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Bridging Asia

Japan Securities Finance's Yosuke Kobayashi discusses the latest trends in Asia's bond and equities markets

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Toward the Development of the Securities Market

Established in 1950, Japan Securities Finance ("JSF") is Japan's only securities finance company, specializing in lending funds and securities needed for the securities market. As such, our mission is to contribute to the development of the securities market by proactively meeting the diverse needs of the securities and financial sectors and to enhance the long-term interests of users

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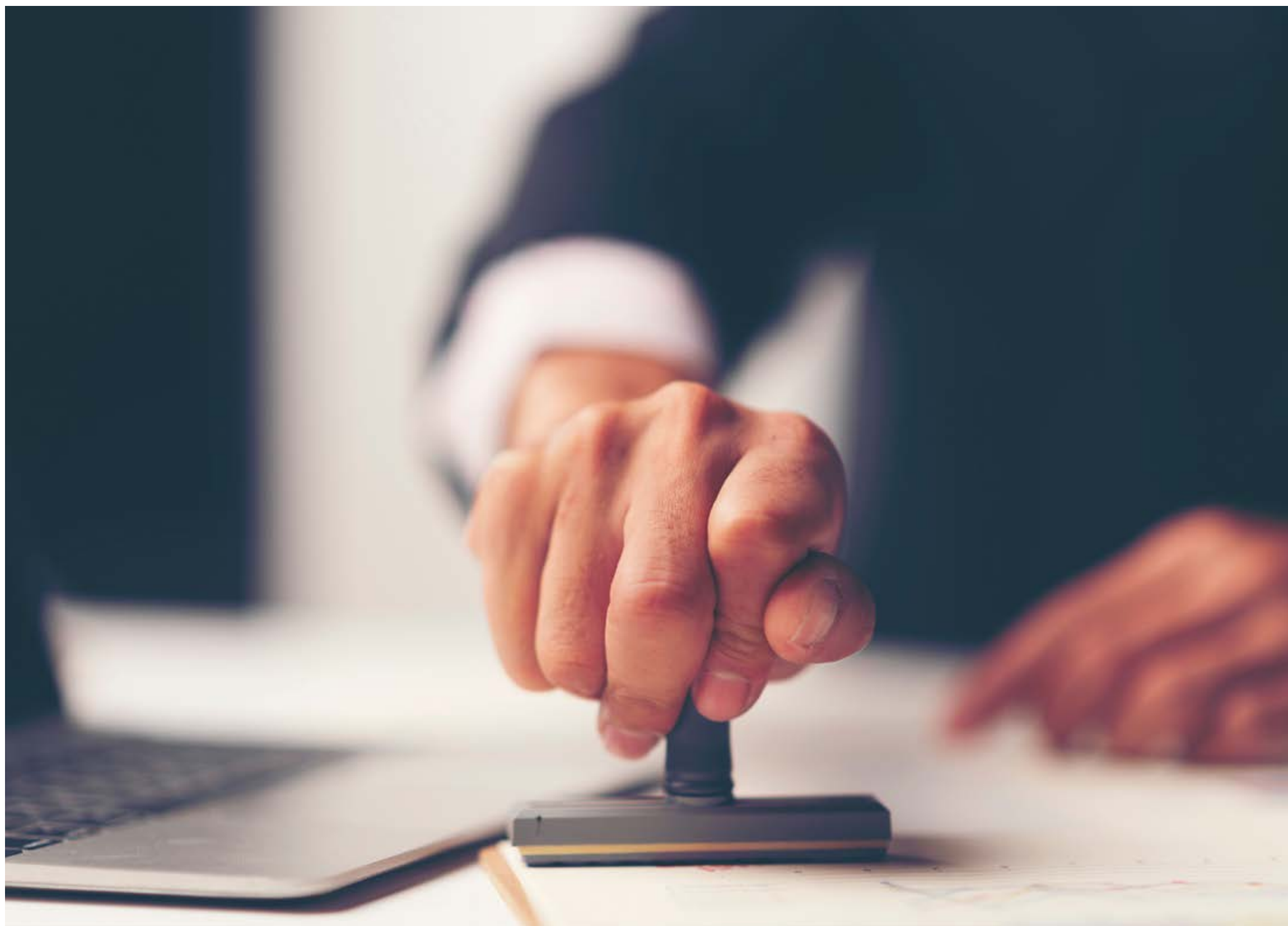


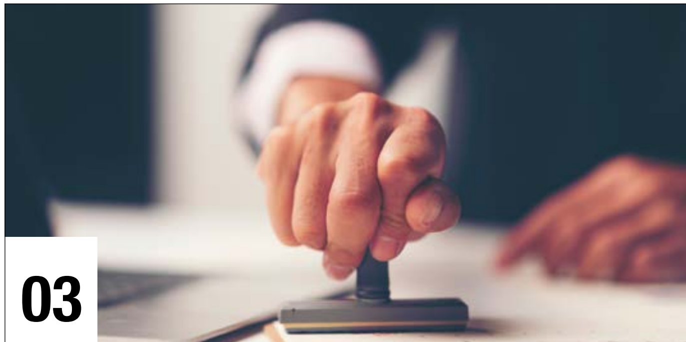
CME Group and DTCC receive regulatory approval

DTCC and CME Group have received regulatory approval from the SEC and CFTC for their enhanced cross-margining arrangement.

The arrangement will enable capital efficiencies for clearing members that trade and clear both US treasury securities and CME Group interest rate futures. It is expected to launch in January 2024.

The new cross-margining arrangement will permit eligible clearing members of CME and the Government Securities Division of DTCC's Fixed Income Clearing Corporation (FICC) to cross-margin an expanded suite of products. The products include CME Group SOFR futures, ultra 10-year US treasury note futures and ultra US treasury bond futures, as well as FICC-cleared US treasury notes and bonds. Repo transactions that have treasury collateral, with a remaining time to maturity greater than one year, will also be eligible for the enhanced cross-margining arrangement.

Suzanne Sprague, global head of clearing and post-trade services at CME Group, says: “In line with our longstanding commitment to provide capital efficiencies to market users, we are very pleased to bring this enhanced cross-margining arrangement to the treasury marketplace in January. We appreciate the opportunity to further our collaboration with DTCC for the benefit of market participants who trade across cash and futures markets."



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Basel III Endgame

With the public consultation ongoing, Bob Currie examines the proposal and its potential implications for the banking industry

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Industry appointments

New York-based investment bank Mizuho Securities USA has appointed Jo Ann Morano as executive director of securities lending.

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Securities lending to rethink its engagement with regulated entities

As the market looks to tackle the "extreme outcomes" of Basel IV, the way the industry thinks about engaging with prudentially regulated entities is about to change, according to ISLA CEO Andrew Dyson.

The International Securities Lending Association (ISLA) has released its Securities Lending Market Report detailing the performance of the market as well as key focus points for participants.

In discussing the implementation of the Basel IV regime — which began its slow adoption on 1 January 2023 and is set to continue until 2025 — Dyson says not enough credence within the Basel IV rules is given to short-dated liquidity-driven businesses, including securities finance transactions (SFTs).

Dyson says: "The most recent proposal from the Fed in North America suggests that the largest banks will need significantly more capital to support the higher levels of reported risk-weighted assets (RWAs) than the revised regime will require."

The ISLA report reveals that this raises several important issues as "new capital may not be that readily available".

