional side"

Staffan Ahlner, global head of Collateral+, State Street advantage of the changing needs of borrowers. This can increase utilisation and ultimately generate additional lending revenue.

Ahlner: Non cash remains the focus, a trend that reflects current spreads and returns on cash reinvestment when balanced against the associated risk. However, cash remains the main vehicle for derivatives margin calls. Moreover, for some users the operational advantages outweigh the risk and yield disadvantages of accepting cash collateral, given their current technology.

And in use of pledge-based collateralisation of securities lending transactions versus title-transfer?

Ahlner: The use of pledge for securities lending offers interesting opportunities, notwithstanding the challenges for some firms in perfecting use of pledge in some jurisdictions. It is important for lenders to ensure full perfection of the securities interest down to the underlying principals. In this context, it is useful to draw a parallel with the derivatives world and Uncleared Margin Rules (UMR) where pledge or transfer of securities interest is the norm.

Cardieri: From J.P. Morgan's standpoint, the pledge model is now seeing strong adoption in Europe and in APAC. Its success shows how the securities finance industry can successfully adapt to new regulatory challenges while preserving core client protections.

Pledge has been around for a long time, but became a major focus with UMR in 2016, where pledge, in the form of a tri-party Account Control Agreement (ACA), has been widely adopted across the industry for the posting of initial margin. From a securities lending perspective, pledge has been a feature of US activity for some time, but internationally we worked with the International Securities Lending Association (ISLA) in 2018 to develop the Global Master Securities Lending Agreement (GMSLA) Pledge principal agreement and associated tri-party ACA. We have seen a steady growth in uptake for this solution subsequently.

On balance, pledge is certainly growing in popularity. We currently see growth at 80 per cent across the programme and we expect this to increase as the number of conversations between providers and receivers accelerates and pledge becomes more business as usual.

Walker: We have seen modest interest in pledge collateral. We think it is inevitable that pledge will gain a permanent foothold in the market, but just how large that foothold is remains to be seen.

Where will you target technology investment during 2022 to deliver the greatest benefit in collateral mobilisation and optimisation?

Cardieri: The J.P. Morgan Collateral Services business has been a focus area for technology investments, enabling the team to deliver our strategic objectives of asset mobilisation, collateral efficiency and integration, as well as enhancing the way we support the securities finance ecosystem.

The digital space is an important area that we continue to invest in, creating and driving innovative distributed ledger technology (DLT) solutions to deliver greater collateral mobility and optimisation. Improving tri-party interoperability has been a challenge in the market for years and, with the evolution of digital asset solutions, we are

"UMR will continue to be a major focus through to September. Eurosystem Collateral Management System (ECMS) is also becoming a factor for European banks and accelerating the adoption of centralised inventory management and automated optimisation"

Ted Allen, director of business development, securities finance and collateral, FIS committed to ensuring that tri-party connectivity is multidimensional.

For example, our intraday repo product, which runs over the Onyx Digital Assets DLT network, has seen tremendous uptake in activity and interest since its launch. We are now actively extending this product for global clients, enabling overnight and term repos against a broader spectrum of eligible securities supported by J.P. Morgan's global tri-party platform. The development and adoption of this DLT product is a solid foundation for the future of collateral tokenisation. We believe collateral tokenisation of assets can mobilise collateral more efficiently in many cases — and optimise collateral which may have been trapped with traditional operating flows. In 2022, the financing and collateral world will see some revolutionary products delivered to market by J.P. Morgan and our partners.

Allen: We have just launched the FIS Global Inventory and Optimization Platform. It is a comprehensive, centralised tool that normalises and aggregates inventory, and collateral sources and uses, across the firm in real-time. You get a real-time view of your traded and settled inventory positions across silos, while providing the tools needed for collateral optimisation to make the best overall use of inventory across liquidity, lending and collateral requirements.

This is a cloud-native solution, so it is lightweight and is connected to custodians, tri-party agents, CCPs and all the necessary collateral market infrastructure. It effectively sits on top of existing infrastructure, making it easy to connect silos without having to do a wholescale replacement of your existing securities finance and collateral systems and processes. We have made this quick and cost-effective to deploy and simple to configure.

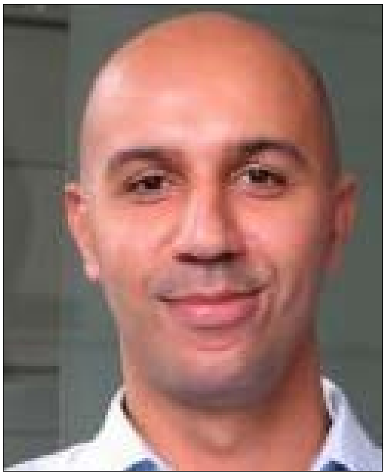
Ahlner: For a trading desk, there is now a range of options available in the market to optimise and manage collateral. We are focusing our effort on bringing new participants to the market, new participants that are not served as well by the existing offering. This includes participants that need a higher degree of automation and outsourcing, participants that require services across the three collateral silos utilising bilateral and tri-party settlement.

