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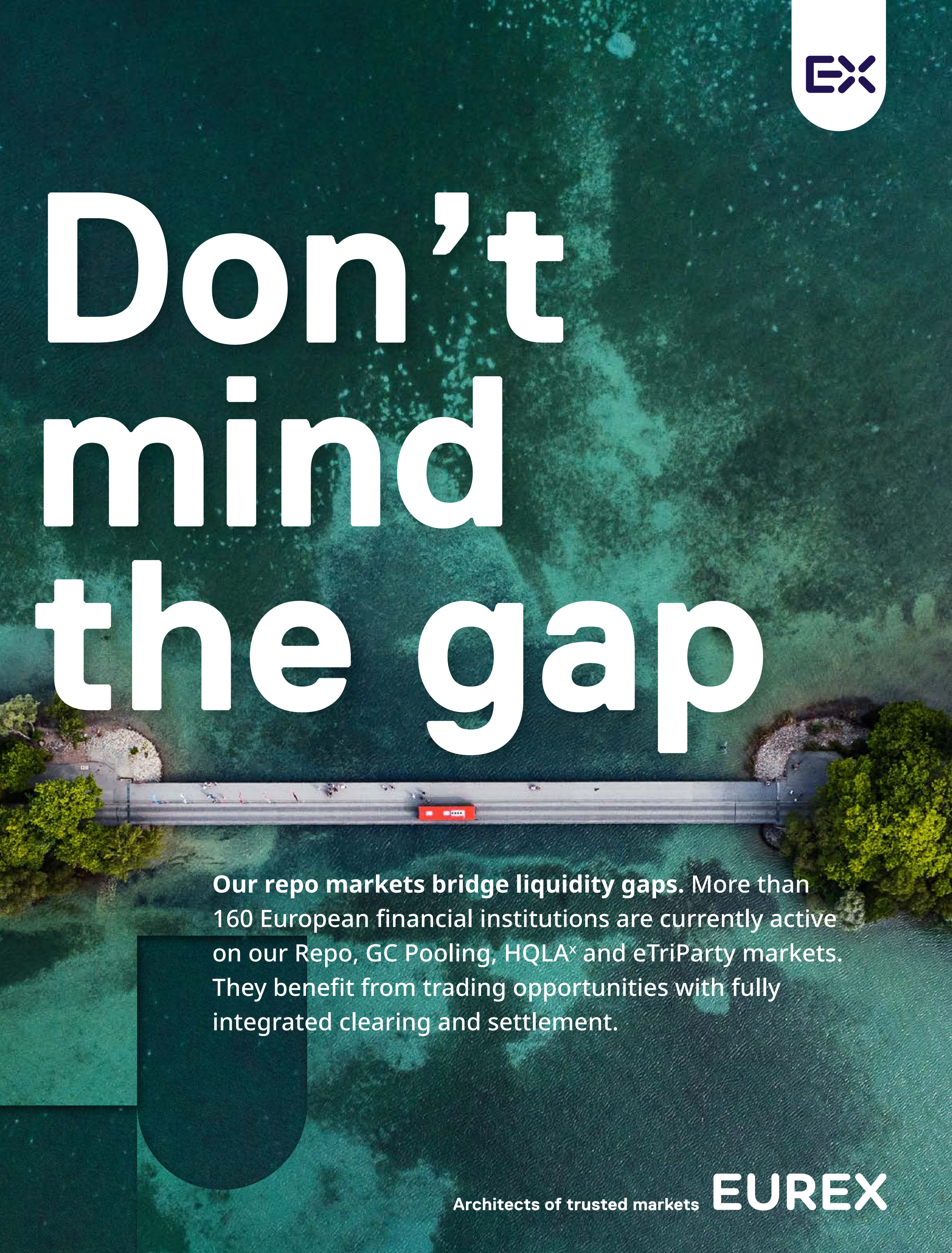
Unlocking new horizons

Joseph Russo and Olivia Russell explain GLMX's vision beyond securities lending and repo to a full ecosystem for money market products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Impact of the SEC’s Treasury Clearing proposal significant

Industry feedback and data analysis collected by DTCC has indicated that the impact of the SEC’s 2022 Treasury Clearing proposal could be “significant”.

The global post-trade service made the prediction in its industry paper, “Looking to the Horizon: Assessing a Potential Expansion of U.S. Treasury Central Clearing,” that explores the possible impacts of the SEC’s proposal.

The proposal would require a significantly larger portion of the U.S. Treasury cash and repo markets to be centrally cleared through an SEC-registered central counterparty.

Based on its data analysis, DTCC projects approximately US$1.63 trillion daily in incremental indirect participant Treasury activity ($500 billion of repo, $520 billion of reverse repo, and $605 billion of cash trades) will come into central clearing.

DTCC’s survey responses indicated the Fixed Income Clearing Corporation’s (FICC's) various central clearing access models and available services are “not broadly understood”, and a majority of FICC members remain unsure which models or services they want to use for indirect participant activity.

Specifically, 52 per cent indicated they were unsure as it relates to the Treasury’s reverse repo and Treasury repo activity, and 58 per cent indicated they were unsure as it relates to indirect participant Treasury cash activity.

FICC expects that the incremental indirect participant Treasury volume could result in a corresponding increase in Value at Risk (VaR) margin, which it conservatively estimates could be approximately US$26.6 billion across the FICC/Government Securities Division membership.

However, these estimates assume that all incremental indirect participant activity clears through one of FICC’s gross margin access models, says DTCC. The estimates could potentially decrease if the activity were cleared through one of FICC’s net margin models, it adds.

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Pirum and FIS offer recall interoperability

Pirum has announced new connectivity and interoperability measures that aim to assist clients in the upcoming transition to T+1 for the US and Canada.

The developments will enable users of the FIS Securities Lending Processing Platform (formerly known as Loanet) to connect with users of Pirum's post-trade services or FIS' platform, with full interoperability and network coverage across all platforms.

Pirum says this will increase straight-through processing of recalls and callback messages, enabling clients to issue recalls and manage callbacks centrally with connectivity to trading counterparts on either platform.

Philip Morgan, CEO of Pirum, says: "I am thrilled to announce this significant evolution ahead of T+1 regulatory change, which reiterates Pirum's commitment to providing global automation and supports our expanded coverage in North America. Much like for the Securities Financing Transactions Regulation (SFTR), industry participants asked that service providers work together — we listened and reacted accordingly."

Impact of the SEC's Treasury Clearing proposal significant

Continued from page 3

DTCC's survey respondents suggested a variety of risk- and operations-focused enhancements to FICC's offerings and services in connection with the potential expansion of central clearing of Treasury activity, such as improved cross-margining opportunities, increasing transparency of margin and CCLF calculations.

This is in addition to enhanced reporting tools related to FICC's risk management processes and operational enhancements to FICC's novation processes and timelines.

Commenting on the SEC's proposals and DTCC's findings, Laura Klimpel, general manager of FICC and head of Systemically Important Financial Market Utility business development at DTCC, made a statement.

She said: "We are committed to continuing to work with our members, their clients, the broader market, and our public sector stakeholders to raise awareness regarding FICC's various central clearing access models and services.

"We will also continue to foster efforts that consider the potential impacts the SEC's Treasury Clearing proposal could have on FICC's operations, risk models and the tools we provide. We look forward to engaging the industry for further feedback as we move forward."

Danmarks Nationalbank and BNY Mellon select Eurex to centrally-clear repo trades

Eurex has onboarded its first Nordic central bank, Danmarks Nationalbank, to trade and centrally-cleared repo transactions on the platform.

Eurex says its liquid and centrally-cleared repo markets allow clients to trade repos with more than 160 registered participants. The platform enables clients to raise or place cash in four currencies against more than 13,000 domestic and international securities.

Danmarks Nationalbank is the second central bank outside the euro area to join Eurex and the fifth central bank connected to Eurex for repo so far.

The move is a milestone for Eurex's cleared repo markets and follows the recent addition of BNY Mellon — which selected Eurex as the first European central counterparty to trade centrally-cleared repo trades for the US bank.

Both banks have now become trading and clearing members at Eurex.

Commenting on the announcement, Martin Wagner Toftdahl, head of banking and markets at Danmarks Nationalbank, says: "Joining centrally-cleared repo markets is an important milestone in our reserve management.

"First and foremost, centrally-cleared repo transactions are perfectly in line with our aim of having broad market access and ensuring efficient management across products. Having access to liquid markets for cleared repos will further strengthen our ability to achieve underlying demand for our euro liquidity."

Björn Storim, CEO of BNY Mellon's European bank, adds: "Access to Eurex enhances our overall liquidity management tool kit. The demand for European repo is continuously increasing and this important milestone supports us in expanding our business and risk management capabilities in Europe."

CME Group and DTCC receive cross-margining 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."

Laura Klimpel, general manager of FICC and head of SIFMU business development at DTCC, comments: “We are pleased to have received regulatory approval of our enhanced cross-margining arrangement.

“The approval of the arrangement paves the way for increased efficiency and resiliency of the overall US Treasury Market, and we look forward to working with CME Group to deliver upon these important enhancements.”

ISLA integrates its Clause Library and Taxonomy with the CDM

The International Securities Lending Association (ISLA) has announced the integration of its Clause Library and Taxonomy with the Common Domain Model (CDM).

The integration is the first complete contribution to the CDM in respect of a master agreement.

The CDM, an open-source project hosted by FINOS, aims to unify a series of actions, lifecycle events and product definitions by developing a single openly available language or code.

ISLA reports that its addition of a master agreement structure to the CDM has enabled the model to represent terms negotiated in a standardised form.

The Clause Library and Taxonomy launched in 2021 in partnership with D2 Legal Technology (D2LT), with the aim of facilitating more efficient negotiation of the 2000, 2010, and 2018 Security Interest over Collateral versions of the Global Master Securities Lending Agreement (GMSLA).

The association says integration of the Clause Library and Taxonomy with the CDM will facilitate improved management of executed contracts and future contracts between industry participants by providing an industry

data dictionary for GMSLA contracts.

ISLA says the integration allows for the use of data extraction tools with artificial intelligence (AI) and natural language processing (NLP) capabilities.

Andrew Dyson, CEO of ISLA, says: "The pursuit of digitalisation in all its forms, including the wider adoption of DLT and tokenisation, can only realistically realise its full potential if products are built on solid and sustainable foundations.

"Bringing key elements of the Clause Library into the CDM is part of the process that will allow market participants to increasingly develop solutions and novel products that are underpinned by these standards, thereby driving better interoperability and efficiencies across our markets."

Akbar Datoo, CEO of D2LT, says: "It is very exciting to see this next step in the GMSLA's digitalisation journey. It will address the issues of legal agreement data quality and governance, and will no doubt ensure resource optimisation, regulatory compliance and operational management for the industry over the coming months."