Dyson indicates: "Investors may be less inclined to subscribe to new equity issuance, and growth from retained earnings can take years to reach the desired levels. In reality, we may see banks reducing or exiting businesses that are high consumers of RWAs."

The Association is following these developments closely and will work with market participants and wider stakeholders in efforts to ensure that markets remain open and are able to provide liquidity — something that is the "lifeblood" of the capital markets, says Dyson.

Global securities lending revenue up

The global securities finance industry generated US$945 million in revenue for lenders in August 2023, an 8 per cent year-on-year increase from August 2022, according to market data provider DataLend.

Month-on-month, this represents a 0.2 per cent increase on the revenue recorded in July 2023.

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Global broker-to-broker activity, where broker-dealers lend and borrow securities from each other, totalled US$241 million in revenue for lenders, a 0.4 per cent decrease YoY.

In the US, equities market revenues rose 8 per cent YoY. US equity performance was driven by AMC, Kenvue, and former Kenvue parent Johnson & Johnson, which together brought in US$182 million — equating to 40 per cent of August's US equity lending revenue.

In contrast, EMEA equities revenue fell 30 per cent YoY and 21 per cent MoM for August.

Similarly to July's performance, APAC equities were the most improved asset class YoY, according to DataLend. While Korean equities continued to be a highlight with 114 per cent YoY growth.

The market data provider also reports a 29 per cent YoY increase in lender-to-broker revenue, which was driven by a 14 per cent incline in balances and a 13 per cent jump in borrow fees.

The top five earners in the securities lending market in August 2023 were AMC Entertainment (AMC), Kenvue Inc. (KVUE), Johnson & Johnson (JNJ), Nikola Corporation (NKLA) and Sirius XM Holdings (SIRI). The five securities generated US$217 million in revenue for the month.

Corporate debt continued to grow, gaining 21 per cent YoY.

Norddeutsche Landesbank live with MX.3

German bank Norddeutsche Landesbank (NORD/LB) has gone live with a new version of Murex's MX.3 platform.

NORD/LB capital markets activity relies on the MX.3 platform for back-office services, including collateral and accounting.

It also utilises Murex's front-office capabilities which include enterprise risk management for limit control, credit risk and stress testing.

By upgrading its MX.3 installation, NORD/LB sought to primarily protect itself against technical deprecation and issues related to third-party components.

NORD/LB says that utilising MX.3's platform reduces time-to-market for new products or regulations, removes operational risk related to IT manual and repetitive tasks, and maximises velocity with predictability and traceability.

NORD/LB's adoption of the newest MX.3 version is also part of an effort to improve operations resiliency concerning the DORA regulation.

NORD/LB's financial markets programme manager Joachim Grimme says: "The implementation of the continuous integration is a major milestone for the NORD/LB financial markets platform and supports our business strategy and related Murex projects."

Hadi Abi-Tayeh, project director at Murex, says: "Using the Murex continuous integration toolchain allowed NORD/LB to automate the conversion activities required for the upgrade and eliminated operational risks. It is a big success for the bank and validates the strategic decision to progressively adopt continuous integration tools and methodology."

Eurex welcomes Goldman Sachs as a member of its listed FX Futures business

Eurex welcomes Goldman Sachs as a member of its listed FX Futures business, both as a trading and clearing member, by

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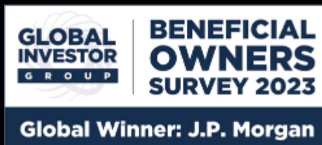

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offering liquidity for off-book transactions.

Through this arrangement, Goldman Sachs highlights the ability to maintain a bilateral trading relationship to access OTC liquidity while benefiting from a fully cleared FX contract. This allows market participants to swap OTC trades into exchange-traded and centrally cleared contracts.

Jens Quiram, global head of FIC derivatives and repo sales, at Eurex, says: "Goldman Sachs' engagement as a clearing member and liquidity provider will enable even more clients to benefit from listed FX liquidity at Eurex. This is another major milestone on our way to expand Europe's leading listed FX liquidity hub."

Repo ADV on Tradeweb up 33.1%

Repo average daily volume (ADV) traded on the Tradeweb platform increased 33.1 per cent year-on-year to US$491.9 billion for August.

Month-on-month, repo ADV decreased by 0.9 per cent compared to the US$496.3 billion recorded in July.

Tradeweb reports that client adoption of Tradeweb's electronic trading solutions drove global repo activity, with US market conditions pushing demand from the Federal Reserve's reverse repo facility to money markets.

Elevated interest rates continued to encourage retail money markets activity, the company reports.

The New-york based electronic trading provider for rates, credit and money markets indicated that ADV for all asset classes for August has increased 41.2 per cent YoY to US$1.44 trillion. US Government bond ADV rose 14.9 per cent YoY to US$142.7 billion. Similarly, European government bond ADV increased 19.6 per cent YoY to US$32.9 billion.

Tradeweb reports strong activity across all client sectors, with high interest rates driving retail market participation. Volumes for both US and European government bonds were supported by sustained rates market volatility.

For swaps and swaptions, average daily volume has grown 125.4 per cent YoY to US$381.8 billion, and total rates derivatives increased by 89.0 per cent to US$535.9 billion.

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In credit markets, fully electronic US credit ADV has risen 38.9 per cent YoY to US$4.8 billion and European credit ADV has increased 48.5 per cent YoY to US$1.6 billion.

EquiLend adds DLT-based SSI repository using SSImple

EquiLend has appointed SSimple to provide a distributed ledger-based SSI repository and management solution which links to its Post-Trade Solutions suite.

The two companies indicate that this collaboration is designed to address the challenges presented by inaccurate standing settlement instructions (SSIs) and to deliver a more efficient and secure trading environment.

In previous articles published in SFT, EquiLend has highlighted how SSIs have been a significant reason for failed trades. To address this concern, the company has partnered with SSImple to gain access to an industry-standard SSI repository, enriched with market validations based on security type and place of settlement (PSET).

SSImple' distributed ledger technology-based solution is built on R3 Corda and offers API connectivity to support data communication between market participants.

EquiLend associate director of post-trade solutions William Daws says: "Custodians, prime brokers, and other stakeholders can leverage SSImple's cutting-edge platform to manage SSIs effectively and automate SSI data flow to their buy-side clients.

"We believe this collaboration marks a significant step towards reducing trade failures and enhancing overall trade settlement efficiency.

"We are excited about the potential of SSImple's open permissioned approach in solving the industry's SSI challenges. This partnership reflects our commitment to future-facing industry solutions."

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Eurex's Partnership Program welcomes more participants

Eighteen participants from the US, UK, and Continental Europe have now registered to be part of Eurex's Partnership Program for short-term interest rate (STIR) derivatives.

The initiative has been established to create a viable alternative to trade and clear euro-denominated STIR derivatives within the EU to offer liquidity across all fixed income derivatives and repo products — along the entire euro yield curve-traded on-exchange and OTC.

Eurex says this step offers market participants the opportunity to benefit from margin and operational efficiencies, building on its trading, clearing and risk management infrastructure.

In June, Eurex announced the expansion of its Partnership Program for interest rate swaps to include the short-term interest rate STIR derivatives segment.

The STIR Partnership Program will be accompanied by a new programme for liquidity providers for EURIBOR and euro short-term rate (€STR) derivatives which will come into effect at the beginning of November.

The initiative also demonstrates the commitment of Eurex and the broader markets to support the European Commission's stability and autonomy agenda.