Dammak: As a specialised software vendor, we invest heavily in our collateral solution COLLINE. The investments that we have made to help comply with UMR are already behind us, but there are still areas for improvement. Adopting standards around data interoperability is key for the industry. We are onboarding Common Domain Model (CDM) digital representations of legal agreements and eligible collateral schedules for a seamless integration with the wider collateral ecosystem.

Another priority is the need to provide extensive flexibility in the rules managing collateral eligibility, haircuts and concentration limits. This is required to cater for the increasing complexity of collateral eligibility schedules that have accompanied the rise in use of securities under UMR regulations.

How much progress has the industry made in establishing a high-STP, low-touch collateral environment? What are the next steps forward in promoting front-to-back automation across the lifecycle of a collateralised transaction?

Allen: Our securities finance and collateral platforms already provide unprecedented automation levels for trading, inventory, analytics, optimisation, risk management and collateral management. Greater



"Low-touch collateral management is a reality today at many financial institutions, especially in the sell-side community. The extensive use of APIs to integrate with the wider collateral ecosystem helped in automating the end-to-end life cycle from trade receipt, to margin agreement, to the final settlement of the margin calls"

Wassel Dammak, director, collateral management product, VERMEG connectivity and widespread adoption of the CDM will further the possibilities for automation across the lifecycle of the trade.

AI offers potential for further performance enhancements. AI technology acts on the variables given to it, assesses the outcomes against set parameters and then adjusts subsequent decisions to improve its performance against those same parameters. For example, in trade automation, AI may consider not only factors such as cost to borrow and capital requirements, but also counterparty or sector behavioural patterns to determine the most economic trade to put on. FIS is working on solutions to bring these influences together in an integrated platform, driving automation of trading decisions, which weigh up all the point-in-time influences, assessing and reviewing the outcomes to improve the results of the next decision.

Combining AI with automated, connected systems enables the best economic outcomes and uses these results to adapt as the market changes.

Ahlner: As an institutional industry, we still have some distance to go. We have a lot to learn from the retail industry, which offers a range of integrated services. As private individuals, we expect to have the ability to trade, settle and safekeep in one application, but for some reasons we accept the fragmentation when we look at the institutional side. We spend a lot of time building front-to-back solutions, where we look to give optionality to the client for integrated pre-installed workflows.

Cardieri: The industry has made strides with a high-STP, low-touch collateral environment, with a combination of factors including the connectivity of Equilend's NGT and the use of tri-party accounts. Targeted availability with offer rates has automated the majority of the general collateral and warm name trades, leaving traders to focus more on hard-to-borrow names. The use of tri-party accounts expands the approved collateral set of a lender and the increased utilisation of digital collateral schedules expedites that process.

Dammak: Low-touch collateral management is a reality today at many financial institutions, especially in the sell-side community. The extensive use of application programming interfaces (APIs) to integrate with the wider collateral ecosystem helped in automating the end-to-end life cycle from trade receipt, to margin agreement, to the final settlement of the margin calls. All the processes happen in near real time if no exceptions are detected by the STP workflows.

There are still inefficiencies when it comes to smaller entities, particularly on the buy side. Certain processes like margin messaging are still manual and rely on the use of emails with heavy human intervention.

The next step is to aim towards no-touch collateral management, with auto-recovery tools that promptly handle exceptions whenever possible to resume the processing if the STP chain is broken. Such tools can leverage machine learning capabilities in certain cases and rely on natural-language programming whenever possible. This should be coupled with strong monitoring tools, on both the technical and business side, to control the overall activities.

As buy-side firms apply ESG overlays to their investment strategies, are you experiencing rising demand from collateral takers to apply ESG-screening to accepted collateral?

"Improving tri-party interoperability has been a challenge in the market for years and, with the evolution of digital asset solutions, we are committed to ensuring that tri-party connectivity is multidimensional"

Mike Cardieri Jr, head of agency securities finance, corporate and investment bank, J.P. Morgan

Cardieri: Focusing on asset owners, they are increasingly aligning their eligible collateral with their funds' overall ESG objectives, given that the lender receives full legal title to the collateral for the duration of a title transfer loan. However, collateral eligibility criteria should be considered carefully to balance the need to receive highly-rated ESG collateral with the need for highly liquid assets, especially given that the primary purpose of non-cash collateral is counterparty credit risk mitigation.

Generally speaking, the market is in the early stages of applying ESG-screening to accepted collateral, but there is an expectation that demand will grow significantly in the short term.

Walker: ESG acceptability and management is hamstrung by the proliferation of ESG vendors on the one hand and the lack of clear industry standards on the other. Agreement on what constitutes acceptability can only be achieved if both parties are singing from the same hymn sheet. We really need to make headway in data standardisation so that firms can come to a common agreement on ESG criteria.

What solutions are you developing to help clients to align their collateral management with their organisation-level ESG and sustainability objectives?