D2LT also partnered with the International Capital Markets Association to launch its Clause Library and Taxonomy in August 2023.

EquiLend commences with 1Source testing

EquiLend has commenced with the pilot phase of its anticipated distributed ledger technology (DLT)-based 1Source system, which will go live across the market in 2024.

The global technology, data and analytics firm says a number of agent lenders and broker-dealers within the securities lending industry are among those participating in the pilot.

The EquiLend 1Source ledger will retain a central record of the agreements made between counterparties in a securities lending transaction.

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It aims to eliminate mismatched trade details — which the firm says is common in existing workflow — that are currently resolved only through manual, costly reconciliation processes.

The system was first announced in July 2022 as a technology programme that would incorporate emerging technologies to develop a common record, or a "single source of truth", to support trade processing across transaction lifecycle.

According to EquiLend, analysis conducted by an independent consulting firm found that ensuring all lifecycle events remain in sync for both counterparties in a transaction with EquiLend 1Source could reduce industry costs by up to US$100 million per year.

Commenting on the announcement, EquiLend's chief information officer Ken DeGiglio says: "When we developed the concept for EquiLend 1Source with the industry's Digital Transformation Working Group, our goal was to solve critical industry pain points and to empower businesses to continue to trade accurately and efficiently.

"The successful launch of the EquiLend 1Source pilot shows that the market shares that vision, and that a new, modernised and efficient chapter has begun for the securities finance industry."

Tradeweb welcomes JSCC clearing for Yen swap transactions

Institutional clients executing Japanese Yen swaps on Tradeweb Markets' multilateral trading facilities (MTFs) and swap execution facilities (SEFs) can now clear their transactions via the Japan Securities Clearing Corporation (JSCC).

Clients will now be able to benefit from fully automated workflows on Tradeweb's MTFs and SEFs from pre-trade credit checks to execution and clearing.

It will also enable users to achieve straight-through processing (STP) improvements, according to Tradeweb.

The announcement follows JSCC's decision to support MTF and SEF trading, which Tradeweb says replaces a previously 'time-consuming' and 'redundant' confirmation process between the clearing house and clearing brokers subsequent to the execution of their clients' Yen swap transitions.

JSCC provides clearing services for listed cash and derivatives, over-the-counter (OTC) derivatives and OTC Japanese Government Bond cash as well as repo transactions for both domestic and foreign financial institutions.

Commenting on the announcement, Enrico Bruni, head of Europe and Asia business at Tradeweb, says: "Yen swaps form an important part of many institutional strategies, and harmonising these transactions with the real-time, STP nature of the other instruments in their portfolios will create significant efficiencies to the institutions that trade them."

Yasuyuki Konuma, JSCC president and CEO, adds: "We are pleased to be working together with Tradeweb to address institutional investor demand for fully electronic trading workflows in Yen swaps.

"As a primary central clearing counterparty for Yen derivatives products, we are always focused on ensuring our services are competitive, and offer global investors convenient and enhanced access to Japanese markets."

"Enabling investors to hedge their JPY risk, while simultaneously enjoying the benefits of trading electronically, can only add tailwinds to their strongly growing interest in Yen assets," comments Taichi Shibuya, head of Japan at Tradeweb.

Clearstream GSF volumes increase 12%

Clearstream's global securities financing business recorded a 12 per cent year-over-year increase in volumes outstanding to €686.4 billion for August, according to recent monthly figures.

Year-to-date GSF outstanding volumes have increased 6 per cent to €624.7 billion for 2023, relative to €589.0 billion for the equivalent period in 2022.

Assets under custody held in Clearstream have increased 5 per cent YoY to €17,563 billion for the month of August. Year-to-date, assets under custody saw a 4 per cent rise to €17,350 billion for 2023.

For Clearstream's investment funds services (IFS), securities deposits saw little change YoY, standing at €3,280 billion for August. The total number of transactions through this service has increased 1 per cent YoY to 3.81 million for August.

International business (ICSD) securities deposits have increased 5 per cent YoY to €8,325 billion for August. The number of transactions through this service increased 10 per cent YoY to 6.4 million for August.

Hidden Road joins Komainu Connect collateral management platform

Global credit network Hidden Road has joined digital asset custody service provider Komainu's collateral management platform, Komainu Connect.

Komainu Connect removes the need to store collateral with trading and liquidity counterparties, reducing client counterparty risk and ensuring that assets are kept in secure and regulated custody. Using the platform allows clients to leverage digital assets in collateralisation scenarios.

Hidden Road is the first digital prime brokerage service provider to join the platform, and follows the addition of cryptocurrency exchange OKX to the network in June.

Nicolas Bertrand, Komainu CEO, says: “Hidden Road is a key addition to our expanding collateral management network, [and is] another piece of the puzzle in bringing this institutional grade offering to the digital asset marketplace.”

Michael Higgins, global head of business development at Hidden Road, comments: “Thanks to its focus on security and regulation, Komainu Connect has the potential to unlock additional volume in institutional digital asset trading.

“As we build out our offering to counterparties trading in traditional and digital assets, Hidden Road continues to cultivate partners that enable efficient and mature workflows with robust, modern approaches to risk and compliance.”

OCBC joins LCH SwapClear

OCBC has joined LCH SwapClear as a direct clearing member.

The London Stock Exchange Group (LSEG)-owned interest rate swap (IRS) clearing house will offer OCBC Group and its banking subsidiaries liquidity and interest rate products in the Singapore dollar and 26 other currencies.

The firms say this access will help OCBC support demand for interest rate hedging instruments from its corporate customers.

OCBC’s banking subsidiaries include OCBC Malaysia, OCBC Hong Kong, and OCBC NISP in Indonesia. The group says the membership reinforces its approach to support accelerated business growth arising from its focus on the ASEAN and Greater China regions.

The Singapore-based banking and financial services firm aims to scale up its transaction volumes and achieve greater cost efficiency and capital optimisation through its membership with LCH SwapClear.

The number of OCBC over-the-counter (OTC) IRS transactions cleared by LCH SwapClear, through the first eight months of 2023, has exceeded the number of such transactions for the entirety of 2022 by 10 per cent.

Kenneth Lai, head of global markets at OCBC, says: “Joining LCH as a direct clearing member is a natural step for OCBC as we have seen steady growth in transaction volumes and outstanding position size with LCH over the years.

“The benefits of better risk management, cost efficiency and deeper liquidity derived from being a direct clearing member are valuable. It will enable us to support our customers’ growth ambitions in ASEAN and Greater China.”

Isabelle Girolami, CEO of LCH, adds: “We look forward to partnering with OCBC in future product designs, together with other banks in Singapore, as we continue to grow our global offering and expand our presence across the APAC region.”

Navigating the currents of the financial industry

GLMX's Joseph Russo, senior advisor, and Olivia Russell, sales, client development and marketing, provide insights into the growth of securities lending and cash reinvestment trading on the platform, as well as the firm's expansion into electronic trading of money market instruments

GLMX recently announced key milestones across securities finance electronic trading. Where do you believe the market is along the electronic trading curve?

Olivia Russell: When I joined GLMX, the firm was in the early stages of its journey, but the potential was evident. Over the years, we have seen substantial growth, especially within our repo offering. We have worked to enhance our platform's capabilities and user experience and it is gratifying to see that effort reflected in the industry's adoption of electronic trading.

Based on the growth GLMX has experienced over the past several years, it is clear that a number of participants in the industry appreciate the ease of access to liquidity and the operational efficiency that electronic trading provides. GLMX currently has more than 115 individual firms on the platform, a pipeline of institutions currently in the on-boarding process, and recently achieved a single day high trading balance of US$1.7 trillion.

Joseph Russo: The acceleration of client adoption, and the growth in balances, is driven by a combination of the need for digitalisation and the availability of a comprehensive technology solution that supports all of their trading requirements. Manual workflows have persisted for far too long, causing inefficiencies and limiting the potential for innovation.

GLMX is transforming how financial transactions are conducted across the money market ecosystem, making them more efficient and accessible. Although GLMX continues to build aggressively in the repo space, the firm's focus has expanded into the securities lending market as agent lenders, beneficial owners, brokers, as well as banks, need the efficiency that only technology can provide.

GLMX is rooted in building technology for the repo market, but it is now involving itself within securities lending. How is this progressing and what value can GLMX provide to that market?

Russell: GLMX has played a significant role in defining the dealer-to-client electronic negotiation sector, as well as the execution of securities finance transactions. GLMX's strengths lie in its network of borrowers and lenders — which consist of more than 45 repo desks and prime broker relationships, and 10 agent lenders who currently use the platform, or are in the process of on-boarding. The platform's strengths also lie within its technology — which generates large daily trade volumes of general collateral (GC), special and hard-to-borrow government and corporate bonds — and in its ability to customise technology to client workflows.

There is a large crossover between repo and securities lending when it comes to price discovery, trade structures and participants. Given this foundation, supporting securities lending activity on the platform has been fairly seamless.

Russo: At GLMX, the team listens to their clients and builds great technology accordingly. Seeing the process up close is impressive, and the amount of client-driven functionality to support securities lending trading that has been produced over the past 18 months is an example of this powerful process. The request-for-quote (RFQ) protocol, combined with many other platform tools, is effective for both lenders and borrowers to engage in price discovery and source liquidity for GC and hard-to-borrows from a much larger liquidity pool than can be achieved through emails and chats. This functionality provides the securities lending community with comprehensive solutions for real workflow issues that add immediate and sustained value.

Why do you feel that the securities lending market is ripe for the type of automation that GLMX provides, and how does GLMX propose to help market participants?

Russell: The securities lending market is massive, with US$35 trillion of lendable inventory and roughly US$2.5 trillion worth of securities on loan. However, less than 10 per cent of the on-loan transactions are executed electronically. As we have seen in the repo market, manual negotiation, execution and processing of this activity is highly inefficient.

GLMX technology is fit for purpose for this market as our technology is a mechanism to maximise access to liquidity pools, increase revenue opportunities, and to minimise operational risk. Tools to quickly match lenders' availability and borrowers' needs across fixed income and equity securities, in cash or non-cash transactions, with a range of communication and negotiation protocols, provide enhanced price discovery and facilitate best execution. Pre- and post-trade APIs with comprehensive support for real-time trade lifecycle management — including reprice, rerate, return and recall, and substitution — minimise operational risk.

Russo: Investing in the right technology is the only way to successfully achieve targeted returns and meet the growing demands of compliance. Several lenders and borrowers have done an internal review of the implications of the new regulations and have developed strategies to optimise trading across collateral and counterparties.

In all cases, having many options available to express financing strategies, whether that be across more counterparties or trade types, is the best way to achieve optimal returns. However, this analysis falls short if the only way to act on these options is by using the existing languid and error-prone market process for price discovery, negotiation, execution and trade processing.

