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Bridging traditional and synthetic finance

Wematch co-founder David Raccat speaks to SFT about the advance of the company's cross-asset platform, digitisation of securities finance and its ambition to be the number one TRS ecosystem worldwide

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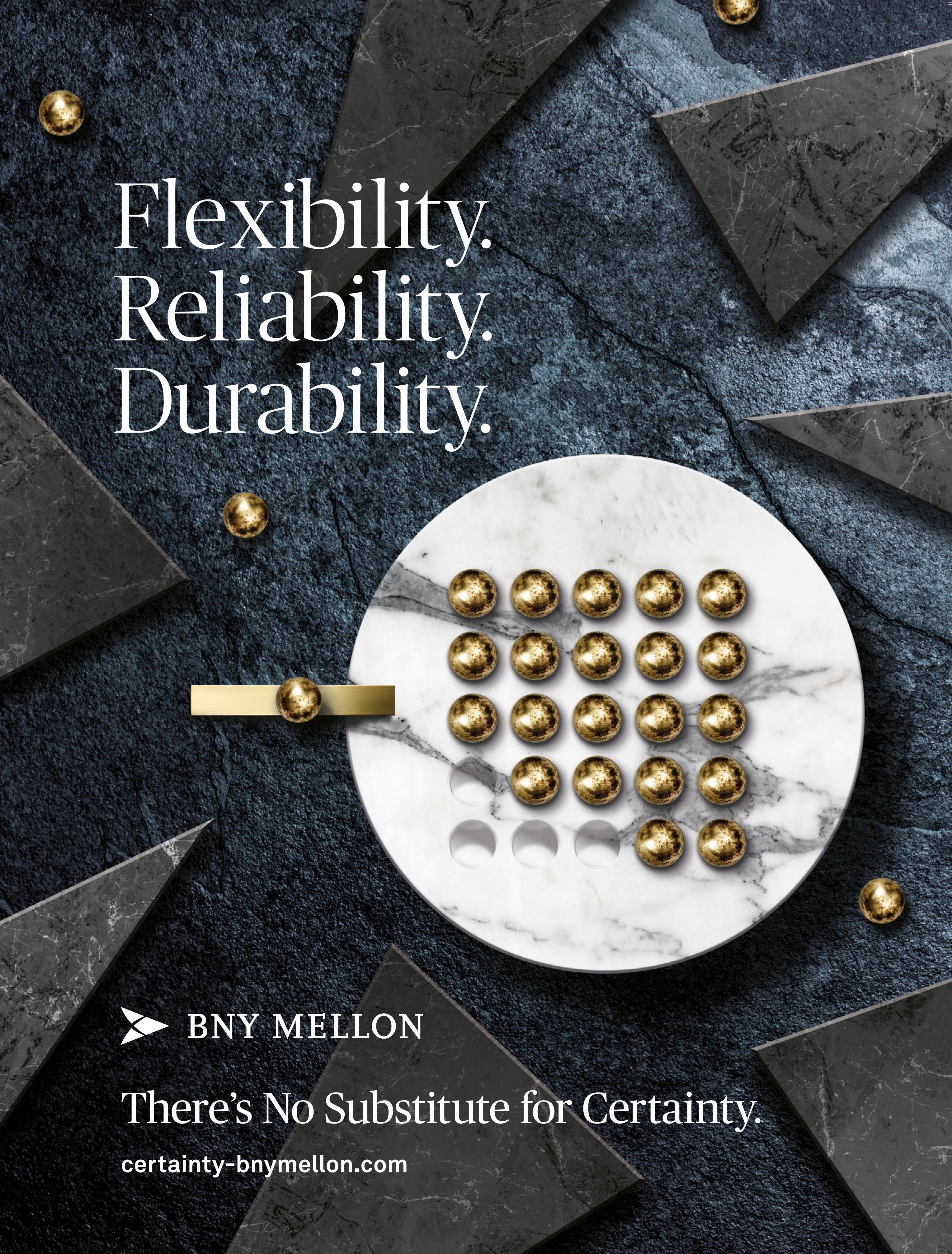
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RISCfp introduces managed treasury pool notes

Financial solutions provider RISCfp has introduced managed treasury pool (MTP) notes to enable insurers to diversify or reduce their short-term investment risk as they pledge collateral.

The RISCMTP-Notes, which are also available to institutional investors and corporate treasurers, are Moody's-rated, listed, debt securities. They combine the liquidity of bank deposits with the managed returns of government money market funds (GMMFs).

The RISCMTP-Notes have been designed to address the challenges of the existing alternatives, such as credit concerns, liquidity constraints and collateral eligibility.

The RISCMTP-Notes represent a proportional interest in the assets backing the notes. For example, US treasury bills and notes, and temporary assets such as GMMFs. They are also annually redeemable at par.

They may be redeemed at any other time for same-day value by transferring the investor's share of each asset in the portfolio to a redemption account where, at the investor's option, they may either be delivered to the investor or sold at market prices.

BNY Mellon, Merganser Capital Management and Waystone are supporting RISCfp to deliver the RISCMTP-Notes to financial markets. BNY Mellon acts as the custodian and Merganser as investment manager. Waystone provides operational support. RISC Financing Platform Services is a financing solutions advisory and platform management company that was established to help institutions to meet their demands for financing, current and contingent liquidity, collateral and capital.

It uses standardised secured lending structures, including repo, securities lending agreements and secured loans, that are eligible for protection under bankruptcy procedures in major OECD countries.

RISCfp's board of directors includes CEO Derrell Hendrix, CFO Richard Black, former Citibank executive Thomas Huertas as chair, and John I Williams jr as additional director.

Its management board also includes Roy Zimmerhansl, securities finance industry veteran and practice lead at Pierpoint Financial Consulting, along with tax counsel Jeffrey Tretin, Karson chief risk officer Jose-Maria Saez-Benito and Karson Management Ltd executive partner Martin Kauer.

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UBS executes first cross-border repo trade on DLR platform

Switzerland-based investment bank UBS, alongside a global Asian bank, has executed the first cross-border intraday repo transaction on Broadridge's blockchain-enabled Distributed Ledger Repo (DLR) platform.

The intraday trade marks the launch of the next phase in the rollout of Broadridge's DLR platform, which was first released in June 2021.

DLR is designed to provide a utility where market participants can agree, execute and settle repo transactions, providing flexible settlement cycles based on counterparts' needs.

Broadridge's platform aims to increase settlement velocity and collateral mobility, therefore making intraday settlement possible. The platform also reduces the operating cost and risk of all repo activity, including overnight and term repos, says Broadridge.

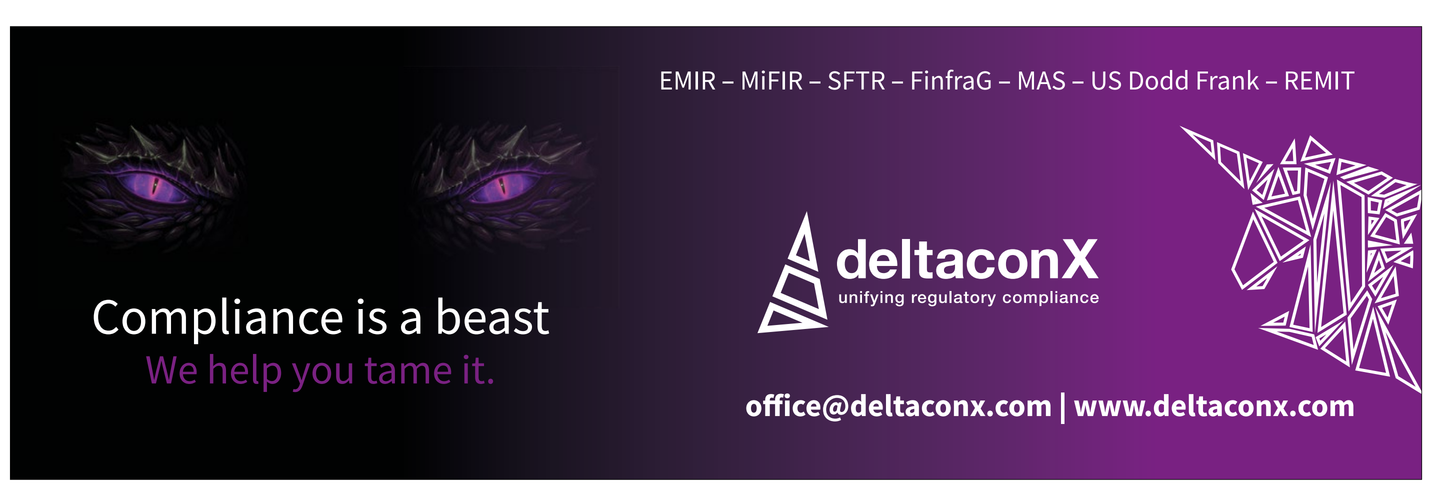
Continuing to build on the initial success of the platform and leveraging the growing expansion of the network across the global repo community, Broadridge says that the announcement is a major step forward to providing a more efficient means of intraday liquidity management.

The firm indicates that the global expansion of the platform across sell- and buy-side firms enables a network effect of increased benefits and additional transaction types.

Broadridge aims to bring the benefits of distributed ledger capabilities to transform the global repo market. The firm reports that it has captured US$1 trillion in monthly volume.

UBS group treasurer Beatriz Martin comments: "Intraday repo is a valuable tool to manage our liquidity usage and provides flexibility in our funding capabilities with reduced operational risk. This accomplishment builds on the foundation we have established as an early adopter of the distributed ledger platform."

Horacio Barakat, head of digital innovation at Broadridge, adds: "This is the next step in executing on our vision of transforming global repo market infrastructure. We are empowering leading financial institutions like UBS with the ability to dramatically lower risk and operating costs and see enhanced liquidity."



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Eurex Repo average daily volume rises 85% YoY for March

Trading volumes on Eurex Repo have grown 85 per cent YoY to €296.5 billion for March, a striking rise from the €160.7 billion in term-adjusted average daily repo volume recorded for March 2022.

GC Pooling volumes were up 125 per cent YoY for March to €114.9 billion and special repo has increased 66 per cent YoY to €181.6 billion.

For GC Pooling, this also represents a slight month-on-month increase, growing from €111.9 billion for February 2023. Special repo volumes are slightly down month-on-month from the €209.8 billion recorded for February 2023.

This year-on-year expansion has been mirrored in the OTC derivatives clearing segment, where aggregate notional outstanding for OTC clearing has risen 18 per cent YoY for March to €32,136 billion.

This includes a 10 per cent YoY rise in notional outstanding for interest rate swaps (IRS) to €13,578 billion and a 42 per cent expansion in overnight index swaps cleared through the CCP to €2,795 billion.

Average daily cleared volumes through Eurex Clearing have increased 4 per cent YoY to €171 billion.

This features 175 per cent YoY growth in overnight index swaps for March to €23 billion, although cleared ADV for IRS has contracted 38 per cent YoY to €20 billion.

Komainu launches collateral management solution

Komainu, a regulated digital asset custody service provider, has launched its new collateral management service, Komainu Connect.

Now live, the offering aims to enable leverage clients' digital assets in collateralisation scenarios while they remain in secure, regulated custody, segregated and verifiable on blockchain.

According to Komainu, the service comes as a response to an industry requirement to reduce counterparty risk by removing the need to store collateral with trading counterparties.

In mitigating counterparty risks, Komainu has designed Komainu Connect to facilitate 24/7 trading with assets held in custody, allowing clients to maximise investment opportunities while keeping their assets separate and secure.

This is achieved through triparty agreements, the firm says, which marry Komainu's technical and legal acumen with their clients' requirement for the safety and segregation of assets held under custody.

Komainu was created as a joint venture between Nomura, digital asset manager CoinShares and digital asset security company Ledger.

Sebastian Widmann, head of strategy at Komainu, says: "Komainu Connect cements our vision of introducing true trade connectivity to ramp up the utility and velocity of digital assets, while under our secure, institutional grade custody.

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"As this industry matures, we will continue to pioneer the development of time-tested traditional finance products to match digital asset requirements."

Darren Jordan, head of sales at Komainu, adds: "With the addition of collateral management and enhanced staking services, we are demonstrating loud and clear that we are more than a simple repository for digital assets.

"Our new collateral management services allow clients to maximise trading opportunities, reduce counterparty risk, while keeping their assets secure with a regulated custodian. This is the benchmark for full-service institutional custody."

OCC cleared securities lending volumes jump 11.2% YoY for March

Securities lending volumes cleared on the Options Clearing Corporation (OCC) platform has increased 11.2 per cent year-on-year to 235,633 trades for March 2023.

However, the average daily loan value for securities lending trades cleared on the Chicago-based platform contracted 3.9 per cent YoY to US$132.2 billion.

For futures and options contracts, total volume for all futures and options cleared through OCC has risen 12.2 per cent YoY to 1.1 billion transactions for March 2023.

Total clearing volume in March 2023 was the highest in OCC's history and the first time cleared contract volume surpassed 1 billion contracts in a single month.

The year-to-date average daily volume for March 2023 for all futures and options cleared on the platform increased 8.4 per cent to 46.3 million contracts, compared to March 2022.