Walker: On the ESG front, Broadridge continues to develop enhancements to the recalls process to make it more data driven and supportive of the governance aspect of ESG.

We are also investigating the modelling of ESG-based collateral eligibility checks in our SFCM system.

Cardieri: Adaptable solutions are available within the J.P. Morgan lending programme and tri-party offering to provide a multi-level approach to clients when defining their eligibility criteria for non-cash collateral.

Within the lending programme, clients are offered three levels of eligibility restrictions: standard collateral schedules; bespoke ESG-style schedules; and schedules linked to specific ESG indices. This allows for maximum flexibility.

Within the tri-party programme, we have a variety of concentration limits and exclusion options that can be applied to enable bespoke ESG criteria to be set to client accounts and schedules. Additionally, we have built the capability for lenders to create eligibility schedules based upon underlying ESG indices and sectors — thereby helping these lenders to achieve their ESG objectives.

Allen: In early 2021, FIS made the strategic decision to develop the next generation, a cutting-edge platform to support the entire securities finance and collateral lifecycle tightly integrated into the market infrastructure. It was clear that the platform needed to be future-proof and one of the key trends was the growing adoption of ESG standards in securities finance and collateral.

To that end, we created a framework in which a firm's ESG parameters — along with those of their counterparties — can be configured directly into the trading, portfolio management, collateral management and optimisation rule sets. This includes trading and position analytics, limits and restrictions, as well as digitised collateral schedules that translate those parameters

"ESG acceptability and management is hamstrung by the proliferation of ESG vendors on the one hand and the lack of clear industry standards on the other. We really need to make headway in data standardisation so that firms can come to a common agreement on ESG criteria"

Martin Walker, head of product management SFCM, Broadridge into an automated framework for securities finance and collateral programme compliance.

Ahlner: We are seeing a rising demand for ESG, with a strong driver from the underlying investor. We expect even stronger demand for ESG-compliant services in the future, as the retail investor will make ESG a more prominent factor in deciding where to invest. We are already benchmarking assets and giving ESG scores on portfolios — and we are investing more in ESG selection of collateral and governance.

Which regulatory drivers will have the greatest impact on collateral managers during 2022?

Allen: UMR will continue to be a major focus through to September. This will, of course, have a knock-on impact on repo and securities lending markets and drive further volumes to clearing. Eurosystem Collateral Management System (ECMS) is also becoming a factor for European banks and accelerating the adoption of centralised inventory management and automated optimisation.

Dammak: The regulatory framework will continue to evolve in coming years. During 2022, the need to be compliant with UMR wave 6 will require that an operational framework is in place to monitor the regulatory initial margin threshold and to be ready whenever there is a need to exchange initial margin.

Other regulations may also impact collateral departments operationally. For example, the CSDR regulation may impact collateral bookings settlement, requiring tighter management of processes including fails or partial settlements, especially given the increasing use of securities for collateralisation of regulatory IM under UMR regulations.

As the regulatory framework evolves, this will reinforce the need for effective management of the data. Collateral managers will be asked to normalise the data and to make it available in near real time for external and internal use, recognising that the data handled in collateral systems is vital for proactive counterparty risk management.

Cardieri: With the recent completion of the penultimate phase of UMR, the clock has been reset for the final phase in September 2022 — bringing over 700 entities into scope and impacting an increasing number of insurers, mutual funds, large pension and hedge funds who may be the underlying beneficial owners of agent lenders. The challenges presented by Phase VI will benefit from the standardisation delivered in earlier phases.

