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Collateral squeezes and bond duration fatigue

DekaBank's Michael Cyrus examines the recent actions of the German Finance Agency and their potential impact on funding markets

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UK competition authority approves LSEG acquisition of Quantile

The UK Competition and Markets Authority (CMA) has approved London Stock Exchange Group's (LSEG's) proposed purchase of Quantile Group.

The deal, which was first announced in December 2021, was referred by the CMA for additional investigation by an independent group of CMA Panel members after identifying competition concerns during the first phase of its inquiry.

Specifically, the CMA identified concerns during its Phase 1 review that LCH's acquisition of Quantile could disadvantage third-party compression providers that provided competing services, thereby leading to reduced competition in this segment of the UK market.

Following the Phase 2 inquiry, which was conducted in May 2022, the CMA has concluded that the deal does not present substantial competition concerns in the UK. This investigation was based on detailed engagement with LSEG and Quantile customers, and with third-party compression vendors, alongside a more detailed evaluation of the proposed acquisition.

"Although the evidence showed that LSEG may have the ability to disadvantage Quantile's rivals post-merger, the investigation found LSEG would not have the commercial incentive to do so as its customers were clear they could take steps to stop such efforts," explains the CMA.

Martin Coleman, chair of the CMA independent inquiry group comments: "The in-depth investigation and consultation allowed us to engage extensively with LSEG, Quantile, and their customers and competitors, enabling us to better understand the impact of the transaction on those businesses and the market.

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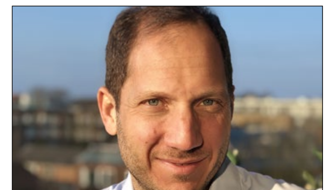

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The coming revolution in repo

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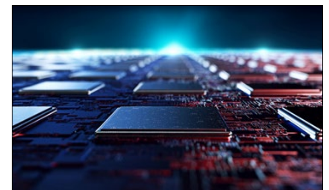

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Push me, pull you

FIS' David Lewis examines the use of short interest activity as a gauge of investor sentiment and the growth of solutions that aim to meet this demand from the market

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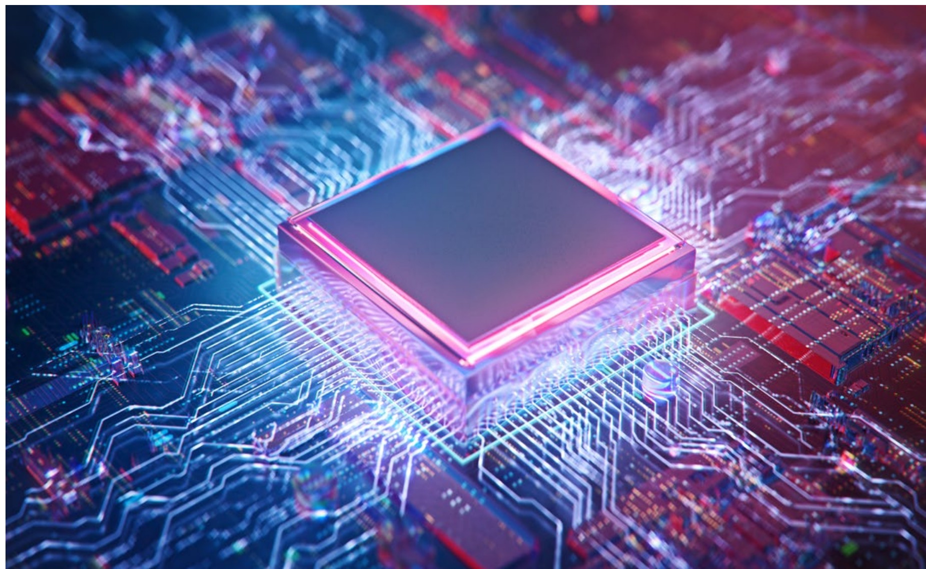
[1] *Global Investor*/ISF Survey 2020 – Securities Finance Agency Lending named Most Innovative Lender



Saphyre AI platform extends to securities lending

Saphyre, a firm incorporating artificial intelligence (AI) to power pre- and post-trade activities, is working to “transform” securities lending through seamless integration and transparency.

The firm’s AI-driven interoperable onboarding platform aims to help lenders and borrowers to remove the bottlenecks created by legacy systems.

Through automating the onboarding process using Saphyre’s AI, institutions are able to reduce the potential for errors, increase the speed of transactions and provide greater transparency to its stakeholders, says Saphyre.

Saphyre’s chief operating officer Ray Shivers says: “Saphyre’s capabilities, when applied to the securities lending business, will transform operational processes. The Saphyre platform de-risks the onboarding process and bringsneeded efficiency to the marketplace.”

UK competition authority approves LSEG acquisition of Quantile

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“On the basis of that engagement, and other evidence we have gathered, we are satisfied that this deal will not worsen the options available to businesses and consumers. As such, the transaction can go ahead.”

Founded in 2015, Quantile is a London-based provider of trade compression and portfolio, margin and capital optimisation services.

On announcing the proposed acquisition on 6 December 2021, LSEG stated that the transaction will enable the stock exchange group to extend its post-trade risk management solutions in these areas, complementing its existing range of global OTC derivatives clearing services.

LSEG indicated at this time that it has agreed to pay a maximum aggregate consideration of up to £274 million to Quantile shareholders, subject to customary adjustments.

It declared that Quantile’s services will be available through an “open model approach” that will offer customers a choice of where

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to clear, compress and optimise their trading activity. LSEG has proposed that, following the transaction, Quantile will remain a standalone entity within its post-trade division.

