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Securities Finance Technology Symposium

2020 review

Securities Finance Technology Symposium goes digital

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report

Securities Finance Times' Technology Symposium, the market's first full-day digital event, saw industry leaders assemble (virtually) to discuss the latest innovations in liquidity management, blockchain, collateral and regulatory compliance

SFTR: building bridges or walls?

The story of the Securities Financing Transactions Regulation (SFTR) is one of technological innovation coming to the fore like never before. SFTR was a hot topic throughout the day and was zeroed in on by the morning's panellists who revisited the long journey leading the creation of the various technology solutions we have today, as well as looking at reporting challenges from a trade repository's (TRs) perspective.

The first of two SFTR-focused panels — the TR review — was hosted by representatives from international TRs who explained how they cleared the hurdles presented by the first three phases of SFTR and what the future may hold. A new market feature expected to emerge next year was the likelihood of regulatory divergence between the UK and the EU after Brexit, which was highlighted by Nick Larrieu, DTCC's head of sales for Europe, the Middle East and Africa.

The final and fourth phase of SFTR, which is set for 11 January, will see non-financial counterparties (NFCs) begin reporting SFTs in the EU, while the UK national regulator has scrapped the equivalent requirement as it falls outside the Brexit transition period that ends on 31 December. This, panellists noted, marks the first of several predicted areas of divergence.

Fellow speaker Catherine Talks, product manager at UnaVista, the TR owned by the London Stock Exchange, agreed with Larrieu that TR reconciliation won't occur between UK reported trades in the EU27 as they will come from separate regulations. However, Larrieu explained that "there will be similarities when it comes to updates for SFTR next year where both regulators will take a practical alignment in terms of rules in XML schema changes".

The second SFTR panel — the tech success story — focused on the question of whether the securities finance industry should have collaborated on a standardised solution to SFTR. Sarah Nicholson, partner at securities finance consultancy Consolo and panel moderator, queried if, in hindsight, market participants would have been better served by a single reporting solution, as opposed to the patchwork quilt of service provider platforms that now exist.

Panellist David Lewis, senior director, securities finance, at FIS Astec Analytics, suggested that in a perfect world, a standardised solution would be "ideal" but that in reality it "wasn't practical". The prospect of an industry reorganising its entire process was simply too many hurdles for firms to cross in order to come to a single way of doing things, Lewis concluded.

The panellists noted SFTR had stimulated a greater level of collaboration in the market but concluded that a single solution would have eliminated the "healthy competition" that often drives innovation. Joanne Salkeld, SFTR product manager at MarketAxess, suggested that multiple solution providers are necessary to protect end users against the scenario of the sole provider leaving the market for any of a number of reasons, including default. The example of CME's recent departure from the reporting space was offered to reinforce the point.

Elsewhere, Cappitech's recent regulatory reporting market survey was also raised to highlight that to the fact that although SFTR was close to being fully implemented, it will remain a live issue for some time to come.

Lewis noted that although collaboration had achieved great outcomes in the industry, it wasn't all "plain sailing" and the survey's results revealed that a significant portion of respondents believe SFTR will remain a major challenge in 2021. This was due to a combination of factors including a lack of funding to invest in compliance-related technology beyond the bare minimum and also a lack of internal expertise that bridged the gap between both technology and regulation.

As a result, service providers may need to extend a hand to one another to reinforce each others' strengths and weaknesses and create a complete offering, such as in the case of EquiLend-MarketAxess.

CSDR: Witchcraft, disorientating, too much rum?

The 'CSDR: the zombie regulation' panel began with panellists gamely trying to settle on the appropriate metaphor to describe the Central Securities Depositories Regulation (CSDR), which is arguably going to leave a bigger impression on financial market processes than SFTR

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> *David Lewis*
> *Senior director, FIS Astec Analytics*

— if it's settlement discipline regime ever comes into effect, that is. Whether it's best characterised as a cocktail with too much rum, a reincarnated, aimless corpse seeking your brain or, alternatively, a lost driver who refuses to ask for directions, we may never know. What the range of colourful metaphors did clearly represent was the diversity of opinions that CSDR has brought out from different corners of the market.

Before the nightmarish vision of hordes of the undead brandishing poorly-constructed alcoholic beverages at waylaid travellers could be dwelt upon too much, the panellists turned their attention away from questions of whether CSDR was fit-for-purpose and focused on what technology could do to help.

