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CSDR buy-in delay | EBA guidelines on outsourcing go live | Euroclear Collateral Conference report

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EC considering CSDR buy-in provisions delay

The European Securities and Markets Authority (ESMA) has confirmed that it is in talks with the European Commission on the need for a delay to the Central Securities Depositories Regulation (CSDR) settlement discipline rules.

The buy-in provisions of CSDR are expected to be pushed back from September to November 2020, at the earliest, to allow for essential technical updates to be completed on the SWIFT messaging framework.

The provisions create a mandatory obligation for trading parties to execute buy-ins against counterparties who fail to settle their trades within a required period.

The requirements will apply to trades that are intended to settle on EU international central securities depositories (ICSD) and CSDs.

A spokesperson for ESMA said it is aware that CSDR's settlement discipline "requires significant IT developments for market participants, including the adoption of ISO standards the publication of which depends on the SWIFT standard release yearly schedule (November 2020)".

ESMA said it was "working towards a solutions" with the European Commission but indicated no official decision would be offered this year.

Moreover, the International Capital Market Association's (ICMA) senior director in market practice and regulatory policy team, Andrew Hill, said he "anticipated" a delay was forthcoming as the technology framework around the regulation would not be in place by the current deadline.

Hill explained that the need for a delay is related to the cash penalties element of CSDR, which has the knock-on effect of also delaying the buy-in provisions.

According to Hill, the application of cash penalties on the Target2-Securities (T2S) platform requires an update to the SWIFT messaging protocol that is not scheduled to be released until November.

"Because of the way the settlement discipline package is written, the penalties and the buy-ins go together so if one gets delayed then they both get delayed – it's purely technical," he said.

Messages related to CSDR cash penalties will be conducted on the ISO 20022 framework between T2S and CSDs and via ISO 20022 or the older ISO 15022 between CSDs and sub-custodians or participants and clients.

SWIFT did not immediately respond to questions on the matter.

The news of an expected delay comes as ICMA produces plans to update its 'buy-in rules' to support the implementation of the CSDR mandatory buy-in provisions in the international bond markets.

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EC considering CSDR buy-in provisions delay

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The association's buy-in rules are part of its report on 'secondary market rules & recommendations'.

The ICMA rules apply automatically to trades in international securities between ICMA members.

As part of the proposed changes, ICMA intends to consult with members in early 2020 on any proposed revisions.

ICMA says it is also exploring contractual provisions to address the asymmetric treatment to the settlement of the executed buy-in or cash compensation differential and the absence of a pass-on mechanism in the regulation.

On the proposed rule changes, ICMA CEO Martin Scheck said: "Participants in the international bond markets have relied upon the ICMA buy-in rules to manage their settlement risk for decades."

"The introduction of the CSDR mandatory buy-in regime creates some problematic anomalies and another level of complexity, however, we expect the ICMA buy-in rules to continue to provide a contractual framework and best practice for executing buy-ins, while also addressing some of the issues presented by the regulation."

ABN AMRO selects UnaVista for SFTR and MiFID II reporting services

ABN AMRO has selected UnaVista, part of the London Stock Exchange Group, as its regulatory reporting platform for the EU Securities Financing Transactions Regulation (SFTR), which is set to go live in April 2020.

UnaVista will additionally provide the Dutch bank with transaction reporting services related to the second Markets in Financial Instruments Directive (MiFID II).

ABN AMRO will use the UnaVista SFTR Accelerator, a data testing tool that allows firms to import sections of the required data to test against the European Securities and Markets Authority's (ESMA) regulatory technical standards.

According to UnaVista, the Accelerator Tool includes the ability to import data in the ESMA mandated XML ISO20222 format and to reconcile with counterparties for pre-matching.

UnaVista's extensive Partner Programme allows clients to connect directly to the repository via its collaborative reporting solutions.

In a statement on the mandate win, UnaVista said it was selected for MiFID II reporting due to its "suite of additional products offered, which help firms to streamline their regulatory reporting".

ABN AMRO's SFTR implementation lead, Jop Rouw, said: "We like to focus on our core business and fulfil our trade reporting obligations at the same time. With professional partners like UnaVista, we think we can have the best of both worlds."

UK/EU CCP equivalency extension proposed by EU VP

The European Commission's (EC) vice president for financial stability, financial services and capital markets union has confirmed his intention to push for an extension to the equivalency period for UK central counterparties (CCPs) to their European peers.

During a recent speech at the Guildhall in London, Valdis Dombrovskis said that the deadline for the equivalence for UK-EU CCPs will be pushed back from it 30 March 2020 to counter the on-going Brexit uncertainty and "prepare for any eventuality".

It was not made clear in the speech when the new deadline date might be.

Dombrovskis' highlighted that central clearing has been identified as a clear systemic risk in the case of a no-deal Brexit.

The EC initially addressed the issue last year via a temporary equivalence decision which was set to expire on 30 March 2020, however, the third delay UK's withdrawal from the EU means that the risk to financial stability posed by Brexit has not yet been fully removed.

The UK's EU withdrawal period was originally meant to conclude in March 2019 but the deadline was later delayed until 31 October. Following UK Prime Minister Boris Johnson's failure to get his version of the withdrawal bill through the House of Commons, the timetable was delayed again until 31 January 2020.

Dombrovskis' comments came in the same week the International Swaps and Derivatives Association (ISDA) and 13 other trade associations sent a letter to the EC requesting that the EC extend the temporary equivalence determination for UK CCPs.

Other signatories include the Association for Financial Markets in Europe, the Alternative Investment Management Association, and the European Banking Federation. The associations asked the EC to "extend the temporary equivalence until the date 18 months after entry into force of the relevant Commission delegated acts under European Market Infrastructure 2.2".

The letter also requested an additional three-month period to allow UK CCPs to serve termination notices to EU clearing members in the event that their recognition is withdrawn following the European Securities and Markets Authority's review.

In a note to members on the letter, ISDA highlighted that it is important for the purpose of maintaining financial stability in the event of a 'No Deal' Brexit for the EC to provide this certainty in a "timely fashion".

Women in Securities Finance group opens first European chapter

The Women in Securities Finance industry group has opened its first European chapter in London chapter.