ISLA pinpoints key focus areas for the industry in new whitepaper

The existing ecosystem supporting the market is complex and the path to change remains a journey, according to David Shone, director of market infrastructure and technology at ISLA.

The International Securities Lending Association (ISLA) has published its newest whitepaper in collaboration with Linklaters, “The Future of the Securities Lending Market: On the Cusp of Transformation”.

As the third in a series of whitepapers on the future of the market, ISLA’s most recent edition reveals areas of the lifecycle that require further attention and development.

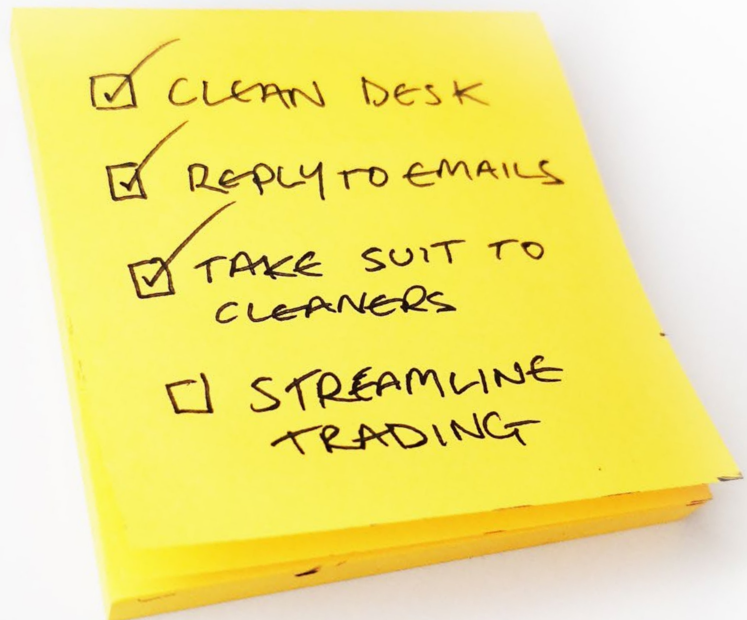
From a technological perspective, the association highlights streamlining Know Your Client (KYC) processes, dealing with Central Securities Depository Regulation (CSDR) impacts, and how to improve the next iteration of regulatory reporting, as focus areas.

Despite this, ISLA’s work on the Common Domain Model (CDM) and the ISLA Clause Library & Taxonomy has now progressed to a point where member firms can see opportunities for application.

For ISLA members, the whitepaper found that this year brought about an interest in new business opportunities afforded by digital technology. This shift can be seen, in particular, on the benefits to collateralisation, and the use of CDM as building blocks for smart contracts on blockchain ecosystems created by ISLA members.

In this whitepaper, the association presents discussions on how trade negotiation can be standardised, therefore increasing interoperability. In addition, ISLA explores how a digitised version of the ISLA Clause Library could assist in automation.

Shone comments: “The industry continues to progress along its transformational journey. As we teeter on the cusp of seeing the fundamental building blocks have identifiable use cases, indeed, on the cusp of actual transformation, the next eighteen months should be a very interesting time.”



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MarketAxess reports 22% YoY increase in matched repo trades

MarketAxess has revealed a 22 per cent year-over-year increase in matched repo trades for Q3 2022, representing more than 160,000 matched trades across the platform.

The platform recorded a 120 per cent YoY jump in matched lifecycle events to 6500 for Q3 2022, representing an average of 100 matched lifecycle events per day.

It currently supports 57 matching counterparties on its post-trade repo service, with additional buy- and sell-side firms due to go live this quarter.

In terms of match rate, MarketAxess indicates that the top five dealers on its platform are Deutsche Bank, J.P. Morgan, BOFA Securities, BNP Paribas and Goldman Sachs.

In volume terms, the five top dealers are J.P. Morgan, Barclays, BNP Paribas, Nomura and Deutsche Bank.

Taiwan again tightens short-selling restrictions

Taiwan's financial authorities reinforced short-selling restrictions on Friday, following on the back of similar action in the Taiwanese market taken on 3 October.

According to new rules applied by Taiwan's Financial Supervisory Commission (FSC), restrictions will apply to short sales of an equity security if its share price has fallen by 3.5 per cent or more from its closing price from the previous trading session.

In these circumstances, investors will be prohibited from using the previous closing price, or a lower price, to short the stock through borrowing securities, according to a statement released by the FSC through Taiwan's Central News Agency (CNA).

However, securities houses and futures traders will be exempt from these restrictions if they are conducting short selling activities

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for hedging purposes, according to the FSC.

The FSC's Securities and Futures Bureau reported that share prices for 105 stocks on the Taiwan Stock Exchange's main board, and 47 stocks traded through the OTC market, fell by 3.5 per cent or more on Friday 21 October.

Consequently, these equities have been covered by the new short-selling rules when Taiwan's markets reopened this morning.

State Street to open new office in South America

State Street is to open a new office in Chile to help the firm serve and support institutional clients in South America, with a focus on securities lending, custody and fund administration.

The firm has appointed Alberto Menendez to lead the Chile office and to serve as sales representative for Chile and Peru.

Menendez is based in Chile and will report to Maria Ximena Vasquez Barbosa, regional sales head for Latin America and Caribbean excluding Brazil.

Menendez joins State Street from Credicorp Capital Chile, where he served as distribution manager, overseeing the distribution of first-class mutual funds, exchange-traded funds (ETFs) and alternative asset managers, including State Street's ETFs for Chile, Colombia and Peru.