How will GLMX aid securities lending market participants in terms of the new regulatory regime?

Russell: Regulation typically has mixed impacts on the marketplace — certain positive outcomes, such as enhanced settlement or transparency, versus additional costs. This is true of the proposed regulation that is overhanging the securities lending market. The industry is under intense regulatory pressure which may bring needed transparency, but it also creates additional capital and reporting costs. Borrowers and lenders are constantly reevaluating existing trading

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Olivia Russell
Sales, client development and marketing
GLMX

workflows to produce the best returns for clients. T+1 settlement, the SEC's 10c-1 regulation in North America, and the Basel III Endgame in Europe will make the cost of capital for some trades prohibitive and require additional resources to meet reporting requirements.

Lenders and borrowers can use GLMX as a hub to effectively deploy capital-efficient and revenue-maximising trading strategies with the benefit of operationally expedient and risk-reducing post trade connectivity, and real-time trade lifecycle management. Also, executing on GLMX provides near-real time automated communication of trade information for new and existing transactions — for example, returns and recalls — which speeds up the confirmation and settlement process. This is extremely helpful when complying with the Central Securities Depositories Regulation (CSDR) and T+1.

Finally, the information communicated on the platform is captured digitally so trade data can be enhanced with a time stamp, UTI, LEI and other data, and can be quickly reported as needed. GLMX is experienced in reporting on behalf of clients for the Securities Financing Transactions Regulation (SFTR). GLMX provides solutions for deploying diverse trading strategies, improving the settlement process, and is essential for data reporting requirements.

What are the other benefits of utilising GLMX's securities lending services?

Russo: GLMX technology provides lenders and borrowers with access to the tools and solutions needed to thrive in today's dynamic financial landscape. This applies not only to the ease of price discovery, negotiation and execution across a number of counterparties and with multiple trade structures — such as cash collateral, non-cash collateral, callable, extendables and evergreens — but the technology also allows lenders to reinvest the cash collateral they receive from securities lending transactions on the same platform, in multiple products. Its relevance lies in the fact that the global short-term rate environment is creating a wealth of cash investment opportunities.

These same benefits for collateral movement also apply to cash investment; access to a large pool of liquidity, familiar RFQ trading protocol, block level negotiation and fund and portfolio allocation process, interactive trade blotter for trade lifecycle maintenance, and post-trade straight-through processing (STP). With support for triparty, GC baskets and cleared transactions, GLMX is supporting lenders' reinvestment and money market fund activity on the platform.

In addition to traditional repo reinvestment, GLMX offers other short-term investment options including active pilots for time deposits and certificates of deposits. This is only the beginning however, as we are building towards offering a complete suite of money market products to meet the diverse needs of our clients.

What's on the horizon for GLMX? Can you share GLMX's latest initiatives and the importance of offering clients a full suite of financial products?

Russo: GLMX is committed to continuous innovation and expanding its offerings. Our vision extends beyond repo and securities lending, encompassing a complete ecosystem of money market products. We want to be at the forefront of modernising financial workflows, and we believe our clients and the broader marketplace will reap the rewards.

Beyond growing repo and securities lending activity on the platform, our latest initiatives revolve around expanding our suite of money market products, including time deposits, CDs, money market funds, and eventually commercial paper and other short-term products. The importance of offering a full suite of products lies in providing our clients with a one-stop solution for all of their financial needs.

Traditional workflows in the money market have been sluggish, but in today's world efficiency is key. Equity market trades occur and are reported in milliseconds. There is no reason the money market cannot operate with similar speed and efficiency. A healthy and accessible money market marketplace is the key to liquidity, and technology is the bridge that will make it happen. We are also looking to expand our client base, offering solutions that resonate with corporate, state and municipal treasurers, addressing their workflow pain points, and transforming a marketplace that has long been overdue for a technological revolution. As GLMX continues to navigate the financial industry's currents, our commitment to innovation, security and client-centricity remains unwavering.

With our expansion into securities lending and the imminent introduction of a full suite of money market products, we are not just opening doors but unlocking new horizons for our clients. This dedication reaffirms GLMX's position as a pioneering force, helping to reshape the world of financial services. Expect to see even more developments from us in the near future, as we remain steadfast in our mission to digitise and transform the marketplace for the better.

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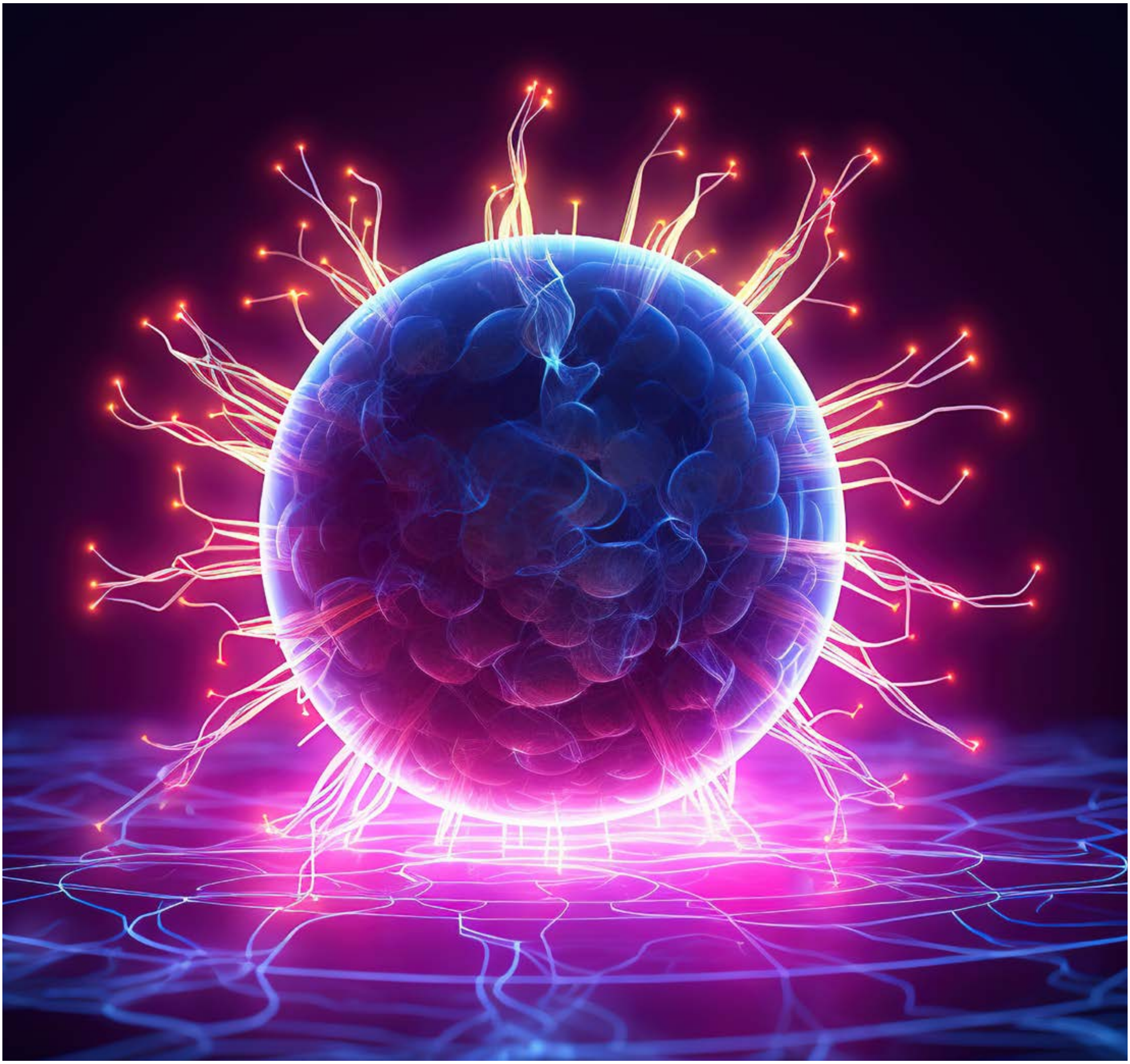
Joseph Russo
Senior advisor
GLMX



The Plasma Effect: the impact of accelerated settlement on securities lending

Broadridge's Martin Walker, head of product for Securities Finance and Collateral Management, and Amanda Sayers, product owner for Anetics, explore how the securities lending market would fair in a T-Instant world

The common consensus is that there are only three states of matter; solid, liquid and gas. Heat any solid long enough and it melts into a liquid, heat it further and it eventually turns into gas. However, if you put a sufficiently large electrical discharge into a cloud of gas, such as lightning or you create an electrical arc, a fourth state of matter is produced called plasma.

Plasma can often be seen in neon lights, displays and in plasma balls. It appears gaseous, but it is unlike gases, and is indeed more similar to solids in that it is a good conductor of electricity. Steps in securities trading can also be comparable to these distinct 'states'. Some may consider the states to consist of order creation, execution and settlement. Alternatively, it could be thought of in terms of trading, matching and settlement. As the securities settlement cycle continues to be compressed, what new and strange states are likely to emerge? And what does that mean for securities lending and borrowing?

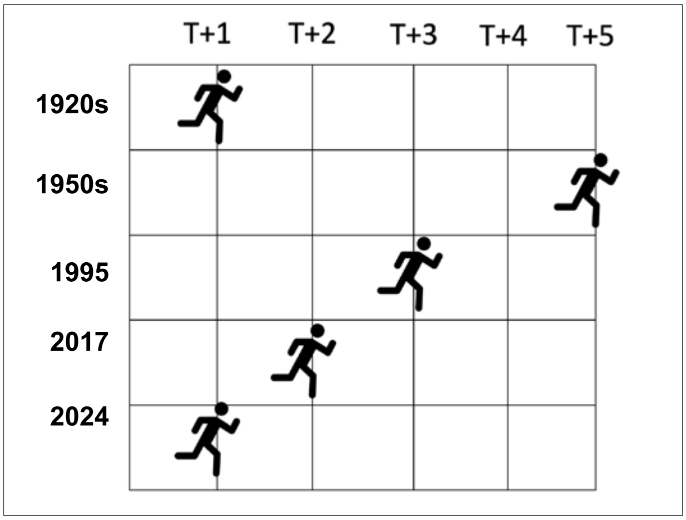
Settlement cycles exist because of the need to carry out the administrative tasks necessary to transfer ownership after the sale of a security. In the 1920s, the settlement cycle on the New York Stock Exchange was T+1, in spite of an almost entirely manual process. In other words, trades would settle one business day after a trade. In the 1950s and 1960s, the settlement cycle was increased to T+5 as manual processes could not cope with the dramatically increased volumes that ultimately led to the so-called 'Crisis of Wall Street'.