Pirum Systems' Robert Frost, global head of product development, offered a positive take, stating he was pleased to see firms use the regulatory-mandated nudge to examine where their transaction fails were coming from and ask why, and then seek solutions.

Karan Kapoor, Delta Capita's head of regulations and technology, concurred and noted that firms appear to be using the newly-confirmed implementation delay to 2022 to review their operational efficiencies and assess where technologies can improve their systems.

Frost added to this by recommending that audience members engage with industry working groups in order to stay abreast of any changes to the regulation that may appear in the next year and also advised against complacency as "a year may seem like a lot of time but there will potentially be a lot to do".

Moderator Matthew Johnson, ITP product management and industry relations at DTCC, asked panellists how much they thought firms were turning to new technology as the path to avoiding CSDR's mandatory buy-ins and cash penalties.

Kapoor stated that from his vantage point at a major consultancyand service provider, clients were currently focused on meeting the minimum requirements of the regulation, meaning a technology solution for tracking penalty accumulations and buy-ins. But, when it came to more sophisticated solutions,clients were often excited by the prospect of what some of the solutions can do to boost settlement efficiency, but, those conversations were "on-going", he added.

Adrian Dale, head of regulation and market practice at the International Securities Lending Association (ISLA) and amateur mixologist, explained that the discussions from the trade body's working groups had highlighted that a focus on increasing pre-matching rates (currently below 50 percent) was a key part of how to raise overall settlement rates, which are currently around 90 percent for the market as a whole.

Dale added that, similar to SFTR, manual processes and a lack of standardisation were the main barriers standing in the way of higher pre-matching rates.

The need to embrace technology to solve these issues was a central theme and panellists noted that, unlike other regulations of the moment, the innovations needed for CSDR have already existed for a while.

"It's not so much about whether technology is the answer," stated Dale, "it's about adoption".

Kapoor proposed that 2021 might be a good year to go window shopping and see what vendor solutions are out there to improve settlement efficiency.

You can't escape being impacted by CSDR, he argued, but you can control how negatively affected you are by getting your house in order ahead of go-live.

To conclude, an audience member questioned panellists on how high they felt settlement rates would have to go above the current 90 percent to make them view CSDR as a success.

ISLA's Dale suggested that moving up to 95 percent or, as high as 98 percent, was "within our grasp" using the technology we avaliable today but that 100 percent would be near impossible due to the complexity of the average transaction lifecycle.

The recipe for success in settlement rate perfection, it seems, is still up for debate.

Collateral optimisation: a ways to go

It will come as a surprise to few to hear that proficiency in collateral management is considered an increasingly important feature of a securities finance transaction's lifecycle.

To this point, it was highlighted by panellists that the rise of automation and overall sophistication of the process for over-the-counter (OTC) and exchange-traded derivatives (ETD) trades means service providers have their work cut out for them if they want to remain competitive in this fast-evolving arena.

Moreover, the combination of tightening margins, which played a significant role in the less-than-stellar revenue results seen this year, and the regulatory pressures from the Uncleared Margin Rules, and CSDR, are conspiring to apply acute pressure on all market participants to review their collateral processes.

Optimisation was another watchword of the day, and moderator Bill Foley, managing director of SecFin Hub, highlighting that collateral is becoming more complex to manage effectively. Foley described how collateral optimisation as an "ongoing process", and asked the panel for their views on where that process begins and ends.

Ted Allen, director of business development, securities finance and collateral management for FIS, noted that one interesting trend is how participants are not just looking at the assets they've already got but also the ones they could potentially gain access to.

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> *Securities lending, product management, Calypso*

internalise it is an interesting trend I've not seen before," he said.

The conversation shifted from a focus on what is required of participants to how to get there. This inevitably turned to a debate on budgets and costs, and whether the sophistication of the market and increasing regulatory demands were putting off potential new market participants.

Grant Davies, EquiLend's head of sales for Europe, the Middle East and Africa, suggested there are "a lot of barriers to enter the market" from a cost efficiency point of view.

"We talk about efficiently optimising assets but optimisation, whether it be pre-trade and knowing what aset you've got and how you are going to employ it, and then post trade for the lifecycle of the transaction, is a complex market and we have to break it down," Davies told audience members.

Davies continued: "Rather than layer it we need to figure out how we can connect technology solutions. This is certainly a focus at EquiLend."