Prior to that, he held leadership positions at AFP Provida, Celfin and AFP ING of Colombia.

The launch of the Chile office marks an important milestone as the firm builds on its ongoing expansion of client capabilities in the region, says State Street.

The office opening in Chile comes a year after State Street's Brazilian bank began offering foreign exchange capabilities and sales operations.

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European repo market size grows 10.9% YoY for June, says ICMA

New figures have revealed an accelerated growth for the European repo market, which has reached a record high of €9,680 billion for 8 June 2022, a 10.9 per cent year-over-year increase.

The statistic highlighted in the International Capital Market Association's (ICMA) European Repo and Collateral Council (ERCC) survey represents the total value of the repo contracts outstanding on the books of the 56 institutions who participated in the latest survey.

The 43rd European Repo Market Survey notes that the rise in the headline number compares to €9,190 billion in December 2021, representing a 5.2 per cent increase. The figures follow a very similar rate of growth to those highlighted between the June and December 2021 repo surveys.

While headline numbers represent accelerating growth in the European repo market, the underlying conditions showed few major differences to the previous survey in December, according to ICMA.

A notable difference highlighted in the survey suggests that while the outstanding size of the market grew, there was a usual seasonal shortening of maturities in the survey as a whole, but there was "virtually no growth" in turnover in electronic trading.

This finding suggests smaller transactions or longer maturities in the latter market segment.

ICMA reveals that shorter maturities in the overall survey could reflect collateral scarcity, which would encourage shorter-term securities-driven repo. While longer maturities in electronic trading could reflect increased term trading in cash-driven repo in response to the further normalisation of interest rates.

The repo survey also notes an increase in the shares of floating-rate repos and in trading on automated trading systems (ATS), as would be expected in an environment of rising rates.

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Collateral squeezes, bond duration fatigue and funding

Michael Cyrus, DekaBank's head of collateral trading and FX, evaluates the recent decision of the German Finance Agency to increase its holdings of German government bonds by €54 billion and the potential impact of this action on collateral and funding markets

The German Finance Agency (Deutsche Finanzagentur, DFA), has increased its holdings of German government bonds and tapped 18 federal securities each by €3 billion, totalling €54 billion. The increase was justified with the need to "cover extraordinary financing needs, …, to address the energy crisis".

The DFA also mentions that "the increase is made for use in the repo markets". Furthermore, "federal securities were selected that are particularly in demand in the current (repo) market environment". This article analyses the motivation for this decision and the potential intended and unintended consequences.

Collateral Squeeze

Certainly, there is some 'specialness' in government bonds. This said, the DFA also tapped bonds including the 30-year government bond that are not special. Specialness is a function of collateral scarcity in the financial markets. This scarcity has been discussed for a long time. However, it seemed to exist like a mirage – manifest somewhere on the horizon and yet nobody had seen it in reality. Now, it seems to be here for real. Why? First, demand for highly liquid assets, or collateral, has increased. Specifically, recent volatility has increased haircuts for all kinds of financial instruments. Exchanges and counterparties demand more collateral for the same set of financial instruments.

Regulation has also increased incentives to move over-the-counter exposures to central counterparties, implicitly increasing and standardising collateral demands. Uncleared margin rules ensure that, even with uncleared derivatives, futures and forward business, there is now a requirement to collateralise exposures.

Energy price fluctuation has brought the potential neck-breaking nature of collateral demands (aka Metallgesellschaft) to the forefront of utilities. Energy providers, for instance, sell their production in futures markets to ensure predictable prices. However, the sky-high valuations of energy forward contracts led to similar steep increases in margin requirements for existing futures contracts entered into at lower prices. This created liquidity issues for many small and mid-sized enterprises (SMEs), but

also bigger energy companies. In some instances, governments had to step in to bail-out corporations.

Second, the supply of government bonds available for collateral has decreased. This is counter-intuitive, since the news is full of articles about new government debt. However, regulation after 2008 has cut out bank balance sheets from government debt to a large extent. Today, banks are not holding a lot of government debt and the onus has shifted to central banks to take up the slack. Quantitative easing in this context just means buying government debt that other investors do not want, or cannot buy any longer, thereby stabilising long-term interest rates. Consequently, a lot of government debt has left capital markets and collateral is less readily available, therefore contributing to collateral squeezes.