The new arm will be headed by J.P. Morgan's Harpreet Bains and BNY Mellon's Ina Budh-Raja.

At J.P. Morgan, Bains serves as the global product head of agency securities lending, while at BNY Mellon, Budh-Raja acts as a director in product and strategy, securities finance.

The group was first formed in early 2018 in the US by Elaina Kim Benfield, senior counsel at Vanguard, Arianna Collette, executive director at Morgan Stanley, and Jill Rathgeber, director at BNY Mellon, who act as joint chairs.

It describes itself as an independent industry women's group that was formed to foster connections in the securities finance industry regardless of roles.

The group's guiding principles are to encourage and empower women in securities finance to connect professionally, collaborate and share insights.

Speaking at the Risk Management Association's conference in October as part of the Women in Securities Finance group's second time opening the event members of the group's original US chapter said they were focused on it being a talent development programme, rather a "coffee group".

The group has already forged links with a variety of industry bodies including the International Securities Lending Association and the Canadian Securities Lending Association.

To find out more about the Women in Securities Finance Group, check out Securities Lending Times' panel discussion.

Financial market jitters caused by Brexit have been on-going even before the October Brexit delay. At the start of the year, Rafael Plata, secretary general at European Association of CCP Clearing Houses (EACH) stressed the fact that the European CCPs post-Brexit plans need to be further developed.

OpenGamma to provide derivatives optimisation in Denmark

Two of Denmark's largest pension and social security providers, ATP and PFA, have appointed the margin software vendor OpenGamma to provide cleared and uncleared derivatives analytics.

OpenGamma said the mandate comes at a pivotal time for the derivatives industry with voluntary over-the-counter (OTC) clearing on the increase in anticipation of the funding challenges non-centrally cleared derivatives margin requirements are set to have over the next 22 months.

The final implementation phases of the bilateral margin rules drafted Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS/IOSCO) will take effect in 2020 and 2021.

For PFA, the contract with OpenGamma is an expansion to its existing partnership on cleared derivatives, which began almost two years ago.

Commenting on the appointment, Lars Dreier, senior portfolio manager at ATP, points to the need for derivatives optimisation and said OpenGamma's solution offers the ability to proactively manage a derivatives book "as efficiently as possible".

Joe Midmore, OpenGamma's chief commercial officer, added: "These are transformational times for buy-side participants trading OTC derivatives and our recent traction in the Nordic market reflects the growing need for innovative margin analytics that meet the needs of large, sophisticated pension schemes and other asset owners."

EquiLend sets sights on automating swaps market

EquiLend will be launching a new technology solution, Swaptimization, in December for the US market, which is set to automate the total return swaps market.

According to EquiLend, Swaptimization will deliver automation and efficiency to equity total return swaps (TRS) trading.

EquiLend explained that the solution utilises a proprietary matching algorithm to pair natural positions across market participants to facilitate bilateral security-based TRS in an efficient, centralised and scalable manner.

The key features of Swaptimization, according to EquilLend are automation of global equity TRS trading workflow, proprietary matching algorithm, and easy onboarding for existing EquiLend clients.

In addition, EquiLend said that further features include the pairing of natural positions across market participants and support by EquiLend's 'seasoned' securities finance trading team.

Following the platform launch in the US, rollouts are expected to follow in Europe, the Middle East and Africa, and the Asia Pacific.

SIX and Euronext to compete for Spain's BME

Swiss financial services provider SIX Group is facing competition from Euronext, the pan-European exchange, in its bid to acquire the Spanish Bolsa de Madrid (BME) stock exchange.

SIX Group has laid down an all-cash tender offer for the Spanish exchange in order to create a "top-three European financial markets infrastructure group" to pursue 'growth opportunities and strategic initiatives.

Meanwhile, Euronext is also considering making an offer for BME and confirmed that it is in talks with its board of directors, "which may or may not lead to an offer being made".

SIX's all-cash voluntary tender offer is for 100 percent of the share capital of BME for €34 per share, implying a total equity value of €2,843 million.

The offer represents a premium of 47.6 percent over BME's six-month volume weighted average share price and 33.9 percent over its closing price of €25.4 on 15 November.

SIX explained that it is comparable with BME as they are vertically-integrated and diversified, profitable, business models, operating along the entire value chain (pre-trade, trade, post-trade).

The proposed transaction, SIX believes, would allow both companies to enhance their home market positions and strengthen Europe's importance in global markets.

According to SIX, it would also create the potential for Swiss asset managers to enhance their presence in the EU as it would leverage BME's capabilities as the preferred platform of the combined business to carry out new potential ventures and business opportunities in this region.

SIX also plans for BME to be the business hub and interconnection with the Latin American markets, and to increase the appeal for BME's Latin American, Middle East and Africa partnerships.

Jos Dijsselhof, CEO of SIX, commented: "It is intended that BME will continue to operate independently with its existing management team, regulated by the CNMV as now."

"With our combined scale efficiencies in technology and securities services, as well as the development of centres of excellence to support best practices and an enhanced product range for both companies, this is a highly compelling combination."

Dijsselhof added: "This proposed transaction will give us the capability to invest in both groups and create a very strong platform to compete and innovate in the global financial market infrastructure sector."

SIX noted that it intends to preserve and strengthen BME's positioning in Spain by keeping, at least for a transitional period of four years, the current brands of BME and BME's current business activities, headquarters, office locations and its strategy in Spain.

It was further added that the offer will be subject to the following conditions and requirements: minimum acceptance level of at least 50 percent plus one share of BME's share capital; authorisation of the transaction or non-opposition by the Spanish National Commission on Markets and Competition and the Spanish Securities Exchange Commission; and approval from the Spanish Government.

ICMA: Don't be fooled by the data, year-end risks lurk ahead

The International Capital Market Association (ICMA) has urged the European Commission and repo market participants not to be lulled into a false sense of security by its seemingly positive market report about the very real liquidity challenges due at year-end.

The chair of ICMA's European Repo & Collateral Council (ERCC), Godfried De Vidts, delivered the stark warning alongside the association's latest report on the European repo market, which showed a 5.6 percent year-on-year market growth from June 2018.