Contributing to the new record, the platform experienced a 67.7 per cent YoY hike in index options contracts for the month to 89.6 million and a 35 per cent YoY increase in cleared futures contracts to 6.1 million.

ETF options contracts cleared on OCC rose 32.9 per cent YoY for March to 463.4 million.

In contrast, equity options contracted 6.9 per cent YoY to 500 million for March.

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Global securities lending revenue rises 27% YoY for Q1 2023, says DataLend

The global securities finance industry generated US$2.76 billion in revenue for lenders in Q1 2023, a 27 per cent year-on-year increase, according to DataLend.

Global broker-to-broker activity, where broker-dealers lend and borrow securities from each other, generated an additional US$758 million in revenue during Q1, a 21 per cent increase from Q1 2022.

The market data service of fintech EquiLend reports AMC Entertainment Holdings as the top earner for the first quarter of 2023, with lending revenue for the firm totalling US$181 million in the lender-to-broker market.

The second highest earner according to DataLend was Beyond Meat Inc, which accounted for US$68 million in lending revenue for Q1 2023.

In March 2023 alone, the global securities finance industry generated US$1.02 billion in revenue for lenders. The figure represents a 22 per cent increase YoY from March 2022.

Broker-to-broker activity totalled an additional US$271 million in revenue in March, a 10 per cent increase YoY.

According to DataLend, the continuing trends in rising lending fees contributed to the increase in lender-to-broker revenue. Globally, across all asset classes, lending fees climbed 27 per cent YoY as loan balances fell 5 per cent.

The top five earners in March 2023 were AMC Entertainment Holdings (AMC), Beyond Meat Inc (BYND), Roche Holdings AG (ROG SW), Upstart Holdings Inc. (UPST) and Lucid Group (LCID). In total, the group generated US$132 million in revenue in the month.

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Trade associations respond to PRA Basel Consultation

Derivatives and securities finance industry associations have published responses to the Prudential Regulation Authority (PRA) consultation on Basel 3.1 implementation.

The International Swaps and Derivatives Association (ISDA) and the Association for Financial Markets in Europe (AFME) issued a joint response to the PRA consultation paper 16/22 on 31 March.

The associations indicate that the Basel 3.1 capital framework is a necessary element of protecting financial stability but they warn against "disproportionate capital requirements" that may impact a bank's ability to provide key financing, liquidity, hedging services and a wider range of products to end users.

According to aggregated cost benefit analysis conducted by the PRA, the PRA's proposed rules outlined in CP 16/22 would require banks to raise an additional 3.1 per cent in Common Equity Tier 1 (CET1), equivalent to £14.2 billion across all firms falling into scope, compared with a baseline where the provisions detailed in the consultation paper are not implemented.

The PRA's cost estimates predict that total capital, including CET1, Additional Tier 1 capital and Tier 2 capital will rise by 3.1 per cent, or £19.7 billion, across all firms falling into scope.

Additionally, total operational compliance costs associated with these changes will be close to £4.9 billion, the largest share resulting from changes to the market risk framework, at £3.8 billion. These costs, the associations indicate, will be borne mainly by the large banks.

In responding to the PRA consultation, ISDA and AFME put forward recommendations which they intend should maintain global connectedness by supporting the role of the UK as an international financial hub.

This should also encourage appropriate risk-calibration under the Basel framework which aligns with international standards, but which permits adaptations to reflect "regional specificities". They note that, post-Brexit, the UK has the ability to write its own rules independently in line with the provisions of the Financial Services and Markets Act of 2000 and the Financial Services Act 2021.

In a separate response to PRA CP 16/22, the International Securities Lending Association (ISLA) focuses on Question 8 in the CP relating to the proposed approach for unrated corporates.

ISLA indicates that it supports the introduction of a move to a more risk-sensitive approach to unrated institutions, but raises concerns that a significant increase in capital costs under the new output floor may "inevitably cause the activity of securities financing to become uneconomical", potentially resulting in a decline in this activity and a reduction in liquidity across the capital market.

"This effect will be most noticeable in the case of low risk, financially sound but unrated institutions which is where a majority of the supply for SFTs in Europe derives from." This, the Association believes, will drive up costs for low-risk entities such as pension funds and mutual funds.

The PRA's proposed approach will allow exposures for firms rated as Investment Grade to be risk-weighted at 65 per cent, but for firms classified as Non-Investment Grade to be risk-weighted at 135 per cent.

Drawing on data from ratings specialists S&P Global and Credit Benchmark, ISLA indicates that the average credit quality of funds that lend securities in Europe are mostly "of the highest credit quality".

Given that ratings are typically used by issuers of securities to raise capital, many mutual funds and pension funds may be unrated because they do not raise capital through issuing securities and have little requirement for an external credit rating.

However, ISLA fears that the proposed changes may unduly punish securities loan trades where these entities are the lender — potentially resulting in a rise in risk weight for these types of counterpart from 12.5 per cent to 65 per cent.

This may result in borrowers — predominantly banks and broker-dealers — reducing their borrowing from these 'unrated counterparties'. Alternatively, borrowers may seek to pass this increase in the aggregate cost of trading through to the counterparty, which may render securities lending activity increasingly "uneconomic" for many pension fund and mutual fund lenders.

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BoE working paper dissects gilts market crisis

The Bank of England (BoE) has released a staff working paper analysing the 2022 gilts market crisis.

The paper, authored by Gabor Pinter, draws on transaction-level data from government bond, repo and interest-rate swap (IRS) markets to evaluate movements in market liquidity, price trends and investor behaviour during the market disturbance in September and October 2022.

With a sharp rise in gilt yields following the UK mini-budget of 23 September 2022, some pension fund and asset managers with significant exposure to highly-leveraged liability-driven investment (LDI) strategies experienced a deterioration of their repo and derivatives positions and significant rises in collateral and margin requirements.

Some were forced to liquidate gilt positions to access cash to meet these margin requirements, triggering a further rise in gilt yields and liquidity tightening in gilt markets, prompting the BoE to intervene to restore orderly market functioning.

The paper finds that total net sales of gilts between 23 September and 14 October exceeded £36 billion, with sales being particularly pronounced for index-linked gilts and spread relatively evenly across the maturity spectrum, whereas sales of conventional gilts were relatively much smaller and focused at the longer maturities, typically 10 years and above.

The impact of this disruption was quite concentrated, with three liability-driven investment pension and insurance firms (LDI-PI) accounting for more than 70 per cent of LDI-PI sector gilt sales to primary dealers during the crisis.

This finding is consistent with “the LDI-PE sector being highly concentrated, with a few

firms generating most of the LDI-PI activity in the UK market," the paper explains. From regression analysis, it concludes that gilt sales by these firms had a significant price impact on the gilts market.

Perhaps unsurprisingly, the impact of interest rate rises was felt most severely by LDI-PI firms that had larger interest rate exposures in repo and swap markets. Regression analysis indicates that a 1 per cent rise in interest rate exposure in the overnight index swap (OIS) market corresponded with a 0.52 per cent rise in gilt liquidations by LDI-PI firms as they came under selling pressures during the crisis.

This effect becomes less significant when firms' exposure in the secured repo market is also factored in. The paper concludes that the pre-crisis repo market exposure, where index-linked gilts are used as collateral, was the primary driver for gilt sales. A 1 per cent rise in linker-repo exposure prior to the crisis (on 22 September) resulted in a 0.49 per cent rise in gilt liquidations between 23 September and 14 October for the LDI-PI firms monitored in the sample.

With these selling pressures, transaction costs rose sharply in the market from 23 September, indicating a contraction in market liquidity, with trading in nominal gilts being affected most severely, followed by linkers. The paper finds that in cases where trading relationships were strong at the onset of the crisis — indicated by strong pre-crisis trading volumes between the primary dealer and the client — this often provided some mitigation of these transaction cost hikes.

On balance, the author finds that hedge funds served as liquidity providers to the LDI-PI sector during the crisis, but these liquidity volumes were relatively modest and were commonly timed by these hedge funds to maximise the returns that they could gain as cash providers during the crisis.

"The average hedge fund received significant compensation for liquidity during the crisis period," says the paper. "Hedge funds as liquidity suppliers pursued contrarian strategies and increased their gilt purchases as yields were increasing" (p 32).

"Overall, one interpretation of these results is that the high hedge fund returns during the crisis were compensation for liquidity provision to the LDI-PI sector," it says. "The outperformance of liquidity-supplying hedge funds points to less-binding financing constraints in this sector — consistent for example, with windfall gains hedge funds realised on their OIS positions against LDI-PI firms" (p 33).

In parallel, the paper concludes that hedge funds' positioning in the overnight index swap market meant that some hedge funds experienced large mark-to-market gains on these derivatives positions during the crisis period, with LDI-PI firms realising significant losses on the other side of these trades (p 32).

Examining this positioning in the index rate swap market more closely, the paper finds that the LDI-PI sector is substantially the largest fixed-rate receiver in the market, with an interest rate exposure of £185 billion. The principal counterparties are hedge funds, with net position of £155 billion, and other clients, with net position of £120 billion.

Particularly for OIS contracts with maturity of five years or longer, the paper finds that the LDI-PI sector is virtually the only net payer of the floating leg, with dealers, hedge funds and other clients standing on the other side of these contracts.

"The spikes in interest rates during the outbreak of the crisis led to a quick deterioration of the LDI-PI sector's swap positions," it says.

Mark-to-market values of these contracts dropped sharply — by an estimated £8 billion between 23 and 27 September — resulting in sizeable margin calls from counterparties and putting pressure on the sector's funding capacity. The LDI-PI sector also took steps to reduce its net exposure during the crisis, lowering its position in absolute value by approximately £23 billion by October 14.

In parallel, the LDI-PI sector was subject to mark-to-market losses in inflation swap positions and consistently reduced its net position during the crisis, resulting in a fall of approximately £2 billion by 14 October.

For repo transactions, the LDI-PI sector reduced its net repo exposure by close to £33 billion as it progressively sold off gilts positions in the face of the challenges outlined above. At the start of the crisis, LDI-PI firms had collectively financed £40 billion in liquidity through repo trades secured by nominal bonds and a further £90 billion through repos backed by index linked securities.

Hedge funds represented the major cash providers to LDI-firms through repo trades backed by nominal gilts, with a net negative position of close to £65 billion. This is indicative of the hedge fund sector adopting short positions in the gilt market prior to the crisis, the paper says. Primary dealers represented the largest lenders to LDI-PI firms via linker-backed repos, with a negative net position of around £100 billion.

The paper is titled, An Anatomy of the 2022 Gilt Market Crisis, and is published by the Bank of England as Staff Working Paper No 1019, March 2023.

The repo market is dead, long live the repo market!

Cyril Louchtchay de Fleurian, consultant on repo markets and securities finance trades, argues that current inflationary pressures and central bank rate increases are delivering what 15 years of low interest rates have failed to do, reshaping a securities finance industry which has become vulnerable and outdated

We have been entering a VUCA environment: volatility, uncertainty, complexity, ambiguity.

This acronym, which was born in the military world, could perfectly characterise current Eurozone repo and money market conditions: increasing complexity, multiplying interactions, unprecedented phenomena, acceleration of cycles. What 15 years of low interest rates have not allowed, the current inflationary sequence and central bank rate increases — marked by a dislocation of liquidity — are delivering, reshaping the settings of a securities financing transactions industry which has become vulnerable and outdated.

Injections of liquidity against collateral, which began in 2008-9 have increased massively since 2015 and dramatically in 2020 and 2021. These have been skyrocketing the Eurozone money market into a new era which we are just beginning to understand.

The ECB's asset purchase programmes (traditional PSPP and

pandemic emergency PEPP) are responsible for €5 trillion of liquidity injected; the long-term refinancing operations (TLTROs) are responsible for €2 trillion. According to data from the International Capital Markets Association (ICMA), there is currently 60 per cent excess liquidity, representing €4.2 trillion (ICMA January 2023), in the Euro banking system. This excess remains structural since liquidity is always stuck in one bank or another, but always held in an account with the central bank; it is a closed system. Liquidity cannot leave the Eurozone.

By definition this excess liquidity puts pressure on collateral that precisely embodies changes the Euro has gone through during the past 15 years, shaped by an ongoing crisis and unconventional monetary responses. This strain weakens the integrity of market channels, causing "minor" damage (like chaotic end-of-reserve periods, quarter and year-end reporting) and then generating major malfunctions, such as bubbles and frequent panics (2019-20-21-22) followed by emergency interventions driven by the central banks. In a market context where some basic mechanisms are disturbed — generating windfall effects (tiering phenomenon, TLTROs arbitrage) — such liquidity must be invested in the best possible way into "current opportunities", amplifying and crystallising the market's disruption. For instance, this may result in massive and unreasonable treasury bill purchases, with repo market rates being pulled down abnormally, disconnecting them from the rest of the money market and reinforcing the continued scarcity of collateral.