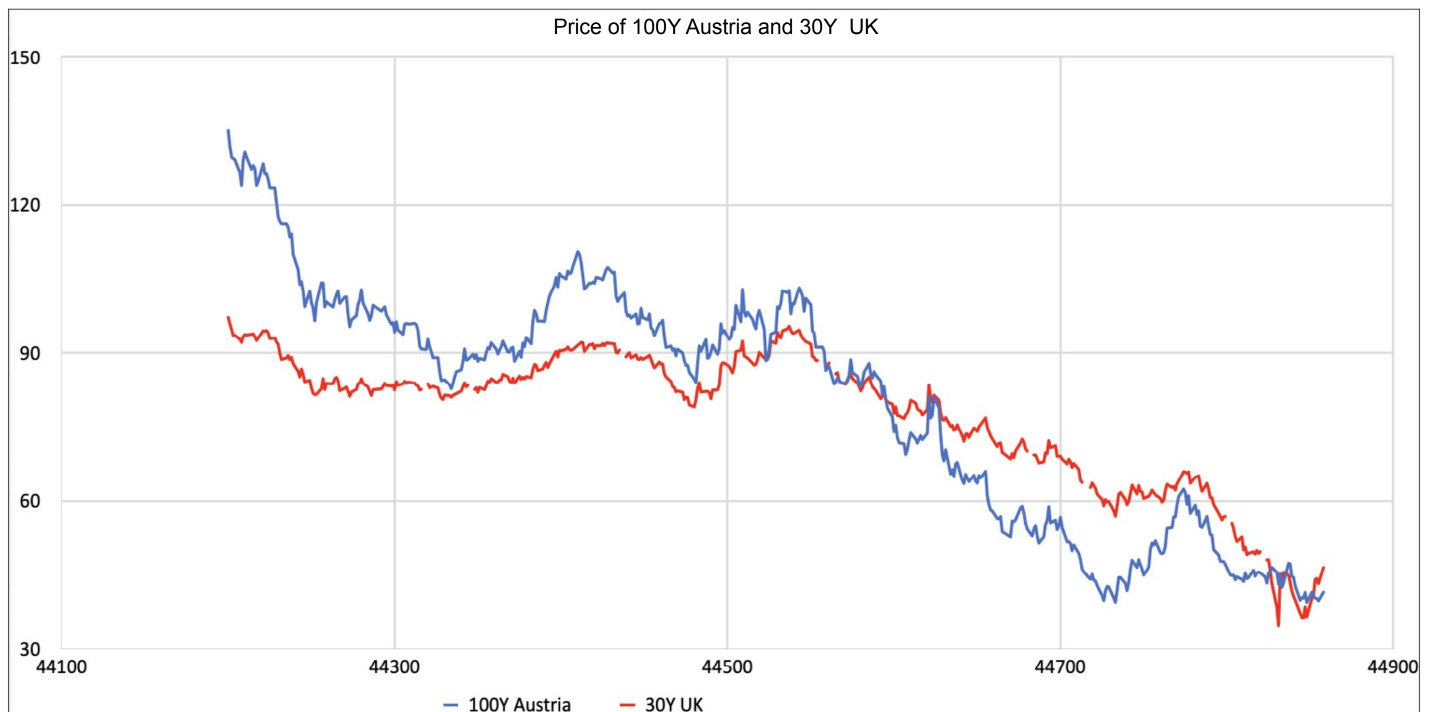
With interest rates rising faster than expected, the price of (in particular longer-dated) government debt has decreased by approximately 20 to 35 per cent. The price decrease was most pronounced with the longer-dated issues like the Austrian 100-year or UK 30-year gilt. Obviously, if you collateralise your exposure with a financial instrument that decreases more than 50 per cent over the course of the financial transaction, your counterparty will give you a margin call at very short notice!

Last, but not least, sanctions have frozen larger collateral inventories of government debt sitting idle in sanctioned accounts and not supporting financial market liquidity any longer. This was particularly evident with the Schatz squeezes directly after the sanctions froze large amounts of short-term government debt held by Russian counterparties

Bond duration fatigue

Bond duration fatigue is a relatively new phenomenon and the US, the Federal Government of Germany and the Japanese government should not have any difficulties in selling their (longer-term) debt to investors since these are considered to be the safest assets on earth. However, recently, we saw a couple of auctions fail in Japan, the US and in Germany. Is this a structural or a transitory development? Let us take a closer look at what is going on.

First, we need to examine the balance of long-term interest rate uncertainty and short-term liquidity management: given the recent and massive value destruction of long-term government debt on a mark-to-market basis, investors prefer the short-term end and are reluctant to invest into longer–dated government debt. In particular, the example of British pension funds that were hit hard by margin



calls for their government debt that they used as collateral (e.g. UK 30-years) will have substantially dented their risk capacity for more long-dated government debt. Sanctions have played their part as well. Usually, episodes of higher debt issuance and high energy prices have been unproblematic from a capital market point of view. Commodity producers used the proceeds of their better-than-expected revenues from energy bills to invest into government debt of industrialised nations, thereby sterilising the impact of higher than expected government bond issuances on long-term interest rates. However, with the recent sanctions, it has become clear that countries can lose significant amounts of their net-wealth with the tip on a button.

Consequently, it seems that foreign, and in particular BRICs, (Brazil, Russia, India, China) investors have become wary investors in (Western) government debt. In the last auction for 7-year German government debt, a supply of €4 billion was met with offers for €1.86 billion. This is not just a problem for the Federal Republic of Germany. Custody holdings of US government debt with the Fed have also decreased steadily this year.

Funding Flexibility

The €54 billion [rise in DFA holdings of German government bonds] does allow for more flexibility in covering funding needs arising from the energy crisis. That said, the DFA already holds €148 billion, which should give it enough funding power to cover unforeseen events. But there may be a further reason to move the €54 billion to the DFA now. This year, there is a waiver for the Schuldenbremse; the institutionalised debt brake in Germany. However, next year, this institutional debt brake will be reinstated and make it much more difficult for the finance minister to issue more debt. Given that the economic outlook is more than a little bit uncertain, the €54 billion now certainly increases the flexibility – if not in this year, certainly in the next year.

There is, however, a more intricate argument. If you do not find enough investors for your (long-term) debt, you can still issue the debt and then move it into repo markets. You sell your long-dated bonds in a short-term repo and meet your funding requirements this way. You turn the investment of a risky (see above) long-term investment into a yield pick-up financing transaction at the very short-term end. Your counterparty is the government and if the bond loses value you just issue a margin call. The government

"The German debt agency has emphasised the transitory nature of making more government debt available for the repo markets. Then again, we recently had a couple of developments which transgressed from transitory, to not so transitory, and eventually permanent"

can certainly increase the amount of collateral you hold by pressing a button.

