A Securities Finance Times publication

RMA Securities Finance & Collateral Management Conference Daily

DAY 3

Thursday, October 12

Ken DeGiglio on tackling reconciliation issues through a digital-first approach

Day three agenda inside

Interoperability requires consensus as fears of fragmentation continue

Market participants fear that the move to increase interoperability could cause further fragmentation for the industry, according to the Risk Management Association's (RMA's) Cutting-Edge Technologies Part 1 panel.

As part of a double-session on technology at the 38th Securities Finance and Collateral Management Conference, Pirum Systems' CEO Phil Morgan, EquiLend's chief information officer Ken DeGiglio and Goldman Sachs' head of EMEA digital assets Amar Amlani, provided a basic understanding of certain new technologies and their practical use cases.

Part 1 of the series also heard from BNY Mellon's Victor O'Laughlen, head of digital for Clearance and Collateral Management (CCM), and J.P. Morgan's Keerthi Moudgal, head of product for Onyx Digital Assets, who helped to explain key innovations such as tokenisation, digital assets, distributed ledger technology (DLT), smart contracts, artificial intelligence (AI), machine learning (ML) and robotic process automation (RPA).

Interoperability has become a buzzword in the industry, and the aim to become even more interoperable has presented a challenge, the panel heard.

Interoperability is defined by the Bank of International Settlements (BIS) as something that "refers to the ability to make something happen in one payment system based on something happening in another payment system".

Panellists were questioned on whether the case for further interoperability was setting the industry up for another future issue.

Every country has its own payment rail — the infrastructure that moves money from one party to another — a panellist said. If firms create digital currencies, all on fragmented rails, firms will 'end up with the same scenario', in terms of further fragmentation, unless the industry 'solves' interoperability.

Panellists expect to see further use of interoperability in the future, with firms increasing their activity with regards to blockchain technology.

Interoperability is solvable, commented one panellist. However, interoperability requires consensus.

US Treasury Clearing proposal to increase costs

The anticipated US Treasury Clearing proposal has caused concern for some firms, which indicate that the costs of its implementation will outweigh the benefits, according to a panel at the Risk Management Association (RMA) Securities Finance and Collateral Management Conference.

The Challenges and Economic Considerations in Cash Collateral, Fixed Income and Repo panel engaged in a comprehensive analysis of the challenges faced by market participants, including the outlook for interest rates, credit risk, regulatory constraints and market volatility.

Panellists explored how these economic factors shape decision-making, investment strategies and risk management practices in securities finance.

The discussion continued previous conversations relating to the U.S. Securities and Exchange Commission's (SEC's) US Treasury clearing proposal.

The proposal, released last year, requires mandatory clearing for cash Treasury transactions, as well as Treasury repo transactions.

Securities lending activity is not explicitly included within this proposal. However, one panellist indicated that it could be scoped in at some point.

The Commission is forcing all transactions to go through a central counterparty (CCP). The repo market, a panellist commented, would face the largest impact of this.

Although the SEC proposal does provide both benefits and costs, said one panellist, the 'costs outweigh the benefits'.

The panellist relayed that the benefits of the proposal included further resiliency to the overall Treasury market structure, a reduction in the impact of any single counterparty default, as well as 'some' netting benefits across dealers.

However, the costs of the proposal included higher haircuts, which are mandatory and are required for any repo transaction. This will therefore increase the cost of doing business, a cost that can be significant, the panellist argued. Hedge fund clients worry that, if the proposal is brought into the market, they could be doing 'less of a trade for more of a spread'.

This means, a panellist explained, that the hedge fund client would not be able to 'get as much leverage' due to the higher haircut requirements, but they would still be demanding 'the same amount of compensation' that they are earning today. The panellist argued that spreads will need to widen.

This means dislocations — circumstances in which financial markets, operating under stressful conditions, cease to price assets correctly on an absolute and relative basis — are likely to increase in the Treasury and repo market, the panel heard.

Firms are facing questions from their clients regarding when the clearing proposal will go into effect. A panellist confirmed that the answer to this question is currently unknown.

Some market participants speculate that the SEC proposal will 'be out soon' with rumours indicating an October release and a short implementation timeline, though this has not been confirmed.