The STIR Partnership Program is due to go live in the last week of October in conjunction with a product re-launch.

Matthias Graulich, member of the Eurex Clearing executive board, says: "We are excited to welcome these 18 participants to the STIR Partnership Program.

"This initiative will enable global clients to benefit from a comprehensive product offering including Eurex's leading European government bond derivatives and repo segment as well as the clearing of OTC interest rate swaps.

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"At the same time, it will further enhance Eurex's value proposition by building out the 'home of the euro yield curve' ambition for euro-denominated derivatives and repo, delivering efficiencies to a global client base."

OCC average daily loan value up 16% for August

The Options Clearing Corporation (OCC) saw the average daily loan value for securities lending trades increase by 16 per cent YoY to US$139.8 billion for August.

The total securities lending volumes cleared by the Chicago-based clearing house during the month increased 6.9 per cent YoY to 218,910 transactions.

For futures and options, total volume has increased 12.2 per cent YoY to 1 billion contracts for August.

This growth has been driven by a 41.4 per cent YoY increase in index options contracts, which rose to 89.1 million contracts, and ETF options, which increased 29.1 per cent YoY to 410.9 million contracts.

Equity options saw a slight decrease, falling 1.6 per cent YoY to 518.3 million contracts. Equity options accounted for more than half of all options trades in August.

For futures, volumes increased by 24.7% YoY to 5.5 million contracts.

The year-to-date average daily volume for all futures and options cleared on the platform was 44.6 million contracts, an increase of 10.2 per cent as compared to the YTD average in August 2022.

CME BrokerTec sees 8% repo increase

CME BrokerTec has reported an 8 per cent month-on-month increase in US repo average daily volumes (ADV) to US$292 billion for August.

This makes August 2023 the fourth-best month on record for US repo in the platform's history.

EU repo ADV showed steady growth through August and, at €309 billion, is up 13 per cent compared to the same period two years ago.

US treasury ADV on the BrokerTec platform was US$99 billion for August, in line with prior months as market volatility settled.

The firm also reports that overall book depth hit a high point for 2023, with 10-year book depth and its highest point post the invasion of Ukraine.

Erik Norland, senior economist at CME Group, says: "Bond yield in the US rose slightly over the course of August amid strong consumer spending data and the Fed's insistence that it will maintain rates at a high level for longer than the forward curve suggests is likely.

"UK and Eurozone bonds were little changed in August, but 10Y JGB yields continued to drift higher as a result of the BoJ's softening of the yield cap. Going into September the main source of uncertainty surrounds the possibility of further ECB and BoE rate hikes."

TP ICAP's eRepo reports £100 billion trading day

TP ICAP Group has announced that its eRepo order book recorded a volume of £100 billion in one day.

The record trading day took place on 7

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September 2023, reflecting significant growth over the previous 12 months.

The London-based financial services firm says its fully electronic order book eRepo is designed to help market participants manage high volume demands in the European repo market.

The firm reports that eRepo month-to-date average daily volume is up 180 per cent year-on-year for September.

It credits eRepo's fixed rate fee schedule with generating major participant sign-ups.

TP ICAP plans to expand eRepo with a web-based front end through the company's existing Fusion platform, introducing new features as well as improved navigation and deployment capabilities.

HSBC and Terra Quantum partner to tackle collateral optimisation

Terra Quantum and HSBC are to collaborate to explore hybrid quantum technologies applications on optimisation challenges.

The project aims to demonstrate the potential for a hybrid quantum solution for optimisation challenges, a widespread and complex suite of issues in financial services such as collateral optimisation.

Existing methods for collateral optimisation primarily rely on linear optimisation solvers, which can falter when confronted with higher complexities.

HSBC and Terra Quantum say they are joining efforts to excel beyond traditional methodologies, aiming to handle high-dimensional optimisation problems and improved scalability.

As quantum technology evolves, HSBC claims the bank is set to explore its potential benefits of increased efficiency, cost reduction and competitive edge.

Vishal Shete, managing director at Terra Quantum UK, explains: "Optimisation of capital is one of the core functions in a bank, quantum technologies have the potential to enhance optimisation solutions across many parts of a financial institution, we look forward to realising the benefits of this in the near term future."

Steve Suarez, founder and CEO of HorizonX, says: "Together, [Terra Quantum and HSBC], we have explored the ability and readiness of hybrid quantum to take on large scale, business critical problems and create transformational impact."

Markus Pflitsch, CEO and chairman at Terra Quantum, comments: "Working with HSBC allows us to apply our technology to real world use cases at a financial institution. Hybrid quantum algorithms will revolutionise large scale intractable optimisation tasks in the future."

BME Clearing launches digital asset derivatives segment

BME Clearing has been approved to provide clearing for USD-denominated bitcoin and ethereum futures by the Spanish regulatory authority, Comisión Nacional del Mercado de Valores (CNMV).

This represents part of the Spanish clearing house's plans to offer central counterparty clearing services for a new digital asset derivatives segment targeted at institutional investors.

This, it suggests, will extend institutional access to digital assets through a secure and tightly regulated environment, enhancing trading, clearing and cash settlement flexibility for this institutional segment.

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Bridging Asia’s securities finance and wider global markets

Japan Securities Finance (JSF) is a licensed financial institution under Japan’s Financial Instruments and Exchange Act with a long track record in the Japanese market. SFT sat down with Yosuke Kobayashi, managing director of the Institutional Sales Department, to discuss the latest trends in Asia’s bond and equities markets and JSF’s role in facilitating this market

JSF was established in 1950 as a specialised institution supporting loans for margin transactions (LMTs). These margin transactions were introduced in Japan after World War II to increase the liquidity of its stock markets, recognising that Japanese securities companies did not have the same fundraising capabilities as they do today and the stock lending market was still undeveloped. Consequently, LMTs were introduced for securities companies in 1951, enabling securities or funds to be delivered for settling margin transactions.

JSF is licensed to engage in LMT operations and is currently the only securities finance company in Japan.

What are JSF’s primary business lines?

JSF’s core business continues to be LMTs and we serve as an important infrastructure for Japan’s securities and financial markets.

In addition, JSF is focusing on its lending business, lending securities such as Japanese government bonds (JGBs), government-guaranteed bonds and Japanese stocks, along with financing and collateral upgrade transactions.

In the funding and upgrade businesses, JSF accepts a range of assets and provides high-quality liquid assets (HQLA) such as cash and JGBs. Eligible assets include JGBs and Japanese stocks, as well as Asian equities such as Taiwanese stocks and Hong Kong stocks.

Asia’s stock markets continue to differ significantly in terms of their regulatory frameworks and market characteristics. We draw on our deep pool of knowledge across Asia’s markets — supporting trading in Asian assets and cooperating with a triparty collateral management service — to ensure that trades are compliant with these regulations.

By accepting Asian assets, including Japanese stocks, and providing HQLA, we are able to meet the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) regulatory compliance needs of financial

institutions such as global systemically-important banks (G-SIBS).

What are the latest trends in the lending market for Japanese bonds? What role does JSF play in this market?

Short trading in JGBs, mainly implemented by hedge funds and other overseas firms, has been growing owing to speculation around changes to the Bank of Japan's monetary policy. Supply and demand of JGBs has been extremely tight in recent market conditions, with the spread between domestic and overseas repo rates widening for both special collateral (SC) and general collateral (GC) transactions.