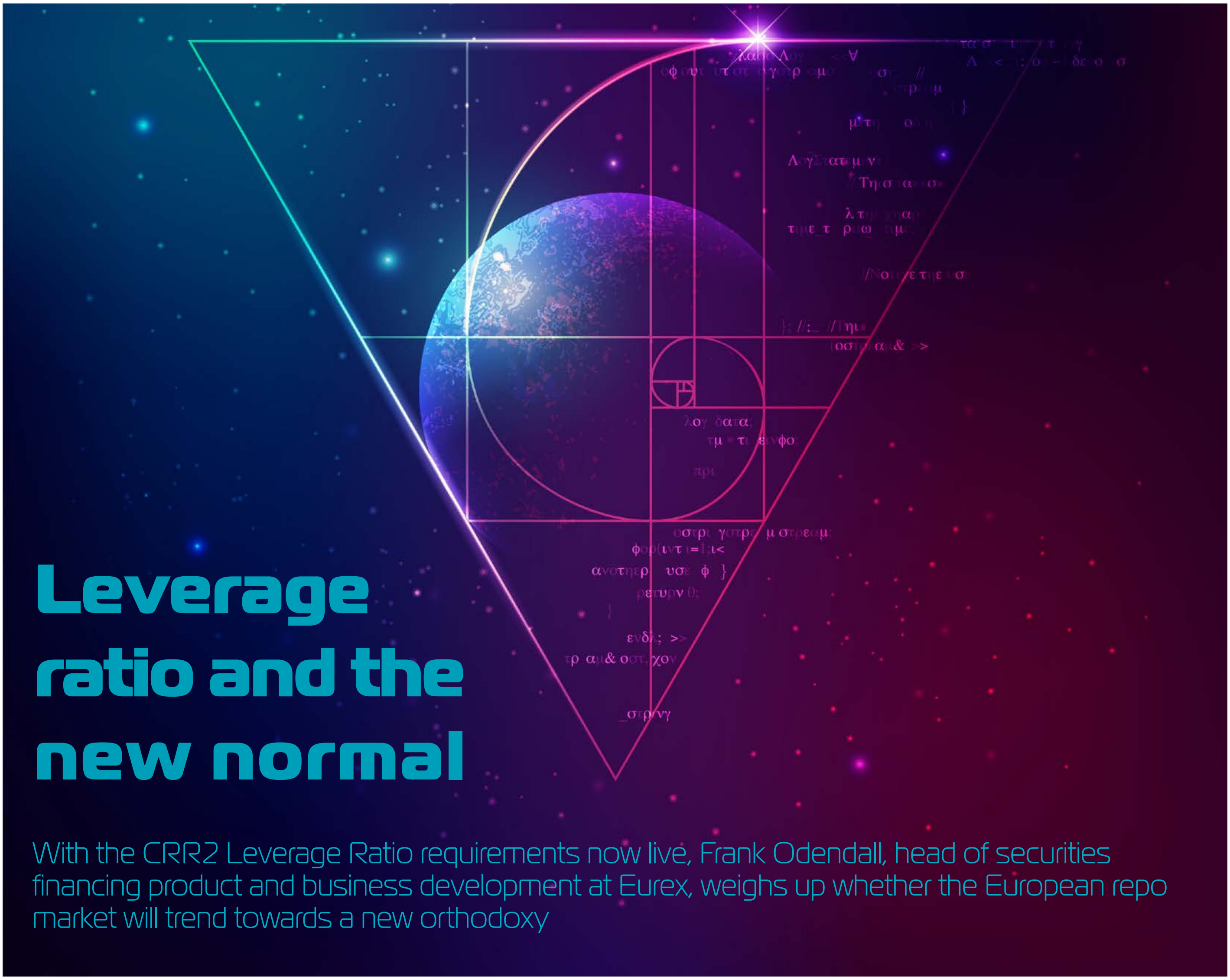
Counterparties and service providers have refined their documentation and services since 2016, so it is important to engage with your service providers early. In-scope participants must be ready to prioritise between active collateral arrangements with counterparties needed for day one and counterparties where a monitoring approach may be more appropriate.

We have the solutions in place to serve as our clients' collateral partner for UMR, providing threshold monitoring, pre-trade analytics, IM sensitivity creation, collateral processing and dispute resolution in a complete UMR package. In addition, we can assist through workshops, helping clients to understand each of the key milestones and steps needed to be ready on time.

Walker: Regulation is a key part of our 2022 roadmap across the full Securities Finance and Collateral Management solution. There are three regulatory drivers that we have identified as key for the collateral product and we will be working towards these dates with our clients. These are the Securities Financing Transactions Regulation (SFTR ISO Changes for January 2022), the Central Securities Depositories Regulation (CSDR) fines and penalty regime that went live in February 2022, and UMR Phase 6 for September 2022.

With respect to UMR, we see a lot of impact here, particularly for smaller institutions whose operations can be very manual and they do not have the technology in place to manage these regulations effectively. Consequently, it can be challenging — whether it is in data gathering, managing settlements, legal contracts and building connectivity to market utilities — to meet compliance requirements and to deliver this in a cost-effective way. Smaller firms that fall into scope for UMR Phase 6 will be heavily dependent on vendors to provide accurate calculations that match with their counterparties.

Ahlner: Given State Street's client base, 2022 will be dominated by the UMR regulation. We also expect attention to risk-weighted assets and capital requirements to take over the latter part of the year, where collateral and counterpart adjustments will be needed to support sustained trading activity.



Leverage ratio and the new normal

With the CRR2 Leverage Ratio requirements now live, Frank Odendall, head of securities financing product and business development at Eurex, weighs up whether the European repo market will trend towards a new orthodoxy

The Leverage Ratio continues to be one of the most widely debated prudential measures implemented since the Great Financial Crisis of 2007 and 2008. Supporters of the Leverage Ratio laud the measure as a critical prudential backstop in benign economic environments and a defence against creative quantitative modellers, weak model governance, and under-resourced supervisors. The Leverage Ratio is considered to be the perfect tool for an imperfect prudential framework. Its detractors condemn the measure for its dependence on accounting standards, arbitrary calibration, the lack of risk-sensitivity, and the perverse incentives towards risky behaviour that it creates. There is now a growing chorus calling for its outright removal, arguing that many of the objectives of the Leverage Ratio measure are now met with the Standardized Output Floor introduced as part of the Basel III final rules, which employs more credible standardised approaches.