The panel heard from State Street Global Advisors' Karyn Corridan, head of US securities lending cash collateral strategies within the fixed income, cash and currency (FICC) team.

Other panellists included BlackRock's Eric Hiatt, US head of cash portfolio management; Invesco's Ripal Tilara, senior portfolio manager for Invesco Fixed Income; Bank of America Securities' Mark Cabana, head of US rates strategy; and BNY Mellon's Michael Evan, senior portfolio manager.

US banking regulators 'failing' to deliver on Basel III Endgame goals

US banking regulators are not delivering Basel III Endgame goals of improving risk sensitivity and comparability, panellists heard at the Risk Management Association's (RMA's) Securities Finance and Collateral Management Conference.

The panel provided the foundation for a two-part discussion on Basel III Endgame, a regulation that is being closely watched by market participants.

Part 1 of this discussion relates to the 'significant implications' for the securities finance industry and saw panellists raise concerns for beneficial owners, banks and broker dealers.

The Basel Committee on Banking Supervision (BCBS) introduced a dual-stack requirement into capital rules for Basel III Endgame. This development means that firms have to compute capital requirements under two different methodologies; the standardised approach and the expanded approach.

The dual-stack risk-weighted asset (RWA) requirement is currently applicable to Category I and II banks, and will now extend to Category III and IV banks.

It requires these banks to calculate two RWAs. Banks will calculate their risk-based capital ratios under the two approaches, with the higher of the two being used to set the firm's minimum capital ratios.

The aim is to create a more risk-sensitive framework and improve comparability in terms of the capital framework, panel attendees heard.

The revision to the Basel III framework under the expanded approach is intended to 'make things more risk sensitive', a panellist commented. However, the panellist believed that the rules did not go far enough to achieve this.

Market risk capital requirements will 'go up significantly', a panellist indicated. Consequently, it will be more expensive for dealers to carry inventory.

The Basel III Endgame Part 1 panel revealed that the US banks today are subject to 'the most onerous' and 'the highest minimum capital standards' globally.

A key purpose of Basel III Endgame was to reduce the gap between the US banks and the European banks, in this respect.

However, a panellist indicated that due to the way the US is implementing and proposing these rules and requirements, this gap is widening.

The panel heard from Chen Xu, corporate counsel at Debevoise & Plimpton, Glenn Horner, chief regulatory officer at State Street Global Markets, Joseph Hwang, head of US regulatory policy at Goldman Sachs, and Michael McAuley, head of product development and strategy at BNY Mellon.

Ken DeGiglio
CIO
EquiLend

1Source: reconciliations and transaction breaks a thing of the past?

EquiLend CIO Ken DeGiglio explores how the firm's upcoming 1Source system will support market participants in tackling reconciliation issues through a digital-first approach

Price breaks, orphan breaks and rate breaks are among the most common securities lending reconciliation issues which occur several times, on a daily basis, across any number of trades. With EquiLend 1Source, we aim to eliminate them all.

In 2021, we assembled a Digital Transformation Working Group, consisting of several agent lenders and broker-dealers. These group members identified the elimination of the antiquated reconciliation process as the top priority to be solved by a new, digital-first approach to transaction and lifecycle management. A third-party consultancy — commissioned by the working group to assess the cost of these top-three breaks and other reconciliation problems — determined that the cost to the industry totalled approximately US$100 million per year. From this, EquiLend 1Source was born.

EquiLend 1Source is a distributed ledger-based system that ensures all transaction information and subsequent lifecycle event information remains in sync for both counterparties in a contract at all times. With a single source of truth for all contract data across the trade lifecycle, the need for reconciliations simply goes away. Lifecycle events produce a multitude of breaks that demand reconciliation — this includes price differences, rate adjustments, orphan breaks, in addition to mid-processed dividends, overfunded collateral, and settlement errors.

In addition, the effort to reconcile breaks is managed by operations and traders with considerable labour required to resolve complex breaks. Fines and fees incurred due to contract breaks, which may remain unreconciled for days and even weeks, contribute further time and monetary costs. Now, the underlying technology is available to eradicate these issues completely.