Such collateral overconsumption is also rooted in the growing needs of banks and final investors, forced by regulation to post ever more securities (i.e. massive requirements to meet LCR ratio obligations, UMR waves 1-7, and for clearing activities elsewhere). This "inflationary" phenomenon appears all the more powerful as the level of sovereign bonds issuance in Europe — while supported and driven by endemic indebtedness, up 5 per cent in 2023 compared to 2022 for a total amount of €1,200 billion — struggles to meet demand for collateral.

A second issue is that bank intermediation remains weak in the context of this money market dislocation. Bank intermediation is sometimes viewed as a necessary evil that is critical for the participation of buy-side players (insurance companies, pension plans, regulated money-market funds, liability-driven investors, real estate investment trusts, non-financial companies, etc.) — which is sometimes viewed as “the preserve” of banks, but heavily constrains the buy-side. In any case, bank intermediation has been severely impaired since the 2008-9 financial crisis and for good reason. Banks and dealers have reduced the part of the balance sheet allocated to repo business, as regulatory costs have increased sharply. Today, an incredible 40 to 45 basis points is charged to the customer to compensate bank balance sheets in Europe, according to ICMA.

As it stands, balance sheet availability has become a limited and expensive resource, which is complex to increase, especially in times of tension. The regulatory "tsunami" that hit banks in the past 15 years — severely limiting balance sheet capacity — has significantly eroded bank intermediation. This is now a major congestion point. It has become a point of discrimination, due to high prices, and leaves a fallow market in its wake.

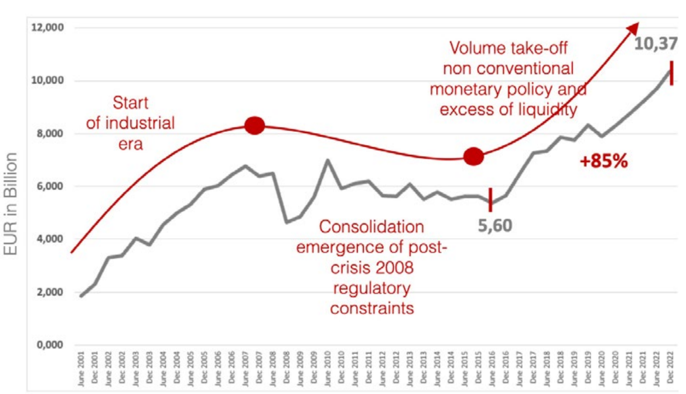
The disequilibrium situation created by excess liquidity and the scarcity of high-quality liquid collateral, combined with the weakness of bank intermediation, could have killed off secured funding and the repo market, at least in its current form.

Obviously, flows are not down. Quite the opposite is the case; they are boosted by unconventional monetary policy, prompting an 85 per cent increase in repo market volume from 2015 to 2022. In reality, the days of the current market framework are numbered because it is unable to meet participants’ specific demands born from 15 years of crisis and regulatory proliferation. But it could be so much worse, and conditions are accumulating for a breakout. In a letter dated 25 October 2022, ICMA warned that such a worrying environment could imperil the transmission of monetary policy. Here we are.

Volatility, uncertainty, complexity, ambiguity

The term ‘VUCA’, which is an acronym for volatility, uncertainty, complexity and ambiguity, was coined by the US Military at the end of the Cold War. It characterises a changing and abrupt dynamic that must be constantly adapted to. The world has shifted and a new normal is emerging, even though its outlines are not yet clearly defined and visible. **www.vuca-world.org**

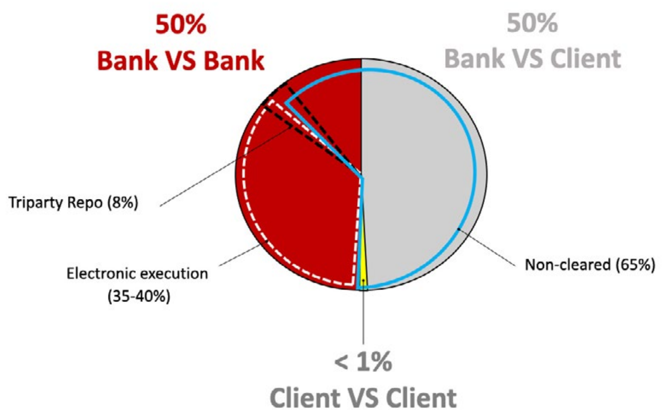
European REPO market outstanding



Source ICMA & ERCC Oct. 2022

What emerges from this light and dark? An analysis of the European repo market partly answers this question: with a total outstanding of €10.37 trillion, the market is made up of a dealer-to-dealer (D2D) segment, 60 per cent cleared, mainly electronic, offering full STP, based on vanilla flows and poorly triparty. The other half of the market is the dealer-to-client (D2C) segment: a non-cleared, non-electronic, non-triparty market that offers poor STP rates and is not transparent. In other words, we are talking here about a second-hand repo market network which no longer serves the interests of participants and threatens global balance through the contagion effect.

So the market has reached a crossroads just before a major change, offering bank intermediation a chance to completely transform itself. Banks are quietly shifting from the role of counterparty (principal) to that of guarantor (agent). The D2C model might move to a "client-to-client" model: exit the "matched-book" activity, exit the balance sheet impact and risk capital. Banks would now only be responsible



Source CLdF Consulting Dec. 2022

for guaranteeing the credit risk of its clients, giving them the opportunity to deal directly with each other (i.e. via a peer-to peer model). For a few basis points — typically from 5 to 8 bps — banks can support the operational process, that is the liquidation of the collateral, in case of client default. This model can be used in addition to the clearing facility, even though it does not provide a complete solution to the equation. Actually, “sponsored clearing” capability simply replaces one counterparty with another — the clearing house instead of the bank.

Despite the key advantages of netting and low consumption of risk-weighted assets (RWA) — which generate increasing volumes in the US — this cleared model for the buy-side is failing to convince European markets so far, with many believing that it is too costly and complex to implement. In this regard, we have the FICC's Sponsored Clearing offer in the US and those offered by Eurex or LCH in Europe.

The same concept based on the “bank as a guarantor” principle is even more promising as it works well without a clearing house. This allows a much larger and more diverse range of counterparties to access the market, while restoring banks to their original and central role as "risk taker" without being a counterparty — with a profitable business case at stake.

We are talking here about a guaranteed and indemnified repo model demonstrated by some fintechs and by custodians. Actually, international custodians have a significant comparative time-to-market advantage here, as they already have a large number of buy-side customers in their books. This is the case for State Street, for example, which launched its Venturi trading platform at the end of 2022. This may be particularly suitable for transactions between long cash money market funds facing hedge funds, for example, which are structurally liquidity borrowers.

Let’s be real: this move has just begun. But we can assume it might expand rapidly. Firstly, because this model can be replicated easily as a puzzle to be put together – there is no specific IP. This means that a wide variety of players will be able to get to grips with this topic, including trading platforms, tri-party agents or even ad hoc partnerships — such as with a fintech, CSD or ICSD, or with an exchange, for instance.

Another benefit is that this will enable a rapid ramp-up as several regulatory "options" can be chosen depending on the typology of service level, the geographical location and the architecture set up. The platform may or may not be regulated and, if it is, different models

are possible: a regulated market (RM) managed by a market operator, a multilateral-trading facility (MTF) or an organised-trading facility (OTF), both of which can be operated by a market operator or by an investment service provider.

Nevertheless, the cost of a licence is not neutral and players that are already regulated will have a head start in taking market share. In France, trading platform managers are jointly supervised both by the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and the Autorité des Marchés Financiers (AMF) under the EU's MiFID II. For the buy-side community, the choice of a transactional process fluctuates between the cost of the transaction and credit exposure to the counterparty. There is no holy grail in this respect.

However, benefits of guaranteed and indemnified repo include substantial cost savings for users, price transparency, ease of onboarding, STP execution, and potentially natural connection to DLT technologies, tokenised and durable assets.

On the legal side, this also facilitates use of an all-to-all standard version of the General Master Repurchase Agreement (GMRA), allowing trading parties to sign a single multilateral contract instead of multiple bilateral contracts. In this spirit, the Financial Security Board (FSB) itself has recently encouraged participation of non-banking firms to support the development of all-to-all electronic execution services to facilitate market access for end-investors.

As much as Uber and eBay created huge value for end retail-customers, guaranteed and indemnified peer-to-peer (P2P) repo offers a similar, duplicable and decentralised value proposition for the benefit of buy-side players in the repo space.

It is obvious that we are not just talking here about some technical developments, but rather an idiosyncratic reshaping of the repo market, meaning a decisive step ahead towards a shift in gravity. Buy-side players used to facing banks and dealers so far will face clearing houses more regularly in future and will increasingly deal with each other on a peer-to-peer basis. For banks and dealers, this is not so much a trend of "disintermediation" but a tactical repositioning of the intermediation model.

As a result, both technical ecosystem and trading flow capacities will need to be revisited along the value chain — including electronic trading platforms, order flow management, collateral management and optimisation applications, pre- and post-transaction data providers, and so on.

On top of that, guaranteed and indemnified repo bears the seeds of "credit normalisation" for some buy-side players, involving the first step of their next interaction with central bank monetary policy as is already the case in the US market. This is a highly strategic topic that is still taboo in the Eurozone, but will definitely fuel both the central bank's current macroeconomic (relating to intervention in the economy, investment guidance) and microeconomic (encouraging innovation and business modernisation) progress.

With all due caution, both the ECB and wider regulators should promote this type of solution which introduces a type of new systemic anchoring for the market. One of the underlying objectives of monetary policy is to maintain government bond rates at a level that preserves solvency of EU governments. As part of the normalisation of its monetary policy (QExit), the ECB's challenge will be to manage a reduction of its balance sheet without major impact on rates. This will have to be synchronised with an increase in government bonds issued in the market and therefore held in clients' accounts with depositories and clearing houses. Guaranteed and indemnified repo is becoming one of the important tools in facilitating this strategic shift and, therefore, a tangible promise of renewed liquidity contributing to both market stability and resilience.

Cyril Louchtchay de Fleurian,
Consultant on repo markets and securities finance transactions

Bridging traditional and synthetic finance

David Raccat, Wematch co-founder and global head of securities finance, speaks to Bob Currie about the advance of the company's cross-asset platform, digitisation of securities finance, and its ambition to be the number one TRS ecosystem worldwide

Wematch has been making big strides since its formation in 2017 by co-founder and CEO Joseph Seroussi, David Raccat, and CTO Elie Slama, with the goal of connecting market participants and driving the digitisation of the securities finance sector.

Subsequently, it has set about building a cross-asset platform, growing from its early roots in the financial incubator programme of its key investors — and a primary focus on the total return swap (TRS) market — to also offering optimised workflow and lifecycle management for interest rate derivatives, equity derivatives and delta one products, collateralised finance, and securities lending.

While the Wematch platform spent its early life predominantly supporting dealer-to-dealer (D2D) activity, it is also broadening its focus to deliver wider efficiency to the dealer-to-client (D2C) segment. It indicates that it has now onboarded close to 1000 traders and sales staff at 90 financial institutions onto the platform and is playing a prominent role in bridging traditional and digital finance.

Synthetics ecosystem

For Wematch, the primary objective is to be the global one-stop-shop for synthetic trading, and traditional lending, explains Raccat. Total return swaps occupy an important place in the securities financing ecosystem, with an expanding community of users recognising the flexibility, risk management and balance sheet advantages of synthetic lending. Dealers and investment bank clients remain Wematch's largest constituency of users, but a handful of agent lenders are currently looking to extend their coverage to synthetic lending. Wematch also supports buy-side institutions that are already involved in the TRS space and are interested in broadening their TRS franchise to a wider range of trading partners. "We aim to be the number one TRS platform on a global scale," explains Raccat.

To do so, it has been developing innovative workflow solutions that extend well beyond the trade matching element profiled in the company name. It offers an automated platform that helps dealers to issue indications of interest (IoIs) and conduct trade negotiation, to navigate collateral eligibility schedules, and ensure that trade details align with counterparties, thereby providing a sound foundation for high STP rates across the trade lifecycle.

Beyond this, Wematch offers a broad suite of workflow and optimisation tools which includes lifecycle management, market data and analytics, sales-to-trader workflow, an ETF optimiser and collateral optimisation.

To complete this vision of a full TRS lifecycle coverage, Raccat indicates that the company is soon to add two missing components which will be delivered during Q2. The first is cashflow reconciliation, enabling clients to reconcile funding and equity performances for each TRS contract at reset and at expiry. This is a significant pain point currently.

Second, Wematch will release a new module supporting TRS market data and pre- and post-trade analytics, thereby providing predictive insights that will help users to draw maximum value from their trading strategies. "Data in the TRS space has typically been a constraint," explains Raccat, "with few data vendors able to provide comprehensive and accurate data for this asset class. Given that a major share of TRS volumes are concentrated on Wematch's platform, particularly in EMEA, this sets us as an ideal candidate to work out the data and to redistribute on a smart basis to our community of users."

Indeed, Wematch now supports approximately US$150 billion of notional outstanding on its platform globally, a sharp increase from the US$20 billion it supported globally in July 2020. EMEA continues to account for a large share of this global activity, representing US$116 billion in ongoing notional at the time of writing.