The ERCC data revealed that the EU repo market's size now sits at €7,761 billion, up from €7,351 billion in June last year but down 1.1 percent from December 2018.

The data comes as part of ICMA's 37th semi-annual survey of the European repo market, which asked financial institutions operating in a number of European financial centres for the value of the cash side of repo and reverse repo contracts still outstanding at close-of-business on 5 June 2019.

The report includes survey responses by 55 offices of 51 financial groups, mainly banks.

However, commenting on the results, De Vidts said: "While the headline numbers paint a picture of a robust market, what they do not reveal is the underlying vulnerability that we see around certain events such as year-end."

"This was the message delivered to the recent European Commission expert group on pension scheme arrangements," he added.

In a public briefing published in June, ICMA argued that while the markets have so far proved resilient, they are still some way from reaching a new normality, with regional markets at different stages of that evolution reflecting the divergent implementation of regulatory reforms on different timelines.

The association went on to note that this market environment often requires central banks to step in and provide much-needed capacity, particularly at key reporting dates, such as year-ends when multiple regulatory and other measures such as bank levies encourage banks to reduce balance sheet capacity allocated to low-risk/low return activity.

ICMA concluded that this is of "particular concern given the need for the private sector to absorb the unwind of quantitative easing programmes over the coming years".

The ERCC has been paying particular attention to the EU repo market's year-end liquidity issues since the severe turbulence felt in 2016.

In a report on the 2018 year-end, published in January, ICMA described how 2016 saw “unprecedented market stress and pricing dislocations, particularly in higher grade euro-denominated repo”.

Research by ICMA after the 2016 event has highlighted that a combination of factors, including market positioning, foreign exchange basis, access to central bank lending facilities, as well as regulatory reporting requirements (Basel ratios and national banking levies) all contributed to the “perfect storm” event.

After 2016, questions were raised around the impacts of regulation and monetary policy on market functioning and the degree to which these were possibly exacerbating volatility.

ICMA has noted that market participants have been at pains to learn the lessons of 2016 and are yet to suffer anything as serious in subsequent year-ends.

However, the increasing regulatory-driven pressure on liquidity and an overreliance on central bank intervention during EU reporting dates means that the market is yet to find a long-term solution to future liquidity squeezes.

EU working group proposes €STR fallback arrangements

The European Central Bank’s (ECB) working group on euro risk-free rates has published a report on recommended fallback arrangements for the new euro short-term rate (€STR).

€STR is the euro risk-free rate set to replace the Euro OverNight Index Average (EONIA), which was previously the preferred overnight rate of all overnight unsecured lending transactions.

The rate switch comes as part of the introduction of the EU’s Benchmarks Regulation (BMR), which first came into effect in 2016. As part of BMR’s introduction, EONIA was reviewed and found to suffer from a lack of underlying transactions and a high concentration of volumes on just a few contributors supporting the benchmark.

Following the EONIA review, the ECB’s private sector working group recommended €STR as a replacement in a 2018 report.

In switching to €STR, BMR requires supervised entities to have “robust written plans” setting out the actions they would take in the event that a benchmark materially changes or ceases to be provided.

The plans should include the nomination of one or more alternative benchmarks that could be referenced to substitute the benchmarks no longer provided.

The report by the working group, which is the latest step in its EONIA to €STR legal action plan, now addresses this specific requirement with two suggestions for fallback arrangements.

The first option suggests switching to one of the two other alternative rates that were considered in the consultation before the selection of the euro risk-free rate.

This includes: the GC Pooling Deferred rate, a one-day secured, centrally cleared, general collateral repo rate produced by STOXX.

Or, the RepoFunds Rate, a one-day secured, centrally cleared, combined general and specific collateral repo rate produced by NEX Data Services.

The report noted that the key advantages of these rates are the transactions-only non-panel-based methodologies of both rates, combined with high volumes.

The report goes on to note that both rates reflect the secured market, while the €STR reflects the unsecured market.

"In times of market stress, market participants may change their funding strategy from unsecured to secured funding, which would make secured rates such as GC pooling deferred or RepoFunds rate a natural alternative" to €STR if it were to permanently cease to exist due to a lack of underlying transactions.

Meanwhile, option two is to take into account the regular review of the methodology of the €STR by the ECB to "provide for the possible cessation of the €STR, combined with the use of fallbacks consistent with the relevant parts of the EONIA fallback".

BME adds EU bond clearing

BME Clearing, the central counterparty (CCP) arm of the Spanish stock exchange, now offers repo clearing on sovereign bonds from several European countries including Italy, Germany and France.

The CCP will leverage its network established by Iberclear, the Spanish central securities depository, with its peers across Europe to expand clearing to repo trades executed by its members on sovereign debt.

Other in-scope countries include the Netherlands, Austria and Portugal.

BME clients will clear these trades without having to change their processes and systems.

The bonds service comes in addition to the clearing of Spanish sovereign debt repo trades that BME already offers.

The initiative adds to the launch of the connection with the BrokerTec platform in December 2018.

EBA guidelines on outsourcing come into effect

Institutions are increasingly adopting models that involve outsourcing IT development activities in order to reduce costs and improve flexibility and efficiency.

In its final report, the European Banking Authority (EBA) has taken note and while accepting potential benefits in outsourcing, has identified challenges related to security issues and the governance framework, "in particular to internal controls as well as to data management and data protection".

Outsourcing can deliver cost benefits to financial institutions that are grappling with a low interest rate environment. If a solution has a life value of, say, €10 million, a large institution need not invest time and resources in hiring IT specialists to develop a solution that may or may not ultimately work. A less risky strategy would be to allow a fintech to develop a fully working solution and then buy it off-the-shelf for, say, €4 million, realising a near risk-free profit of €6 million.

The European philosophy to regulations, as born out in regulations including the second Markets in Financial Instruments Directive and the Securities Financing Transactions Regulation, and in the UK the Senior Managers' and Certification Regime, has been to establish direct lines of responsibility and, hence, liability in the event of failure. In keeping with this, the standout statement from the EBA was: "The responsibility of the institutions'... management body for the institution … and all its activities can never be outsourced."