If you do that for a limited time and limited amounts of government debt to address particular squeezes in a particular bond, this is called “Marktpflege” (you help sustain liquidity in particular bonds). However, if you do this across the whole curve, for longer and with large volumes as part of your existential funding requirements, because you lack long-term institutional investors this would be government-bond financing or debt monetisation.

Conclusion

The debt agency of Germany has emphasised the transitory nature of making more government debt available for the repo markets. Then again, we recently had a couple of developments which transgressed from transitory, to not so transitory, and eventually permanent.
So, kudos to Minister of Finance Christian Lindner for spotting the opportunity at the end of the year to expand his leeway into the next year and circumvent the debt brake in 2023. And a big thank you from repo markets for the added liquidity. The interplay of weak auctions and increasing collateral needs did show that German collateral is en vogue, but auctions are not. Let’s hope we do not need more of this help in the near future.

David Raccat
Co-founder and head of EMEA
Wematch

Creating a standardised TRS market

Digital technologies will be a critical enabler in meeting a growing demand for the Total Return Swaps market to be standardised and industrialised. Wematch's co-founder and head of EMEA David Raccat explores the future TRS ecosystem and the opportunities it presents

Historically, the Total Return Swaps (TRS) market has been highly bespoke. Each trade is essentially unique, based on the nature of the seller's constraints and the buyer's inventory. The face-to-face relationships of dealers and brokers have been key, and workflow is still dominated by multiple manual processes. For most TRS trades, phone and chat are still the main tools of business, and trading processes have changed little in the past 20 years.

Drivers for TRS market standardisation

There is now strong momentum for change. In our discussions with financial institutions around the world, we are hearing growing demand for a large part of the TRS market to be standardised and industrialised.

In part, this trend is being driven by the need to comply with regulations, such as the Fundamental Review of the Trading Book (FRTB), which mandates that trades should be observable, improve capital treatment and have a positive impact on the balance sheet.

More broadly, firms are looking to reduce the risk that comes from operating in a bespoke market. The more complex the term sheet, the greater the risk. There is also a significant cost consideration. By standardising the TRS market, financial institutions stand to reduce expenses and generate capital and balance sheet improvements.

Having already delivered significant operational improvements in asset classes such as foreign exchange, interest rates derivatives and some equities products, standardisation marks a natural evolution for the large swathes of the TRS market that do not require bespoke interventions. The vision is for a TRS market that is normalised and efficient, where data is, therefore, reliable, accurate and more easily challenged from a regulatory, capital and market risk standpoint.

The role of digitised workflows

As banks and dealers push the TRS market towards this future, digital technologies will be a critical enabler. By replacing manual trading workflows and inefficient communications protocols with digital alternatives, TRS market participants can rapidly move towards a more industrialised model for the market.

Soon, the entire TRS market will be underpinned by a single, end-to-end platform that both automates and optimises workflow and improves the way market participants communicate externally and internally. This digitised approach will create a TRS ecosystem that unlocks significant efficiencies while making dealers much more productive. With powerful algorithms at the heart of TRS workflows, dealers will be able to benefit from improvements in areas such as:

- **interest matching.** The matching process becomes digitised and automated, making it easier and faster for dealers to send and

receive indications of interest for swaps. Historical and live data is combined with smart negotiation protocols to navigate collateral schedules and conditions, providing dealers with access to the best trading opportunities every time.

- **lifecycle management.** Integrated tools for any type of trade event, including rate changes, recalls and substitutions make lifecycle management exponentially easier.
- **collateral optimisation.** Dealers need only set rules for the platform to then carry out all the heavy lifting, leveraging automated processes with the ability to send notifications to multiple counterparts with one single click.
- **sales to trader.** Internal communications are improved with seamless workflow between sales teams and TRS dealers, including the ability to make tailored outputs for clients.
- **synthetic ETFs.** Workflow is streamlined across UCITS management, substitutions, and collateral optimisation, with the ability to manage multiple issuers, master funds and funds simultaneously.
- **cash-flow reconciliations**. The cumbersome reconciliation of cash flow data related to the performances of the equity and funding legs of equity swaps is alleviated through automated workflows, and discrepancies can be identified at the outset, which will dramatically increase efficiency.
- **enhanced regulatory reporting.** Digitised workflow delivers a complete audit trail of transactions to improve trade observability and inform regulatory reporting.

Build the future

Given the demand for a more standardised TRS market, firms that have not yet adopted digital dealing workflows soon will. As always, firms face a choice over whether to build these tools for themselves or buy them from platform vendors. There is a third option, however, which combines the control provided by in-house builds with the cost efficiencies that come with vendor systems.

Companies like Wematch.live are increasingly looking to co-create their platforms in collaboration with market participants. The advantages of doing so are clear. To make a platform that is truly end-to-end and which meets the needs of all market participants, collaboration with users is vital. What is more, the digital marketplace approach needed for features such as automated matching lends itself best to a single, one-stop-shop approach where new capabilities are made available to all users equally.

To achieve the levels of standardisation required by the industry, what is needed is something different to the usual vendor approach. What is really being created is the technical underpinnings of TRS ecosystems, whether that is of an external marketplace or an internal collaboration zone. Continual quarterly feedback from users, such as Wematch sources in our TRS Forums, then helps inform the feature roadmap for the months ahead. This ensures continual improvement that closely aligns to what market participants need the most.