During these decades, the back offices of broker-dealers were overwhelmed by paperwork and were therefore forced to use computers for the settlement process. Eventually, further automation and the creation of dealer-to-client (DTC) allowed the US equities settlement cycle to gradually reduce again, to T+3 in 1995 and T+2 in 2017. We will likely see the reduction to T+1 in 2024.

Securities lending has managed to survive these changes because it generally operates under a shorter settlement cycle than the cash equities market. However, with the proposed reduction in the settlement cycle to T+1, the time available for a core securities lending process and recalls will be uncomfortably squeezed by the shortening of the equities trade lifecycle.

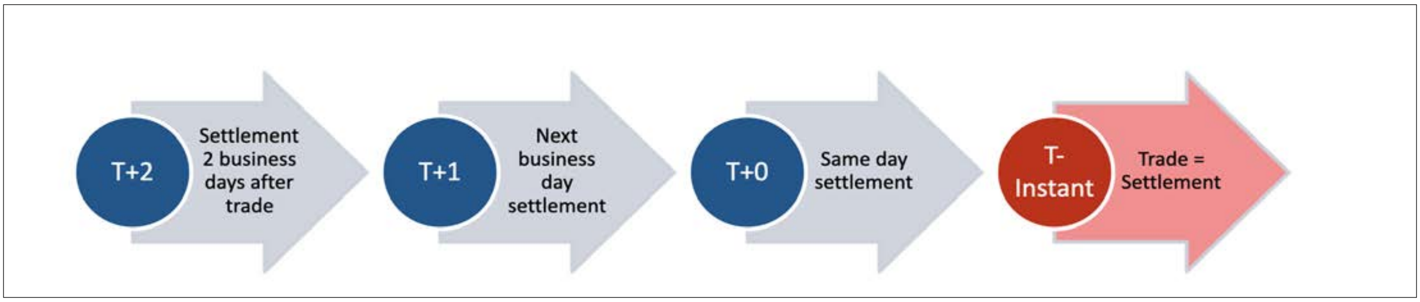
Market participants are attempting to work through the impact of T+1 recalls. However, to be prepared for the future, it is necessary to start thinking about the logical end point of compressed settlement cycles. Not T+0 — same day settlement — but 'T-Instant', also known as 'Trade = Settlement'.

Figure 2: T-Instant, the logical endpoint



T-Instant settlement refers to the execution of trades which are then settled in seconds or even milliseconds. The post-trade world is finally catching up with the high-speed world of algo trading to free up billions of dollars deposited at CCPs to mitigate settlement risk.

Figure 1: Shortening settlement cycles?



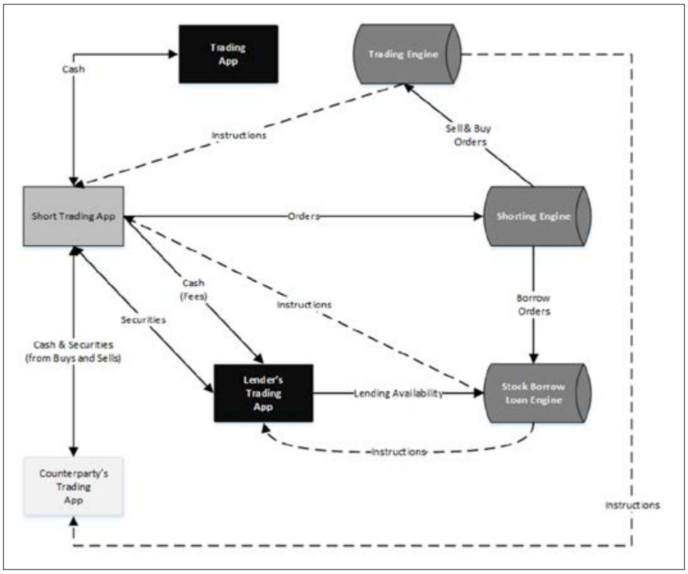
Trying to squeeze the settlement cycle for equity trades into an even shorter period may produce major implications for securities lending.

The time delays in the current system, in both settlements and trading, are highly advantageous for creating liquidity. Market makers can trade all day long, creating liquidity for the market, without needing physical possession of the stocks they buy and sell. As long as they flatten their position by the end of the day, the operations team will be able to settle the trades two business days later — subject to a certain amount of friction.

Those trading short in the US market can sell stocks — creating liquidity for buyers — knowing that if they have located the stock beforehand, they should be able to borrow the stock and have it delivered in time for them to settle their sale of stock. A T-Instant world means participants can only buy stocks if they have the funds in an appropriate account, and they can only sell if they have possession of the relevant stocks in a depo.

Under the pressure of instant settlement, the trade and the settlement would merge into a new state — like plasma.

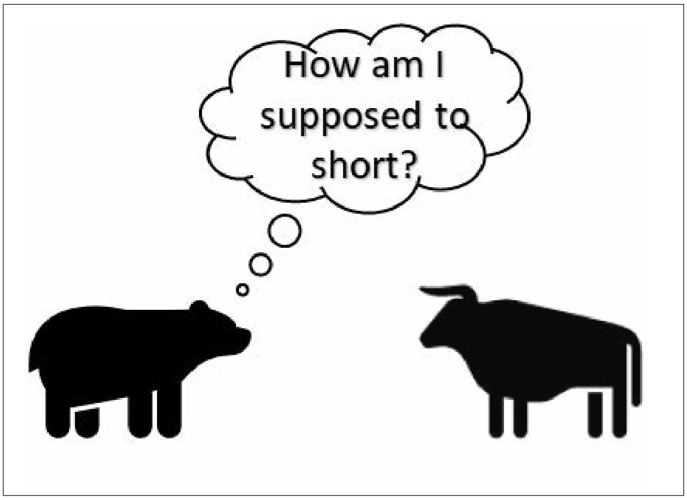
Figure 3: Integrated trading, shorting, lending and settlement



A difficult life for short sellers

A liquidity squeeze would prove challenging for anyone familiar with the way the current market works, unless there is a radical change to the trade execution process. For instance, by slowing down trading to have periodic auctions, rather than matching orders — which currently makes life difficult for short sellers.

Figure 4: Short selling will become tricky as the settlement cycle shrinks



In a T-Instant world a short seller would need to either:

- borrow the stock in anticipation of selling when the market is at the right place, potentially returning the stock 'unused', if the market goes in the wrong direction.
- have a stricter locates process whereby lenders are obliged to immediately deliver stock on demand.
- borrow, settle the borrow, sell and settle the sell in a more high speed, 'atomic' event.

Designing a market that supports the latter model is logically possible. However, it is important to discuss whether the model for doing so would be too much for the market to swallow. This model would include fixed term lending transactions, a market order book for borrows and loans, harmonised collateral (i.e. cash only) and automated exchange driven margin calls. The first two options make for a clunkier trading process for short sellers, but are still possible, despite additional costs.

The T-Instant experiment makes some of the trends that are currently nascent seem more inevitable. These include fixed terms of trades and the centralised clearing of trades. Only when these become standards can securities lending become more similar to cash equities trade, and 'atomic transactions' — that include the sell, borrow and their settlements — can be created. Atomic settlement makes the recall process close to irrelevant, because securities would have to be returned at the duration of the trade.

This would leave the door open for settlement failure if short positions cannot be covered by borrowers in time to return stock to lenders.

In fact, if sellers are dependent on holding securities to sell, and buyers can only buy if they have funds, most causes of fails would be eliminated. This would leave securities lending as one of the main sources of settlement failure. In such a situation, it is likely that a market mechanism would be introduced that automates buy-ins for borrowers that are unable to return stock by the designated time.

How does this apply to T+0?

T+0 may not seem quite as extreme as T-Instant. It would allow for a whole trading day to deliver stock. However, the window to recall stock, have it returned and then delivered in relation to a sell, would be small. The overall trading and settlement day is likely to be extended, with a significant proportion of settlement activity for cash trades and financing trades happening at the end of the day. If there is a massive compression of settlement activity at the end of the day, the issue lies with the further squeeze of time to borrow stock and have it delivered to cover settlement failures.

The push towards greater clearing and fixed terms for trades will not be as strong as in a T-Instant scenario, but it will still exist. If no movement is taken in that direction, there is the possibility of a greater number of settlement fails and those fails being directly attributable to stock lending. Even if those shorts are covered within the timelines set out by regulations, such as Reg SHO 204, the pressure would likely build on the industry to reduce fails. At a minimum, traders would need an accurate and real-time view of their settle positions, new trades and fails. Relying only on overnight position feeds from stock record systems would not work.

And T+1?

Finally, we return to the near future of T+1. System processing deadlines are being extended to allow recalls to be received and actioned until 11.59 pm (Eastern Time). The outstanding questions are whether:

1. firms will take advantage of this extended time on T+0 — considering equity sales that will generally trigger recalls.
2. whether there will be anyone working to process that recall.

No market consensus has emerged about the answer to these questions, but there are likely to be more fails. As described in the T+0 scenario, simply following existing practices should allow fails to be addressed within regulatory deadlines, but it will not present a pretty picture of the impact of securities lending to the overall market.

Coming to a consensus on market practices is essential, as is removing any frictions in trade processing. A real-time view on trading and settlement is needed to deal with potential recall situations. This real-time view should be conducted as early as possible on the trading day.

Looking beyond T+1, we will quote the movie Plan 9 from Outer Space: “Greetings, my friends! We are all interested in the future, for that is where you and I are going to spend the rest of our lives.”

Amanda Sayers
Product owner for Anetics
Broadridge

Martin Walker
Head of product for Securities Finance and Collateral Management
Broadridge

Enhancing efficiency through triparty collateral management

As the structured finance market continues to evolve, the adoption of triparty collateral management systems is likely to grow, according to J.P. Morgan's Graham Gooden, EMEA head of collateral services product management, and Julie-Anne Atkins, sell side trading services sales

Structured financing solutions have long been constituent elements of the financing ecosystem, as both a source of collateral to be financed and as a vehicle to facilitate broader capital markets activity.

In recent times, there has been a renewed interest in established structures as well as new applications driven by the imperative to finance trapped assets, improve liquidity and optimise binding constraints.

Structured financing as a source of collateral

Asset-backed and mortgage-backed securities, covered bonds and esoteric assets have long been eligible as collateral in triparty. The transferability of the asset to the triparty agent — to be able to enforce security over the asset, through a custody network or transfer agent — and the availability of pricing for the triparty agent are key considerations. By their nature, many secured financing assets have limited liquidity and price transparency. However, that does not mean that the security has zero value. Evaluated prices can be made available through data service providers.

Consideration should be given to understanding the methodology used to calculate the evaluated price, as well as the appropriate haircut to be applied, given the type of price used. In triparty, the collateral receiver can accept or decline the use of evaluated prices, and eligibility tests or haircuts can be configured down to individual CUSIPs or ISINs to reflect risk appetite.