This echoes the UK's Financial Conduct Authority's (FCA) own approach, expressed on the occasion of fining Raphaels Bank for failures in systems and controls during outsourcing: "[t]here is no lower standard for outsourced systems and controls and firms are accountable for failures by outsourcing providers."

The EBA states: "[a]ny outsourcing that would result in the delegation by the management body of its responsibility, altering the relationship and obligations of the institution … towards its clients, undermining the conditions of it s authorisation or removing or modifying any of the conditions subject to which the institution's … authorisation was granted,should not be permitted."

The EBA's guidelines come in the form of four titles:

- Proportionality: group application
- Assessment of outsourcing arrangements
- Governance framework
- Outsourcing process

In line with money laundering legislation, the EBA opts for a risk based approach when implementing the guidelines. The "individual risk profile … the scale and complexity of their activities" should be considered. Consideration should also be given to whether the activity is a one-off or recurrent.

The starting point is for institutions to establish whether an arrangement with a third party falls under the definition of outsourcing and if so, if it is considered a "critical function". A list of activities that do not constitute outsourcing is provided.

Regarding critical functions, institutions should be able to reintegrate or transfer the functions to another provider within "an appropriate time frame".

There should be a defined outsourcing process commencing with a pre-outsourcing assessment, followed by a risk assessment, due diligence and a clear contractual phase.

Firms should "should identify, assess, monitor and manage all risks resulting from arrangements with third parties".

The management body should "clearly assign the responsibilities for the documentation, management and control of outsourcing arrangements". Institutions should retain sufficient staff and expertise at all times and not become "empty shells" or "letter-box entities".

The management body should "approve, regularly review and update a written outsourcing policy and ensure its implementation". This policy should identify the main phases of the life cycle of outsourcing arrangements and define the principles,responsibilities and processes in relation to outsourcing. The EBA provides granular details on the policy's content.

There should be a central outsourcing register containing key outsourcing information, defined by the EBA.

The EBA is concerned with data confidentiality and requires that "appropriate confidentiality arrangements are in place regarding data and other information". The EBA also reiterates the requirement that data is processed in accordance with General Data Protection Regulation when using providers outside of the EU. This becomes especially relevant with global cloud service provides that include data centres outside of the EU's jurisdiction. It is for this reason that my firm, Market FinReg ensures all of our clients' cloud data is stored within EU regions.

These guidelines are a proportional response to a growing trend. Once again the EU has taken the lead in ensuring sound business practice, striking the right balance between encouraging business and ensuring consumer rights.

Written by Seb Malik, head of financial law at Market FinReg.

Left to right: Dietmar Nowatschek, Michael Walliss, Troy Peterson

Game for change

Hudson Fintech co-founder Troy Peterson speaks about revolutionising the "stagnant financial software market" with an advanced system architecture that meets the industry's need for a light-touch technology solution

Tell us about the origins of Hudson Fintech?

The origins of Hudson really started shortly after I began my first development role in banking. Very early on I was tasked with adding support for equities to a legacy repo system and as a junior developer at the time I was astonished by the decisions that were being made about the architecture. The key directive was to make it work while changing as little as possible. This involved re-using existing fields that didn't apply, such as re-using a field called 'coupon' to store a price.

I quickly learned that big production systems are fragile and suffer from a lot of entropy and in with the traditional design of those systems the lowest risk approach is usually the one that involves the fewest changes. This creates the compounding problem of a software design that is completely divergent from reality of its implementation.

The simplest of requests from the business for small changes thus require massive amounts of analysis in order to determine the minimal change that could be made to just get it working and proper engineering practices are utterly impossible in this environment. I faced years of frustration with having to explain to traders why they couldn't price a certain instrument or handle a certain trade with a client because it would take weeks of development for a simple change.

This fundamental design issue is a problem that I always wanted to solve, but I was at a loss how to go about it until I came across the entity-component-system (ECS) architecture a number of years later. Although it's used almost exclusively in video games I immediately saw potential for it to enable the dynamisms that I thought trading systems should have. As I started to play with the idea and create prototypes. I also talked to people in my circle of contacts about the idea.

I had worked with Dietmar Nowatschek (now Hudson Fintech's product owner) in the past, and when I spoke with him about the idea it immediately resonated. He, like many that we've spoken to, had lived with the same pain points for years and could suddenly see a new way of doing things. Dietmar put me in contact with Michael Walliss (now Hudson's CEO) who knows about starting and running successful businesses and after a few roundtable discussions we agreed to form Hudson and make it happen.

Tell us about the Hudson platform and the ECS architecture, what is different about this to other systems?

The ECS architecture is a design philosophy that is widely adopted in video games. In the world of games ECS is not the only approach, but it is by far the most common because it presents a set of guidelines that allow for very quick, iterative development and separation of concerns. What this means is that the graphics experts can work on the graphics subsystem and the AI experts can work on the AI subsystem and game designers who don't necessarily know anything about the actual code can bring the pieces together into a complete product. It allows for extensive re-use of assets, so once you've written (for example) a bit of code to calculate compound interest, you can use that same logical module anywhere that you need to calculate compound interest.

The core concept is to eliminate the complex hierarchies of objects relationships that are present in traditional systems and instead view everything as just an abstract 'entity' with arbitrary data on it. Previously you had to think out the data model ahead of time and then stick with it. even if something has changed, such as a new requirement or a new regulation (the Securities Financing Transactions Regulation, for example) then you would need to change that data model.

In the ECS world, new data can be added or removed from entities at any time and data is always fee to move between entities. We do not designate an entity as being a 'trade' or a 'book' or a 'price'. To us it's just a container of data. We then use pattern matching to classify entities based on their properties and put them into what we call 'families' of related entities based on their properties. Thus, an entity can be considered to be many things at once and can evolve at run-time.

In ECS, the 'system' is what we call processors that work on handing the data. This is where the business logic is performed. Because the business logic is separate from the data, and because each system is small and independent of other systems, you can test the systems in isolation and have domain experts develop them independently without having to know or understand the data model. This means that the data model is free to change over time and the business logic can evolve independently as new systems (or data) added won't adversely affect any existing rules in place.

Hudson's company mission statement says its aim is to revolutionise processes and tackle the "stagnant financial software market". How?