Repurchase agreements (repo) are probably the product most unduly penalised by the Leverage Ratio regime, aside from perhaps prime residential mortgages. Some would argue that this is an unintended consequence of the application of accounting measures in the Leverage Ratio calculation which reports repos on a gross basis, while the collateral received is given no recognition. Others would argue that this is exactly what was intended, given the use of repo to create significant, even infinite, leverage in the financial system. Regardless of which side of the fence you are on, it is difficult to argue about the importance of the repo market and the critical role it plays in the smooth functioning of the global financial system.

End to window dressing

In June 2021, the second iteration of the Capital Requirements Regulation (CRR II) for the European Union went live. The revisions included a change which reflected a recommendation from the Basel Committee that the Leverage Ratio should be calculated using average measures, rather than spot measures, for those inputs that can exhibit volatility during reporting periods. This was a polite way of saying that the regulators needed to take steps to stop institutions from "window dressing", a practice where firms adjust their trading activity in the lead up to key regulatory or external reporting dates to make their prudential and statutory performance measures look better than would be the case in the normal course of trading. While markets should be a simple function of supply and demand, these nuances around the regulation can have profound effects on market structure and dynamics. The European repo market dysfunction of year-end 2016 and the collateral scarcity effects during the fourth quarter of 2021 are just two of many examples of the complex interaction of regulation and the markets.

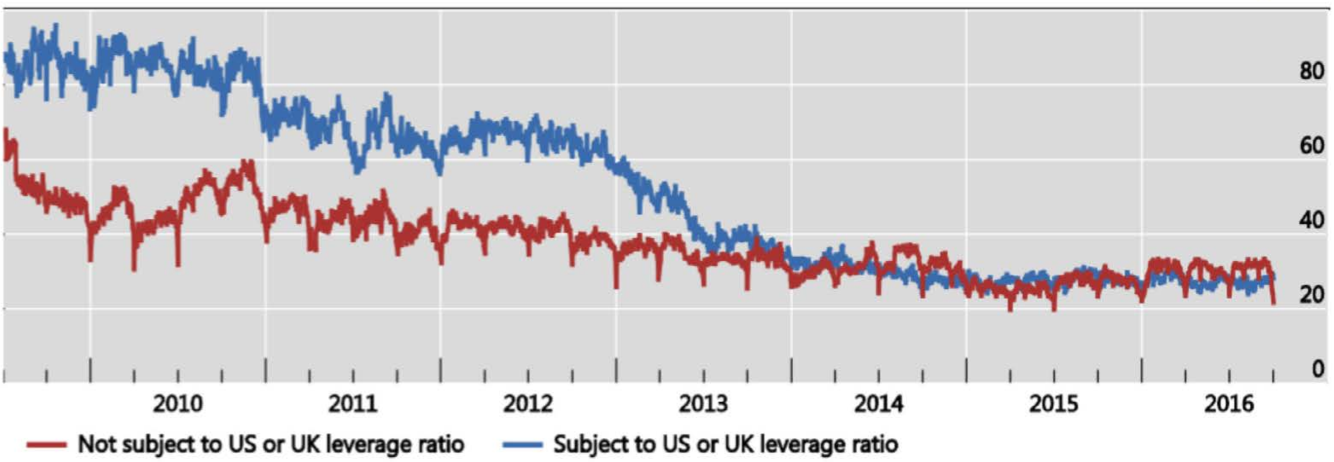
Under CRR II, the Leverage Ratio measure must now also be calculated and disclosed based on a daily average of exposures for securities financing transactions (SFTs), rather than the period-end measures. European regulators have lagged behind their US and UK peers in implementing daily averaging, which may go some way to explain why such an important change has largely gone unreported. The landmark 2017 report on repo market functioning by the Committee on the Global Financial System — J Cunliffe, "Repo market functioning", CGFS Paper No. 59 — gave an illustration of the market impact of average versus spot reporting and disclosure requirements. The report includes charts, reproduced below, showing primary dealers' average daily repo positions for firms subject to US and UK leverage ratio rules alongside firms not subject to US and UK leverage ratio rules.

Prior to 2012, both charts showed pronounced dips in trading volumes at times coinciding with quarter-end and year-ends. For firms subject to US and UK leverage ratio rules, these periodic dips begin to subside from 2013, which broadly aligns with the time when US banks started to report on a daily basis and began to manage under the Leverage Ratio regime. For firms not subject to US and UK leverage ratio rules, where calculation and disclosure of the Leverage Ratio was still based on spot period-end measures, the dips remained. What is more sobering about the chart is the downward trend of the use of repo, as measured through trading volumes. A Leverage Ratio regime based on averaging, rather than spot, resulted in a "new normal" for repo trading, the impacts of which still reverberate today.

Primary dealers' average daily repo positions by regulatory group

In billions of US dollars

Graph 12



Source: Federal Reserve Bank of New York.

With Leverage Ratio measures based on daily averaging of SFTs now live in Europe, the question then becomes what the new normal will look like for the Euro repo market, and for the European repo market more generally. While it is too early to tell, it raises several other questions about how firms should respond to these coming changes. At Eurex, we are working with our sell-side and buy-side client institutions to shape this new normal.