This is not another distributed-ledger technology (DLT) solution for name's sake alone. Our Working Group was tasked not with finding a use for DLT, but with identifying the largest pain points that could be solved through digital transformation. It is not the first wave of digital transformation in our industry, nor the first time EquiLend has worked together with the wider market to develop an improved model for securities lending.

An example is the industry-wide adoption of EquiLend NGT, a trading platform in our market through which more than US$2.4 trillion in notional is transacted monthly. NGT revolutionised the securities finance sector with pre-matching, unique trade identifiers, post-trade connectivity and SSI pairing, with more recent developments including real-time data integration and hard-to-borrow functionality with the Competitive Bid screen.

EquiLend 1Source is a complete reimagination of the transaction flow which will be equally as transformative — it will do for the trade lifecycle what NGT has done for execution.

Rendering moot, the current inefficient, expensive reconciliation process, using EquiLend 1Source will ensure both sides of a transaction match at every point of the contract lifecycle. All contract records will be held on the ledger as a unique record and all transaction events will update immediately for both parties, eliminating those problematic price, orphan, rate and other breaks. Our use of smart contracts — rules on which conditions for actions can be defined — on DLT additionally smooths the pathway to an efficient, mutualised workflow. Trades will flow through the EquiLend 1Source system and smart contracts will serve to automate further lifecycle actions.

EquiLend 1Source is a complete reimagination of the transaction flow which will be equally as transformative — it will do for the trade lifecycle what NGT has done for execution.

Ken DeGiglio
CIO
EquiLend

EquiLend 1Source is built on Digital Asset's Canton Network, a DLT "network of networks" upon which dozens of the largest corporations on the planet have connected their systems. This will result in unparalleled interoperability — a favourite feature across the EquiLend tech stack — and synergistic opportunities across the finance sector and beyond.

Participants have engaged in a pilot and are actively integrating to EquiLend 1Source prior to the full system roll out next year.

T+1 and 1Source

The benefits of monetary and time cost savings are obvious. However, EquiLend 1Source also supports even larger-scale industry changes such as the move to shorter settlement cycles. Scheduled for late May 2024 in the US and Canada, Mexico is also looking to move to the same reduced settlement schedule. The efficiency gained in maintaining perfect contract records throughout the lifecycle with EquiLend 1Source means that T+1, and even T+0, become significantly less burdensome. With no breaks to threaten settlement, trades can be agreed and executed, and pricing, terms and other events will be updated immediately, on any timeline, no matter how short.