Specific accounts or ring-fenced collateral pools can be established between collateral providers and receivers to facilitate term financing for specific hard-to-finance, less liquid or lower credit inventory.

Collateralisation of structured trades

Structured financing activity often includes collateral as the source of credit enhancement — triparty can work in consort with corporate trustees and special purpose vehicle (SPV) administrators to collateralise structured finance transactions. Asset-backed commercial paper programmes have long participated as collateral receivers in triparty, accepting collateral in return for cash proceeds from multiple repo sellers. The collateral received is therefore owned by the SPV, providing security to the buyers of the commercial paper issued by the SPV.

A collateralised commercial paper is an augmented version of this structure, where the banks or broker-dealer sponsor the SPV, and are a single seller for term repos to help diversify their funding sources away from traditional repo counterparties and to institutional investors that are more used to buying commercial paper.

Other examples include the use of structured notes to be financed in triparty, with illiquid securities not readily accepted by the usual collateral receivers, but instead combined as a diversified pool with appropriate haircuts and credit ratings. Repacks are another variation, where collateral is held in custody by the collateral manager on behalf of SPVs in partnership with corporate trustees for the note holder.

Structured trades within triparty

Structured trades in triparty can be more targeted with specific objectives. Contingent funding trades are one example — a dealer can borrow high-quality liquid assets (HQLA) and immediately post the collateral back to the originating counterparty through triparty, drawing down on the HQLA in times of necessity, substituting for lower-quality collateral and paying a utilisation fee.

Margin loans are collateralised via control accounts to collateralise equity derivatives or equity market acquisitions. The merging of the recent demand-for-pledge transactions with financing activity for either repo or securities lending is another structured or augmented trade type from traditional triparty. Collateral is transferred to the receiver under transfer of title arrangements, the receiver in turn pledges back the principal or the haircut received to the original collateral provider, with the benefit of potentially helping to reduce the capital costs.

Looking ahead

Triparty collateral management is an invaluable tool for structured finance trades. Its ability to enhance operational efficiency, mitigate risks and provide greater transparency and regulatory compliance benefits both counterparties involved. As the structured finance market continues to evolve, the adoption of triparty collateral management systems is likely to grow, leading to improved efficiency.

Electronify investment: delivering repo to D2D and D2C markets

Global head of BrokerTec John Edwards and global head of Repo Sara Carter speak to Carmella Haswell about the firm's advances within the repo space since its acquisition by CME Group and how the team is expanding its platforms to remain at the forefront of electronification

Since CME Group's acquisition of NEX Group in November 2018, BrokerTec has been migrated to the CME Globex platform and has made significant investment to the technology and system architecture that now supports its products, in particular, the firm's core dealer-to-dealer (D2D) platform relating to cash bonds and repo.

BrokerTec, a provider of electronic trading platforms and technology services in fixed income markets, has expanded its team with a number of key appointments over the past 12 to 18 months. The team brings knowledge from a variety of backgrounds including sales, trading, voice-broking, fintech and post trade.

In May 2023, Sara Carter joined BrokerTec, overseeing the continued development of the firm's global repo business and the BrokerTec Quote platform.

The BrokerTec platform has recorded an increase in volumes over the past few years and, as BrokerTec works to provide additional offerings and expanded functionalities, it remains at the forefront of electronification of the repo market.

With the repo market recording strong organic growth over the past few years, CME Group's global head of BrokerTec John Edwards indicates that BrokerTec will continue to innovate and develop new features as markets evolve.

"BrokerTec is the largest liquidity pool for repo in the D2D, cleared markets," says Edwards. "Across our US, European and UK repo products, we transact over 30,000 trades per day, and more than US$750 billion in nominal repo volume. US repo volumes have been particularly strong over the last 12 months, as specials remain in demand in the current environment."

Moving forward in repo

BrokerTec hosts three defining platforms which cover the D2D market via the central limit order book (CLOB) and the dealer-to-client (D2C) markets via BrokerTec Quote and BrokerTec Stream (for the cash market).

The BrokerTec CLOB is a D2D electronic trading platform that covers US, UK and European markets and has been available to trading clients for more than 20 years. Trading on an anonymous basis, clients can execute US treasuries, US repo, EU repo and European government bonds.

BrokerTec Quote is the firm's D2C trading solution for the European and US repo markets, offering request for quote (RFQ) capabilities which aim to provide clients with an intuitive and efficient means of trading. This is complemented by BrokerTec Stream, a relationship-based streaming platform. Both Quote and Stream were launched within the last five years under CME Group ownership.

"Offering multi-modality execution services via RFQ, order books and streaming services allows us to cater for a diverse set of customer needs when it comes to execution in either repo or cash bonds. Providing tools and connectivity that brings these altogether then becomes a very interesting offering," says Edwards.

The BrokerTec Quote platform is relatively young in comparison to BrokerTec's activities within the D2D space. Nonetheless, the firm believes its experience will enable it to develop a wider network of opportunities on the D2C side, especially by leveraging synergies across the larger CME Group post acquisition.

"BrokerTec Quote has gone from strength to strength over the last 12 months," says Sara Carter, global head of BrokerTec Repo.

"Not only are volumes significantly increasing, but we are also seeing a flurry of sell- and buy-side firms moving to the platform and partnering with us to move the business forward. We expect this growth to continue in H2 2023 as new functionalities and asset classes are brought onto the platform."

A natural step in development

BrokerTec built Quote to increase liquidity within the repo market, enhance automation while also providing technology

We continue our innovative development with new markets and product features added across both 2022 and 2023. An approach which will certainly continue in 2024.

Sara Carter
Global head
BrokerTec Repo

to reduce risk when conducting securities financing activity. It is an RFQ platform for securities financing transactions (SFT) within fixed income assets. It provides a full straight-through processing (STP) workflow from pre-trade to post-trade and is designed to meet the challenge with the best execution, manage lifecycle events and reduce settlement time.

The Quote platform also provides a 'white-glove service' — which enables the platform to 'handhold' sell- and buy-side queries at any point throughout the negotiation of the trade, development or onboarding.

Edwards adds: "As BrokerTec is the largest repo trading platform, it was a natural step for us to look at launching the D2C RFQ service on BrokerTec Quote. We have a network of international and regional banks over our order book and worked closely with these long-established relationships to finalise what Quote should look like. Under Sara's leadership, we are focused on capitalising on opportunities and delivering a streamlined repo service between both D2D and D2C."

BrokerTec continues to develop the Quote platform to bring new features and products to market, working closely with buy- and sell-side participants to build out BrokerTec's API solution for order entry, negotiation, lifecycle management and post trade. "We continue our innovative development with new markets and product features added across both 2022 and 2023. An approach which will certainly continue in 2024," Carter says. "We continue to offer new asset classes in the Asian markets and will expand our white-glove service accordingly."

Edwards adds: "We have a meaningful demand from a broad number of customers who want to trade additional new instruments as we expand our collateral availability and extend what they can transact via BrokerTec Quote."

According to Carter, additional "big functionalities" are on route in this domain as the firm has recently gone live with a full suite of SFT transaction functionalities, including the addition of securities lending features. BrokerTec's Axe Board feature is now live, which aims to reduce negotiation time and allow the sell-side to show positions to selected counterparts — buy-side clients are able to quickly turn into RFQs, Carter indicates.

She adds: “Alongside these functionalities — a key for the buy side and sell side is to manage their up and coming role positions. The first step of this is building a position management tool which is available on the platform.”

She continues: “Given the agile development sprints that we are able to conduct and the production timelines that we are working to, we can work with clients to ascertain their priorities and develop features while pivoting development where required to consider pressure from, for example, regulation.”

Discussing the firm’s new upcoming features, Carter says: “We have added €STR floating rate repo onto our CLOB platform. This is expected to go live in Q4 2023 and will be available across all European countries apart from Italy and Spain — having been only available in France previously.”

Edwards says that by operating on the CME Globex system — a premier electronic trading system providing global connectivity to futures and options across all asset classes — BrokerTec can differentiate its product offering as it seeks to bring correlated and adjacent products of interest to repo and cash bond traders. “Bringing CME Groups' wider products to BrokerTec customers is at the forefront with things like ESTR and SOFR Futures, but also looking to develop better pre trade analytics and order routing capabilities on the D2D platform. This is all about focusing on the value proposition and being able to offer our clients a unique and differentiated service.”

In November 2021, CME Group confirmed a 10-year strategic partnership with Google Cloud to accelerate CME Group's move to the cloud and transform how global derivatives markets operate with technology. Under the agreement, CME Group began to migrate its technology infrastructure to Google Cloud at the beginning of 2022 with data and clearing services, and will eventually move all of its markets to the cloud. Through this relationship, BrokerTec plans to develop additional new tools such as pre-trade analytics and market data products.

We have a network of international and regional banks over our order book and worked closely with these long-established relationships to finalise what Quote should look like.

John Edwards
Global head
BrokerTec

US securities finance panel

Leading participants in US securities lending markets speak to SFT about market performance during 2023 and the impact of monetary tightening, opportunities for cash reinvestment, and the potential implications of accelerated settlement and Basel III Endgame

Panellists

Dennis Cahill
Head of trading, North American fixed income and cash collateral re-investment, Securities Finance, **BNY Mellon**

Saverio Costa
Executive director, head of Securities Optimization Unit, Americas, **Natixis**

Joseph Gillingwater
Global head of fixed income securities finance trading, **Northern Trust**

Patricia Hostin
Head of agency lending, **State Street**

Alexander King
Agency securities lending trader, **BNP Paribas' Securities Services**

Rob Sackett
Global head of prime finance, **Clear Street**

Anthony Toscano
Head of global securities lending solutions, North America, **Mitsubishi UFJ Trust & Banking Corporation**

Phil Zywot
Head of trading, North American equities and US corporates, Securities Finance, **BNY Mellon**

Market dynamics

Which trends stand out in terms of lending activity and strategy in the US securities lending market over the past 12 months?

Joseph Gillingwater: US Treasury repo markets remain extremely active, with the Fixed Income Clearing Corporation's (FICC's) sponsored repo volumes hitting a new all-time high of over US$750 billion in the first half of the year. Rising rates and falling liquidity has prompted a return of the cash-futures bond basis trade, an opportunity for leveraged funds to benefit from very small dislocations in the US Treasury market, while recent rhetoric from the US Securities and Exchange Commission (SEC) around plans for mandatory clearing of treasury repo has only accelerated the need to have as many routes to market as possible.

At the end of July, US banking regulators unveiled changes to the Basel III rule. The updated version of the regulations, known as "Basel III Endgame", are expected to require banks to hold more regulatory capital to provision against potential risk within trading books and operational processes. A tightening of regulatory standards is creating greater emphasis and acceleration of more regulatory-efficient lending and borrowing trade structures. The emergence of workable centrally cleared securities lending models in the US and international markets is beginning to gain more focus and we expect momentum to gather over time as market participants seek to manage a variety of regulatory binding constraints.