Since launching in the US two years ago, Wematch has seen ongoing notional grow in this location to US$25 billion. The company also relaunched its services in the Asia-Pacific region in January, following a hiatus during Covid, and is on its way to hitting the US$10 billion mark in ongoing notional from the APAC region.

Wematch offers integrated workflow across the trade lifecycle, but indicates that it is agnostic to where the trade is negotiated, whether on Wematch's platform or elsewhere. "This is an important component of Wematch's offer," says Raccat. The focus has been on developing an open architecture workflow, enabling the user to import trade data into the system wherever the trade has been printed.

"As a solutions vendor, we do not feel we should be telling traders how they should access liquidity, when that is their job and their core expertise," adds Raccat. "Regardless of how the client negotiates and executes the trade, when the trade details are uploaded to Wematch's platform we can then support the downstream workflow and offer a full set of solutions to deliver efficiency across the trade lifecycle. This is changing our relationship with the user."

Bridging traditional and synthetic

In earlier discussion, we have already identified a potential blurring of the lines between synthetic and traditional lending. Wematch recognises this as a technical challenge, but also as a commercial opportunity for the company and the community that it supports.

Prime broker firms are constantly seeking ways to reduce the regulatory capital impact of their trading and financing strategies and are liaising with their counterparts on the lending side to identify whether they can shift some of the balance from physical to synthetic lending, reducing risk-weighted assets and managing their balance sheets more efficiently.

Agency lenders are also reviewing the potential benefits of adding synthetic lending to their lending capability. “As a synthetic lending platform, we have had discussions with a number of agent lenders that are evaluating agency TRS-based solutions and exploring whether they can draw on the technology that we have developed over the past five years to help them to develop their solution,” says Raccat.

These are typically large and well-established agency lending businesses that will take time to adapt to synthetic lending alongside their established physical-lending expertise. But Raccat is already starting to recognise disruption in this segment and believes that the early movers will capture significant business advantage. “We are moving towards an inflection point for the industry,” he says. “Prime brokers will begin to direct a rising percentage of their current physical borrowing towards synthetic — and the first agent lenders that establish an agency TRS product are likely to attract significant volumes.”

“The race has already begun to capture this activity,” he continues, “and this transition is likely to move faster than many commentators might expect. We are not talking in the near term about agent lenders switching 100 per cent of their lendable assets from physical to TRS — but the ability to extract a slice of these assets, for example from their largest beneficial owners clients, is likely to take months or quarters rather than years.”

Voice negotiation with digital workflow

In February, Wematch announced that it has entered into a cooperation agreement with MTS in the interest-rate derivatives space, whereby the Euronext-owned electronic fixed-income trading platform will apply Wematch technology to offer web-based interdealer trading for interest-rate swaps.

This solution, MTS Swaps by Wematch.live, aims to digitise voice trading in rates swaps, combining benefits of traditional voice trading and fully electronic execution platforms in providing additional flexibility to traders to do voice negotiation supported by digital workflow.

Traders will benefit from higher automation compared with traditional voice-based trading workflows, along with trade protection through pre-trade price and size controls, and electronic audit trails across the negotiation and trade lifecycle. The service partners indicate that this facility will reduce trading costs through a transparent fee schedule offering per-trade or bundled fee options.

This will be released with interdealer order-book trading functions and will offer additional negotiation choices to the electronic rates swap market such as meet-in-the-middle and upsize. The two companies indicate that D2C request-for-quote (RFQ) trading facilities are likely to be added later this year.

MTS Swaps draws on Euronext MTS’ large European trading network, which supports average daily trading volume in advance of €160 billion, reinforced by Wematch’s expertise in delivering digital trading workflow.

Raccat explains that this service will go beyond the dealer-to-dealer platform to also provide a dealer-to-client solution, integrating the Wematch technology within the MTF BondVision platform, Euronext’s multi-dealer-to-client trading platform for government bonds and credit. “This provides an opportunity to partner with a top-quality D2C platform backed by Euronext, the Paris-based exchange offering multi-asset trading in seven EU markets,” he says.

Hard-to-borrow

The processes associated with accessing and borrowing hard-to-borrow (HTB) securities have typically been manual and inefficient, with trade negotiation relying heavily on voice, chat or email and with few effective facilities in place to facilitate electronic negotiation and automated workflow. Responding to this constraint, Wematch has built a digital lending module for HTB securities as part of its securities lending platform, enabling traders to access liquidity in these names more easily in lit and dark markets. This supports automated negotiation, matching and RFQ facilities to enable users to offer prices and bid on

specials and relatively illiquid mid- and small-cap stocks for which there may be high borrower demand.

"The hard-to-borrow platform is making strong progress," comments Raccat. "We already have more than 20 clients that are using this platform on a daily basis and we have been issuing regular new releases for this service. We are talking to a wide community of clients, which will scale up what is achievable in terms of the volumes we support."

This platform has been live in Europe for more than 12 months and Wematch intends to make this available in the US in coming weeks, as well as extending this out to APAC clients. "The Wematch HTB platform is compatible with a wide range of negotiation protocols and offers automated workflow, delivering high STP rates that mark a significant departure from the manually-intensive trading and process flows that have traditionally dominated hard-to-borrow securities," says Raccat.

ETF Synthetics

Banks face significant complexity when hedging synthetic ETF positions using TRS, requiring information relating to how the ETF is structured, investment guidelines, concentration limits, and potential restrictions imposed by sustainability and ESG parameters.

Since the inception of the ETF market, these exposures have typically been managed through inefficient and time-intensive manual processes that present substantial operational risk. Wematch aims to bring automation and more efficient workflow in hedging ETF synthetic positions using TRS.

In handling ETF synthetics, banks are engaging directly with ETF issuers and face significant complexity in managing term sheets and working with the associated collateral. "This may require monitoring all the concentration limits associated with a UCITS fund, for example, and ensuring that these limits are never breached when there is a collateral allocation," says Raccat.

By adding this solution to the Wematch workflow, the company is confident that this may open the door for more buy-side organisations to use the Wematch platform. It aims over the coming 12 months to onboard more ETF issuers, and asset managers more generally, providing them with technology, assisting their STP workflows, offering API interfaces and access to the TRS ecosystem that it has established.

"We are very aware that the ETF synthetic space is an underserved part of the market," notes Raccat. To manage collateral efficiently, a firm needs to have all of its trades in one place, accessible through a single platform. Otherwise, this will result in additional fragmentation. "So by ensuring that every trade, physical or synthetic, is managed in the same system, this moves us ever close to a one-stop shop for collateral. That is where we want to go."

Concluding thoughts

In closing, Raccat indicates that Wematch views itself as the reference platform for the synthetic lending market, serving the important objective of bringing standardisation and automation to a market segment that was previously characterised by inefficient manual processes.

The company continues to manage its solutions development and IT capability in-house, with developer teams based in Tel Aviv, Paris, and New York to support its expanding global footprint. Raccat explains that the primary investors and shareholders also continue to play a key role in guiding strategy and solutions development. J.P. Morgan, for example, was central to guiding the development of Wematch's interest rate derivatives solution and Société Générale was prominent in driving the equities derivatives product.

Wematch closed a Series B funding round in December 2021 that raised close to US$28 million and added several new investors, including Barclays and CE Innovation Capital. This Series B funding was led by DB1, the corporate venture capital arm of Deutsche Börse, with J.P. Morgan, Societe Generale, Augmentum Fintech and Illuminate Financial among the other companies that participated in this funding round.

"We are fortunate to have strong shareholders and banking partners," says Raccat, "and they are fully aligned with Wematch's growth and success, participating through a collaborative approach that drives the company."

"A member of our user group may put forward an idea and we will work together to scope, design, develop, test and release for the benefit of the full Wematch community. But this stakeholder may also benefit from ideas that have been proposed by other user group members, such that this process works more as a partnership than a series of client-provider relationships," concludes Raccat.

Distributed Ledger Repo enters its next phase

After reaching a new milestone, Broadridge's head of digital innovation for capital markets Horacio Barakat says the firm's blockchain-enabled DLR platform will continue to expand to new use cases and trade types as it enters the next phase of rollout. Carmella Haswell reports

A blockchain-enabled Distributed Ledger Repo (DLR) platform, designed and launched by Broadridge Financial Solutions, reached a new milestone in early April with the execution of its first cross-border repo trade. This transaction was conducted between Switzerland-based investment bank UBS and an unidentified global Asian bank. It marks the beginning of the next phase in the rollout of DLR.

Celebrating this event, Broadridge's head of digital innovation for capital markets Horacio Barakat believes DLR will continue to lead the digitisation of the global repo market, simplifying processes, increasing collateral mobility and reducing risk for counterparties.

> *"The simplicity of DLR has also contributed to the platform's success. It operates using existing market infrastructure and regulatory frameworks for processing collateral and cash"*
>
> **Horacio Barakat**
> Head of digital innovation for capital markets
> Broadridge

With the launch of this repo solution in June 2021, DLR users executed US$25 billion in average daily volume on the platform in its first week. Built on Broadridge's fixed income trade processing platform, the DLR service employs Daml smart contracts from Digital Asset and distributed ledger platform VMware Blockchain.

DLR is designed to provide a single platform where market participants can agree, execute and settle repo transactions. The underlying securities remain immobilised in users' custody accounts, while transfer of ownership takes place via smart contracts on the distributed ledger platform.

This offers lower costs in repo transactions, including intraday, overnight and term repos, on a bilateral and an intracompany basis, while reducing counterparty risk and strengthening the audit trail across the trade lifecycle.

A number of clients, including Société Générale, have been welcomed onto the platform since its go-live, with others in the process of onboarding.

According to Barakat, the platform's success can be attributed to the flexibility of its smart contract functionality, which allows Broadridge to deliver greater efficiency for a range of repo flows including intracompany transactions, sponsored repos, bilateral and intraday.

The simplicity of DLR has also contributed to the platform's success. It operates using existing market infrastructure and regulatory frameworks for processing collateral and cash, says Barakat, such that DLR is just another technology implementation in clients' technology stack.

The benefits are three-fold. First, DLR is designed to increase operational efficiencies through the use of smart contract and digitisation, thereby reducing operating costs primarily by eliminating the need for reconciliation between counterparties and reducing clearing and settlement costs.

Second, the front-to-back digitisation of the entire repo workflow, from execution through settlement, offers greater collateral mobility, enabling collateral to be used when and where it is most needed. Additionally, DLR aims to improve firms' ability to manage their liquidity requirements intraday.

Expansion across borders

The DLR roadmap has been constantly evolving. Initially, Broadridge focused on repo transactions in the US treasury market, given the size of this market and Broadridge's ability to make a significant impact through this channel.

DLR has now expanded into other types of trades including cash trades, pledge, borrows and collateral upgrades. "We are also expanding to other markets, with our recent cross-border intraday trade being the first step towards that. We believe that European and Asian markets will be a key driver of growth for DLR," Barakat states. "Our ability to support a wide variety of transactions via our smart contract technology has proven critical in our initial platform success."

Intraday repo allows firms to manage their intraday liquidity more efficiently, providing another source of funding for firms during the day and enabling financial institutions to manage their cash deficits more cost-effectively. "In supporting cross-border repo trades, this helps to bridge counterparties' different time zones and to maximise utilisation of their cash and collateral," he says.

As Broadridge's recent DLR milestone marks the next phase in its rollout, Barakat expects the platform to evolve and expand to add new use cases and trade types, taking advantage of the flexibility of DLR and simplicity of the onboarding process.

He explains: "Since the very beginning, DLR is a product driven by market participants. From the early proof of concepts (POC) and pilots, we closely co-innovated with our clients to design the product and its functionality to ensure that DLR solves critical and meaningful pain points for the industry. We continue to be true to this guiding principle — and our clients' ideas and requirements are a key driver of DLR's roadmap and the next phase in its evolution."

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US securities lending rules back in focus

S&P Global Market Intelligence's Igor Kaplun and Matthew Chessum examine the progress of the SEC's Rule 10c-1 proposals designed to enhance transparency for securities lending and borrowing trades in the US

Almost 18 months ago, on 18 November 2021, the US Securities and Exchange Commission (SEC) issued a significant proposal to implement a new reporting regime in the US for securities finance. Given the timing, heading into the Thanksgiving holiday, many industry participants had limited time to respond. Consequently, the proposal was again put forward for public consultation in the Spring of 2022, offering more time for the public to comment and for broader industry engagement to take place. Many issues were raised on the draft proposals, and the fact that the SEC allowed more time for consultation gives the industry some confidence that regulators will take the market's perspectives into consideration when the final rules are published in 2023.

The proposed rules are designed to increase transparency in securities lending and borrowing transactions in the US. All lenders and lending agents will be required to report lending activity to a registered national securities association, such as the Financial Industry Regulatory Authority (FINRA), which will subsequently make the information public. The quest for transparency in the securities lending market segment is nothing new and was outlined in the implementation of the Dodd-Frank Act in 2011. It has taken the SEC more than a decade to formulate a set of rules to fulfill the mandate set out in the legislation. The reporting of securities lending transactions has been live in the EU and UK since 2019 and the industry has largely come together to find a workable solution that addresses concerns over transparency, data quality and investor access.