Cleared repo

While repo is reported on a gross basis under the Leverage Ratio, the netting of cash payables with cash receivables is permitted under the regulation, but subject to a range of stringent criteria. The criterion that payables and receivables must be with the same counterparty is quite challenging in the repo market because buy-side clients tend to be segmented into natural cash takers and natural cash providers.

Clearing houses are well positioned to solve this problem. By inserting the clearing house between the buy-side cash takers and cash providers, the repo dealer is well placed to apply balance sheet netting because the dealer is facing the clearing house on both the long and short positions. Eurex, in partnership with Clearstream, offers integrated trading, clearing and settlement for repo. This maximises balance sheet netting opportunities, opening the door to capital efficient trading strategies such as funding specials trading with Eurex GC Pooling. For further information, refer to our whitepaper, “Innovations with balance sheet netting solutions for repo trading,” available at www.eurex.com.

Leverage Ratio constraints can also be managed using Eurex’s ISA Direct clearing models, which provide the buy-side with direct access to cleared repo markets, facilitated by a dealer (clearing agent) which covers the default fund and default management obligations. Buy-side clients can maintain, or even enhance, their access to repo liquidity, while leaving the option for the clearing agent to act as the liquidity provider or step out of the trade flow to control their leverage exposure. In addition, the buy-side would, of course, also benefit from other typical benefits associated with CCPs (e.g. risk mitigation, operational efficiency and price transparency). There are immediate risk-weighted asset (RWA) benefits with this model, along with potential Leverage Ratio benefits from balance sheet netting for banks if the financing to the buy-side via ISA Direct is also funded via the clearing house. Further details are available in the whitepaper, “Capital efficiencies through direct access repo clearing models for the buy-side,” published on the Eurex website.

Perhaps it is not a coincidence that buy-side entities started to take central clearing of US treasury repos through the DTCC Fixed Income Clearing Corporation’s (FICC`s) sponsored programme more seriously when US banks were not only required to report, but to fulfil, minimum supplementary leverage ratio requirements on a daily basis from January 2018. Buy-side US repo central clearing volumes increased from US$20 billion in 2017 to more than US$400 billion at the end 2021, according to data from the US Federal Reserve. Eurex recently launched an extension of ISA Direct which is specifically targeted to those buy-side clients which would not otherwise qualify for clearing membership (e.g. hedge funds). Under the ISA Direct Indemnified model, buy-side clients can directly access cleared repo, with the assistance of a clearing agent that provides an indemnity to the clearing house.

In summary, the change in basis of calculation of the Leverage Ratio from spot measures to daily averaging for SFTs under CRR 2 will have an enduring impact on the Euro and European repo market if the experiences of the US and UK markets are any indication. On the one hand, the change may help stabilise the volatility in liquidity levels at period ends. On the other hand, market liquidity may trend to a new normal based on new average capital costs which may push overall trading costs higher. Eurex’s cleared repo market has a number of solutions to help firms optimise their trading and navigate the new normal.

Frank Odendall
Head of securities financing product and business development
Eurex

Transparency reporting for securities lending transactions

Fran Garritt, Risk Management Association director of securities lending and market risk, speaks to Bob Currie about the SEC's 10c-1 Proposed Rule and key points in the RMA's response to consultation

The 10c-1 Proposed Rule appears to envisage a much 'leaner' reporting framework than SFTR, with 12 reporting fields in the current 10c-1 design, compared with 155+ for SFTR. Does RMA believe that additional fields may need to be added to provide a more accurate picture in terms of pricing transparency?

In terms of the number of reporting fields, RMA does believe the SEC will capture all the pertinent information related to pricing transparency with the proposal. From RMA's perspective, excess data fields add limited benefit considering the additional cost of sourcing and transmitting the additional fields. It's also worth noting that the scope of 10c-1 and the Securities Financing Transactions Regulation (SFTR) are different. 10c-1 would implement statutory authority for rulemaking with respect to securities lending specifically, while SFTR covers other kinds of transactions.

RMA's 10c-1 response states that the SEC should modify the rule to require reporting by SEC-registered broker-dealers only, whether acting as borrower or lender serving in a principal or agency capacity. Can you expand on that position?

This response is based on two tenets. The first concerns the fact that FINRA does not regulate most agent lenders and beneficial

> *"FINRA charges could essentially make a large segment of lending activity — notably general collateral lending — uneconomical for the agent lender community"*

owners, whereas they do have oversight of broker-dealers. The current proposal would require market participants that essentially have no contact with FINRA today to effectively become limited purpose members and for FINRA to expand its purview, all of which is costly. It seems reasonable to find a solution within their current purview. Additionally, there is a cost to setting up the reporting pipes and FINRA may charge an additional transactional charge.