Furthermore, the industry has begun preparing for changes in the standard securities clearing and settlement cycles. In February 2023, the SEC adopted an amendment which brings T+1 into the US market by 28 May 2024 after the Memorial Day long-weekend. Naturally, this will require increased efficiency and automation at every touchpoint in the trade lifecycle. From an agent lender's perspective, accelerating the timings when we receive sale notifications, and the speed at which we can cover that sale through internal processing or external recall, will be crucial.

Rob Sackett: The push for balance sheet and risk-weighted asset (RWA) optimisation continues. Non-cash flows, upgrade trades, CCP trades and internalisation remain major focuses. We see those trends carrying into the new year. ETF hedging is still very active as investors continue to stay away from single stock hedges.

Patricia Hostin: For equities, borrower strategy has been heavily focused on internal resource management. There has been an acute focus on capital usage by some of the larger borrowers in the US equity market and, for certain participants, this has spread through their global platform. There have been continued conversations across the industry around how borrowers, and lenders, can lessen their RWA footprint. This has perpetuated the conversations around viable CCP solutions and the overall demand for "smart" bucketing of GC loans. Similarly, to the extent borrowers can, there has been a continued push to finance their borrowers with non-cash collateral sets in the form of bilateral US treasuries or equities via triparty relationships.

For fixed income, lending and borrowing trends for US treasuries have followed Federal Open Market Committee (FOMC) hiking actions, with treasury bills and specials activity dominating the overall business. T-Bills have experienced major flows across the curve — with so much cash continually parked in the front-end due to Fed speculation — and have easily seen the most interest for lending and borrowing. Volatile cash markets have kept various current issues in play, with 20-year bonds and 10-year notes experiencing the deepest demand. Fed quantitative tightening has also lowered System Open Market Account (SOMA) supply in some cases, further widening the spread of some issues at times.

Dennis Cahill: Over the past 12 months in US treasuries, volatility in the rates market has resulted in bouts of deep specials and demand for short coupons. More recently, as inflation has become less of a concern and we are nearing an end of this rate cycle, the demand for short coupons has slowed and the market remains a GC market.

With quantitative tightening starting to have an impact, we have seen an uptick in non-cash funding trades owing to a reduction of assets on the Fed's balance sheet — leading to the removal of liquidity from the market. As borrowers' US treasury holdings increase as a result, we have seen an increase in non-cash trades due to their preferential balance sheet treatment.

Phil Zywot: Since the regional banking crisis in March, we have seen focus shifting to improved RWA exposure and a change in book structure as counterparties look to manage limited resources. In addition, the return of the bull market has been a headwind for US equity lending volumes, with increased inventory at prime brokers and greater internalisation taking place, which has impacted overall balances. There has also been an overall lack of deal and IPOs, with IPOs down 36 per cent by value and M&A deals down 40 per cent during the first half of the year.

Saverio Costa: Exchange-traded fund (ETF) lending and hard to borrow have been the main revenue drivers and focus for market participants over the past 12 months in the US securities lending business. From a borrower perspective, a key feature has been to follow the corporate actions that are happening in the market. Further, general collateral (GC) utilisation is a significant focal point for lenders but, on the US side, there is a clear limitation due to the Securities and Exchange Commission's (SEC's) Rule 15c3-3. In addition, the revenue extracted from portfolios reaches a cap relatively quickly.

Anthony Toscano: Lenders are taking a closer look at their current securities lending agents and starting to inquire what else is available in the marketplace. The pandemic put many searches to the sidelines. Now that things are somewhat back to normal, institutional investors are now kicking the tyres of their current providers, as well as the other providers in the market.

Alexander King: Securities lending activity over the last 12 months has been largely defined by the rising level of interest rates and persistent inflation, which impacted every corner of the economy and drove demand across the board when it comes to interest-rate sensitive sectors, resulting in increased specialness in those areas.

Which trades have been particularly vibrant in terms of loan fees and revenue? What have been the primary drivers of supply and demand ?

Toscano: We continue to see strong demand for HQLA and experience very high utilisation based on managing client portfolios on an individual basis. We also see many opportunities in global lending and the ability to move assets to where demand is the strongest — for example lending US treasuries outside of the US against a much more diverse range of collateral than can be found onshore. This achieves wider spreads, diversifying counterparty risk and collateral types while avoiding concentration into the large US counterparties.

Hostin: AMC Entertainment Holdings Inc has clearly been the name that has driven the US equity securities lending market for 2023. The uncertainty around the outcome of court rulings left both long and shorts in this trade anxious for an outcome of the conversion of the AMC Preferred Equity Units (APE) shares and subsequent stock split. Outside of AMC, it is certainly worth mentioning the continued demand in the electric vehicle (EV) space. Lucid Group Inc and Nikola Corp have certainly been at the forefront of demand, while demand for other related names have been in focus at different parts of 2023 (Fisker Inc, ChargePoint Holdings Inc, Quantumscape Corp).

With crypto rebounding to start the year, there was strong demand for companies in this sector, including Coinbase Global and Marathon Digital Holdings. One noticeable outlier for the first half of 2023 has been the presence of capital markets activities, both in the M&A space as well as IPOs. The tides have started to turn in Q3 with the Johnson & Johnson split off from Kenvue Inc providing lucrative trading opportunities. Finally, successful issuances of Arm Holdings, ADR, CAVA Group, and Instacart over the past few weeks should hopefully signal more opportunity ahead.

Zywot: Two trades stand out in the US equity space in 2023. Johnson & Johnson (JNJ) announced it planned to split off at least 80.1 per cent of shares of Kenvue (KVUE) Inc. on 24 July through a discounted exchange offer. Borrowers were interested in take-no-action shares and willing to pay a premium for guaranteed no-sale shares that were not tendered. The other trade of note is the reverse stock split of AMC Entertainment (AMC), a top earner year-to-date, which occurred on 24 August. The highly anticipated conversion of AMC preferred APE shares into AMC common stock completed on 25 August, with the APE shares ceasing trading and subsequently being delisted from the New York Stock Exchange. Following the internal processing of the corporate action, the majority of the AMC shorts and loans were closed out and returned the following week. There has been very little directional demand since completion of this corporate action event.

Another sector that continues to attract demand is the auto sector — in particular, EV securities — but not at the highs we have seen in recent years. Specials continue to pop, but they are not driving the top 10 as they have done in the past, with only one making the current cut, Fisker Inc. (FSR). Meme stocks such as GameStop (GME), Carvana (CVNA) and Tupperware (TUP) have also had sporadic demand.

Cahill: For fixed income, another driver outside of quantitative tightening is the long bias in the equity markets for the first half of this year. This increased the need for equity collateral funding trades. Funding spreads widened after the regional banking stress in March, increasing the need for contingency funding across the Street. Spreads have started to tighten, but they remain wide compared with spreads before Silicon Valley Bank (SVB) collapsed.

Utilisation of US treasuries remains high, despite the inconsistencies of the specials market as lenders look to raise liquidity to meet term reinvestment demand. The wider investment spreads continue to provide opportunities for GC trading.

Sackett: The AMC/APE conversion trade dominated the US market this year and utilisation across the board still appears rather low. Convert hedging was not particularly active and the lack of syndicate activity negatively impacted the market.

Gillingwater: Borrower demand for credit and emerging market (EM) bonds continues to enjoy robust revenue growth. Rising inflation and subsequent global central bank interest rate increases have seen bond valuations decline, prompting significant shorting opportunities which have translated into increased volumes and fees for these asset classes. This is particularly evident for US corporate bonds and dollar-denominated EM debt as issuers are forced to endure higher funding costs.

North American activity has continued to dominate borrowing demand, with USD and CAD-denominated issuance regularly making up the top-10 revenue generating corporate bonds on a global scale in recent quarters. High-yield issuance remains well-sought from a borrow perspective, while we have observed the development of a market more focused on specials, with shorter-dated bonds across investment grade, high-yield and private placements dominating the highest revenue generators list given the sensitivity to interest rate risk.

From an equity perspective, the upward trajectory of markets and the wider macro uncertainty has meant investors have been cautious in picking an appropriate entry point against a rising market. This has created an environment where the demand has been heavily concentrated in a relatively small number of overcrowded specials. These names alone have driven specials revenue close to all-time highs. Demand within this space has been driven by weak fundamentals or unique asset arbitrage prospects.

Elsewhere, less established companies within the electric vehicle sector continue to attract elevated short interest, given the competitive nature of the industry and growing pains to profitability. Corporate activity has cooled against the backdrop of rising borrowing cost, with companies reluctant to come to market at this time. IPO issuance has also suffered.

Directional demand for corporate bond ETFs continues, given policy rate expectations and funding pressures within the corporate debt asset class. Emerging market ETF trackers, especially those replicating an index within countries without a robust SBL model, have also attracted strong short demand. The ETF asset class continues to represent an efficient way of expressing an investment in such markets.

Basel III Endgame

What impact will the Basel III Endgame have on securities lending activities in the US market? How will banks need to adapt to maximise the capital efficiency associated with their borrowing or agent lending activities?

Hostin: Basel III Endgame will have a material impact on bank capital requirements, primarily driven by changes to standards for operational risk and the Basel output floor. RWA increases of 20 per cent are expected on average for US G-SIBs, which will only increase the focus on efficiency where optimisation paths can be pursued. With a number of capital saving solutions in play, securities finance will be an ongoing focus for banks to drive efficiency as Basel reforms begin a multi-year phase in mid-year 2025.

Toscano: On 27 July, the Federal Reserve Board issued its long-awaited proposal on the US implementation of the Basel III regulation. While it is still being analysed, the initial reaction is not favourable and just how punitive it may prove to be depends upon the capital structure and business lines of the particular banking organisation. The new framework may impede the ability of some agents to offer indemnification under the most favourable of terms and pricing.

Capital is always a scarce commodity and the return targets for that capital vary from institution to institution. For organisations in search of higher returns on capital, it may be that they no longer find their current indemnification models fit for purpose to meet those returns.

Cahill: Most large agent lending firms subject to the capital rules will see an increase in their overall capital requirements as a result of the recent US proposal. However, this impact may be felt more in other business lines outside of agency securities lending.

The newly expanded risk-based approach contains some provisions beneficial to securities lending transactions when compared to the current standardised approach, which remains unchanged. These provisions include a new risk-sensitive formula for calculating exposure at default for repo-style transactions and lower risk weights for certain broker-dealer counterparties, which is partially offset by an increase in risk weights for bank counterparties. The impact to any one agent lender's programme is dependent on a number of factors, including current constraining ratio (advanced or standardised), the size and diversification of their netting sets, and the composition of their portfolios.