The Securities Financing Transactions Regulation (SFTR) was the first regulation to go live and offers a blueprint for successful implementation across the board from borrowers, agents and lenders. The implementation of an efficient and cost-effective solution by IHS Markit (now S&P Global), Pirum and more than a dozen of the largest agent lenders in the industry has made this reporting regime a success across Europe. This extensive level of collaboration, common sense requirements and the extended implementation timeline were the key drivers of a successful go-live.

However, the data requested, and the timelines involved in the implementation of SEC 10c-1, are significantly different to those for SFTR. Some key differences include:

- A single sided reporting regime, instead of the dual-reporting requirement under SFTR.
- Real-time submissions within a 15-minute timeframe, instead of a T+1 requirement
- Submissions to FINRA, instead of a trade repository.
- The scope of reporting is not currently clear (repo appears to be excluded and US-domiciled firms only appear to be captured).
- The exact data requirements are not yet specified.
- Only registered broker-dealers currently appear to have a requirement to report.
- Third-party agents are not permitted to assist with reporting.
- A limited number of data fields will be reported for 10c-1, compared with 155 data fields under SFTR.
- ISO 20022 XML standards exist for SFTR, but the data standards are currently unknown for 10c-1.
- As the legislation stands, 10c-1 requires each lender to submit their on-loan balances, as well as their available-to-loan inventory, at the end of each business day.

Since the consultation process closed over 12 months ago, the industry has had time to digest the responses across all segments of the market and the issues above reflect the critical themes and points of contention that have emerged from these submissions. The question at this point is whether the SEC will modify the final rules to address these concerns or whether they will implement the proposal as it is currently written.

As it stands, the market believes that this rule has the potential to be heavily operational, time consuming and costly for most market participants. As many in the industry have noted, securities lending transactions currently settle on a T+1 basis, while the proposal requires reporting within 15 minutes of a securities lending transaction being executed or modified. Typically, securities loans are frequently modified throughout the day as borrowers' trading needs shift. This can be due to changes to loan size, pricing, or credit concentrations, to name a few possible reasons.

It is still to be confirmed what happens between the time a securities lending order is executed and the time it settles? How many lifecycle events, corrections and modifications on that single order would need to be reported within 15 minutes? The move to a T+1 cash equity market will also mean that timelines are potentially consolidated further.

Even if firms could handle the 15-minute reporting timeframe, questions remain regarding the value that the regulator, and the market at large, will gain from these modifications. As proposed, the data reported to FINRA will be made available to the public — though at which point is still to be determined. As it stands, there is no clarity regarding how the publicly-available information will be disseminated. If FINRA does not

publish the data in real time to the public, is there value in collecting that data in real time? Will the data provide any insight into the risk a counterparty is holding? The market is hoping that these questions will be addressed in the final version of the new rule.

The issue of transparency also arises with the requirement for firms to report their available-to-loan inventory. There are multiple concerns with this requirement. There are challenges, for example, with interpreting when a security is available for lending, which may generate an inaccurate picture of what is available for loan. Will this additional disclosure change the lending practices of the industry? Instead of using a US agent lender, could the buy-side firm instead rely on a UK or EU entity, which would be out of scope for SEC 10c-1 reporting obligations and instead be caught under the purview of SFTR? The market's experience under SFTR suggests that this will not be the case — but, again, more clarity is required before these questions can be answered.

> *"The fact that the SEC allowed more time for consultation provides some confidence that regulators will take the market's perspectives into consideration when the final rules are published in 2023"*

Despite the challenges faced by market participants in interpreting the current rules and managing the implementation of a new reporting regime, it is important that full consideration is given to the reasons why this requirement is being implemented.

Since the global financial crisis, additional attention has been directed to the "shadow banking sector". This is a financial market segment that offers bank-like services, such as leverage, but without the regulatory oversight of the banking sector. Securities finance has been viewed as a part of these operations and the functioning of securities finance markets, and the build up of leverage using securities finance transactions, has come under heavy scrutiny.

A lack of transparency in these markets, and the paucity of readily available reporting to regulators, has resulted in suboptimal regulatory responses from global regulators (such as short selling bans) in their attempts to contain assumed market risk. With the advent of clear and efficient reporting, regulators will be better placed to implement the right decisions for the market during any future market events. The recent banking turmoil shows the speed at which a potential market event can unfold and how transparency is essential in ensuring market stability.

S&P Global Market Intelligence is well placed to understand the value that market data can bring to all market participants. As a provider of multiple data points to multiple clients on a minute-by-minute basis, the value of data in managing risk and decision making can be clearly documented. Transparency is also key to any well-functioning, efficient market. With the addition of the information offered to all stakeholders through the implementation of Rule SEC 10c-1, market participants will have more data points available to assist them in managing their inventories and exposures. This can only be a positive in a world where data is at a premium and is integral to any financial institution.

Many unknowns do still exist and the potential effects still need to be fully evaluated. There are clear concerns regarding implementation costs, implementation timeframes, cross-border applications and the impact that these rules will have on the competitive environment. However, the market is encouraged to show patience in evaluating the new rules until the final text is made available.

From a securities finance perspective, the industry already has experience in managing this change through the implementation of SFTR and the European Market Infrastructure Regulation (EMIR). Many US desks also offer international coverage within the firm and are, therefore, able to leverage their knowledge and existing playbooks for implementing reporting requirements for securities finance transactions in the US.

S&P Global Market Intelligence Cappitech continues to monitor this upcoming regulation and stands ready to help the industry to gather and disseminate the required information. Our experience with SFTR gives us the knowledge to facilitate the reporting requirements that will come out of this regulation. We welcome the opportunity to discuss SEC 10c-1 with market participants.

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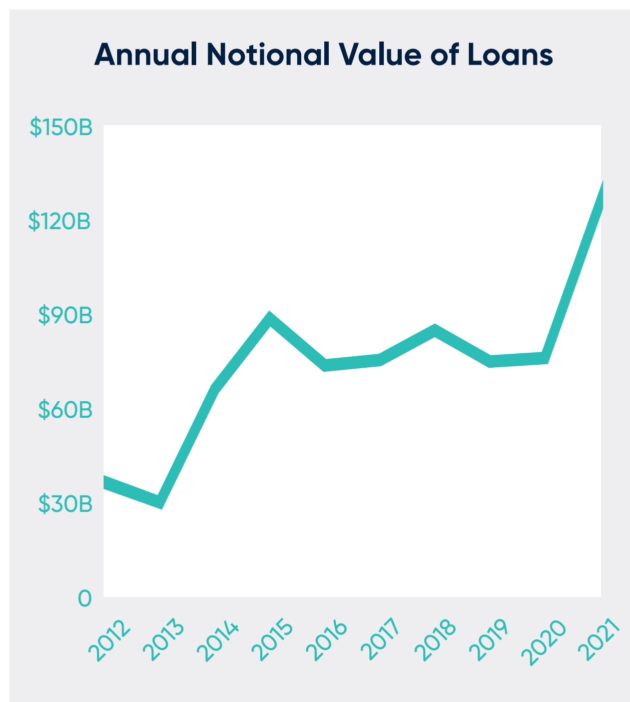

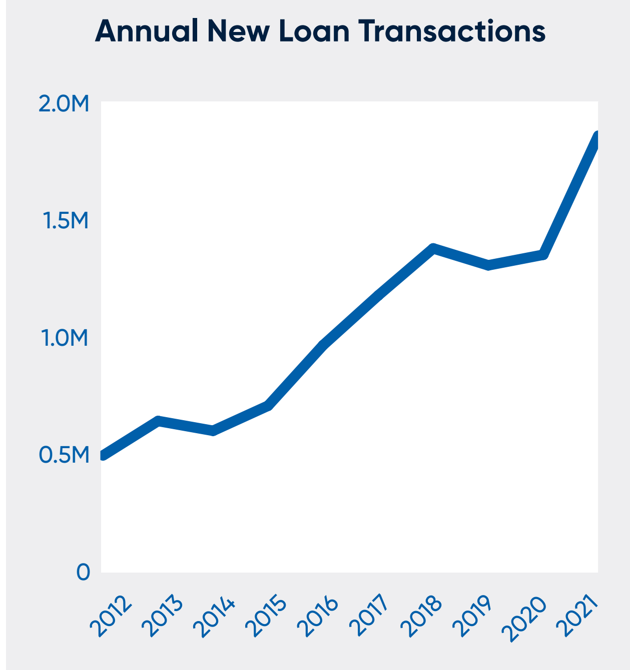

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SECURITIES FINANCE TECHNOLOGY

SYMPOSIUM

02 MAY 2023

Agenda

Regulatory Reporting: Rewrite, reform, refit

An update on recent regulatory implementations, new regulations and regulatory reviews. Taking the views of our panel, we will look into what is keeping you up at night, including the potential challenge presented by SEC 10c-1.

Moderator

Vinod Jain
Senior Analyst, Capital Markets
Aite-Novarica Group

Panellists

Jonathan Lee
Senior Regulatory Reporting Specialist
Kaizen Reporting

Igor Kaplun
Global Head of Business Development
S&P Global Market Intelligence Cappitech

Nancy Steiker
Senior Director, Trading and Processing
FIS

Marney McCabe
Head of Relationship Management
Agency Lending, Fidelity Investments

9.35am- 10:30am

Repo Returns: Repo on the rise

The monetary policy environment has moved from an extended period of low interest rates and abundant liquidity to a landscape of inflation, rising interest rates and indication from central banks that they intend to step up the unwind of their asset purchase programmes. How is this shaping the dynamics of repo markets, trading opportunities and priorities for risk management? How are technology developments and regulatory amendments defining future direction in repo markets?

Moderator

Thomas Kinnally
Formerly of BlackRock and Morgan Stanley

Panellists

Ed Tyndale-Biscoe
Head of Product Management, Secured Funding
ION Group

Colleen Stapleton
Product Manager
MarketAxess

Travis Keltner
Global Head of Repo Financing
State Street

Paul Chiappetta
Product Management & Business Development
Broadridge Financial Solutions

11.00am- 11:55am

Innovation: Now and the future

Experts in the field of technology discuss current platforms and technological innovations that are leading the way, plans on the horizon and their vision of the future.

Moderator

Bob Currie
Group Editor
Securities Finance Times

Panellists

Matthew Cohen
CEO
Provable Markets

Divyesh Bhakta
Founder & CEO
FinOptSys

Gary Klahr
Director of Strategic Initiatives
EquiLend

Vijayshankar Venugopal
CIO
Helix Financial Systems

Tammy Phillips
Chief Executive & Co-Founder
Asterisk Network

11.55am- 12:40pm

Industry Leaders: Past, present and future

A cross section of the industry from users to creators look at how technology has changed over the past 10 years, where the market is now and what their expectations are for the future of securities finance. What is the direction of travel and what is possible through technology innovation? Where are your clients and service partners taking you in shaping this journey?

Moderator

Bob Zekraus
COO, Head of Americas and Global Head of Key Account Management, Pirum

Panellists

Oberon Knapp
Executive Director, Participant Solutions, Head of Securities Lending, OCC

Craig Starble
CEO
eSecLending

Chelsea Grossman
Head of North America Agency Lending Client Management, Securities Finance, State Street

Ed Corral
Global Head of Collateral Strategy for Collateral Services, J.P. Morgan

Justin Aldridge
Senior Vice President, Head of Agency Lending
Fidelity Investments

2.15pm- 3:10pm
TradFi v's DeFi: Can they work together?

How will decentralised finance (DeFi) shape the future of securities finance? This panel will examine the benefits and challenges presented by adoption of DeFi-based structures and how these will evolve alongside 'traditional' trading, lending and financing arrangements. What new avenues does this offer for peer-to-peer and what role (if any) will financial intermediaries play in future lending and financing structures? How will the supporting technology evolve?

Moderator

Gavin Marcus
Head of Sales Americas
S&P Global Market Intelligence Cappitech

Panellists

Charlie Amesbury
Sales
HQLA^{X}

Jesse Overall
Associate
Clifford Chance

Nadine Chakar
CEO
Securrency, Inc.

Tammy Phillips
Chief Executive & Co-Founder
Asterisk Network

Mike Norwood
Head of EquiLend Trading Solutions
EquiLend

3.10pm- 4:00pm
Women In Securities Finance: Boston Chapter

Taryn Siglain, global head of principal securities lending programme, Enhanced Custody at State Street, will be speaking with Provable Markets COO Halima Butt and Camille McKelvey, head of business development STP for MarketAxess Post-Trade, about challenges faced by women in technology, progress made and the strides needed to change perceptions.

Moderator

Taryn Siglain
Senior Vice President, Global Head of Enhanced Custody, State Street

Panellists

Camille McKelvey
Head of Business Development STP
MarketAxess Post-Trade

Halima Butt
COO
Provable Markets

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Implement new knowledge in your own company

Boost your network

Learn about your competitors and exchange views on shared challenges

Meet event organiser and Securities Finance Times publisher Justin Lawson

A bridge between markets

Digital Prime Technologies' head of lending solutions Courtney Campbell speaks to Carmella Haswell about spearheading the firm's new digital asset lending platform, Tokenet, and how it plans to reshape the institutional digital lending market

Digital Prime Technologies is set to release its automated lending platform Tokenet at the end of Q1 2023. The platform will enable institutional dealers to post borrow needs, broadcast lend availability and select collateral haircuts. It seeks to provide loan lifecycle management, as well as a number of counterparty risk tools.