> *"A new phase in the story of TRS trading is about to start and it promises to bring with it unprecedented efficiencies for the firms involved"*

An evolving market

As anyone in the TRS market knows, there will always be trades where a bespoke approach is required. However, for a large proportion of the market, the legacy approach is highly inefficient. Why create a new framework for every single trade where most can be conducted faster and cheaper by leveraging digital and automated workflows? Doing so creates a standardised model for the market where data is much better suited for analysis and regulatory reporting.

To compare apples with apples, you first need an apple tree — and that is what an end-to-end digital TRS ecosystem promises to provide. The result is more observable trades, faster working processes, improved communication with internal teams, and better data insights into trading activities.

It is exciting to note that the technology enablers for this future are already available. What is more, given the conversations that we are having with financial institutions in Europe, the US and Asia Pacific, it is clear that the appetite for change is also in place across the world. A new phase in the story of TRS trading is about to start and it promises to bring with it unprecedented efficiencies for the firms involved.

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The coming revolution in repo

State Street's Travis Keltner and Kevin MacNeill argue that uncertain global financial market conditions, the rise of P2P business models and technological developments in the industry mean that repo markets could be poised for their biggest leap forward

Liquidity in financial markets is often taken for granted. Like water, we do not typically think much about it until it is not there. But with a changing interest rate environment unleashing greater volatility in global markets, liquidity is re-emerging as an important consideration.

Recent turmoil in the UK market underscores the point. As interest rates suddenly rose in response to announcements about new fiscal policy measures, bond values slumped and pension funds scrambled to cover collateral demands, resulting in a liquidity squeeze that forced the Bank of England to step in.

While those conditions were UK specific, the global buy-side has become all too familiar with liquidity stressors in a macro environment dictated by unprecedented events and rapidly changing trends. That has implications for repo markets, where each day approximately US$4.5 trillion is traded in the United States (over US$3 trillion in US treasuries alone) and close to double that globally.

To understand why, let us start with what these markets do. The market for repurchase agreements (repos) makes up a crucial part of collateralised money markets by providing buy-side firms with funding options for their changing investment needs.
These markets facilitate the flow of cash and securities and have implications for intra-bank loan activity and monetary policy more broadly. In particular, the repo market allows investors that need cash — both in well-functioning and stressed markets — to convert assets temporarily instead of selling outright, which can be disruptive, especially when buyers are scarce.

In the US, prolonged low rates during the COVID-19 pandemic made it difficult to find value and fund opportunities on the short-end of the curve. Conversely, the current environment of unprecedented rate hikes and prolonged inflation uncertainty has flooded cash into overnight markets, while associated collateral supply remains sparse in comparison. The Fed's Reverse Repo Facility (RRP), a key player in the US treasuries repo market, has ballooned since the start of 2021, reaching all-time highs above US$2.3 trillion this year.

The influx of cash and rapidly rising rates provide opportunities for the buy-side, but not all firms have access to every outlet, like the Fed RRP. Also, the Fed RRP is just overnight repo against US treasuries. Opportunities exist for the buy-side to expand into a broader set of collateral types and maturities. Unlocking new liquidity outlets for the buy-side in repo markets has implications not just for money markets, but for the economy more broadly. Peer to peer (P2P) models can help. P2P models allow buy-side firms to transact directly with non-dealer counterparties to capitalise on identified trends in a changing market. When the buy-side has the power to negotiate among themselves, opportunities can be customised under a broader set of options to more closely fit each firm's needs.

P2P platforms such as Airbnb and eBay already have unlocked tremendous value in many sectors of the economy. They can do the same for repo markets by increasing visibility and options for buy-side firms via an intuitive, sleek platform. More importantly,

advances in technology support the design of automated front-to-back solutions, especially critical for financial markets, and provide real-time intelligence.

The benefits could be significant and include:

- A ready ability to send and receive indications of interest to a broad counterparty set for price transparency.
- Integrated messaging supporting settlement and collateral management, enabling more firms — who otherwise lack the necessary infrastructure — to engage.
- Broad participation by firms lacking the requisite infrastructure themselves to readily interact.
- Opportunity for lower costs for buy-side participants. Traditional repo intermediaries (i.e. dealers and banks) may incur material balance sheet utilisation costs, which is not-unreasonably passed along to counterparties in the form of less-favorable spreads.

As State Street and Finadium outlined in April, overall costs are expected to be lowest in a P2P model, in which the intermediary costs are removed or reduced. Under an indemnified P2P model, buy-side counterparties transact directly and a bank or insurer guarantees either or both the repo buyer and seller that the repurchase price and collateral securities will be returned in the case of a counterparty default. A fee for this protection is passed along in spreads, but the overall cost that is passed along is expected to be less than in traditional repo models. This also offers the same peace of mind that the buy-side has come to expect when transacting with traditional counterparties.

Lastly, a P2P platform in the repo market could, over time, be used to include other markets such as the securities lending market and, eventually, with the adoption of blockchain technology, markets for digital assets.

The repo market has been evolving since the late 1970s, but the confluence of an uncertain global economic and financial market environment, the rise of P2P business models, and technological developments in the financial industry mean it could be poised for its biggest leap forward yet — and bring other related markets along with it.

Travis Keltner
Global head of financing and analytics,
Funding and Collateral Solutions team
State Street

Kevin MacNeill
Product strategy, repo trading and
financing solutions
State Street

Push me, pull you

FIS' David Lewis examines the use of short interest activity as a gauge of investor sentiment and the growth of solutions that aim to meet this demand from the market

Much has been written over the years about the need to increase market education for clients, participants and other stakeholders, as well as the demand for more transparency into the inner workings of the securities finance and collateral markets. To many, the very idea of lending or borrowing a security seems like a dark art, or overt and excessive financial engineering. The act of buying or selling a security is, by comparison, a significantly simpler proposition. The progress that has been made over the past 20 to 25 years has meant that many more people, in the financial markets at least, understand the role of securities finance and collateral management in the wider financial markets. It is, as is often said, the oil in the machine.