Risk management and sector-wide efficiencies

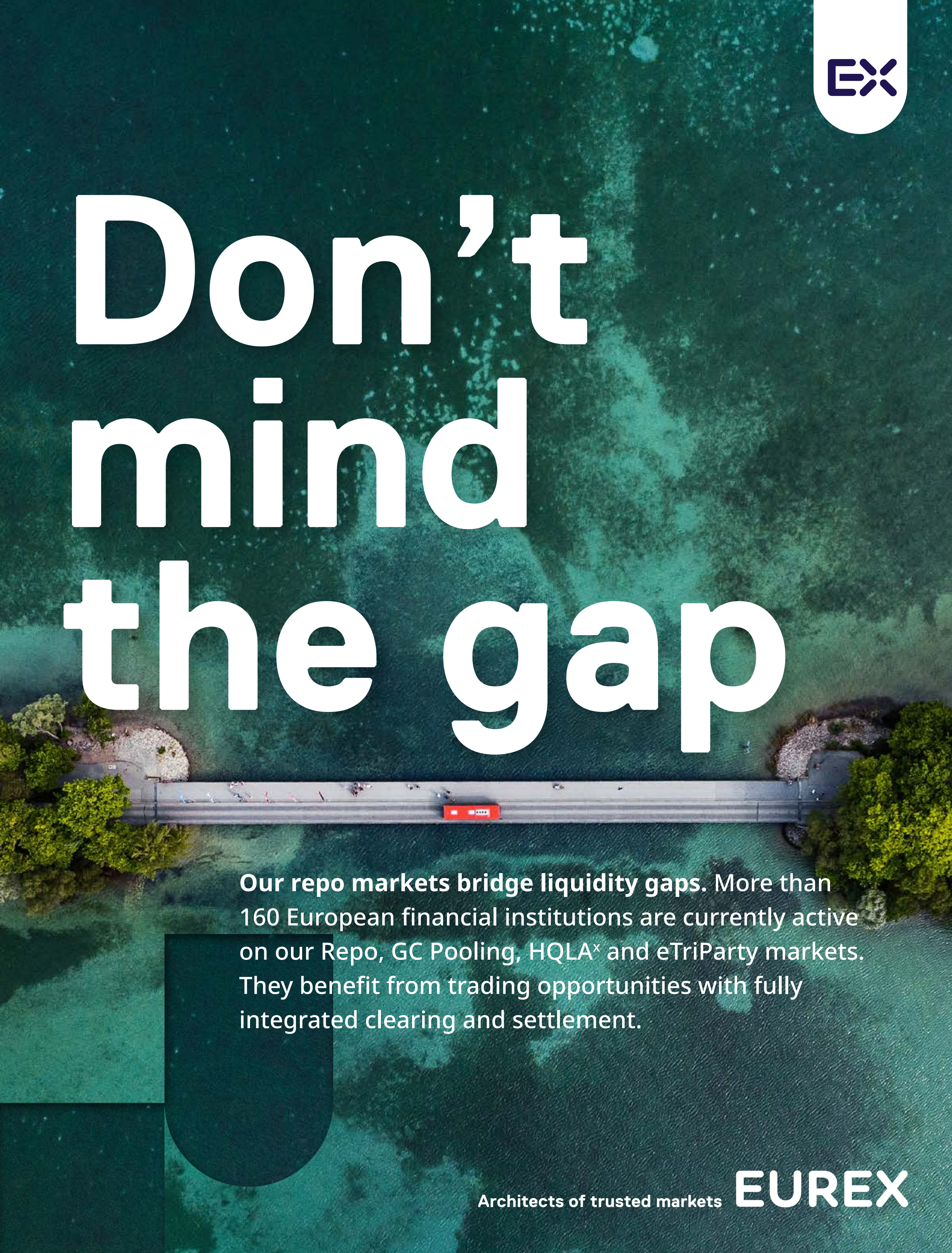
Removing reconciliation as a breakpoint is a primary benefit of EquiLend 1Source, but there are ancillary benefits too. Firstly, firms benefit from an assurance that contracts are always correct, allowing for accurate daily accruals and accurate accounting. Billing becomes a non-contentious issue because accruals are always right on this centralised ledger.

In ensuring the accuracy of contracts across the lifecycle, this DLT technology also enables efficient regulatory reporting as contract details are accurate, on one single ledger, supporting reporting under existing and future regulation such as SEC 10c-1.

Furthermore, through EquiLend's connectivity to the Canton Network, 1Source is positioned for the future, with the ability to connect to DLTs in other market segments. Interoperability, global connectivity and accuracy are guaranteed at every stage. The simplicity is revolutionary and the applications are long ranging from day one.

The working group members who concepted 1Source in their identification of reconciliation as their biggest challenge have also been the biggest advocates of the project, dedicating time and effort to develop a proof of concept, execute a successful pilot programme and embark on the final phase of development prior to the 2024 go-live. Test trades have already moved through EquiLend 1Source and flowed through the trade lifecycle without issue.

The benefits of EquiLend 1Source extend to all of those covered here. However, in practice, it delivers not only time efficiency, cost reduction and simplicity to the securities finance market, but also carries positive applications for the wider financial ecosystem. With this technology, we are not simply solving problems, we are reimagining the securities lending workflow to remove reconciliation issues at source. We look forward to continuing our mission of working with all securities finance market participants to bring about positive change and efficiency to our industry.


Don't mind the gap
Our repo markets bridge liquidity gaps. More than 160 European financial institutions are currently active on our Repo, GC Pooling, HQLA^x and eTriParty markets. They benefit from trading opportunities with fully integrated clearing and settlement.
Architects of trusted markets
EUREX

Securities finance: an industry in motion

Upgrading technology systems is crucial for success, says Clear Street's Robert Sackett, head of prime financing, who discusses the significance of investing in modern and cloud-native technology to tackle industry changes

The adage goes, "If it's not broken, don't fix it". This is the attitude that a number of firms have maintained towards their clearing, custody and finance systems, neglecting legacy technology and implementing years of band-aid solutions.