As one of the top brokers in the Japanese repo market, JSF plays an important role in mediating between the domestic and overseas repo markets. JSF has a high level of expertise in Japanese assets, maintains a strong credit rating, and brokers repo transactions with coverage reaching almost all financial institutions in Japan. JSF has an established reputation for speedy and accurate transactions from lenders and borrowers, supporting the needs of clients in Japan and abroad.

The balance of JSF's bond repo transactions has grown rapidly, by about 2.5 times in the last three years. One reason for this has been a larger number of transactions with overseas clients.

As a professional with knowledge of Japanese stocks, what trends do you see in the lending market for Japanese stocks?

The Nikkei Stock Average has remained above 30,000 since mid-May 2023, its highest level in about 33 years. The performance of Japanese equities markets stands out among the major developed country stock markets and is attracting the attention of domestic and foreign investors.

Against this backdrop, lending of Japanese stocks is also strong. The rise in Japanese stock prices has strengthened demand from investors for all Japanese assets and JSF offers a range of flexible solutions to support this demand. Trading volume is substantial, particularly given that clients wish to increase their inventory of Japanese stocks, including small-caps.

Alongside demand for short-cover purposes, there has been a growing appetite to receive Japanese stocks as collateral when borrowing other assets. Japanese assets are in demand for use as collateral since they are widely eligible for transactions using triparty collateral management services and collateral deposits with a central counterparty (CCP). We have been able to meet the needs of a wide range of market participants by accepting not only Japanese yen, but also foreign currencies and domestic and foreign securities as collateral for Japanese stock lending transactions. As a result, the balance of our Japanese stock lending transactions has increased tenfold over the past decade.

In terms of SC transactions, lending in the past has typically been through callable loans. However, non-call lending is also becoming more common in line with efforts to expand suppliers. It is possible to lend a variety of Japanese stocks — including small-cap stocks listed on the Growth Market where lenders such as pension funds have limited holdings — to meet the borrowing needs of market participants.

Given this flexibility, the Japanese stock market continues to be a popular market both domestically and internationally and we expect further growth in the future.

What are some of JSF's initiatives for the business globally outside of Japan?

JSF has focused its business on Japanese markets. However, it is also an important player in Asian markets and we have recently started funding with Asian stocks, including equities listed in Taiwan, Hong Kong and South Korea. We can accept these assets and offer JGBs, Japanese yen and US dollars in return. The demand to access HQLA is increasing — partly due to the impact of liquidity regulations imposed on major financial institutions — and the number of repo transactions handled by the JSF is also on the rise.

Japanese institutional investors and regional banks hold substantial portfolios of JGBs and we are well positioned to source this supply, given the strong relationships that we have with these organisations owing to our high credit rating and neutrality (we do not belong to any major Japanese financial group). As a broker, we can source JGBs from these organisations and meet demand from overseas investors.

Our business has grown in recent years as many global banks, broker-dealers and investors have entered the Japanese market. Alongside the depth of our expertise in Japan, we have strong knowledge of the

international lending market, especially in Asia, and we do business with many overseas clients, including G-SIBs.

In addition, we are considering entering derivatives markets globally, including the total return swaps market, to support the growing demand for synthetic transactions using derivatives.

What are your latest initiatives?

We are focusing heavily on the IT field in response to the ongoing expansion of the fintech sector. As noted, we have been offering LMTs since 1951 and have a well established history in this sector. Consequently, we have a large amount of trading data for LMTs and margin transactions which provides valuable insights on trends in the Japanese equities markets, particularly the trading trends of individual investors. With this in mind, we offer a data provision business and sell data to domestic and overseas investors as well as information vendors.

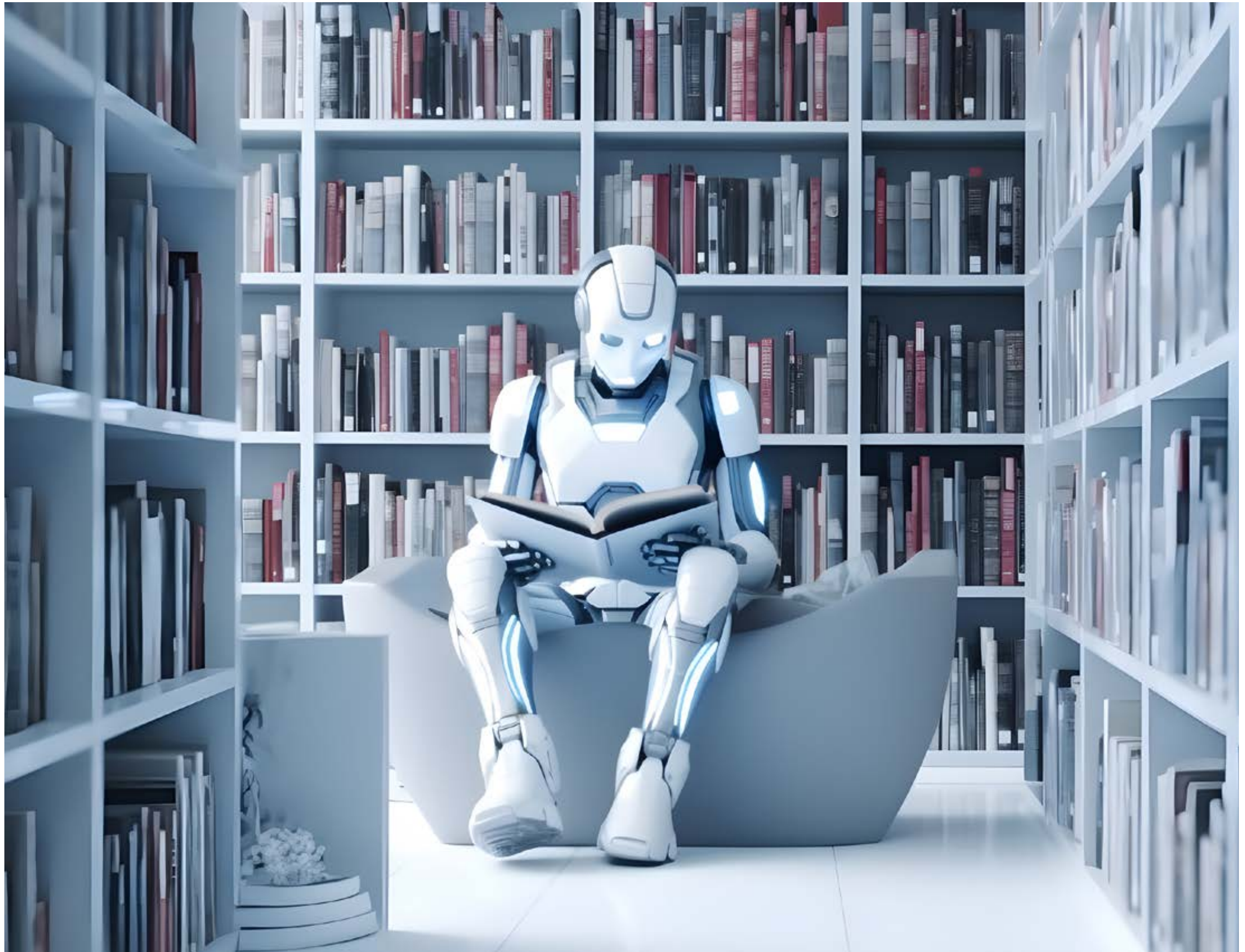
Beyond this, we are looking to expand into distributed ledger technology (DLT). As a specialist in securities finance, we believe that the use of blockchain technology and digital tokens in securities finance is a valuable area to explore. Based on this idea — in collaboration with Associate Professor Kenji Tanaka and his research lab at the Graduate School of Engineering of The University of Tokyo — we have been conducting empirical research on whether DLT can be used to facilitate securities finance trades based on tokenised securities and collateral. JSF published a report based on this research in May 2023.