Impact of regulation

Regulations — either proposed, like the Securities and Exchange Commission's (SEC's) 10c-1, or in place, like the Securities Finance Transaction Regulation (SFTR)— have often focused on bringing increased transparency to the markets. Those in the know realise that third-party data sharing services within the market have been around for more than 20 years.

Almost every market participant on the planet employs at least one of the three main providers, with larger organisations often combining the services of all three. These services, one of which is our own FIS Securities Finance Market Data suite — formerly known as FIS Lending Pit — have served these markets well. They have expanded their reach and depth, but always within the walls of the securities finance market.

FIS was involved with the Financial Stability Board (FSB) Data Experts Group when it was designing the Transparency Directive that led to the implementation of SFTR, sharing the challenges

and benefits of the shared data model as it delivered transparency to market participants. While SFTR focused on risk management and implementing monitored data gathering to help avoid another financial crisis like that experienced in 2007, it did also include a degree of public disclosure. SFTR, while a European Union regulation, is particularly wide ranging in terms of its jurisdictional reach of reporting obligations. As an obligation pushed onto the market, it has brought multiple benefits in terms of improved market rigour as well as the transparency the disclosures have given.

By contrast, the proposed SEC 10c-1 rule is approaching the market from the direction of public disclosure, with regulatory oversight arguably a secondary objective. As a directive that the regulator is being pulled into implementing, it has somewhat different objectives and potential outcomes. Few would argue that the securities finance market is a very difficult beast to understand, but it is a complex one. There is a world of difference between those two adjectives and the impact of that is being felt by those currently consuming some of the data available — as well as by those required to implement these disclosure requirements, albeit to a lesser extent. SFTR was, as many can attest, an extremely complex regulation to implement, covering up to 155 data fields, depending on the product, and featuring tight timescales for delivery.

Democratisation of the markets

Many of the data providers in this market also offer what some refer to as "retail" products, where derivations of the main "wholesale" market data gathered are processed further and aggregated to deliver signals of market sentiment. Put simply, if borrowing increases or decreases on a security, it can be interpreted as a signal of increasing or decreasing short interest. This, in turn, can suggest the expectation of an impending price change in that security.

This is highly valuable information for those buy-side users that construct advanced models seeking to generate alpha from asset price movements. Such firms, often with deep pockets where data consumption is concerned, have had access to a huge number of data sources for many years, enabling them to process and manage that data to their advantage in trading strategies.

In recent years, individual investors have benefited from ever-widening market access, enabling them to access brokerage fee-free platforms to buy and sell investments with ease. This process of disintermediating institutional providers is described by some as the democratisation of the financial markets, and it is becoming ever more apparent in the securities finance markets. Several providers are now taking advantage of new technology, with the lower costs enabling them to bring down the fiscal barriers to entry, opening access to the lending and borrowing markets to individual investors. In the long run, this can only benefit the overall market, but there are going to be growing pains along the way.

The pushing demand for access from such quarters is pulling the market toward ever greater data disclosure. This will bring benefits to the market and its participants, but it will not be without some adjustment. Backed by the SEC's proposed rules, individual investors are demanding a level playing field with the institutions in terms of both market and data access. There is some merit to that, for sure, but the need for market education, like that with beneficial owners 20 years ago, is now front and centre.

At the risk of stating the obvious, lending and borrowing a security is not the same as buying and selling it outright. There is a term to the trade, lifecycle events, the quality of the collateral and that of the counterparty. All these factors affect the cost of the borrow over and above the simple dynamics of supply and demand. Couple that with the myriad of adjustments, recalls and reallocations that are involved in a securities lending transaction, and the valuable data points begin to become obscured.

Seeking transparency

The benefits of market transparency are more than clear. The implementation of SFTR was complex but ultimately not that difficult — although that may just be hindsight talking. However, when it comes to a market pull or demand for something, that demand should be met head-on and answered correctly. If market participants wish to understand short interest activity as an input into market sentiment, then the simplest solution may just be to provide it.

Securities lending and borrowing activity is a proven proxy for measuring short interest and will no doubt continue to be used effectively — but it also often raises many more questions from those not familiar with the idiosyncrasies of securities lending than it can answer. As ever, getting the answer right involves truly understanding the question.

Latest moves at UBS, BNP Paribas Securities Services and HSBC

The International Securities Lending Association (ISLA) has appointed Keren Halperin to its board of directors

Based in London, Halperin is deputy CEO and chief of staff at capital markets fintech Sharegain.

Halperin has more than two decades' experience in capital markets and fintech, having worked at algo trading firm FINAL and the Tel Aviv Stock Exchange.

With a background in trading, legal and operations, Halperin is also involved in Women in Securities Finance and promoting diversity in the industry.

Commenting on her election, Halperin says: "I have seen first-hand the pivotal role that ISLA plays, advocating for securities lending as a force for good and promoting best practices across the industry. I look forward to working with my fellow board members, as well as other stakeholders, to make the industry a more inclusive and more integral part of capital markets innovation."

UBS has appointed Gregory Bander as head of funding and optimisation solutions for the Americas, based in New York.