The securities lending market is critical to the health of the overall global ecosystem. But similar to clearing and custody on the post-trade side, essential components of the securities finance industry run on decades-old technology. Several firms still use a patchwork of tools built at least two decades ago. These tools are outdated, require manual processing and create a cognitive overload for traders. Simple tasks require navigating multiple pages of information, negatively impacting efficiency.

A mix of regulatory concerns and the intertwined, manual nature of these back-office systems have deterred many firms from replacing or managing their tech stack. The culmination is an increasingly severe problem impacting all business areas, from client service to compliance. The collapse of Credit Suisse and the US regional banking crisis have shown how quickly events can unravel and the importance of transparency and agility in ensuring market stability.

The securities lending market generated US$7.02 billion in revenues during the first half of 2023, nearing heights not seen since 2008 when reported revenues for the half-year reached US$8.4 billion. Amid this period of growth, firms are adjusting to increased reporting requirements, settlement changes and the latest implementation of the Basel regime.

At a minimum, legacy platforms are a deterrent, slowing innovation and demanding manual reconciliation. In acute cases, they can be a roadblock to future innovation, market expansion and regulatory compliance.

Looking for locates

By mandating more transparent and efficient reporting, regulators hope to be better prepared to make decisions for the markets during future events. Around the world, they are tightening their rules and guidelines to keep a closer oversight on the market, particularly in traditional opaque businesses such as securities lending.

The Securities and Exchange Commission (SEC) says that the proposed Rule 10c-1 is "a revolution in the stock loan world and would heavily shift the balance of power back towards a centre; currently, the power is in the hands of the banks, by a very long margin against the public". The quest for transparency in the securities market is nothing new — tracing back to the implementation of the Dodd-Frank Act in 2011 — it has taken the SEC more than a decade to define the mandates in the 10c-1 legislation.

Global securities lending businesses are no strangers to reporting mandates and several are still recovering from the introduction of the EU's Securities Financing Transactions Regulation (SFTR). A big piece of the difficulty in meeting SFTR requirements came from reporting complexities. There is much that US firms can learn from their overseas counterparts about the importance of data harmonisation and quality.

A significant difference between short selling in the US and Europe is US regulators' focus on the availability of stock for borrowing before a short sale and documentation of that "locate". Under 10c-1, firms will need to report stocks available for loan and stocks on loan at the end of each day, allowing the SEC to verify whether locate requests are being checked against accurate data and target broker-dealers more efficiently.

This data is often siloed and sometimes compiled manually at firms with out-of-date technology. Firms with more modern technology are better equipped to offer access to accurate, real-time information and the rich portfolio analytics that investors and regulators need.

Time to settle

Much has been written about the upcoming transition to T+1, but there remains more to discuss as the implementation date inches closer. Securities lending transactions currently settle on a T+1 basis, while the SEC's proposal requires reporting within 15 minutes of a securities lending transaction being executed or modified. Even if firms can handle the 15-minute reporting timeframe, questions remain regarding the value that regulators and the market at large will gain from these modifications.

While the move to T+1 initially seemed to follow the shortening process from T+3 to T+2, the technical and operational issues for the buy- and sell-side are shaping to be more challenging than anticipated. Faster settlements will improve liquidity, reduce risk, and create a ripple effect for innovation and operational efficiency at every step of the trade lifecycle. The speed of internal processing and external recall will be crucial, and a recent Citigroup whitepaper estimates that the transition to T+1 will impact up to eight different departments within an organisation.

Under a shorter settlement cycle, investors can access their funds quicker and utilise that capital earlier, increasing market liquidity. The window for counterparty default also contracts, reducing the likelihood of settlement failures and mitigating counterparty, market and liquidity risks. Additionally, the Depository Trust and Clearing Corporation (DTCC) predict that a move to T+1 settlements on its National Securities Clearing Corporation (NSCC) could potentially reduce the volatility component of its margin by 41 percent, helping strike a balance between risk-based margining and reducing procyclical impacts.