Neil Fowler, securities lending, product management at Calypso, stated: "We [as an industry] have to admit the total cost of ownership of platforms is not cheap. If you are looking at hosting a number of platforms due to historic purchasing then your total cost of ownership needs to come down.

"We need to look at the total cost of ownership. With SFTR there are lots of other things to take into consideration. As regulation increases we can only expect it to become more difficult for us to own platforms going forward. You need to take these factors into serious consideration before moving forward. It needs to come at a cost that is worth paying for."

But, Jerome Cardon, securities finance and collateral management, at Broadridge Financial Solutions, contradicted this. While he agreed the total cost of ownership is high, Cardon suggested the emphasis is more directed around having legal ownership and being regulatory compliant.

"There are lots of business solutions and software vendors dropping solutions exactly for the purpose of making it cheaper for people who want to have a smaller set of abilities that are cheaper to execute," he argued.

"For me, I think we are coming out of a long period where we were just keeping up with regulation. We are now into an innovation period. I am seeing a lot of innovation allowing much smaller participants to access that market," Cardon added.

Liquidity: quality and quantity

Market liquidity was another hot topic at the event with panellists stressing its essential part in a functioning securities finance market. All speakers agreed that liquidity is a question of efficient use of assets as much as the raw total of inventory available to lend.

Panel moderator Gabriele Frediani, independent advisor at ZBO International, explained there are many drivers pushing overall liquidity and the movement and use of collateral upwards.

Kicking off this conversation, CEO of HQLA^X Guido Stroemer said that his firm's tagline is 'to accelerate collateral capability', but added that what the blockchain-powered platform actually does is "improve the utility of assets without actually moving them" as a way of sidestepping some of the barriers to accessing liquidity in the traditional market.

"We are also working with our clients to expand the type of assets that can be used, we are looking to expand asset classes into money fund units," Stroemer explained. "We are also providing our clients with the capability to transact at very specific lengths of time. Lastly, we are also expanding the time horizon for which ownership can take place. Liquidity is important but it is also important to judge the type of liquidity, and judge volume and provide the market with different ways to raise liquidity."

The moderator then queried the panel on whether it is fair to compare how you manage equities and fixed income.

Mike Norwood, global product owner, trading, at EquiLend, suggested that comparisons can be drawn in terms of loan balances and inventory in the fixed income space and can be seen on par.

"Trades being made off platform, things being approved over email or a phone call can cause inefficiencies," he added. "When you look at the regulatory impact, all of the manual entry processing those traders create can cause an opportunity for a break. If it is executed via an electronic trading platform then for everything else it is additional cost and noise that reduces efficiency of trade."

David Raccat, CEO and founder of Wematch.Securities Financing, added that from the point of view of a trading platform provider today, "the really interesting part is the journey from onboarding to adoption and then the ultimate goal is to go into addiction".

"Addressing risks one by one and going into a digital solution is important and then you get the onboarding done. This has been done now with most of the players in the industry," he continued.

"Adoption is the second pillar; trying to sit down with the users and understand their workflow and trying to identify where the trader is losing a lot of time is a step that must be taken."

"Once you have completed adoption then the fun part begins. Get a trader who can turn the heat up into addiction to make sure it is completely embedded in their day-to-day workflow and activity. The whole liquidity issue is obviously inherent in everything we do."

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Jerome Cardon

Securities finance and collateral management, Broadridge Financial Solutions

Blockchain: a team sport

The day's compere was former ISLA CEO Kevin McNulty who mused that when he left the industry some four years ago blockchain technology was merely a twinkle in the eye of those market participants that could claim to understand it at all.

Fast forward to 2020 and conversations have evolved from hazy, sci-fi-esque perceptions of assets beaming instantaneously between counterparts, paired with the 'blockchain 101' format presentations, to a panel boasting multiple digital solutions that are either live or soon will be.

Matthew Phillips, COO and head of delivery at Trading Apps, crystalised this notion by stating that it is now clear there are two main use cases for blockchain in securities finance: title transfer, and providing a shared database that can serve as a golden source.

Referencing the example of HQLA^X given earlier in the day, Phillips noted that the concept of a physical security being tokenised in order to allow title transfer to occur on a blockchain platform can bring major benefits to liquidity, avoids physical settlement and reduces intra-day exposures.