Bander joins the company from Morgan Stanley, where he has served for more than 14 years. During his time with the firm, he worked in a series of senior roles including executive director of secured funding trading and execution and, most recently, executive director of client financing, repo and fixed income sales.

McCabe joins Fidelity Capital Markets

Marney McCabe has left her position as co-head of global securities lending at Brown Brothers Harriman (BBH) after 16 years at the firm.

With 20 years of experience, McCabe has joined the institutional trading arm of Fidelity Investments, Fidelity Capital Markets, as head of relationship management for agency lending.

McCabe will be responsible for Fidelity Agency Lending's relationship management strategy and client experience.

The Boston Chapter co-lead for Women in Securities Finance has spent more than 16 years in securities lending. McCabe has experience in developing differentiated and highly customised agency lending programmes for several of the world's largest asset managers.

In addition, McCabe worked as a portfolio manager, providing investment and wealth management services to high-net worth and small institutional clients, and as an equity research associate and international wastepaper trader.

Prior to joining Fidelity Capital Markets, McCabe managed BBH's value-based agency programme and market engagement strategy as co-head of global securities lending.

McCabe joined BBH in 2006 as vice president of global securities lending, where she managed the growth and retention of key securities lending clients, as well as providing risk and compliance oversight of client programmes.

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Commenting on his appointment via LinkedIn, Bander says: “I am happy to share that I am starting a new position at UBS. While I will miss the many friends, colleagues, laughs and good times I had at Morgan Stanley, I could not be more excited to start the next chapter with UBS.”

Frankfurt-based trading venue for securitised derivatives Spectrum Markets has appointed Ilja Rempel as head of risk.

Rempel will oversee and develop key risk management control functions, maintaining the local risk strategy, as well as monitoring and promoting all aspects of the risk control environment. He will report to Dr Alpay Soytürk, chief regulatory officer.

He joins Spectrum Markets with extensive experience in the investment and finance industry, with a focus on financial sector regulation and risk management.

Prior to this role, Rempel was risk manager at Julius Baer after four years in risk control at UBS Europe SE.

Commenting on the hire, CEO of Spectrum Markets Nicky Maan says: "We are certain that Ilja Rempel, with his comprehensive expertise in the risk area, will further advance our business in Germany."

Commonwealth Bank has hired Charlie Spall as an associate of global securities financing.

Based in London, Spall joins the firm as part of the bank's continued expansion of its securities finance team in the Northern Hemisphere. He will report to Russell Simpson, executive director and global head of securities financing.

He joins the bank from a six-year term with Daiwa Capital Markets Europe, where he was most recently a junior repo trader.

He held a number of positions at the firm including senior manager and credit risk analyst.

BNP Paribas Securities Services has appointed Charlotte Phillips as senior liquidity advisor, based in London.

Phillips joins from international business administration services provider TMF Group, where she served as operations and projects lead for the capital markets division.

With almost 20 years of experience in the industry, Phillips has worked for major industry players including State Street, Eurobrokers and Reuters.

She has also served at other companies including Swiss capital markets firm Compagnie Financiere Tradition and electronic trading marketplace Elixium.

HSBC has appointed David Ward as global head of agency securities lending technology after 11 years at the bank.

Based in London, Ward will report to head of equity prime services technology Xavier Pleasance.

Ward began his career at HSBC in 2011 as a senior analyst before taking on more senior roles, including project manager and business analyst in prime finance, and, most recently, programme manager for equities and securities finance technology.

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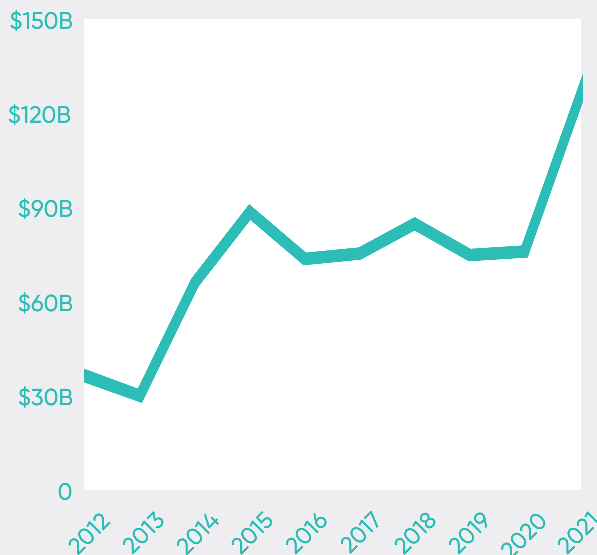

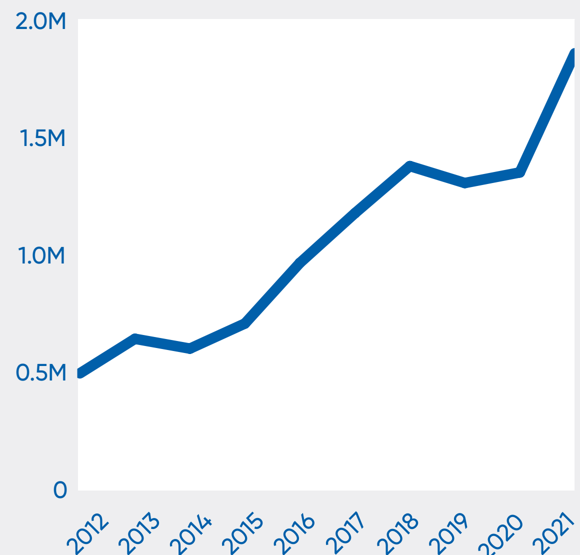

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