Software in this industry hasn't changed much since the 80s. We are constantly seeing new coverings put over aging technology. New releases from the large vendors are supplying user interfaces using Windows Presentation Foundation and other technologies, but the interfaces are identical with no innovation. And on the back-end server side, the code often has not evolved at all since its inception.

Typically, it's layers and layers of accumulated bolt-on pieces assembled in a behemoth infrastructure. Even brand-new software, written with the best of intentions to do things 'the right way' is usually encumbered with the old object-oriented style of design and data modelling that quickly falls apart as soon as someone identifies a new requirement late into development.

Our approach to an agile software 'engine' changes this. We can extend, adapt, and evolve the platform seamlessly without risk to existing functionality. The Hudson platform offers high availability and reliability, along with superb performance and fast turnaround time for changes that existing software just isn't capable of supporting.

Do you see Hudson as being competitive or complementary to the existing industry ecosystem?

As a small upstart vendor we hold no illusions of displacing the whole industry ecosystem overnight. It's a massive undertaking to support all aspects of just one business line at a large firm. Although we envision Hudson expanding into a single go-to solution across many asset classes and business lines, our hope is to start by integrating with the current ecosystems and add value in those edge cases that others can't. Hudson excels at trade capture, position management and lifecycle management of lending trades.

The architecture that it's built on presents immense opportunities to build new standard or bespoke functionality quickly. We're happy to integrate with any existing solutions for market execution, settlement, static data masters, etc.

There are so many problems out there that we can solve creatively with our solutions that can sit in between and compliment the various other technologies out there. We strongly feel that our ability to fit into these niche areas has the potential to disrupt the whole way of thinking in finance IT.

Why would your system be cheaper or better than many alternatives that might currently exist?

Our platform is an 'engine' that drives a trading system. In the same way that a video game engine can be used to build a space simulator, a racing simulator, a puzzle game, or an adventure game on a single engine, we are able to build any sort of trading application on Hudson.

The key is our tools for building screens and workflows without code that allows the business analysts who understand the business to create the workflows themselves by linking together discreet blocks of functionality, called systems.

This means project implementation teams can be smaller and more focused. Overall, the approach is much quicker than traditional development, while providing better testing capabilities to prove the functionality as we progress. The big picture is that as a firm you can put more resources into the business experts that can develop the workflows themselves with much less development effort, resulting in quicker turn-around. Because automated testing is front-and-centre in the process you can have assurance that changes are going to work immediately, and that evolution of the system doesn't adversely impact existing functionality and flows.

How many clients does Hudson have currently on-boarded? What sort of volumes is the platform managing?

The platform has been in development for a couple of years now. A lot of effort has gone into making sure it's reliable and resilient and performant to high standards. Thanks to its data-grid distributed cluster infrastructure, Hudson can be scaled almost infinitely. With powerful enough servers we can easily handle millions of historic trades and daily volumes in the hundreds of thousands, not that anyone ever sees those sorts of volumes in securities lending. Now that we have a stable product base that we are confident in and have proven the concept for ourselves we are just in the early stages of presenting it commercially. At this stage we've had a number of discussions with potential clients and are in early onboarding talks but we do not have any clients using the system yet. We expect this will change in the very near future.

Does your platform have room to grow into new areas? Can we expect any new features in the near future?

Hudson is a designed to constantly grow and move into new areas. Although designed for trading applications we have received interest from other industries are in talks with a solution provider in a completely different industry to leverage the Hudson platform and engine technology in order to power their own service offerings. Within finance we have the ability to manage massive amounts of data and perform complex analysis and deductive decision making functions. The Hudson platform is the perfect place to build advanced artificial intelligence solutions and our open and flexible data model enables us to handle virtually any type of asset class and trade structure. Outright bond and swaps trading are likely in the future with structures like butterflies and curve trades.

> **“The core concept is to eliminate the complex hierarchies of objects relationships that are present in traditional systems and instead view everything as just an abstract 'entity' with arbitrary data on it”**

Troy Peterson
Product technical lead
Hudson Fintech


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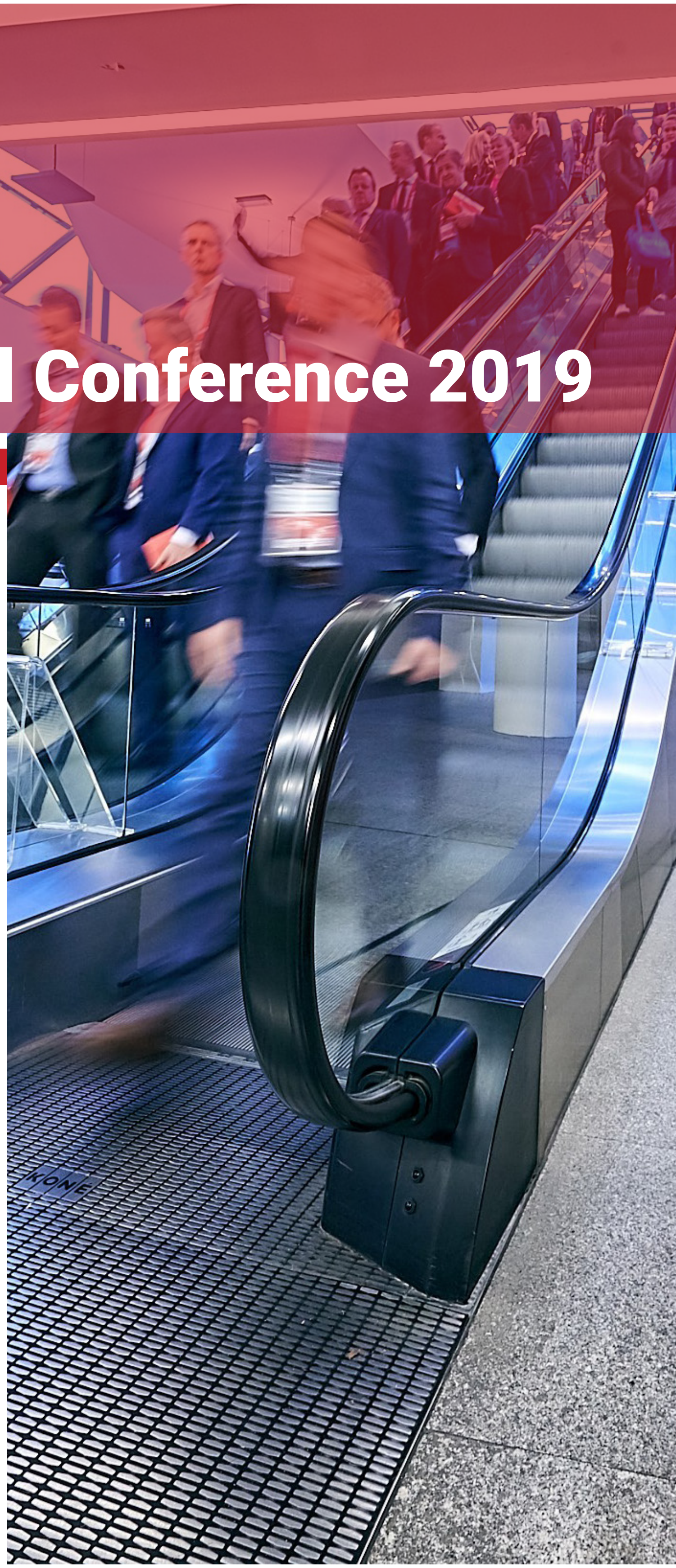