To the latter point, Phillips stated that one of most important utilities of distributed ledger technology (DLT) is what it says on the tin, i.e. offering an immutable database that can only be as accessible or private as needed and can only be updated by consensus.

Phillips went on to wryly describe how at its simplest, the market today represents two counterparties agreeing a loan, creating individual representations of the terms "and then spending their lives trying to keep those to records in sync across the two silos".

"It's not like a stock loan contract sits in a draw and is renewed once a year. It can literally be changed every single day," he stated, also referencing the need for back-dated changes and other administrative burdens.

Earlier, moderator Darren Crowther, general manager of securities finance and collateral management at Broadridge, began the session by noting that blockchain is best described as a team sport. "When there are two people involved that's great, when there are many people involved that's when it gets its real network value," he stated.

This, he added, is why market institutions such as Options Clearing Corporation (OCC), the Tel Aviv Stock Exchange, and other exchanges, are leading the charge in this arena as they can bring that "network effect". The second foundational point was that despite the hype of revolutionising the market as we know it, blockchain does not require a "big bang moment" and can instead be adopted in a piecemeal fashion, as needed.

All speakers reinforced the notion that DLT can be adopted "in slices" and also over a staggered timeline. All four offered examples of why it's important not to let perfection stand in the way of progress, meaning you don't need to wait for a major technology overhaul opportunity to propose pivoting to it. Instead, you can simply see a specific problem and apply DLT to it, and then build out from there.

Representing OCC, Matt Wolfe, vice president, securities finance, reinforced this point by noting that a hurdle he observed in gaining buy-in for the clearing house's securities lending blockchain platform was dispelling the myth that everyone must engage in the network natively. "You can choose to take a node or you can continue to receive the same messaging that you do today," he said.

"We did a proof of concept (PoC) and then shopped it around and got positive feedback," Wolfe explained.

Just over half of clients shown the PoC said they were "extremely likely" to interact with the solution natively, with another 35 percent saying "very likely".

Crucially, he said, it was able to meet all of the "non-functional criteria" the OCC needed as a systemically important financial institution. Axoni, who is spearheading the project, is about halfway through development and it is expected to be ready by July 2021. It will go live along with OCC's entire technology refresh in 2022.

Duncan Johnston-Watt, co-founder and CEO of Blockchain Technology Partners, which is assisting the Israeli exchange with its recently-launched securities lending blockchain platform, described the similar journey that took place in Tel Aviv.

There are alternate paths onto the system, he explained, including a conventional method. But, there are "incentives in place to encourage you to host one or more nodes". One of these sweeteners is that those hosting a node means that access is integrated into your back office, rather than through a conventional application programming interface.

The project is aimed at invigorating securities lending in Israel and Johnston-Watt hinted, this means it could ultimately be opened up beyond the country's ecosystem so that foreign market participants can join.

When questioned if the completed Tel Aviv platform could be "cookie cutter" copied elsewhere, Johnston-Watt noted that the bulk of the solution is middleware and therefore entirely transposable. Moreover, others, such as Nasdaq have created a digital asset suite that allows businesses to experiment with digital contract tools and create use cases much quicker and easier than was previously possible.

Panellists did acknowledge that DLT was not a panacea to all the market's ills and widespread adoption will come up against challenges around books and records integration and standardisation of data, not to mention costs of investment, stakeholder education and market buy-in.

Here, however, the International Swaps and Derivatives Association's common domain model (CDM), which is currently being adapted by ISLA for securities finance transactions, was held up as an escape from some of these pitfalls. Simply, the CDM offers a template for market participants to standardise contracts and data fields in order to enhance trade matching and reconciliation. "It's a match made in heaven," exclaimed Phillips.

Building on this idea, Johnston-Watt noted that Digital Asset has already created a set of digital contract templates that can be used by the market and that the CDM would eliminate the need for each participant to interpret those rules. Users can combine the two and ensure continuity across the market.

Before adjourning, an audience member cut to the heart of the matter by posing the question: will DLT save me money or make me money?

Wolfe took up the challenge and stated that in the near term it will save you money. But, "as we shift away from just standardising data and eliminating cost then we can begin to incorporate better processes, transparency, data availability and access to clients and vendors, and then go deeper into tokenisation of assets where you will be able to further optimise your rates and returns and, ultimately, make money".

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>
> *Matt Wolfe*
> vice president, securities finance, *OCC*