In addition, under the current proposed construct it is a safe assumption that these costs will primarily be borne by agent lenders since they will be the primary reporting parties. RMA's proposal aims, in large part, to establish a more equitable allocation of the costs of regulation. Given the current fee split structure with securities lending and the capital cost of running an indemnified agent lending programme, FINRA charges could essentially make a large segment of lending activity — notably general collateral lending — uneconomical for the agent lender community. This, in turn, could negatively impact market liquidity.

How has this recommendation been received by the securities lending community, particularly broker-dealers?

The broker-dealers may obviously have a different point of view, but that is why RMA plays an important role in voicing concerns of agent lenders.

RMA believes 10c-1 reporting should be limited to securities lending transactions which generate return through providing use of the securities to a borrower — and should exclude cash financing and collateral transformation trades. For securities lending transactions, this should be limited (at least at initial adoption) to liquid equities. Is that correct?

Yes, our view is that non demand driven trades would effectively skew the pricing data and lead to inaccurate or misleading price discovery. Unrelated or misleading activity could result in pricing data that will be less useful both to regulators and the securities lending and borrowing community. Regarding the scope of which securities should be included, our view is that liquid equities that are on National Market Systems (NMS) make the most sense for a starting point.

Non-NMS securities data would tend to lack any value in price discovery because the shares are so thinly traded in the institutional lending and borrowing community. In fact, most of these securities do not meet lenders' minimum requirements to transact in. Further, given the existing transparency for government securities, and the small spread derived in general collateral trading in these securities, we believe the relative cost and benefit of including them in 10c-1 does not make sense.

What are the next steps in RMA's engagement with the SEC and other stakeholders in shaping the final design of the 10c-1 Proposed Rule?

We are hoping to set up a meeting (or meetings) with the SEC staff to further discuss our concerns. We will also look to educate our members about the potential impact of this proposal.

Latest industry appointments at Kaizen, Clear Street and BNY Mellon

The California Public Employees' Pension Retirement System (CalPERS), has announced the hire of Nicole Musicco as chief investment officer.

Effective from 28 March, Musicco will become the second woman to lead the investment operations.

She will report to CEO of CalPERS, Marcie Frost, and lead a team of more than 300 investment professionals.

Musicco joins CalPERS from RedBird Capital Partners, where she led the firm's Canadian investment business.

Prior to this, Musicco managed the private markets investment programme at the Investment Management Corporation of Ontario.

Her experience also includes 16 years with the Ontario Teachers' Pension Plan, leading both the private equity and public equity investment teams. She opened the fund's Asia Pacific office in Hong Kong and helped build its presence in Asia.

Commenting on her new position in an online statement, Musicco says: "CalPERS has achieved remarkable success during the last five years, strengthening the organisation, navigating the pandemic, and improving its funded status. My goal is to build on these achievements recognising that, as long-term investors, CalPERS must maintain focus and discipline to deliver consistent investment returns and retirement security for dedicated public servants."

Kaizen appoints Rory McLaren as chief product officer

Kaizen Reporting has announced the hire of Rory McLaren as chief product officer.

Based in London, McLaren will work across all Kaizen companies to promote product strategy and management.

He brings a wealth of experience with more than 25 years of working in technology, product and regulation.

McLaren joins Kaizen from Deutsche Börse, where he held several senior positions during his seven years with the company, including technology strategist, head of product and services, regulatory services, and product management.

At Deutsche Börse McLaren led the product and services section of the regulatory services entity within the group, providing reporting across the Markets in Financial Instruments Regulation (MIFIR), the European Market Infrastructure Regulation (EMIR) and other regulations to internal and external clients across Europe, Asia Pacific, and the US.

Prior to this, he was co-founder and chief technology officer at Impendium Systems for 11 years, between 2006 and 2017, before the company was acquired by Deutsche Börse.

Theresa Taylor, president of the CalPERS Board, adds: "Nicole's leadership and experience are well suited for the strategic goals we've outlined for our fund. We are getting the investor we need to skillfully manage our investment portfolio on behalf of our members, now and in the future."

Musicco joins CalPERS at a time when the pension fund has increased its funded status from 60 per cent, five years ago, to 80 per cent today and is increasing its investments in private markets to continue closing the gap.

HilltopSecurities has appointed Carlo Esannason as managing director of securities lending development and strategy.

The financial services provider administers services and solutions in the areas of public finance, wealth management, fixed income and structured finance.

Esannason brings to the role comprehensive experience in the investment banking industry, including securities lending, hedge funds coverage, structured funding products and relationship management.

He most recently served as director at UBS since September 2018, before which he was vice president of equity finance and global prime finance at Deutsche Bank between August 2015 and August 2018.

Before that, Esannason was a securities lending trader, equity trading at Nomura Securities for almost 10 years.

Clear Street has announced the appointment of industry veteran Patrick Travers as head of distribution, effective 1 June.

Based in New York, Travers will report to Andrew Volz, Clear Street's chief operating officer.

Travers brings more than a decade of experience in leading teams and developing market strategies to the role.