More broadly, Japanese margin transactions and LMTs are excellent mechanisms for providing liquidity to securities markets and represent a highly effective means of developing securities markets in emerging countries. JSF provides know-how on margin transactions and LMTs to China, South Korea, Thailand and other countries and this has encouraged the formation of securities finance companies in these locations. Most recently, JSF helped to establish PT Pendanaan Efek Indonesia, an Indonesian securities finance company, and we are a leading investor, alongside the Indonesian stock exchange group, holding a 10 per cent stake in this company.

We will continue to leverage the advantages of our unique business format to reinforce our presence as Asia's leading securities finance specialist, thereby providing a connection between Asia's fast-growing securities finance sector and wider global markets.

JSF provides know-how on margin transactions and LMTs to China, South Korea, Thailand and other countries and this has encouraged the formation of securities finance companies in these locations.

Yosuke Kobayashi
Managing director
Institutional Sales Department
Japan Securities Finance



A new chapter of evolution

BNY Mellon's Simon Tomlinson, global head of securities finance trading, and Nehal Udeshi, global head of securities finance, speak to Carmella Haswell about the firm's journey to develop a more client-centric, innovative solutions-orientated approach, forming connections across the financing, liquidity and collateral ecosystem

Simon, having been with BNY Mellon for the past 18 years, how have you seen the business evolve over this time?

Simon Tomlinson: BNY Mellon has been a fantastic company to be a part of as we transformed into an agent lender that has been, and remains to be, at the forefront of a number of notable market developments in the industry.

Regarding evolution, much has changed since I started at BNY Mellon; a merger in 2007 between Mellon Bank and the Bank of New York, a banking crisis in 2008, various material regulatory changes such as Dodd-Frank, Basel III, the Securities Financing Transactions Regulation (SFTR) and the Central Securities Depositories Regulation (CSDR). In addition, there has been a sovereign debt crisis, followed by negative rates and, most recently, a pandemic.

While in a fast-moving business we tend to focus on what is in front of us, such as Basel III Endgame, T+1 settlement or mandatory clearing, when you step back and reflect you are quickly reminded why the industry has had to transform itself over the years.

There is no doubt that regulation has had the largest impact borne out of the various crises, truly shaping the borrow demand of today. As regulation has placed additional pressure on limited resources, the need to optimise has become paramount. Automation, smart buckets, pledge structures, central counterparties (CCPs), collateral expansion and term structures including evergreens, all form part of the success equation to run the business of today. Then there is the digital technology question and the opportunities presented by digitisation, tokenisation and artificial intelligence (AI), all of which we are highly focused on at BNY Mellon.

Beyond that, we have a new global head of securities finance who has just joined us, Nehal Udeshi, and we are looking forward to Nehal bringing her wealth of experience to the business as we enter a new chapter of evolution to meet the ever-changing demands of this industry.

Nehal, having been in the financial services industry for more than 17 years, what is your perspective on the current securities finance and lending landscape?

Nehal Udeshi: Every market cycle brings new considerations for the securities finance industry and this moment is no different.

The regulatory landscape, whether that is capital or liquidity rules, T+1 or mandatory clearing, continues to drive the agenda for securities finance. The capital rules have sharpened the focus on the cost of doing business, with indemnification being central to those discussions. Our clients remain focused on balancing returns with managing risk and ESG considerations.

Huge strides have been made across the industry with respect to technology and automation, and we continue to find additional ways to streamline processes and improve operational efficiency, including through the consideration of fintech solutions, blockchain and AI. Alongside this, data analytics remain an important tool for decision-making in securities lending and participants continue to invest in these capabilities to gain insights into lending opportunities and risks.

All of these focuses point the industry towards important market innovations that will help to optimise the way we are transacting on a daily basis. Collaboration across lenders, borrowers and market partners — collaboration designed to navigate these changes — has never been better.

How is BNY Mellon looking to advance its securities finance and lending services over the coming 12 months? How are you investing in your technology stack?

Tomlinson: Outside of the obvious new markets, such as Saudi Arabia, we are looking to include further integration of digital trading — such as HQLA^{X} and the tokenisation of assets. This is an exciting area and one that we believe can bring meaningful efficiency — while, more interestingly, providing an opportunity to access new pools of liquidity.

We are also very focused on central clearing for both our securities lending and repo businesses and we are confident that CCPs will play a greater role over the coming 12 months, given the benefits of clearing from a capital, risk and liquidity perspective.

In terms of technology stack investment, it is important to remember that we partnered with Trading Apps in 2012 on a new trading system. Since then, we have continuously invested in advancing our technology capabilities — for example, through the acquisition of the underlying lending IP — to enhance our products and ultimately to deliver market leading solutions to our clients.

Our trading system is constantly evolving, we are adding new capabilities around resource management and optimisation, as well as updating our predictive analytics — while ensuring we are connecting with other product offerings as seamlessly as possible to maintain high levels of automation.

How are the impacts of regulation, quantitative tightening and loan indemnification shaping the role of the agent lender?

Udeshi: Evolving regulations since the financial crisis have required agent lenders to enhance risk management practices and increase transparency. These are positive developments for the industry. However, they also bring the challenge of increasing the cost base for the agent lender. The industry continues to debate the role of the agent lender in providing credit intermediation — which continues to be important to many clients — as their requirements and trading

We strive at BNY Mellon to ensure that we offer a range of liquidity solutions to our clients which are easily accessible as market conditions alter.

Simon Tomlinson
Global head of securities finance trading
BNY Mellon

strategies evolve to meet their own regulatory changes.

Tomlinson: The impact of quantitative tightening on market liquidity has prompted agent lenders to adopt new strategies, and to employ new routes to market, to meet the demands of our clients. We witnessed in 2019, with the Federal Reserve's quantitative tightening, how quickly liquidity can change. As such, we strive at BNY Mellon to ensure that we offer a range of liquidity solutions to our clients which are easily accessible as market conditions alter.

Udeshi: Regulatory change, central banks' quantitative tightening policy, combined with the interest rate environment and market specific events — for example, the US debt ceiling and UK mini-budget crisis — have led to an evolving role for agent lenders, offering solutions and credit intermediation to clients, while balancing risk, compliance and profitability.

What trends are you noting in terms of securities finance trading and where are you seeing the most opportunity for your clients?

Tomlinson: 2023 has been a year of low volatility, with pockets of meaningful activity.

Fixed Income has fared well in the first half of the year as rate uncertainty continued. However, this has started to tail off as the end of the interest rate tightening cycle appears to be moving closer. On the flip side, as long inventory pools at prime brokers are bolstered by the equity market rallies, we are seeing a demand for further upgrade trades which had been lacklustre until recently.

Equities have also had a good year so far, driven by highly concentrated specials such as AMC and, more recently, JNJ and Kenvue, but this is a far cry from the broader specials space we saw in late 2022 and early 2023. With the market more long than short, there is increased internalisation occurring and therefore less need to source externally, which is evidenced by lower balances. As terminal rates look more likely, there is hope that the initial public offering (IPO) backlog will start to ease. To date, the US IPO space — a relatively lucrative space for securities finance clients — is down by more than 30 per cent year-over-year.