Courtney Campbell will spearhead the institutional dealer-to-dealer digital asset lending platform that hopes to build a bridge connecting traditional finance to digital asset lending and prime brokerage markets.

Since the inception of Digital Prime Technologies in 2019, regulation, compliance, transparency, best practices and corporate governance have all been core to the firm's DNA, according to Campbell. The provider of prime brokerage technology solutions was formed with a focus to build an enterprise-grade product that was embedded with best practices that could plug into traditional financial institutions.

"We are emulating what is seen and works in traditional finance and applying that to digital assets," says Campbell. "Today, this approach is more relevant than ever, based on what we have all witnessed in the digital landscape in the past 12 months."

Speaking to SFT, Campbell indicates that Tokenet will mirror traditional finance lending platforms to allow its clients to enter the world of digital asset lending, in the same familiar confines that they are accustomed to from traditional finance. "We know the language that our clients speak and we have created a system that speaks the same language," Campbell adds.

Tokenet looks to resonate with clients from an operational, compliance and business opportunity perspective. Users are able to post needs and axe lists, set terms of loans, agree on acceptable collateral and have the support of the system for a full suite of reports.

Having access to a platform that emulates traditional finance creates opportunity for participants in that space to enter into digital asset lending, as those tools "currently, do not exist", explains James Runnels, Digital Prime Technologies co-founder and CEO.

According to Runnels, there have been some painful moments in the digital asset lending space over the past 12 months. "As rapidly as that business has grown, from inception to today, there were a lot of blow ups — mostly due to a lack of best practices in the digital asset space," Runnels says.

The "blow ups" were reflected in international headlines that announced the names of several digital asset lending firms that entered bankruptcy. The world watched as crypto trading and derivatives platform FTX filed for Chapter 11 bankruptcy in November 2022 in the District of Delaware. Digital asset lender BlockFi also filed for bankruptcy later that month and crypto lender Celsius did so four months previous.

"While what we witnessed could essentially be considered a stain on the space, within that chaos, you can find opportunity," Runnels explains. "That is the opportunity that we are solving for, to clean up that non-traditional approach to digital asset lending, provide traditional institutions with the tools that they are accustomed to and manage the cycle of a loan in a very efficient, best practice type manner."

Tackling the hurdles of recent headlines, Campbell believes that Tokenet will bring back confidence and trust in the market. Efficient markets require borrow and loan activity, which have been in decline recently, according to Campbell. She predicts that the use of proper governance and risk management tools will bring participants off the sidelines and back into the digital asset lending space.

Tokenet will support users in managing risk and collateral. Clients will have the ability to post collateral bilaterally or in an FBO triparty account with a qualified custodian. Lenders and borrowers using

Tokenet will have a transparent view of their collateral, as well as a real-time valuation of that collateral. A full suite of APIs, among other technologies, will be incorporated to provide clarity and transparency for each Tokenet user.

The platform offers a full robust chat functionality that aims to help users to speak to one another and negotiate on collateral and mark-to-markets. In addition, users will have the ability to turn on and off different counterparties, set collateral haircuts and assign credit limits, depending on their risk parameters.

Staying ahead of the game

After spending the entirety of her career in the securities finance industry across a number of Wall Street firms, Campbell made the jump to digital assets in 2022. Viewing firsthand how digital asset lending differs from traditional lending, Campbell says the contrast was day and night.

“When James and Bob approached me to spearhead the launch of Tokenet I jumped at the chance, because I knew something like this was desperately needed for the market to mature and to get to that level of institutional adoption,” Campbell recalls.

She continues: “Tokenet and Digital Prime Technologies, as a whole, have built the full tech suite that will enable tradfi to move into digital asset lending and prime brokerage. With our technology, our team and our guidance, the market will be able to uncover new revenue streams and meet their client needs in the digital asset space.”

Financing and lending is the backbone of traditional capital markets, Runnels notes. Without having a safe way to effect that, it will be hard to accomplish mass adoption, from an institutional perspective, in the digital asset world. Tokenet was designed to solve this.

Runnels states that Tokenet provides only a small learning curve for users, as it emulates what has already been accomplished in traditional finance. He explains: “Participants are already accustomed to the practices that are embedded in Tokenet, the only difference really would be that instead of traditional equity securities, these are now digital assets.

“The movement, the operational practices, the governance behind it all is similar to what participants are using already. We feel that Tokenet will be a seamless integration into tradfi, to solve for the lack of safe borrowing and lending in digital assets.”

Currently, Campbell believes that there remains a “massive” opportunity in capital markets, with a large amount of revenue “sitting in the investment bank” — one of the main opportunities that digital assets bring to the prime brokerage space. Moving forward, Campbell predicts a significant uptick for traditional finance to offer prime brokerage in digital assets.

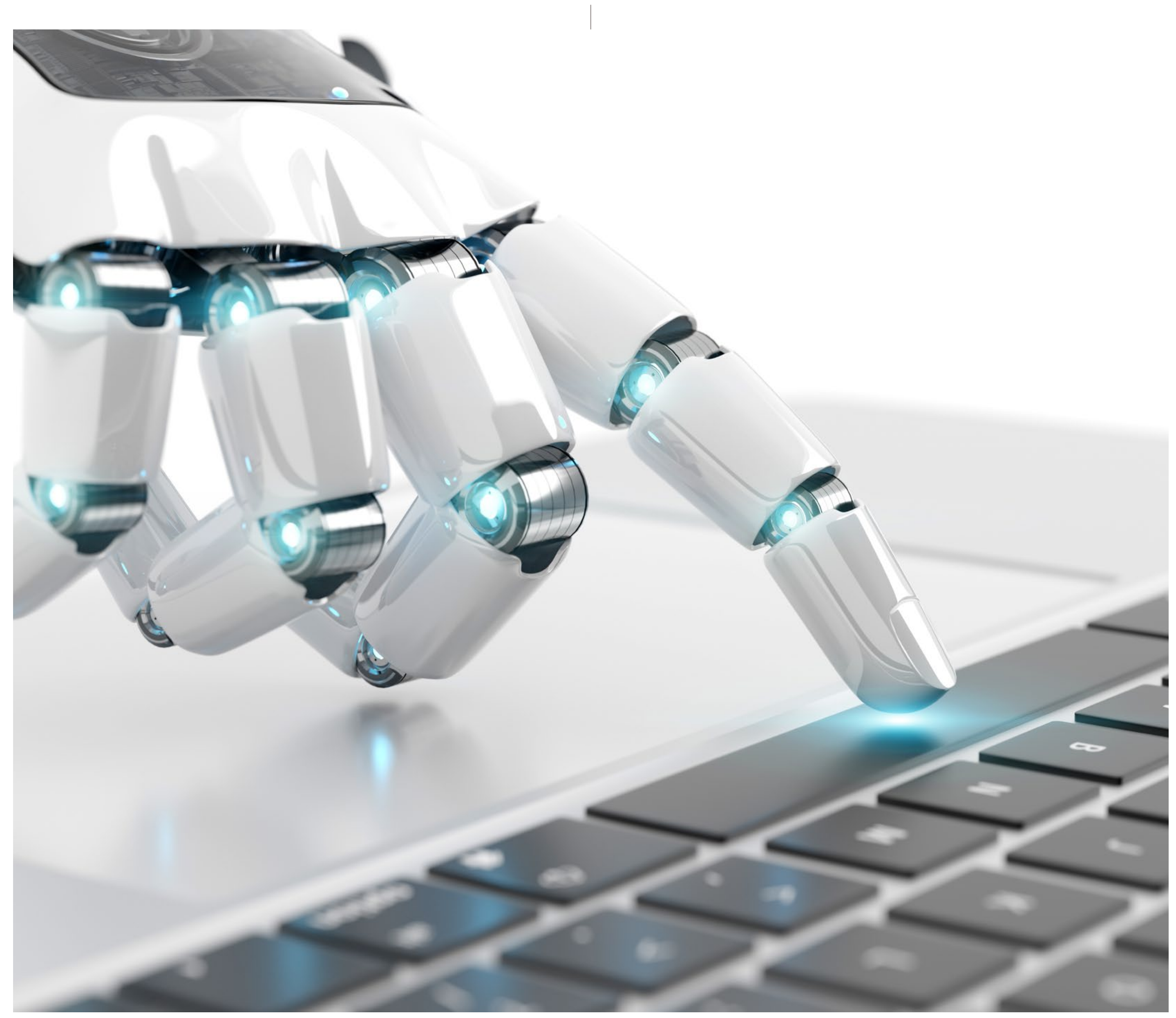
Following Campbell’s comments, Runnels indicates that due to the retail-driven nature of the digital asset sector, a number of prime brokerage tools were not brought to market properly — something Digital Prime Technologies aims to combat with its prime solutions tech stack.

“How prime brokerage has been defined in the digital asset space is definitely not the same way as how traditional finance has defined prime brokerage,” Runnels highlights. “When regulation does become clearer for regulated banks and broker-dealers, I think we are going to see some swift movement into the prime brokerage space, as we define it from tradfi and we are well positioned for that. It is one of our core offerings, there is a lot of opportunity there to do it properly.”

Digital Prime Technologies has received positive feedback from the industry regarding its Tokenet platform, according to Runnels, something that is indicative of what the firm has built and what is needed in this space.

He says: “There is a lot of grey space in digital assets — specifically in lending and in prime — we are here to take that grey space and make it black and white, and define it in a manner that folks are accustomed to and need.”

‘Best practices’ is not just a term, it is how Digital Prime Technologies operates, says Campbell. She concludes: “Staying ahead of the game by bringing the right team in is how we are going to make a difference and get things safely moving in the right direction. It is all embedded in our product suite. It reflects the collective experience and culture of our firm.”



The need for automation in legal opinion

Legal opinions are a fundamental component of global financial stability. They underpin regulatory acceptance of close-out netting, which reduces financial institutions' capital costs, risk and legal uncertainty, and are key for financial stability. Yet their current format is unwieldy, overly complex and increasingly no longer fit for purpose, as Akber Datoo, CEO of D2 Legal Technology, explains

The co-architect of the design and drafting of the current incarnation of master trading agreements, Jeff Golden KC (Hon), once stated that "the answer is always netting". The truth of this statement, in terms of its importance to trading parties for credit risk mitigation and financial stability, has certainly continued to hold true. However, the effectiveness and enforceability of netting under these master trading agreements

has grown around the provision of legal opinions to confirm this enforceability. Yet 35 years after the capital markets industry started to utilise these legal opinions for this purpose, very little has changed in terms of the manner in which they are provided. It has simply not kept up with the current demands of a more complex trading environment, regulatory requirements and the increasing role of technology and the digital agenda.

Legal opinion and why it is Important

A legal opinion — also known as an 'opinion letter' in pure legal terms — might be defined as "an opinion from lawyers issued in letter form expressing legal conclusions about, and/or legal analysis of, a transaction or matter which is relied on by the addressee of the opinion".

The main purposes of a legal opinion are:

- to inform the addressee of the legal effect of a transaction or matter.
- to identify legal risks that the addressee should consider further and evaluate.

Within the context of financial markets, and close-out netting in particular, the legal opinion takes on a slightly more nuanced and complex purpose, though its form remains the same.

Payment netting is often confused or conflated with close-out netting. Payment netting takes place during the normal business of a solvent firm and involves combining offsetting cash flow obligations between two parties on a given day in a given currency into a single net payable or receivable. Although important in, for example, managing Herstatt (or "daylight" risk), it pales to insignificance with respect to the benefits offered by close-out netting. This refers to a process involving termination of obligations under a contract with a defaulting party and subsequent liquidation of any resulting damage or gain by combining positive and negative replacement values into a single net payable or receivable.

It is important to be sure that close-out netting is enforceable in the relevant jurisdiction, were the trading counterparty to become insolvent. If not, any exposure to that trading counterparty ought to be viewed on a gross basis (i.e. without combining positive and negative values), rather than a net basis. This is because insolvency administrators might engage in cherry picking, which involves an insolvency administrator demanding performance of contracts favourable to the bankrupt firm but rejecting contracts burdensome to the bankrupt firm. Accordingly, one might be obliged to pay in full on obligations and, yet, with respect to the obligations owed, prove as an unsecured creditor against the insolvent estate of your counterparty. The impact on credit exposures resulting from this can be very significant.

Global standard-setters recognise the importance enforceable close-out netting has with respect to risk reduction in the financial system, both when it comes to setting regulatory capital requirements and developing effective resolution regimes (for example, the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions).

Additionally, by obtaining reasoned, written legal opinions that confirm the enforceability of the close-out netting provisions of master netting agreements that they use, prudentially regulated firms can use net, rather than gross, exposures to calculate their regulatory capital exposures. The regulatory capital savings for large investment banks in the capital markets run into billions of dollars.