At Clear Street, he will oversee and lead all sales teams, develop new business strategies and opportunities, and help clients achieve maximum value with its products and services.

Prior to this announcement, Travers was managing director and head of US distribution at Wells Fargo for the past seven years, where he was responsible for managing the prime services sales and capital introduction group.

As well as Travers' appointment, Clear Street has welcomed an influx of talent to the company with seven additional hires joining the firm's New York and San Diego offices in managing director and director roles.

Curtis Allemang, Raoul Scott, Doreen Pappas and Ryan Walker will join the firm's prime brokerage sales division.

Additionally, Richard Mormile will take a role in capital introduction while Kevin Salquist enters Clear Street's sales and trading division and Hamed Anvari joins the equity derivatives trading team.

Commenting on the appointment, Volz says: "We are thrilled to have an industry veteran like Pat take the reins of our growing sales team. Each member of the team brings years of experience, skills, and integrity.

"Under Pat's leadership, I am confident that we will continue to deliver a best-in-class experience for our clients. We look forward to what we will accomplish together in 2022 and beyond as we continue to expand our network and bring new products and services to market."

BNY Mellon has appointed Jennifer Barker as CEO of its treasury services business, effective from 2 May 2022.

Barker will be responsible for BNY Mellon's domestic and cross-border payments, US dollar clearing, trade finance and liquidity management capabilities to clients in Asia Pacific (APAC) as well as Europe, Middle East and Africa and the Americas.

Sustainability will also be at the core of Barker's responsibilities, as the bank aims to favour digital alternatives that have a smaller carbon footprint for global payments and the wider trade supply chain.

In addition, Barker will become a member of the BNY Mellon executive committee.

Barker has almost two decades of experience in treasury services, both in the US and APAC.

She joins BNY Mellon from JP Morgan, where she held a wide variety of roles across commercial banking and payments, most recently serving as head of client service and implementation in the firm's payments business.

Paul Adamo, interim CEO of treasury services, will resume his previous role as chief financial and operating officer for treasury services, reporting to Barker.

LiquidityBook, the provider of cloud buy and sell-side trading solutions, has bolstered its team with three new hires to enhance and expand its sell-side solutions and operations.

Brian Cabra will serve as vice president of implementations, while Ryan Stankus will serve as vice president of product management. Terrence Cheung will serve as vice president of post-trade product management.

Cabra will be responsible for the implementation and delivery management of the LBX Sell-Side solution for broker-dealers, while Stankus will work closely with LiquidityBook's chief operating officer Sayant Chatterjee to oversee all aspects of sell-side product management.

Cheung will manage the solution provider's newly launched LBX Trade Match product, while also driving LiquidityBook's middle-office framework across the entire customer base.

Prior to LiquidityBook, Cabra served as senior technical account manager at ION Markets where he oversaw several large-scale global implementations of the firm's Fidessa platform, an integrated trading solution for equities.

He began his career at CA Technologies, where he served as the technology lead for its global commissions system.

Prior to LiquidityBook, Stankus served at Fidessa for more than 20 years. At Fidessa, Stankus gained extensive experience with complex global trading platforms, holding several senior roles ranging from technical architecture to product management. Prior to Fidessa, he was a contractor at RBC Capital Markets.

Cheung joins LiquidityBook from FlexTrade, where he served as vice president, sell-side product manager. At FlexTrade, he managed the company's SaaS-based global middle-office system for the sell-side.

Before that, he spent more than 12 years at Fidessa, where he worked on various products such as Fidessa's LatAM Trading Platform.

Commenting on the new hires, Chatterjee says: "This is an exciting time for our business as we are seeing an increasing number of brokers turn to the LiquidityBook framework to solve complex workflow and operational problems while reducing total cost of ownership. We are thrilled to welcome these three talented individuals, whose expertise and experience will position us to serve as a true partner to the broker-dealer community."

Publisher: Justin Lawson
justinlawson@securitiesfinancetimes.com
+44 (0) 208 075 0929

Group editor: Bob Currie
bobcurrie@securitiesfinancetimes.com
+44 (0) 208 075 0928

Senior reporter: Jenna Lomax
jennalomax@blackknightmedialtd.com
+44 (0) 208 075 0925

Reporter: Carmella Haswell
carmellahaswell@securitiesfinancetimes.com
+44 (0) 208 075 0927

Reporter: Rebecca Delaney
rebeccadelaney@blackknightmedialtd.com
+44 (0)208 075 0923

Accounts: Chelsea Bowles
accounts@securitiesfinancetimes.com
+44 (0) 208 075 0930

Designer: James Hickman
jameshickman@blackknightmedialtd.com

Marketing director: Steven Lafferty
design@securitiesfinancetimes.com

Published by Black Knight Media Ltd

GLMX
GLOBAL LIQUID MARKETS

The Complete Securities Finance Electronic Trading Solution

www.glmx.com
sales@glmx.com
US: +1 (866) 610-4569 (GLMX)
UK: +44 (0)20 3637 9678
@GLMXTech
linkedin.com/company/GLMX