The standout performer for 2023 is corporate bonds, which have continued from their stellar 2022 performance. The environment for

corporates remains challenged, especially in the high yield space, and short demand remains strong with wider spreads holding steady.

For clients, the age-old flexibility question remains key. Borrowers are laser-focused on risk-weighted asset (RWA) and efficiency, so clients that have the most options available — be it collateral flexibility of both cash and non-cash, term structures and participation in CCPs — will no doubt fare the best.

What are your priorities for H2 2023 and going forward into 2024? What can the industry expect next from BNY Mellon?

Udeshi: For the rest of this year, I think we are already well into our journey as we look to develop a more client-centric, innovative solutions-orientated approach which will help our clients to make easier connections across the financing, liquidity and collateral ecosystem. Recognising the upcoming regulatory change agenda impacting various client types, we will continue to stay close to our clients, to support them as they navigate the impact of these challenges, and require a nimble approach to their financing needs.

Tomlinson: That will continue to be a priority, alongside the need to optimise the use of limited resources by working with the CCPs to develop meaningful solutions for scalability and cost effectiveness. CCPs will form an integral part of the securities finance distribution chain. Current engagement with CCPs is progressing well and we feel confident that the time is right to bring SFT clearing to fruition.

Beyond this, we will continue to invest in our technology and I expect there will be several new enhancements to our trading system to improve efficiency and automation.

There continues to be much debate on the impact of the move to T+1 in both the US and Canada, but it is clear that the shorter settlement cycle could have an effect on how assets are lent. The potential that some buffer levels will be increased to reduce the likelihood of fails is a real possibility.

As the accelerated settlement landscape picks up pace, we anticipate seeing similar proposals across the EU and UK in due course and note that UK policymakers are now reviewing the potential benefits and pitfalls of introducing a T+1 settlement cycle in the UK. Global product-level interoperability will be key to ensure a smooth transition and BNY Mellon is well-positioned to support our clients in this changing environment.

Huge strides have been made across the industry with respect to technology and automation. We continue to find ways to streamline processes and improve operational efficiency.

Nehal Udeshi
Global head of securities finance
BNY Mellon

Basel III Endgame: redesigning US risk-based capital requirements

US regulators have released plans to standardise the bank capital framework and to implement final elements of the Basel III Capital Accord. With the public consultation ongoing, Bob Currie examines the proposal and its potential implications for the banking industry

On 27 July, US regulatory authorities launched industry consultation on plans to increase the strength and resilience of the banking system.

The proposal aims to revise bank capital requirements to reflect underlying risks more accurately and to create greater consistency across banking groups in terms of how they calculate those risks. This will also implement final components of the Basel III Capital Accord, known as the Basel III Endgame.

More broadly, the proposal responds to instabilities identified in the banking system in the early part of 2023 — characterised by the collapse of Silicon Valley Bank, Signature Bank and other elements of what these regulators call the 'March 2023 turmoil' — by applying a more comprehensive set of capital requirements to a larger number of banks. If adopted, these measures will apply to banks with US$100 billion or more in total assets.

In particular, the proposal aims to standardise aspects of the capital framework related to credit risk, market risk, operational risk, and credit valuation adjustment risk (CVA risk, which relates to losses on certain types of derivatives contract). Additionally, the proposal will require banks to include unrealised gains and losses from certain types of securities in their capital ratios.

In their proposal, the three sponsoring regulators — notably the Federal Reserve, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) — estimate that these proposed changes may result in an aggregate 16 per cent rise in common equity tier 1 (CET 1) capital requirements for the bank holding companies that fall into scope.

While the impact of these regulatory adjustments will vary from bank to bank, based on their business activities and risk profile, the regulators are confident that most banks currently have sufficient capital to meet the proposed requirements.

Under the proposal, large banks would transition to the new framework as part of a phased roll out beginning on 1 July 2025, with a requirement that banks are fully compliant beginning from 1 July 2028.

In parallel with this proposal, the US Federal Reserve has issued plans to revise the calculation of the capital surcharge for "the largest and most complex banks". The Fed indicates that these changes are designed to align the surcharge more effectively with a bank's systemic risk profile by measuring the bank's systemic importance averaged over a full 12-month timeframe, rather than simply as a point-in-time measure based on a year-end value.

The consultation period for both of these proposals will continue until 30 November 2023, providing respondents with more than 120 days to provide their feedback.

A three-stack approach

In a detailed evaluation of the potential implications of the Endgame package, the Securities Industry and Financial Markets Association (SIFMA) notes that the US Basel III Endgame proposal released on 27 July 2023 will create a "three-stack" approach to risk-based capital requirements.

This three-stack methodology replaces the existing two-stack approach and will include: the revised US standardised approach, in accordance with the Collins Amendment of the Dodd-Frank Act (the "Collins Floor"); a new expanded risk-based approach (ERBA); and a separate standardised output floor (for details, box on p 26).

SIFMA indicates that the proposal makes the mandated Collins Floor, as well as the standardised output floor, effectively obsolete, reducing these provisions to costly compliance exercises for banks.

Significantly, the Association believes that applying the stress capital buffer (SCB) to the ERBA will result in a "duplication of risk capture" — a double counting of some underlying risk elements — for market, operational and CVA risks. This will result in banks being asked to meet capital requirements that are higher than the associated underlying risks in their banking activities.

It concludes that over-capitalisation resulting from these two design issues is likely to impair the ability of the largest banks to provide key capital markets products and services, translating into higher costs for end-users and the broader US economy. Moreover, it could have negative implications for liquidity in the US Treasury markets, US financial stability, and the broader economy.

According to SIFMA's chief operating officer Joe Seidel, the anticipated increases in trading book capital will potentially result in banks raising their costs and reining in their capital market activities.

A "three stack" approach to risk-based capital requirements

The Collins Amendment of the 2010 Dodd-Frank Act requires large US banks — those subject to "advanced approaches" treatment, which particularly refers to the G-SIBs — to calculate their capital requirements in two ways: using standardised approaches set by financial regulators; and, second, using internal models approaches. They are required to apply the larger of these two capital calculations. This creates a "two-stack" approach to calculating capital requirements.

Under the proposed amendments circulated for public consultation in July 2023, the proposal will retain the US current standardised approach for calculating credit risk.

For market risk, it will replace the current internal model approach with the Fundamental Review of the Trading Book's internal models approach (FRTB-IMA).

With these changes, the Collins Floor capital requirement will become the sum of the current US non-modelled credit risk capital and FRTB-IMA market risk capital.

The expanded risk-based approach (ERBA) calculation will be the sum of non-modelled credit risk, operational risk and CVA risk capital — each calculated using the new standardised approaches — and the FRTB-IMA market risk capital.

The standardised output floor will be 72.5 per cent of the ERBA capital requirements, with market risk capital being calculated using the FRTB's standardised approach (FRTB-SA).

He predicts that this may prompt banks to narrow the products and services that they offer, resulting in a loss of market capacity which is unlikely to be replaced by other market participants.

The outcome, Seidel believes, is likely to be higher funding and hedging costs and weaker access to the market for end users, leading — among other consequences — to weaker access to liquidity during times of market stress.

For Seidel, the impact of the Basel III Endgame is likely to be felt more in some types of financial market activities than others, with trading in securitisation products, securities underwriting, equity investments in funds, securities lending and borrowing, and derivatives particularly affected.