Drew Nicol and Maddie Saghir report

A wide variety of securities finance market participants gathered in Brussels for the 18th Euroclear Collateral Conference to discuss the resilience and expansion of the global collateral management industry, which is facing a plethora of regulatory, economic and even political challenges.

The need for optimisation of the processes around collateral management was a key theme of the day as low-yields, negatives rates and new factors such as environmental, social and corporate governance (ESG) take hold in the market.

Multiple speakers made clear that issues around collateral had only become more acute for both borrowers and lenders in recent years and all aspects of the market must adapt to remain competitive.

Panel one: Recent evolutions in collateral trading and optimisation

In the first panel of the day, the potential problems posed by the fast-approaching year-end liquidity crunch in the EU and US repo markets were put under the microscope.

Panellists noted that in September the US overnight repo rate was the victim of what one speaker described as a “butterfly event” that saw the unintended consequences of post-crisis regulatory requirements become compounded by a series of market events around the Q3 quarter-end, which created a notable liquidity shortage.

The result was that over one week in mid-September the overnight repo rate soared from its usual 2 percent to peak just shy of 10 percent as liquidity dried up and the New York Fed was forced to step in and inject liquidity into the market.

Looking ahead to year-end, the speaker explained that the US would see “a lot more volatility” around year-end because banks have to manage their balance sheets and the issues from September have not gone away.

The speaker went on to explain that in Europe the market is notably different in that it is less concentrated and has smaller banks than the US and, as such, although there will also be volatility here, it will be much less pronounced.

Optimisation

The conversation turned to the need for optimisation of balance sheets in order to adapt to leverage ratios and not contribute to market-wide liquidity concerns.

A second speaker said that a key feature driving optimisation in the European market was the introduction of negative hair cut rates and the need for solutions that can offer a zero-rate returns.

Partial and unsecured financing has also developed as a new feature of the European market in reaction to today's market environment.

"From the perspective of liquidity, it actually brings a lower margin capital requirement and therefore brings balance sheet savings as well," a speaker explained.

Borrowing versus unsecured was estimated to be between $80 million to $100 million and speakers said they expect this market sector to grow in the future.

Calculating ratios

Turning to the various ratios that market participants must now consider, panellists agreed that the liquidity coverage ratio was a simple enough calculation to manage, but the net stable funding ratio (NSFR) was another matter entirely.

It was noted that the final rules of NSFR are yet to be released, despite a prolonged period of market consultation that began in 2016.

"We are starting to form an idea of the complexities [around NSFR] and, in fact, it is quite a game-changer when you consider the one-year stress horizons," a panellist said.

"We are going to have to change the way we fund our balance sheets and probably go back to transactions versus cash," they concluded.

Panel two: Securities lending - Why still do it?

Some of the main themes discussed during the panel included data, technology, collateral optimisation and ESG.

Panellists agreed that collective data is key to improving the market, however, this aim is not without its challenges.

One speaker said: "The difficulty is getting the data. The problem is that we operate in an over-the-counter-based market, which makes it very difficult to get standardised data."

As well as this, panellists noted that it can be very difficult to compare data so there is a need for greater transparency.

"The collection of data is important but the next challenge is how are we going to use it," one panellist added.

One buy-side speaker explained: "Data is very important, and we have a lot of data sources at our disposal and we have spent a lot of time in resources and working on new tools when monitoring our agent lender so that we have a good overview of rates and volumes."

"In the past, we relied on spreadsheets and so it was difficult to identify any trends," the speaker continued. "One important consequence is that we can now have much better targeted discussions with our agent lenders and counterparties."

Later in the panel, panellists looked to how technology can improve the securities finance industry. Highlighting its importance, one speaker said: "Technology is at the focus of every strategy. Our strategies rely heavily on high volumes and a lot of manual tasks are required. We want to reduce the workload and human error that can occur."

They added: "We are using a lot of electronic trading platforms but I have noticed that, in terms of electronic trading, the securities lending industry is lagging a bit behind."

"However, regulations such as the Securities Financing Transactions Regulation should push securities lending market towards a technological route."

Speakers went on to discuss collateral optimisation and noted that while "efficiency is the name of the game" and collateral optimisation is trending on the sell side, it is now also a central focus for the buy side.

"The buy-side side of the coin is becoming increasingly complex," the agent lender speaker continued. "If you are a traditional asset manager you might not be expecting it [collateral optimisation] to interfere with your lending process, but you are now going to have to start thinking about the dynamic shift. If you have different actors in the chain, then that can be a bit of a conundrum."

Ending on the topic of ESG, one panellist noted that there are different approaches to implementation. They cited: "As an agent lender we can support recalls in voting but it comes as a cost as it can make the overall attractiveness of your portfolio less attractive."

According to the panellist, there is an increased focus on what is deemed to be acceptable collateral.

"While the same principles are being applied it can be challenging because that approach can be varied and ultimately it is the investor who makes that decision on what matters to them (such as low-carbon-footprint, weapons or tobacco)," the speaker concluded.