Perhaps the most significant change is the elimination of internal models. This will impact those agent lenders that have current approval to utilise a value-at-risk (VAR) model to calculate exposures at default, alongside the ability to use their own internal estimates for counterparty risk weights. If the advanced approach is their controlling measure, then capital requirements in agency lending portfolios are likely to increase. Conversely, if the standardised approach is their constraining measure, they should see a significant decrease.

The elimination of internal models will also impact single counterparty credit limits for firms with approved VAR models. These firms are likely to see an increase in exposures for some counterparties, depending on the composition of the portfolio, the size of the netting set and the amount of diversification. This may require some management of the exposures for those firms, but it is unlikely to result in a significant impact to the overall market.

Nothing in the proposal will change the structures or approaches used to manage capital associated with indemnified agency lending. However, it will continue to foster industry discussion with respect to the cost and benefits of indemnification.

Costa: The increased costs of risk-weighted assets (RWAs) will be challenging for the US securities-based lending industry with regards to the Basel III Endgame. To relieve these costs for dealers, market participants will need to consider clearing, netting and pledging.

Cash reinvestment

What impact is central bank monetary tightening having on the appetite from collateral takers for cash vs. non-cash collateral? How has this impacted the revenue pick-up available through cash reinvestment?

Gillingwater: The rising interest rate environment we have become accustomed to provided opportunities and challenges from an asset-liability construct. The pace and frequency of the Federal Reserve's rate hikes had to be micro-managed, with lending rebates typically resetting immediately, while cash reinvestment yields took longer to 'catch-up' and reset depending on the Weighted Average Maturity (WAM) of investments. In some instances, this led to a pivot to non-cash collateral which provided more revenue security during times of monetary policy uncertainty.

However, with the Fed seemingly reaching the terminal interest rate, that is with no more hikes expected, this trend should begin to evolve, eventually seeing a pivot to more loans versus cash. While the medium-term trajectory of rates is still somewhat unclear due to stubborn global inflation and a US economy broadly holding up well to higher rates, the way down will see cash reinvestment funds maximise available WAMs, therefore enjoying higher rates for longer. This will be met with securities lending rebates immediately setting lower, which should be spread positive.

King: Central bank tightening created various opportunities for beneficial owners that accept cash collateral as the Fed's tightening cycle kicked off — followed by the other major central banks. Lenders that were able to develop a duration-mismatched reinvestment programme have benefited from how clearly the Fed telegraphed their moves. These lenders were able to lend short duration (overnight, etc.), then reinvest the collateral at longer tenors, capturing the spread.

Toscano: It is fantastic. There are demonstrative examples regarding why the fee being paid on a non-cash collateralised loan should be increased. Programmes that default to non-cash will underperform programmes making that same loan taking cash and investing it. In addition, investors only need to look at the returns they receive for reverse repos collateralised by the same securities being pledged in the non-cash loan to see the opportunity lost by not adjusting that fee or doing it versus cash collateral.

Hostin: The higher interest rate environment from the Fed (0-0.25 per cent in March 2022 to current 5.25-5.50 per cent) has increased

internal capital costs to a varying degree across the Street. Most houses have passed these costs along to lenders in the form of narrower spreads. Lenders have responded in turn with client guidelines dictating lending activity and determining whether spread “hurdles” mandate activity or whether loans are closed and supply left in the box. Collateral upgrade trades are still prevalent, but continued lower dealer inventories have limited overall opportunities.

Cahill: When the US treasury market believed the Fed was behind the curve, we saw increased short demand in the front end of the yield curve, with ongoing inflationary concerns. We also saw bouts of volatility in the market driven by Fed-speak and policy changes. Short demand increased, but with increased issuance sizes that did not always equate to increased intrinsic value.

In terms of reinvestment strategy, we looked to minimise interest rate risk by staying short of FOMC meetings or investing in SOFR floaters when available. With increased need for contingency funding, floating rate spreads widened more than the cost of GC loans, which stayed somewhat tight to RRP levels and increased overall return for our clients.

Accelerated settlement

How will the move to accelerated T+1 settlement impact the US securities lending market? How are you preparing for this transition?

Sackett: The Street is still on the back foot for T+1. The antiquated technology that dominates the industry today will bring mainframe batch cycle times in the compressed settlement cycle into question. Trades need to be affirmed promptly and outdated batch processing will delay proper communication. Currently, only 68 per cent of trade affirmations occur on trade date, so considerable work is required to increase this number under T+1.

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

Zywot: The move to T+1 could result in increased fails for securities lending, especially in the less liquid names. The move effectively gives the borrower one day less to locate additional supply to cover a recall and may require some lenders to hold back larger buffers to protect against potential sale fails. This could result in reduced market liquidity.

Automation and streamlining sales information flow are the keys to a successful move to T+1. Beneficial owners need to look at a more efficient way of informing their custodial banks of their transactions (increased batch processing, automation, etc) to provide enough time for the agent lender to process the sale and recall (if needed) in a timely manner before the deadline. Agent lenders need to automate the process to ensure recalls are sent out in an efficient and timely manner to the borrowers, who must automate the receipt of recalls, allowing the maximum amount of time to react and cover the position.

BNY Mellon is working with industry participants, vendors and industry associations on defining the issues and providing the potential solutions to address the shortened settlement cycle. The organisation continues to invest heavily in technology to ensure an efficient process — from beneficial owner transactions to borrower recalls — to reduce the potential of failed recalls and sales. BNY Mellon is also educating beneficial owners on the importance of timely notifications and on the potential downstream impact of the move to T+1.

Costa: Late recalls associated with the T+1 settlement cycle will lead to an increase in cost, alongside technology and profit and loss (PNL) risks. Market participants will need to work to migrate dealers to a single recall format to avoid the need for connectivity to all platforms, and therefore ease the pass through.

I anticipate a complete repatriation of the US securities-based lending business owing to this greater operational complexity.

Toscano: We are communicating and engaging with our clients, their asset managers, and their custodians to proactively address any necessary changes that will mitigate any negative impact to our securities lending programme because of the shortened settlement cycle.

We are currently reviewing agreements with clients, custodians and borrowers to identify any required changes. We are also reviewing current operating models and workflow to identify the need for changes — for example, use batch processing of client sale notifications versus real time processing. Alongside this, we are working closely with our vendors to ensure that any required system enhancements are tested and delivered in a timely fashion.

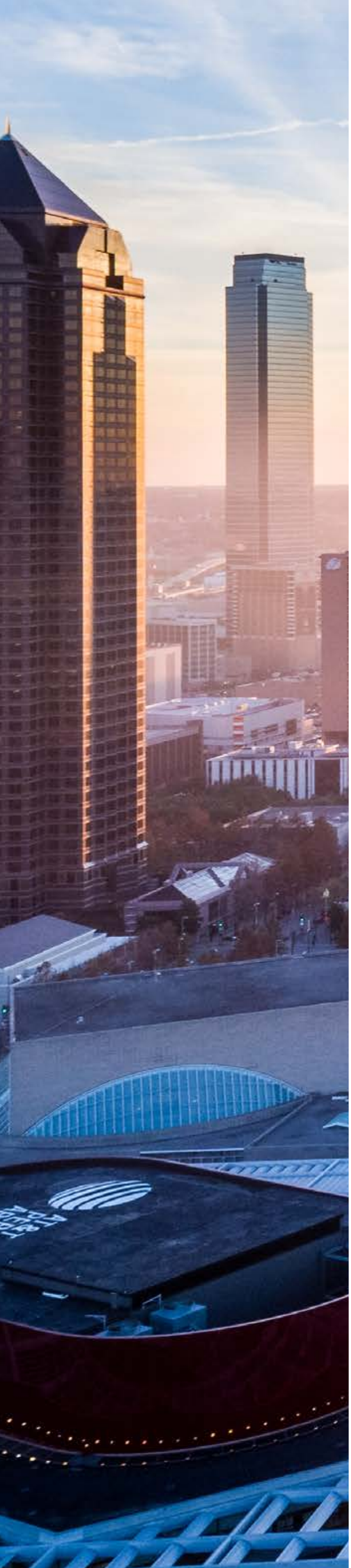
We are excited to meet this challenge and expect that this could lead to greater lending opportunities as counterparts will be much quicker to borrow for delivery management purposes than they are today. Obviously, there will also be lending agents that do not handle this change well and this will create opportunities for us to demonstrate to their clients that there is a better way.

King: The move to T+1 will require securities lenders, borrowers and end-users to perform the same core tasks required to settle a trade today, but in half of the time previously allotted. This time compression will likely lead to increased post-trade issues.

BNP Paribas's Securities Services business is working to develop solutions to mitigate trade fails due to insufficient inventory, including but not limited to the systematic coverage of short positions via solutions such as our principal lending fail coverage programme. Additionally, changes are being instituted for key processes, such as recall timing and margin calculations to ensure support of T+1 on day one. We are actively engaging clients across businesses to assist them with the transition. Separately, BNP Paribas is exploring options to improve current operating models and extend coverage hours in alignment with the T+1 compressed lifecycle, working with counterparts on differing cut offs and what is possible to aid the smooth transition into T+1.

Transaction reporting

What implications will the proposed SEC Rule 10c-1 have for your securities lending business (or the clients you



support)? What adaptations will you need to make ahead of 10c-1 enactment?

Cahill: Proposed Rule 10c-1 is yet to be finalised and there is a possibility it could be reproposed. Unlike the European Securities Financing Transaction Reporting (SFTR) regime, the Rule 10c-1 reporting obligation is one-sided and falls on the agent lender rather than the underlying client. To implement, this will require a significant technology build by agent lenders, especially if 15-minute reporting is required. It will also increase ongoing costs by requiring payments to the Financial Industry Regulatory Authority (FINRA). As agent lenders continue to absorb these costs, it will lead to wider client discussions with respect to the level of fee splits and returns.

From a market perspective, much of this transparency already exists and is used by market participants. It is unclear what the impact will be from an increased amount of data and public disclosure, other than to provide regulators with more information and increase the data sets for models used by hedge funds.

Sackett: Borrows and loan activity must be communicated regularly to a central depository. Our trades are always booked in a timely manner, so we will need to solve for the communication mechanism. There are still many open questions as to how to provide the most accurate and actionable data to investors and other market participants to enable them to make informed decisions.

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

King: SEC Rule 10c-1 is similar to the Securities Financing Transactions Regulation in the EU in many ways. However, the data requested and the timelines involved are significantly different to those of SFTR.

Specifically, the need for participants to report transactions within 15 minutes of execution has two clear implications for lenders, with the potential to separate those that already have advanced technological capabilities from those that do not. Lenders will need to work with their clients to enable the efficient passing of required data from lender to agent for each trade.

Additionally, lenders need to ensure they have the technology in place to enable the capture of all required data elements at trade execution and the transmission of that data to the correct entity. At present, BNP Paribas is dedicating significant resources and working with industry trade groups to formulate an efficient response to SEC Rule 10c-1.