Standardised and expanded risk-based approaches

Under the proposed new framework, all banks above a certain size will be required to use standardised models to calculate capital requirements for market risk, while the use of internal models will be subject to a more stringent approval process and ongoing tests that, according to the International Swaps and Derivatives Association (ISDA), will substantially increase maintenance costs.

A recent survey by ISDA finds that internal model coverage of bank trading desks could drop from an average of 86 per cent to just 31 per cent as a result of these changes.

ISDA's chief executive Scott O'Malia notes that while the new standardised approaches are more sensitive to risk than in the past, reliance on a one-size fits-all model will be a major change that could lead to herd behaviour and drive concentrations in particular assets.

The early headline from the proposal, says financial services consultancy and accounting specialist PwC, was that its "expanded risk-based approach" for calculating risk-weighted assets (RWA)

would result in higher capital requirements for the banks that are impacted by these changes.

PwC indicates that the proposal would effectively remove capital rule tailoring across the four categories of the Federal Reserve's "tailoring framework" by requiring Category III and IV banks to comply with the stricter requirements currently applied to Category I and II banks. This tailoring regime seeks to align a bank's capital treatment to its size and risk profile.

This tailoring framework groups banks by size and systemic importance from Category 1 banks (also known as the Global Systemically Important Banks, or G-SIBs), Category 2 banks (with more than US$700 billion in total assets or more than US$75 billion in cross-jurisdictional activity), down to Category 4 banks (with US$100 billion to US$250 billion in total assets) and 'Other Firms' (US$50 billion to US$100 billion in total assets).

A PwC research paper, Basel III Endgame: the Next Generation of Risk-weighted Assets, estimates that the proposed changes will result in an aggregate increase in RWA of 24 per cent for Category I and II banks and 9 per cent for Category III and IV banks. It estimates that market risk RWA could potentially rise by approximately 75 per cent across all banks.

The proposal expands the scope of market risk capital requirements across bank categories, and introduces a new framework for standardised market risk capital that is expected to require impacted banks to hold higher levels of capital against their market risk exposures.

As noted, the proposal will only allow internal models to be used for market risk assessment, but it will apply enhanced supervisory standards to trading desks that apply an internal models approach (IMA).

Significantly, the US proposal contains several requirements that step beyond the minimum Basel standards – an example of what some commentators call a US "gold plating" of international standards.

Adam Gilbert, partner and global senior regulatory adviser for Financial Services Risk and Regulatory at PwC, explains that standardisation can be helpful in creating a level playing field for all banks. However, the US proposal differs significantly from its application in the European Union and UK in that the US only allows models for market risk, while the EU and UK continue to allow models for credit risk. This is particularly important for businesses where banks compete globally to provide credit.

"For US domestic businesses there is less of a competitive case to be made, but the gold-plating of the US rules will certainly cause banks to assess their willingness to make certain types of loan," says Gilbert. "For mortgage lending, for example, high loan-to-value (LTV) mortgages will attract much higher risk weights under the proposed rules."

As noted, the proposal introduces a Basel-consistent output floor and eliminates the use of internal models for credit risk and operational risk for the largest banks. With respect to the output floor, Gilbert indicates that the lack of modelled approaches for credit risk in the US will render the output floor essentially meaningless in the US. "It will also make the Collins floor nothing more than an additional calculation of RWA under the current standardised approach," says Gilbert.

Securities finance transactions

Unlike the EU, the US Federal Reserve aims in its Basel Endgame proposals to implement a framework for minimum haircut floors for SFTs.

The minimum haircut floors framework for SFTs was introduced into the Basel standards in 2017, taking into account a recommendation made by the Financial Stability Board (FSB) to the Basel Committee on Banking Standards (BCBS) in 2015 to introduce numerical haircut floors for non-centrally cleared SFTs in which secured financing is provided to non-banks against collateral other than government debt (see box on p 28).

Commenting on this feature, PwC's Gilbert observes that the US imposition of haircut floors for securities financing transactions with unregulated financial institutions (hedge funds for example) may very well reset the margin requirements for this sector of the market. Failure to meet the haircut floor — or one of the exemptions in the proposal — will result in much higher capital treatment for US banks.

Conversely, the EU and UK have decided not to implement these

Minimum haircut floors for securities finance transactions

Unlike the EU, the US Federal Reserve aims in its Basel III Endgame proposals to implement a framework for minimum haircut floors for SFTs.

The minimum haircut floors framework for SFTs was introduced into the Basel standards in 2017, taking into account a recommendation made by the Financial Stability Board (FSB) to the BCBS in 2015 to introduce numerical haircut floors for non-centrally cleared SFTs in which secured financing is provided to non-banks against collateral other than government debt.

This approach derives from an earlier report by the Financial Stability Board, published on 29 August 2013, which aims to address shadow banking risk in securities lending and repo transactions.

With regard to haircuts for SFTs, the FSB recommended a two-pronged methodology to limit the build-up of excessive leverage outside the banking system and to help reduce 'procyclicality' of that leverage.

First, this is based on qualitative standards for methodologies used by market participants that provide securities financing to calculate haircuts on the collateral received.

Second, as we have noted, this involves the introduction of numerical haircut floors on non-centrally cleared SFTs in which financing against collateral other than government debt is provided to non-banks.

The numerical haircut floors are not intended to dictate market haircuts. Rather, these set a base level and market participants are required to conduct their own risk assessments to establish an appropriate haircut level for each specific set of circumstances, applying levels above the haircut floor "whenever prudent".

haircut floors and this, Gilbert believes, could be a distinct advantage for banks based outside of the US.

More broadly, he predicts that the expected increase in market risk RWA will certainly prompt banks to examine where they can reduce their trading positions to avoid the large capital charges that they would otherwise have to bear.

Addressing bank failures

Following the banking turmoil in March 2023, the Fed, OCC and FDIC proposal seeks to further strengthen the banking system by applying a broader set of capital requirements to large banks. The proposal would generally apply to banks with US$100 billion or more in total assets.

FDIC chair Martin Gruenberg has stated that although Silicon Valley Bank's (SVB) failure was caused by a liquidity run, the loss of market confidence that precipitated the run was prompted by the sale of assets at a substantial loss that raised questions about the capital adequacy of the bank.

"The lesson to take away is that banks in this size category can pose genuine financial stability risks and the federal banking agencies need to review the supervision of these institutions," says Gruenberg, "particularly for interest rate risk in the current environment, and the prudential requirements that apply to them, including capital, liquidity, and loss absorbing resources for resolution."

Whether the proposed changes to bank capital requirements will be appropriate and sufficient to address the vulnerabilities that contributed to the 'March 2023 turmoil' is an open question.

For PwC's Gilbert, this is by no means certain. "The reasons for a bank's failure are often complicated," he says, "and it is not at all clear that the changes as proposed would have prevented these failures."

According to ISDA's O'Malia, the Basel III regulatory reforms are long overdue, but he warns that a further significant increase in capital requirements could have serious consequences. He references Federal Reserve estimates that implementing these final measures could result in a capital increase of up to 20 per

cent for the largest US bank holding companies. Drawing on BCBS forecasts, he also notes that the revised market risk standards will lead to a weighted average rise in capital requirements of 57 per cent for G-SIBs.

"An increase in capital for market risk of this size is concerning," says O'Malia. Recent periods of stress sparked by the pandemic in 2020 and the invasion of Ukraine in 2022 have highlighted liquidity imbalances that may warrant attention, he indicates, but there has been no evidence that banks were holding insufficient market risk capital to weather those shocks.