Specifically, the regulations require a legal opinion to be obtained in respect of each such master trading agreement — such as the General Master Securities Lending Agreement (GMSLA) — before the regulatory capital benefit can be taken. The legal analysis may differ for some counterparty types — such as insurance companies, due to some specific insolvency rules relating to such entities in some jurisdictions — and agreement type. However, industry opinions are often obtained to provide for generic advice for a particular jurisdiction (of the counterparty) and agreement type, with further analysis required to make this apply to individual facts and circumstances.

This results in large banks needing to maintain large portfolio legal opinions in this way, in some cases running into close to a thousand such opinions. Given insolvency (and other relevant) laws and regulations are dynamic and change over time, the regulatory requirement is to keep this legal advice current and up-to-date — with the increasing expectation being that these legal opinions are refreshed annually. By way of example, earlier this year, updated insolvency laws in the Bahamas meant that a legal opinion in respect of Bahaman bank counterparties changed such that close-out netting can no longer be regarded as enforceable against them.

While these trading agreements, such as the GMSLA, are standard in that most of the terms come from a pre-print, some of the terms and

conditions will be amended by the counterparties — which requires further legal analysis to confirm whether any such amendment changes the legal opinion's view regarding the enforceability of close-out netting. Additional annexes, such as for evergreens, may require additional legal analysis and may therefore not be covered under the scope of the industry (or bespoke) opinion on which a firm might otherwise wish to rely.

The current format of legal opinions

There are a number of issues with the current format of legal opinions which render them impractical for use as a business tool at best — and, at worst, actually contribute to firms' operational risk.

The first of these issues relates directly to the characterisation of the legal opinion as an 'opinion letter'. In the case of close-out netting, legal opinions can be far more lengthy than a letter; indeed, some can be hundreds of pages in length and wander across topics of definitions, relevant regulations and legal guidance. Opinions generally provide a discussion with a non-binary conclusion, resulting in the need for further interpretation and evaluation by a legal professional to answer the fundamental question of whether the master agreement can be enforced given particular facts. For example, legal opinions are subjective, when their regulatory purpose is to provide an objective answer.

The second major issue with current legal opinions lies in their paper-based format. That legal contracts are often unsuited to the business needs of the contracting parties is no longer an unsolicited view. Indeed, the Research Handbook of Contract Design advocates for a move from "the model of a contract as text only towards a more open-textured model of contracts that can be visual, text-based, code-based, or hybrid depending on the needs of the audience." Knowing where, within a document of a hundred pages, the relevant issue is raised — which may mean a netting flag needs to be re-evaluated — is an arduous, manual and therefore costly exercise.

The final, significant problem with today's legal opinion is one of data management. If a financial institution has legal opinions numbering into the hundreds, let alone thousands, then knowing which legal opinion needs reviewing — according to, for example, legal changes in the relevant jurisdictions, changes to the financial transactions themselves, or even simply unforeseen changes — becomes a Herculean task. Moreover, once the applicable section(s) of the legal opinion(s) are located, the specific guidance must, again, be reviewed and further interpreted.

Applying automation

The current close-out netting legal opinions are, quite frankly, impenetrable to most — if not the majority of — capital markets lawyers, being an extremely niche yet vital area.

To start, it is often not clear what the counterparty scope of a legal opinion is. Many firms fail at this initial hurdle, failing to ensure that the right legal opinion is obtained and reviewed in respect of a trading counterparty. This requires significant counterparty due diligence, from reviews of constitutional documents, prospectuses and various registers. This is an operational task that, all too often, has been left to expensive legal teams to plough through and is operated in a silo from KYC teams, despite the overlap in work required.

Even after the relevant legal opinion has been obtained and reviewed, essentially a long and complex legal opinion needs to be reduced to a "Yes" or "No" for regulatory capital purposes, based on certain facts that need to be ascertained — such as terms of the agreement, features of the transactions and where assets are located. This is, unfortunately, all too often "done in the head of the lawyer", with little audit trail or working relating to the path to the decision, despite its complexity.

It is no wonder that so many netting determinations are suspect and that the regulators have begun to question prudentially regulated firms on their processes and systems (if any) in respect of close-out netting. In doing so, they are trying to force firms, typically through fines and other demands for action, to improve their management of legal opinions and the netting determinations — should they wish to receive the huge regulatory capital benefits of doing so. This is where automation and data come in, as the current process is just not scalable manually. Also, there is surely too much at stake in terms of financial stability!

The industry has recognised the issues of manual process and an analogue approach to master trading agreements. If the answer truly is "always netting", we need to ensure the digital journey of the industry — from clause taxonomies and libraries to the common domain model and document negotiation platforms — does not miss out the role of the close-out netting legal opinion. And we need to design for the digital future of such opinions to unlock business value.

Forming a tokenised economy

Industry bodies are working to create a safe environment for the mainstream adoption of digital assets. Carmella Haswell reflects on how market practice changes, regulation and advances in technology and standards will define this journey

The coexistence of digital assets and traditional finance is creating a new world of opportunities for the industry. Firms are continuing to adapt to the changing landscape, where institutional adoption of tokenised and digitised assets is on the rise.

Weaving through the challenges of implementation, the market calls for further education and refined regulatory frameworks to provide a safe environment for this migration, and hopes that these factors will act as a catalyst for moves towards a more tokenised economy.

"Blockchain is much more than crypto assets," says Bhavna Haswani, vice president of product management and digital assets lead at J.P. Morgan. "On the other side of the spectrum of

blockchain, we have digital assets, where we are seeing growing utilisation in the collateral and securities finance space."

A digital representation

According to Simon Squire, managing director, global head of product development for Clearance and Collateral Management at BNY Mellon, tokenised traditional assets are assets that encompass a digital representation of a traditional asset class set on distributed ledger technology (DLT) or blockchain.

There are two main areas of tokenised traditional assets — one is tokenising a specific security and the second is tokenising a pool of assets. Tokenised traditional assets are only one of the non-cryptocurrency aspects of digital assets; securities or other assets may also be issued digitally on a blockchain or DLT. Squire explains that, in this construct, the asset is digitally or originally listed, recorded and then kept on the blockchain or DLT.

As an example, the European Investment Bank (EIB) launched its first ever digital bond issuance on a blockchain platform in 2021, deploying this DLT for the registration and settlement of digital bonds, in collaboration with Goldman Sachs, Santander and Societe Generale.

At the time, the EIB said that the digitalisation of capital markets could bring a range of benefits to market participants in coming years, including eliminating the requirement for certain financial intermediaries, reducing fixed costs, delivering faster settlement speeds and promoting better market transparency by improving their ability to monitor trading flows and the identity of asset owners.

Rina Azumi, executive director of digital assets, Global Banking and Markets, at Goldman Sachs pinpoints an uptick in enterprise readiness and increased institutional adoption of tokenised and natively digitalised assets in recent years. In addition, an acceleration in the representation of traditional financial assets on blockchain has also been evident.

This integration of the digital asset world and the traditional finance world is proving beneficial for market participants. According to Azumi, this evolution provides enhanced functionality — for instance, the speed efficiency in which DLT allows for trading to the nearest minute. Further, it provides potential for fractionalisation — the ability to split an asset into smaller fractions on blockchain and distribute to a wider investor base.

For Azumi, risk reduction is a key additional feature, whereby participants are able to settle with greater precision on blockchain, therefore enabling greater liquidity and capital efficiency. "There are operational efficiencies associated with being able to leverage blockchain and it carries cost savings as it removes the need for intermediaries," she continues. "We have a single source of truth that is shared by all parties, which also removes the need for reconciliation."

According to Digital Asset president Shane Akeroyd, a smart contract contains all of the information that an existing contract does, including an issue date, maturity date and coupon payment date. Smart contracts also include details of workflow or lifecycle events.

"We have checkpoints to ensure that rules, regulations and market standards are adhered to and we have connectors such as SWIFT to allow communication between market counterparties, particularly for the payments leg of the transaction," Akeroyd notes. "What is lacking, and what smart contracts bring to the table, is evidence that this is being done, providing one neutralised view.

"Although we have different roles, responsibilities and permissioning, we will all, using a smart contract, own parts of this process at any moment in time and over time. Multiple parties using a smart contract will have a real-time view of everything that is going on."

Further, Akeroyd says that blockchains are designed to guarantee the integrity of data across multiple counterparties using consensus protocol. There will be various validators on the network that will verify their own information, releasing it to the network on a permission basis or in real time. "One of the benefits," he adds, "is that it will do away with the need to reconcile by replacing it with this consensus mechanism."

The reality of tokenisation

A published report by the Boston Consulting Group (BCG) in September 2022 indicated that the projected growth of asset tokenisation would expand into a US$16 trillion business opportunity by 2030.

The report states there is an impending shift from traditional fractionalisation to on-chain tokenisation, which expands the scope of asset classes, stakeholder groups and regulatory scope for tokenisation. It adds: "Therefore, it is crucial to understand and appreciate the incremental benefit from fractionalising assets on blockchain-based platforms."

Asset tokensiation is opening up a new world of opportunities to revolutionise how assets are issued, managed and transacted, says Yuka Hasumi, head of EquiLend Japan. For Hasumi, “the possibilities are endless”, to tokenise almost anything from personal to business, from property to equity. “Tokenisation is already a reality.”

Focusing on collateralisation and tokenisation — as it continues to evolve towards “a more proactive approach”, with collateral becoming more of a centralised global function for market participants — Hasumi says that though the positives for successful technology adoptions are “obvious”, implementation is always a challenge. Greater efficiency and increased transparency are two benefits of successful technology.

In May 2022, J.P. Morgan announced the transfer of tokenised money market funds (MMFs) shares on blockchain as collateral — stating it was the first firm globally to do so. The firm confirmed that both collateral provider and collateral receiver must be present on the blockchain-based application, known as the Tokenised Collateral Network (TCN), enabling participants to transfer ownership of the collateral without the need to transfer the underlying asset.

“It was a big moment for the industry,” says Hasumi, “in demonstrating how the technology works and to further drive more transparency, diversity and efficient scalability.”

According to Squire, a common problem that the industry faces is getting the right securities in the right place at the right time — an issue that is becoming increasingly important given evolving regulation and the current environment. Squire predicts that this is costing the industry tens, if not hundreds of millions of dollars on an annual basis.

Liquid assets get “stuck” in the real world all of the time, Squire indicates. He uses as an example a European government bond that settles five minutes before market cut off. “Ideally, you have lined up some secured financing for that asset, with five minutes before the market closes, the likelihood of being able to mobilise that asset into the right place is very difficult. The result is that the asset is going to be trapped or unencumbered in that location and not being utilised.

“Imagine a world where that asset is on a DLT and those assets can move seamlessly 24/7, the efficiencies that could be created for our industry is very exciting. Today, global banks hold liquidity buffers in Asia-Pacific, EMEA or the US. Imagine that you could take a US asset as part of the inventory pool and mobilise that around the timezones.”

Squire indicates that DLT gives market participants an opportunity to make assets easier to mobilise.

The next quantum leap

In Q3 2022, EquiLend launched a new DLT solution to combat reconciliation inefficiencies called 1Source. The programme, which is currently in the design phase, aims to use emerging technologies to develop a common record, or “single source of truth”, to support trade processing across the transaction lifecycle. EquiLend indicates that, in building this solution, it will deliver a centralised DLT-based platform that will act as a “single source of truth” for securities finance lifecycle events and a universal source of data for the industry.

Shortly after this announcement, BNY Mellon and Goldman Sachs International settled agency securities lending transactions using the HQLA^{X} DLT platform. HQLA^{X} created ISIN-level securities trackers called Digital Collateral Records (DCRs), from loaned securities it received from BNY Mellon, giving Goldman Sachs a digital copy of those trades. Those records enable holders and agents to transfer ownership of any security on the HQLA^{X} distributed ledger, without the need for conventional settlement mechanisms.

Squire finds a “real value” for DLT in the inventory and collateral management space, noting that the technology can be used to reduce friction associated with the fragmented settlement environments, especially in Europe, where there are a number of different markets. However, there are concerns. Squire highlights: “I do worry a little bit that we are building to create an ecosystem of disparate DLTs and that we end up creating an even more fragmented ecosystem for DLTs and the traditional world.

“We are going to need to take very thoughtful approaches as an industry. We might need to change our approach in the way that we think about competition and the way that we work together to make these worlds really come together and create a collaborative ecosystem.”

Assessing the next move for the industry, Akeroyd believes that there will be an increase in asset tagging — when collateral eligibility details are embedded in smart contracts, similar to how lifecycle events may be embedded into smart contracts. Akeroyd says that this will allow firms to look at the availability of collateral in real time. “A key new functionality is the locking of collateral to secure a party in one location

against a liability in another, without having to move the collateral around," he notes.

"A real-time view of our collateral and our positions will allow us to optimise our collateral and manage risk in a more efficient way. Going forward we will see more asset tagging, embedding eligibility criteria into smart contracts, we are going to be able to do this with many more assets than we are currently doing. We are potentially going to open up the world of collateral to assets that were previously not eligible," Akeroyd explains.

Many within the financial industry look positively toward the adoption of digital assets and for this to become a part of an industry standard operating model. However, market participants remain mindful of potential complications and have recommended further education and regulatory frameworks as tools to promote the safe development of a tokenised economy.