Recall, buy-in, Regulation SHO and fail liabilities are top issues that are making the market feel uneasy. Settlement fails, in particular, can lead to a buildup of counterparty credit risk and negatively impact market liquidity. The risk is further amplified when replacing legacy solutions while continuing to operate normally or making changes 'in-flight'.

Overall, preparedness for T+1 remains a top priority for the securities finance industry, and collaboration in upgrading technological systems will be crucial to success.

Culmination of new Basel rules

After years of anticipation, the final elements of the Basel regime are working their way through the regulatory pipelines. At the end of July, the three federal banking agencies proposed joint changes to the regulatory capital framework applicable to large banks and bank holding companies.

This Basel III Endgame proposal suggests that the largest banks will need significantly more capital to support the higher levels of risk-weighted assets (RWA), noting that "following the banking turmoil in March 2023, the proposal seeks to further strengthen the banking system by applying a broader set of capital requirements to more large banks".

The possibility that banks will need to hold substantially more capital in relation to securities borrowing activities presents a challenge to the securities lending industry. Under the new rules, counterparties without external credit ratings — such as pension and mutual funds — will default to a 100 per cent risk weight. These low-risk, financially sound but unrated funds make up the majority of supply for securities finance transactions, according to data from the International Securities Lending Association (ISLA). As such, some firms are exploring total return swaps (TRS) to manage exposure to credit risk.

The Basel III comment period is open until 30 November. In that time, we can expect industry participants to raise concerns about capital availability. Firms that have not made the necessary investments to update their technology and are dependent on highly manual processes cannot operate profitably with smaller clients or clients with more sophisticated risk profiles or demanding trading strategies. Tightening regulatory standards will likely result in a greater emphasis on lending and borrowing trade structures, and these banks may look to reduce businesses that are high consumers of RWAs.

Regardless of any changes implemented following the comment period, there is no question that the revised Basel rules will drive the approach in the second half of 2023 and beyond.

Adaptability for the future of securities finance

Firms that invest in modern and cloud-native technology will be better positioned to quickly deliver new products and services and will be prepared for industry-wide changes like T+1. Tech-forward firms can offer clients game-changing services, more reliable, real-time access to locates and often have more flexibility to take on clients left behind by legacy banks burdened by capital constraints.

Technologically, there has been an expectation shift. Providers increasingly carry the burden of legacy platform connectivity and updates.

Providers are feeling the pressure — Citi's report found that 64 per cent of firms expect to upgrade or replace their technology platforms. Firms are challenged to manage this large-scale, market-wide technology shift away from legacy systems, all the while balancing innovation in settlement cycles and changing regulatory demands.

Adaptability is crucial for the future of securities finance. Banks and brokers must reduce the manual processes that increase risk of error in favour of technology that provides fast, timely access to the data regulators and clients need. The value of data continues to rise, and those who invest in the technology and capabilities to keep up with fast-paced, intraday market changes will come out on top.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Day three

Basel III Endgame Part 2: Real Impact on Activity

Thursday, October 12, 2023 8:30 AM to 9:15 AM

The economics of a securities lending trade continues to evolve, resulting in the consideration of numerous factors prior to execution. A rising interest rate environment, unprecedented market volatility, pending regulatory changes, and resource optimization are all issues that require continuous contemplation by both borrowers and lenders. Central counterparty (CCP) clearing, peer to peer, synthetics and alternative forms of collateral are some of the levers that can help the industry adapt to the ever-changing environment. Join us as we explore both the challenges and opportunities the industry collectively faces in the current landscape.

Moderator

Bogdan Fleschiu
J.P. Morgan

Speakers

Alex Steinmetz
Goldman Sachs

Joseph Gillingwater
The Northern Trust Company

Patrick Morrissey
Vanguard

Jason Strofs
BlackRock

Supply-Side Perspectives on Securities Lending: Market and Regulatory Challenges for Beneficial Owners

Thursday, October 12, 2023 9:15 AM to 10:00 AM

Our panel will explore the market and regulatory challenges that beneficial owners face in participating effectively in the securities lending market. Delve into supply-side perspectives, including limited availability of lendable securities, counterparty risk management, operational complexities, and regulatory constraints. Gain insights into factors that limit availability, such as concentration risk, restricted securities, and the impact of short selling. Discover strategies to optimize collateral management and navigate the evolving regulatory environment.