"If banks are forced to ramp up their trading book capital by more than 50 per cent, it could result in higher costs for end users and may force some firms to withdraw from certain businesses," concludes O'Malia.

Farrah Mahmood, director of regulatory affairs at the International Securities Lending Association (ISLA), indicates that there are relatively few major deviations between the US Basel III Endgame proposals and Basel III application in the EU.

"Historically, Europe has been able to claim wider Basel application to all EU banks, but in light of the US widening the pool of banks subject to Basel rules, to all above US$100 billion in assets, Europe is likely to face greater scrutiny for its deviations," she observes.

In terms of divergence on substance, Mahmood notes that the EU and US will be misaligned most significantly on unrated corporates and securities financing transactions (SFTs).

Beyond the points already discussed above, Mahmood notes that the Fed suggests a Basel-aligned two-tier system of a 65 per cent risk weight for investment grade corporates and 100 per cent risk weight for other corporates. "While this approach to corporates — including unrated companies — is very similar to what is going ahead in the EU, the US and Basel is likely to see the EU approach as a deviation because the EU also relies on external credit ratings to determine risk weights, while the US does not."

Mahmood notes that the significant expansion in the number of banks falling into scope of the Basel framework in the US will be particularly significant in the area of market risk, with a large part of the capital increase for US banks expected to stem from this risk component. "The Fed's approach appears broadly consistent with Basel on substance, moving the EU and US closer, with the key divergence being the 1 July 2025 application date," she notes.

Significantly, for the first time in the history of US Basel rulemaking, the regulators have shared an impact analysis of the proposed changes. These changes are estimated in the Fed, FDIC and OCC proposal to result in a 16 per cent increase to CET1 capital levels and a 20 per cent increase to RWA for large bank holding companies.

One potential consequence is that this may provide opportunities for non-banks that offer competing services. "These estimated capital increases are significant," notes PwC's Gilbert, "and we believe these will result in either higher cost or reduced availability of credit and bank balance sheets. This would appear to be an opportunity for non-bank institutions to pick up market share."

ISITC Europe director Gary Wright questions the efficacy of the Basel III regime more broadly and whether its design and focus is appropriate to achieve its stated objectives, given the current direction of travel of the banking industry.

"Basel III was conceived in a past world for old objectives and now looks outdated considering the march towards full digitalisation," says Wright. "Tokenisation is growing and the range of cryptoassets looks unending, as does the introduction of distributed ledger technology (DLT) in a international investing industry moving to real time processing."

Wright observes that the fast approaching transition to T+1 settlement for securities transactions in the US and Canada, with implementation scheduled for May 2024, is raising many issues in business as well as technology. This reinforces the need for central banks, and the banking industry, to harmonise financial products under an internationally recognised regulatory standard. "Basel III falls well short in catering for the needs of today's and future markets," he concludes.

Given the importance of these regulatory developments, it is perhaps surprising that a number of large global banks and brokers — and at least one industry association representing them — did not wish to comment on how they would be impacted by these regulations. It is a peculiar time for silence.

2023 UPCOMING EVENTS

4 October

The Fixed Income Leaders Summit
Barcelona

9 October

RMA Securities Finance & Collateral Management Conference
Florida

10 October

Fleming's 17th Annual Collateral Management Forum
Amsterdam

6 November

Securities Finance Technology Symposium
London

For more upcoming events and full desciptions visit our event page www.securitiesfinancetimes.com/events

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*Global Investor/ISF Beneficial Owners Survey - Custodial Lender Category Unweighted, 2021

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BBH appoints Holmes global head

Brown Brothers Harriman has reshaped its senior securities lending team, with Sarah Holmes stepping up to global head.

With almost 30 years of service at the Boston-based bank, Holmes is promoted from her previous position as chief administrative officer within Brown Brothers Harriman’s (BBH’s) systems and technology discipline.

In her role as global head of securities lending, Holmes will oversee product development, trading and client engagement for the securities lending segment.

The bank has moved Tom Poppey to head of product strategy in the securities lending division, with a focus on expanding BBH’s lending activities into new locations, advancing its automated trading technology and building its DealBoard solution, a proprietary technology that identifies optimisation opportunities from underutilised portfolio assets.

Morano joins Mizuho Securities USA

New York-based investment bank Mizuho Securities USA has appointed Jo Ann Morano as executive director of securities lending.

Based in the US, Morano will report to Sandeep Sureka, managing director, head of equity finance and delta 1 trading, who joined the firm in November 2022.

Morano has more than 20 years of industry experience. She joins the bank from a decade-long tenure at ING where she held multiple senior positions within global securities finance, including head of equity lending and repo, and director of US equity finance.

Morano has also worked at Credit Suisse, Fortis Investments and Prudential Investments.

MUFG hires Mullboccus for Asia

Mitsubishi UFJ Trust & Banking Corporation has appointed Reshad Mullboccus as executive director and head of Asia equity lending.

Based in London, Mullboccus will join the global securities lending solutions team.

Mullboccus brings more than 18 years of industry experience to the role. He joins the Japanese bank from an eight-year tenure at HSBC where he was most recently global head of product management for agency securities lending.

Mullboccus held a number of senior positions during his time with the bank, first joining HSBC’s Hong Kong office in March 2015 as head of Asia trading for agency securities lending.

Prior to this, he spent eight years with Mitsubishi UFJ Trust International as a securities lending trader. He began his career at Merrill Lynch, where he took on the role of global equity finance trade support.

Commenting on the announcement, Tim Smollen, global head of global securities lending solutions at MUFG, says: “We are excited to welcome Reshad to our London team, with the responsibility for taking our Asian equity lending desk and capabilities to the next level."

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Panetta appointed chair of BIS Payments Committee

Fabio Panetta has been appointed as the new chair of the BIS Committee on Payments and Market Infrastructures (CPMI), the standard setting body for payment, clearing and settlement and market infrastructure services.

He has been appointed for three years and will replace outgoing chair Sir John Cunliffe, the Bank of England's deputy governor, who has served since January 2020.

Panetta is incoming governor of the Bank of Italy and a member of the European Central Bank's Executive Committee. He will chair the CPMI at the Bank for International Settlements (BIS) in parallel with these roles, beginning on 1 November.

Central bank governors have also appointed Eddie Yue, the Hong Kong Monetary Authority's chief executive, as chair of the meeting of governors of the major emerging market economies' (EMEs).

He will stand for three years and has replaced BIS deputy general manager Luiz Awazu Pereira da Silva, who is retiring. Yue began his three-year term on 1 September.

LSE appoints Walker as deputy CEO

London Stock Exchange has appointed Charlie Walker as deputy CEO. Subject to regulatory non-objection, Walker will also join the company's board.

Walker's new responsibilities relate to assisting in the daily running of the exchange.

He joined London Stock Exchange Group (LSEG) as head of equity and fixed income primary markets in 2018.

Prior to joining LSEG, Walker worked for 11 years within J.P. Morgan Cazenove's equity capital markets team.

As in his previous role, Walker will continue to report to Julia Hoggett, CEO of LSE.

He retains his responsibilities in overseeing LSEG's primary markets business.

Commenting on the appointment, Hoggett says: "Charlie brings deep knowledge of capital markets having worked at the London Stock Exchange for the past six years in addition to his time working in investment banking."

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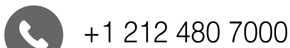

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