Hasumi suggests that a clear regulatory framework is of key importance — ideally, a global alignment of regulatory framework and complimentary standards — to help force all market participants and vendors to think carefully about the best possible outcome and impact on the economy by creating real value.

In terms of regulatory framework, Akeroyd states that the perimeters for digital assets have been drawn "fairly widely" and, therefore, these perimeters need to be narrowed. This comes as no surprise given the broad definition of a digital asset. As stated by the Internal Revenue Service (IRS): "Digital assets are broadly defined as any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary." Akeroyd notes that there are "obvious" differences in the risks presented by different types of digital asset, for example cryptocurrency and a tokenised government bond. Scalability, interoperability, composability are important to consider in this journey.

He adds: "Education will remain a focus. Like all new technologies there will have to be a translation layer between the market participants who will fund initial application and network development and technology providers. Full benefits will be realised once fast followers join the network as cost and operational efficiencies become obvious."

As the industry looks towards the mainstream adoption of digital assets, industry bodies such as the International Securities Lending Association (ISLA) and the Pan Asia Securities Lending Association (PASLA) are working towards specific objectives to facilitate this journey.

"Firstly, standardisation has been mentioned as something which is very important, we are looking to clearly define what a digital asset is and the risk profile of each of them," explains J.P. Morgan's Haswani. She indicates that the Common Domain Model (CDM) will play an important role in delivering this standardisation, essentially representing a dictionary of common terms. She anticipates that this will produce a clearer understanding of what a digital asset is and how to fit digital assets into the lifecycle of the business.

Secondly, ISLA, PASLA and their members continue their efforts to digitalise the Global Master Securities Lending Agreement (GMSLA) onto the CDM, allowing the standard GMSLA to be used for standard product and digital transactions.

Exploring this further, Haswani says: "For example, in the future, we are going to be seeing clients with a hybrid pool of assets — with traditional assets and digital assets. This portion of digital assets is going to grow in the future. How should clients account for a hybrid pool of portfolios going forward?"

Technology is evolving on a day-to-day basis and new ways are emerging to issue and structure digital assets, says Haswani.

Hasumi adds: "We are not quite tokenised. Ultimate nirvana would be interconnectivity of value and data. There are two segments of DLT — one is DLT of data, which is 1Source, and DLT of value, which is tokenisation. I personally feel this is the next quantum leap for the industry."

"One of the really interesting things with this space is that you don't know what is going to happen next week, let alone in three or five years' time," Squire concludes, "the immediate focus is going to be on-ramp and off-ramp." To clarify, an on-ramp is any platform that facilitates users to acquire crypto assets or enter their markets. An off-ramp is a platform that facilitates a user to dispose of crypto assets or exit their markets.

He continues: "At BNY Mellon, we serve an interesting space where we can issue service custody and help finance those assets. As we talked about the fragmentation in this space, we are going to start to see complete solutions and more collaborations. It is going to be really exciting."

ESG considerations and securities lending

By combining global equities lending, ESG and proxy vote data from 2015 to 2021, State Street has evaluated the impact of ESG on loan supply, short-selling demand and institutional investor engagement. Travis Whitmore, senior quantitative researcher at research think tank State Street Associates, explains this research

It is well known that ESG has become an important factor in investment decision-making, having influenced many aspects of the financial market. What is less well known is the impact this will have on securities lending markets. For example, has ESG's influence on the holdings of institutional investors affected securities lending supply? What about their engagement over proxy votes? How have borrowers responded — are there noticeable trends in "green shorting"?

By combining global equities lending, ESG and proxy vote data from 2015 to 2021, we have explored and quantified the impact of ESG on lending supply, short selling demand and institutional investor engagement. Our findings suggest that ESG considerations are deeply embedded in the securities lending market and are growing in importance. This has implications for revenue opportunities, liquidity, and securities lending performance.

ESG and securities lending supply

First, ESG significantly impacts securities lending supply. To start our analysis, we categorise each company into three buckets based on their yearly ESG ranking, the bottom-third being "unsustainable" and the top-third being "sustainable". As Figure 1 shows, companies performing poorly on material ESG attributes have fewer shares available for lending relative to their market cap — close to 1.5 per cent on average. In short, we have identified a significant positive relationship between ESG performance and securities lending supply. This trend has increased significantly, having quadrupled since 2015.

Figure 1: Lending Supply (% of Market Cap) by ESG Ranking

Source: State Street Global Markets, MSCI, IHS Markit, Thomson Reuters. 2015 - 2021

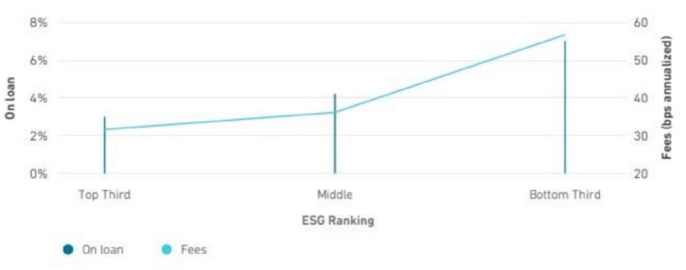
We assess that there are two factors at play here. First, institutions have shifted ownership away from stocks that perform poorly on ESG metrics. Since institutional investors are the largest providers of securities lending supply, the available supply of poorly performing ESG shares has decreased. Second, we find that they are less willing to lend out the shares of poorly performing ESG firms. Institutions own less and lend less of what they own, when it comes to poorly ranked ESG firms.

The positive relationship between ESG rankings and securities lending supply raises interesting observations. Given the lower aggregate supply, we expect borrowing fees to be higher for "unsustainable" firms.

Supply is only half the story. When we examine borrowing demand, we find compelling evidence that ESG is impacting the behaviour of short sellers. For example, in the energy industry, the shares on loan (i.e., actively borrowed) are three times higher for the bottom group of ESG

ranked firms than the top third, as evidenced in Figure 2. This trend has increased through time and is market wide.

Figure 2: Fees and On Loan by ESG Ranking



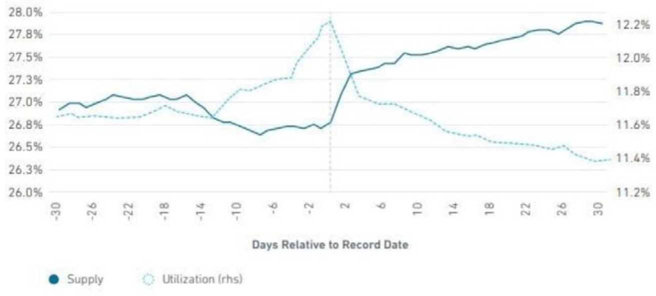
Source: State Street Global Markets, MSCI, IHS Markit, Thomson Reuters. 2015 - 2021

Supply-demand over proxy record dates

A central tenet of responsible asset stewardship is engagement with shareholder investments and here we have also looked at how the supply level of securities available for lending changes around proxy votes.

Proxy events serve as an important channel for institutions to exert their influence and long-term company vision, a process which is often required by law and scrutinised by third parties. Institutional investors wanting to engage in a proxy vote must recall or restrict their supply of shares before the proxy record date. As we expect, there is a significant decrease in the available lending supply within 30 days of the record date — immediately after the date, supply snaps back, accounting for a 1 per cent increase in lending supply relative to the firm's market cap, on average, as Figure 3 shows.

Figure 3: Record Date (T0)



Source: State Street Global Markets, MSCI, IHS Markit, Thomson Reuters. 2015 - 2021

At first glance, our data suggests that institutions may not be considering the ESG performance of a firm when engaging, as we have observed there is only a marginal difference in supply recalls or restrictions for poorly ranked firms. However, that is only part of the story.

When we consider the lending revenue that can be earned over proxy engagement periods, a different story appears. Poorly ranked ESG firms earn twice the level of revenue over proxy revenue dates, suggesting that institutional investors are willing to forgo twice the amount of revenue to engage with those firms, as Figure 4 shows.

Figure 4: Lending Revenue over Proxy Record Dates (annualised)

Source: State Street Global Markets, MSCI, IHS Markit, Thomson Reuters. 2015 - 2021

Overall, we have found evidence that ESG considerations play an important role in institutional investment decisions which, in turn, has significant implications on the securities lending market. There are lower levels of institutional ownership, increased levels of shorting and more engagement for firms that perform poorly on material ESG characteristics. We observe these trends strengthening through time as institutional investors appear to place greater emphasis on ESG characteristics.

Our analysis provides insights into how asset owners and managers are balancing incremental revenue earned through securities lending with their ESG objectives.

Travis Whitmore
Senior quantitative researcher
State Street

Major moves across the industry from Regnology to BNY Mellon, Comyno to Pirum

Jonathan Adams has departed from Delta Capita as head of securities finance and collateral management after seven years at the firm.

He joined Delta Capita from ING Nederland in Amsterdam, where he was a consultant for collateral management between 2013 and 2016.

Adams has more than 25 years of experience within the securities finance sector, working for a number of financial institutions including J.P. Morgan, Euroclear, State Street Bank and BNY Mellon.

Regnology, a provider of regulatory and supervisory technology solutions, has appointed Fabian Klar as vice president of sales.

Based in Luxembourg, Klar will report to Maciej Piechocki, chief revenue officer at Regnology.

He joins the firm from Swiss-based regulatory reporting platform deltaconX AG, where he was director of sales and customer relations between 2019 and 2023.

Klar was previously business development manager at REGIS-TR from 2017 to 2019. Prior to this, he spent a number of years at Clearstream, most recently within the global client relations team.

Commenting on the announcement, Piechocki says: “I am delighted to welcome Fabian into my team. He brings a wealth of sales management experience and valuable knowledge in supporting international regtech companies.”

PASLA appoints Wells committee chair

The Pan Asia Securities Lending Association (PASLA) has appointed Jason Wells as chair of its executive committee with immediate effect.

Wells will replace former chair Ben Burns, who recently resigned from his position following his departure from BlackRock — where he had spent 13 years. Burns had held the post of chair since August 2022.

Wells is the Asia Pacific head of agency trading at State Street Bank and Trust and is based in Hong Kong. He previously served as PASLA treasurer and is an active stakeholder in PASLA working groups.

In his new capacity as chair, Wells will focus on promoting open, transparent and efficient securities lending markets across the region.

Under the leadership of Burns — who spent four years as director of PASLA — the Association launched a regular podcast series, the “Asia Securities Finance Monthly” and resumed its annual conference calendar with record attendance and interest from around the globe, according to PASLA.

During this time, the Association collaborated with the Global Alliance of Securities Lending Associations (GASLA) to update the Global Framework for ESG and Securities Lending (GFESL). The Association thanks Burns for his contributions.

Commenting on the announcement, Wells says: “Securities financing in Asia Pacific still presents a lot of opportunities for development. I look forward to working closely with the PASLA community, our regional regulators and key market stakeholders in my new capacity to build on the solid foundations of the Association supporting and enhancing the development of securities lending in Asia.”

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Comyno, a fintech software and business consultancy firm, has appointed Martin Swiaczny as principal consultant.

Based in Frankfurt, Swiaczny brings more than 15 years of experience in the financial services industry to the role.

He joins the firm from index provider Solactive AG, where he developed programmes to calculate and disseminate multi-asset indices as vice president of complex product development.

Prior to this, Swiaczny was a portfolio manager at First Private Investment Management, where he implemented quantitative investment strategies for the asset management company.

He began his career at Maple Bank as a sales trader for money market products and foreign exchange (FX).

Tony Smith has departed from his senior position at BNY Mellon after more than 15 years with the firm.

In August 2022, Smith was appointed to his most recent role as director of governance and control within BNY Mellon's Clearance and Collateral Management division.

Smith joined the Hong Kong branch of BNY Mellon in 2012, where he was appointed head of collateral management product for Asia Pacific.

He began his tenure at the firm in 2007 within its Global Clearing and Collateral Client Management division.

With almost 35 years of experience within the securities lending industry, Smith has worked at a number of financial institutions including AXA Investment Managers and Skandinaviska Enskilda Banken (SEB).

Making the announcement in an online post, Smith says: "I am eternally grateful to BNY Mellon for allowing me the opportunity to realise my long standing desire to work in Hong Kong. I am now seeking the next exciting chapter for my career dating back to 1989 in the securities finance space."

Pirum has selected Sarah Young as key account director for EMEA.

Young joins Pirum's newly launched global key account management team led by Robert Zekraus, chief operating officer and head of Americas at Pirum.

Based in London, Young will be responsible for a portfolio of clients where she will act as the lead on relationships, drive optimal growth across Pirum's product range and develop strategic plans aligning to client objectives.

Young brings expertise in helping fintech and regtech firms to expand new businesses and grow market share, in addition to her experience in securities financing products, enterprise client management and selling software-as-a-service solutions to the capital markets.

Previously, Young was a sales director at cryptocurrency market data provider Kaiko and, prior to this, she was a senior sales person for the EMEA region at Duco.

In November 2022, Young took on the role of volunteer ambassador for the Women of FinTech — a fintech community supporting gender diversity and inclusion.

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