Panel three: Improving liquidity in emerging markets

The existence of robust domestic money markets and bond markets within emerging economies is an essential ingredient in ensuring developing countries progress and grow, explained a speaker.

A second panellist countered that effective monetary policy of an emerging market's central bank was the "bedrock" of any good economy and must be the first thing to be in place before any financial market can flourish.

The development of a liquid repo market was described as a "classic chicken and egg" scenario when it comes to introducing major international players to a new market by a panellist.

The speaker went on to note that although the existence of major players was always welcome, it was essential that domestic markets were not over-reliant on foreign entities to function as it left emerging markets at the mercy of sudden changes to global risk appetite.

A speaker representing a global bank that is active in several emerging markets outlined that the key challenges were understanding often opaque insolvency laws regarding counterparties and other local features that might be unique to that market.

When speakers were asked what they would like audience members to understand about engaging with an emerging market, the responses included the need for a scalable triparty solution, a requirement to be flexible in your collateral requirements and a willingness to engage with local customs and truly understand market rules.

Panel four: Global regulatory reforms - A cross-border collateral perspective

It was noted at the opening of the panel that market participants often complain about the divergence of regulatory frameworks across national borders. However, a speaker explained that a global regulator could never exist as national priorities are "radically different".

Another speaker explained that regulators were cognisant of the industry's desire for parity and efforts had been made to align standards where possible.

Speakers also countered a common idea that the US regulator "leads the dance" in the global regulatory block's efforts to de-risk. It was noted that sometimes the EU leads and sometimes it's the US, but it is true that where one regulator goes, the other often follows shortly after.

European regulators were praised for their efforts to deliver in the past 10 years on its five key areas: reporting, clearing, capital, trading and margining. "Now it is a process of fine-tuning," a speaker explained.

The CCP conundrum

The conversation shifted to the development of central counterparties (CCPs) as a growing feature in the market.

Concerns were raised that although they all boasted robust risk management processes, no amount of protection was impregnable.

A speaker with an understanding of the regulatory process told conference delegates that CCPs would soon be asked to double down on their "skin in the game" in order to further protect against a major failure, which could be "catastrophic" to effected parties.

It was noted that more safety nets were needed as national regulators had categorically said that taxpayers would not bail out a CCP in the event of a wide-spread market collapse.

Day two

Panel one: Uncleared Margin Rules - Getting ready for phases 5 and 6...now!

On the first panel of day two of the conference, panellists turned their attention to the Uncleared Margin Rules (UMR).

Asset managers, pension funds and insurance companies are scheduled to come in-scope of UMR based on their volume thresholds either with phase five on 1 September 2020 or with phase six on 1 September 2021.

Primarily, UMR initial margin (IM) requirements for non-centrally cleared derivatives seek to establish international standards for non-centrally cleared derivatives.

Panellists reviewed the challenges associated with UMR, and one speaker observed that although there were complications for the first four phases, there was funding from the banks and the process was not particularly painful.
However, it was noted that the next two phases are likely to be "a huge challenge" as there will be less funding available for margin requirements next time around.

The differences between the earlier phases, the panellists identified, is that banks and broker-dealers were quite used to triparty securities lending and triparty repo.

It was highlighted that those coming into scope for phase five and six, they are not used to this kind of environment. Panellists stressed the need to conduct an analysis on which model of calculating and delivering margin is best suited for their needs.

"This is a complex new infrastructure with lots of new counterparties," explained a panellist. "Looking at collateral eligibility schedules as decisions will have to be made as to whether they want to go for a so-called "third party model" or go in-house or chose a triparty provider."

Another speaker added a word of warning that the third-party model can become "very complex and historically custodians have taken care of that for everybody".

Continuing on this point they said: "There are some very significant differences and one of the myths is that everyone's using triparty, but a that is not for everyone."

"There is a great deal of new developments out there but also you should go for something simple; you will have to live with this for a long time and no one will have the appetite to unpick it so give really careful thought to the model and what is going to be most efficient to you," the speaker continued.

UMR's ripple effect

Looking at UMR on a global scale, a panellist observed that there is a knock-on effect occurring in Asia. "If you look at the Asia environment, they generally don't deal in securities and even if they do it's not the right type of security, they also mainly deal in cash," explained a speaker.

"So it starts to crawl into how can they get the triparty infrastructure to accept that Asian world into the European environment and more importantly how do you start to facilitate it in the portfolio of clients, which I think is going to be another interesting challenge. It will add an additional layer to the decision process over which structure to use."

Panel two: How can the industry take tokenisation forward?

At the panel's opening, it was stated that many conversations around distributed ledger technology (DLT) and tokenisation suffered from a lack of mutual understanding of what basic terms in the crypto world actually mean.

The panel set itself up to bring a realistic perspective of the value and applicability of tokenisation, highlight challenges to adoption and set expectations for the industry over the next few years.

A panellist opened the discussion by stating that the legal infrastructure that underpins any tokenised security must be almost identical (in terms of the rights it conveys) to the legal constructs used today, in order avoid introducing new risks.

On the subject of risks, the controversial topic of cryptocurrencies was put to panellists. One speaker involved in a DLT project noted that a decision was made early on in development not to include any digital cash assets on the platform as they were too volatile and had liquidity issues.

Elsewhere, the question was put to panellists whether the introduction of DLT platforms would create new silos in the market.

The speakers were unanimous that their DLT solutions would in fact do the opposite as they would allow for the free-flow of data between counterparties and would even create links between firms that currently struggle to interact.

"I'm optimistic that the direction of travel is away from silos," a panellist stated.

Challenges to adoption

Turning to the limitations of DLT and tokenisation, it was noted that fintech firms alone cannot drive the introduction of crypto to the capital markets and the inclusion of central banks and central securities depositories was essential to ensure mainstream adoption.

Panellists also called on developers of DLT solutions to spend the time educating traditional market participants in the realities of the pros and cons of their products as they related to real-world problems in the market.

In closing a speaker called for a change to the tone of the market's conversations around tokenisation. "We talk too much about how the technology will disrupt and take people out the market," the speaker said. "We should be talking about how it will help people collaborate."