Moderator

Brooke Gillman
eSecLending

Speakers

Mark Whipple
Invesco

Lori Paris
The Northern Trust Company

Michael Newallo
BMO

Dr. Jerry May
OPERS

Clearing the Path for Centrally Cleared Trades

Thursday, October 12, 2023 10:00 AM to 10:45 AM

Gain insights into the challenges and regulatory considerations surrounding centrally cleared securities lending and repo transactions including the proposal for central clearing of certain US Treasury repo transactions. Explore the obstacles preventing some agent banks, broker-dealers and beneficial owners from rapidly embracing clearing mechanisms, including collateral eligibility, default funds, operational complexities, costs, and risk management requirements. Understand the complex regulatory landscape governing central counterparty clearing (CCP), including oversight, capital requirements, resolution frameworks, and global/regional regulatory interplay. Discover the advantages and considerations of central clearing for securities lending and repo transactions, including the proposal for central clearing of US Treasury repo, exploring collateral optimization, liquidity management, pricing implications, market liquidity, and systemic risk. Address the question: Can we, as an industry, resolve these issues and create a path towards enhanced market infrastructure, stability, and improved risk management using centrally cleared trades as part of the solution?

Moderator

Mark Faulkner
Credit Benchmark

Speakers

Jill Rathgeber
BNY Mellon

Paul Tagliareni
Morgan Stanley

Michael Slomienski
Goldman Sachs

Chen Xu
Debevoise & Plimpton LLP

Cutting-Edge Technologies, Part 2: How can we, as an industry, leverage the latest tech?

Thursday, October 12, 2023 11:30 AM to 12:15 AM

The Securities Finance Industry is undergoing a rapid transformation, driven by advancements in fintech. Starting from the foundation developed in Part 1 on Tuesday, our panelists will delve deeper into the evolving fintech ecosystem and shed light on how technologies such as tokenization, digital assets, distributed ledger technology (DLT), smart contracts, artificial intelligence (AI), machine learning (ML), robotic process automation (RPA) , and even quantum computing are changing traditional financial practices. Additionally, we'll cover the integration of fintech with regulatory frameworks, and the potential impact of these trends on market infrastructure, business models, and regulatory compliance. This discussion serves as a continuation of Tuesday's panel: "Cutting-Edge Technologies, Part 1: What does it all mean?"

Moderator

Jennifer Whitcomb
Fidelity Agency Lending

Speakers

Nick Delikaris
State Street

Simon Squire
BNY Mellon

Ben Challice
J.P. Morgan

Industry Leaders Panel

Thursday, October 12, 2023 12:15 PM to 1:15 PM

To close out the conference this year, senior leaders will explore how they integrate the themes covered in this conference, their own experiences in 2023 and their expectations for the years to come. They will share their perspectives on the trends influencing the securities finance industry and the broader market, and the way we work together. They will explore what industry participants need to be successful, how regulation will continue to shape the way we engage with the broader global markets, the roles technology and outsourcing play in improving scale and productivity and how firms and the industry can ensure we are creating a workplace that attracts and develops the strongest talent possible.

Moderator

William Wade
Citigroup

Speakers

Patricia Hostin
State Steet

Marney McCabe
Fidelity Agency Lending

Matt Collins
Morgan Stanley

Simon Heath
J.P. Morgan

Things to do on Amelia Island

Compiled by Jamie Richards

Museum of History

The Amelia Island Museum of History occupies the site of the disused Nassau County Jail. The museum tells the story of the island, from the native Timucua tribe, to Spanish and French colonisers, to eventual occupation by the US. The museum's program is largely based on the tours and speeches given by the knowledgeable staff.

The Marlin and Barrel distillery operates tours and a gift shop for fans of artisan liquor - the team craft vodka, rum, whisky and liqueurs from the site of an old Florida home.

Marlin and Barrel distillery

5 Points Theatre

The 5 Points Theatre in the Jacksonville neighbourhood of the same name was the first cinema in Florida to show "talkies", movies with an audio track built into the film. Officially known as the Sun-Ray Theatre, the cinema has also been commended for its varied vegan menu.