Sustainable finance: From small-stream to mainstream

The final panel of the conference looked at the myriad challenges that stand in the way of incorporating environmental, social and governance (ESG) policies into into the mainstream processes of the financial world.

A panellist observed that in term of regulatory drivers for ESG-friendly financing, the situation posed a unique twist, compared to usual matters dealt with by market rule-makers. Namely, the fact that new regulatory frameworks usually came in response to a negative market event, but in this case, the situation required regulators to be pro-active in encouraging entities under their remit to contribute to ESG initiatives. This, it was noted, was an on-going challenge for national and global regulators that would not be resolved in the short term.

Shortly after, delegates were offered a bullish report on asset managers' and banks' efforts to incorporate ESG into their investment decisions. "It's not just marketing," a panellist explained. "Managers are convinced that ESG strategies have a sound business case and will bring returns."

Another panellist representing a fund manager said that for their firm, ESG was a mainstream topic. This point was reinforced by a second speaker who referenced market research that surveyed 300 asset managers and found that ESG policies and exclusion lists of undesirable assets, including for securities lending collateral, were commonplace throughout the industry; and were more established today compared to previous years.

However, it was also noted that although socially-conscious policies had permeated some investment strategies, it was often not consistent throughout large financial institutions and further work was needed to ensure ESG was a factor at all levels of decision making.

ESG on collateral

The primarily impact of the emergence of ESG on the world of collateral and securities finance transactions was the added layer of complexity it put on collateral selection. Many beneficial owners now maintain exclusion lists of market sectors (such as tobacco, weapons manufacturing and fossil fuels) that they are unwilling to engage with. As such, borrowers must now comply with these lists when posting collateral as part of a securities lending or repo trade.

A speaker noted that although this was undoubtedly a new complexity for asset managers and brokers to manage, it was not insurmountable and wasn't largely different from well-established collateral requirements held by beneficial owners. "ESG and securities lending are not incompatible," stated a speaker.

Data deficit

Research of ESG, it was noted, was hampered by a dearth of legitimate data on the scale and prevalence of these types of investments. There is a lot of data on the 'environmental' piece, explained a speaker, but its often provided on a voluntary basis and therefore often inconsistent.

However, the 'social' and 'governance' sections had very little data publicly available to offer any satisfactory insight into market strategies in these areas.

A speaker added that internal measurements for ESG strategies within financial institutions to rate their portfolios and track their actual positive impact on communities was often lacking as well.

To conclude the event, a speaker highlighted that although ESG as a market trend had begun in developed markets in recent years it was actually businesses in developing economies that should be most invested in making an impact in this arena.

The panellist said that 100 million people are expected to be put into poverty as a result of climate change, with the vast majority of the hardest hit communities located in developing countries.

The speaker added that despite this, until recently, ESG-related activities were not a priority for institutions based in the parts of the world most vulnerable to the extreme weather scenarios caused by climate change. Thankfully, perceptions around the need for immediate action on climate change, as well as social issues, appear to have shifted for the better and today financial market participants appear to be united in pushing for a better tomorrow.

Comings and goings at J.P. Morgan, Stonewain and more

J.P. Morgan has hired former BNY Mellon executive Will Jeffries to boost its Asian triparty collateral management platform sales team.

Jeffries, based in Hong Kong, left BNY Mellon in July after more than seven years with the bank, where he most recently served as a director in sales and relationship management for the Asia Pacific region, excluding Japan.

He first joined in 2013 as a senior associate for global client management in BNY Mellon's Sydney office, before moving to Hong Kong to become vice president, relationship manager for the bank's collateral management business in 2015.

Jeffries assumed his final role with BNY Mellon in December 2018.

Previously, Jeffries worked at Westpac Institutional Bank, based in Sydney, as an associate from 2008 to 2012.

Aviva Investors has appointed Ben Meaden as head of trading, securities finance, based in London.

Meaden has worked at Aviva Investors for 16 years and worked as a securities finance trader since 2003 up until his recent promotion.

In his new role, Meaden reports into Mick Chadwick, director, global head of securities finance, at Aviva.

Prior to Aviva Investors, Meaden worked in collateral management at Maple Securities.

forward in the world of inter-bank trading.Its proprietary architecture enables enhanced efficiencies, providing enormous cost benefits as well as improving regulatory compliance."

He continued: "As a neutral platform that is constantly developing to the markets' needs, Wematch is reshaping the trading market. It is the right product at the right time."

Stonewain Systems has brought on Chris Valentino from Trading Apps to work as a specialist across all its products and services.

Valentino continues to be based in New York and reports to Stonewain's CEO Armeet Sandhu.

A spokesperson for Stonewain said that the hire was part of the firm's response to "tremendous demand" for its global securities lending solutions.

At Trading Apps, Valentino served as head of sales and client management since 2016.

Before that, he was head of sales at EquiLend from 2012 to 2016.

AxiomSL, a provider of regulatory reporting and risk management solutions, has appointed Claudia Thurner from SmartStream as its new Europe, Middle East and Africa (EMEA) general manager.

At SmartStream, Thurner most recently led the European and Latin American sales and global strategic accounts, from November 2018 up until she moved to AxiomSL in October.

Thurner joined SmartStream in 2012 and started out as a senior sales and major account manager, based in London.

Before that, Thurner specialised in risk management business and product development at Thomas Reuters, based in Europe, Asia and the US.

Commenting on the hire, Alex Tsigutkin, founder and CEO of AxiomSL, said: "We are thrilled to welcome Claudia Thurner to AxiomSL during this important expansion period. Her proven ability to drive results and her passion for excellence and client success will enable Thurner to lead AxiomSL EMEA into the future."

Thurner said: "It is exciting to have the opportunity to take our EMEA presence to the next level and I am looking forward to working with the team to deepen and broaden relationships with leading organisations across the region."

Elsewhere at AxiomSL, Edward Royan, who served as CEO for its EMEA business, has been promoted to a global position as head of global products.

According to Tsigutkin, this promotion comes as the firm's clients "take on a global journey to address their regulatory and risk management needs across multiple jurisdictions and regulators".

"These key changes to our executive team will accelerate AxiomSL's growth in EMEA and globally," he said.