Toscano: Ultimately, it will depend on what the final rule looks like. Much deviation from SFTR will create the largest burden. Nevertheless, the lift for all of these regulatory requirements makes the barrier for entry for any new securities lending agent extremely high.

Peer-to-peer

Are you noting a rise in peer-to-peer lending and financing in the US market? How are beneficial owners exploiting this

channel alongside, or instead of, agent bank intermediated lending activity?

Toscano: We are not. Our observation is peer-to-peer activity is limited to a small number of large institutions with the resources to vet the risks involved to their own satisfaction. They are not representative of the vast majority of those who participate in securities lending.

I suppose the concept will continue to evolve and will not be fortified until there is an actual test. The ability of non-financial institutions to liquidate collateral as promptly as financial institutions could be a challenge. The role that regulators (i.e., a state insurance commission) may play during times of stress — and how one measures any cross-jurisdictional or sovereign risk in these transactions — needs to be understood. These scenarios have already been tested by banks as intermediaries.

Zywot: BNY Mellon has had beneficial owners participating as borrowers in our securities lending programme for more than 10 years. During that time, we have found peer-to-peer lending to be a complementary source of distribution to the traditional bank and broker-dealer borrowers. We find that our clients are interested in trading with their peers when it helps them to meet their goals — generally, revenue or liquidity management — without adding operational complexity. Because approving peers does not change the operational process for clients of our lending programme, engagement has not been an issue — outside of regulatory (or similar) restrictions to approving these clients.

In terms of setting up a self-lending programme without the support of their agent, we do not see substantial client interest. Self-lending is typically an inefficient source of investment for beneficial owners, taking into account the need to purchase or develop systems, to conform to the necessary regulations, to negotiate legal documents and to manage the daily operational burden. However, we do see interest from beneficial owners in utilising BNY Mellon's technology to act in the role of borrower to implement leverage (long and short) and liquidity strategies.

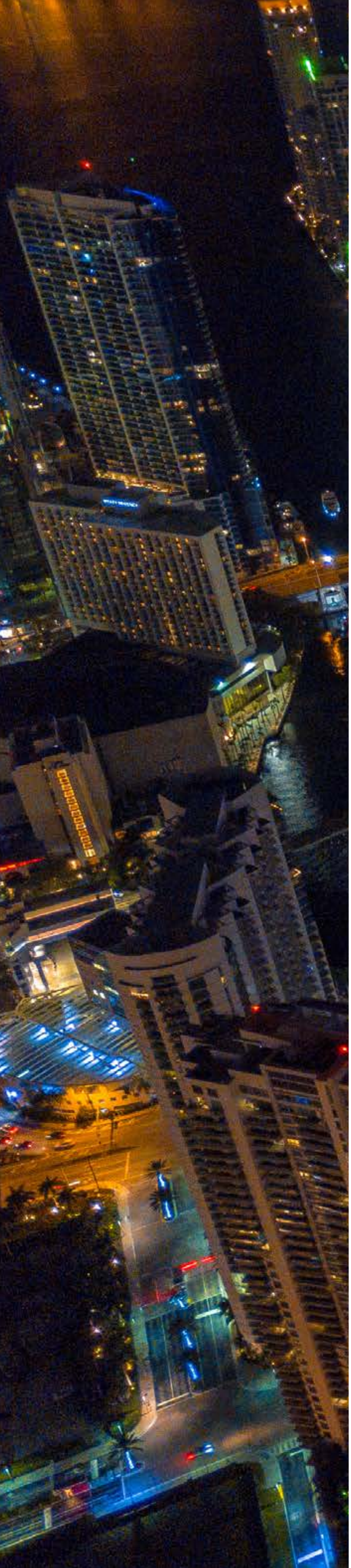
Costa: We have noticed an increase in participation in peer-to-peer groups, but this is clearly a technological change and is likely to benefit the more technologically advanced entities — which would prosper from the demand and inventory of others in that same group. There is still a need to reduce exposure risk, but it is the role of the dealers to diversify the risk that the end users could face.

Development priorities

How are you investing in new product solutions and services through H2 2023 and into 2024? And what updates are you making to your technology and business processes to support this?

King: At BNP Paribas, we have recognised the added-value securities lending can bring to clients. We are making sure we deliver a service that helps our clients to optimise revenue while closely managing risk and staying on top of regulatory and market trends.

Our solution has always been subject to continuous investments. These were amped up recently with the ambition to invest further into our technology and systems. Our focus is currently on efficiency and improving client



experience. We are looking at our client portal, optimisation of collateral processes, settlement times and more. Under our dedicated enhancement project, we believe we will further improve clients' experience with their securities lending programme, as well as making it even more efficient for our borrowers to access securities they can borrow.

Sackett: Clear Street is a technology-first prime broker and almost 40 per cent of our staff is dedicated to building a best-in-class technology stack. We have built a proprietary, API-first prime brokerage platform starting with clearing, settlement, and custody. Over the past few years, we have scaled to other parts of the market, including securities finance, execution and risk management. Our platform adds significant efficiency to prime brokerage and focuses on minimising client risk and cost.

In June, we began to expand our asset class capabilities to include certain types of fixed income and, in July, we announced intentions to expand into the futures clearing market. These developments are possible because of our integrated horizontally-scalable platform that has a single source of truth for any given piece of information. Many platforms struggle to add capabilities for new asset classes, but our technology allows us to do so in months instead of years.

In addition to rolling out new products, we recognise how the client stays connected as we increase these roll-outs. Our dedication to in-house products and services and our mandate to connect them via our front-end and back-end systems is where we truly differentiate.

Cahill: There is no one particular update or new product, but rather a continuous evolution of the business. Automation remains a key driver — maybe even more so as we head into a world of shortened settlement cycles — and we expect much more focus on trade matching and post trade to remove the chance of fails. This area has possibly lacked the investment it deserved.

Beyond this, we are working with $HQLA^X$ and expect, in the not-too-distant future, to be trading fully tokenised transactions. There is a lot of interest here and we can see the benefits of the delivery-versus-delivery (DvD) model from an efficiency perspective and, perhaps more importantly, for its ability to unlock trapped pools of liquidity.

Costa: A driving factor for Natixis is to focus on cash execution and on connecting to securities-based lending vendors to improve inventory and lifecycle management. The US markets remain specific and distinct from international markets, with its own limitations, rules and habits. Consequently, it is difficult to support the market effectively simply by leveraging a global set of tools.

Where do you identify the strongest opportunities for the growth of your US securities lending activities in the 12 months ahead?

Hostin: A strong IPO pipeline, coupled with an uptick in gross leverage, offers promise for specials in what has been a tame end to Q3. Meme stocks are not the theme at the moment, so we turn towards a more fundamental assessment of winners and losers and are hopeful for less concentrated outcomes for lenders.

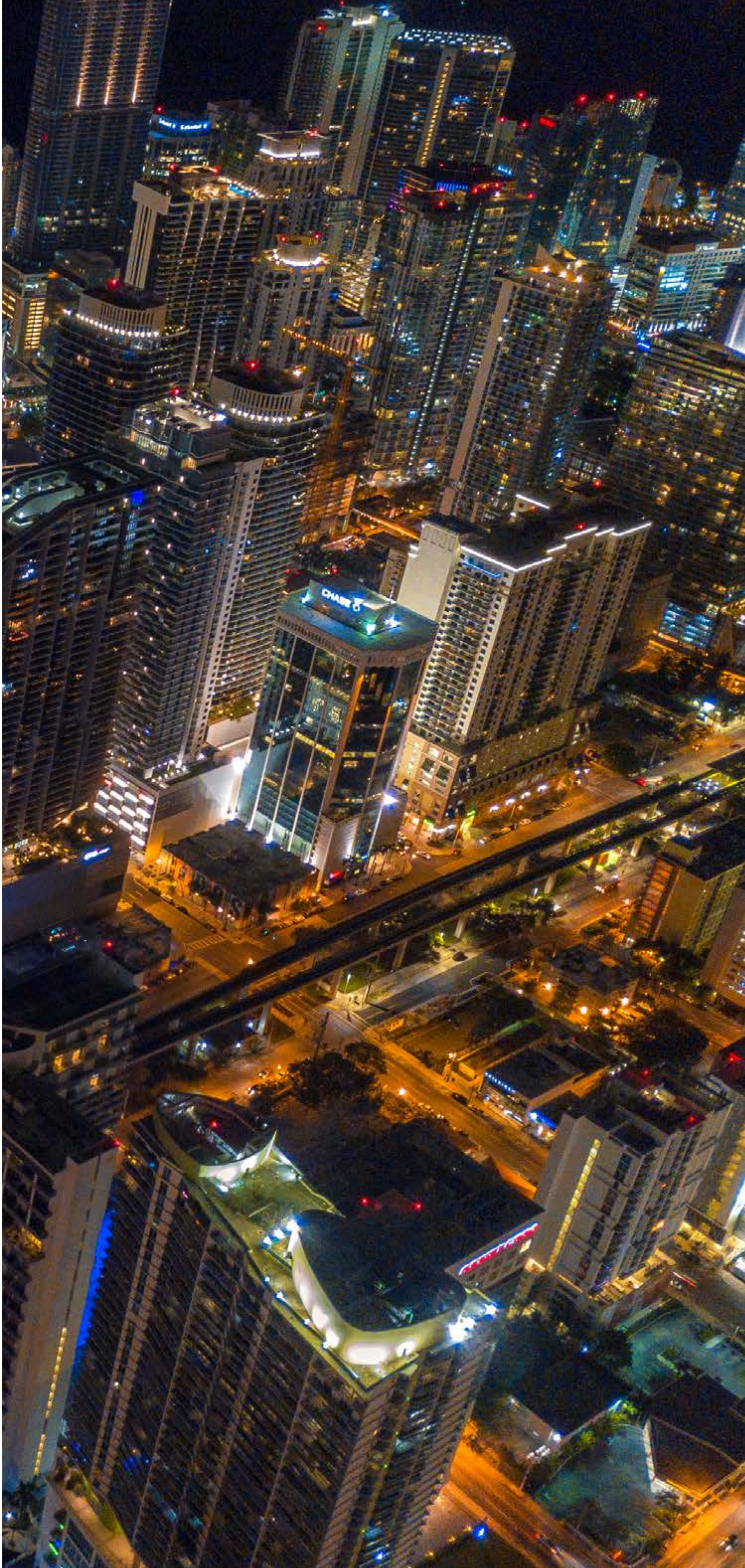
Toscano: There is no shortage of opportunities for us over the next 12 months. Firstly, we anticipate a number of extremely large and important clients coming to market to seek new providers. We are also engaged in interesting discussions with firms seeking to outsource their programme or partner up with us in some capacity.

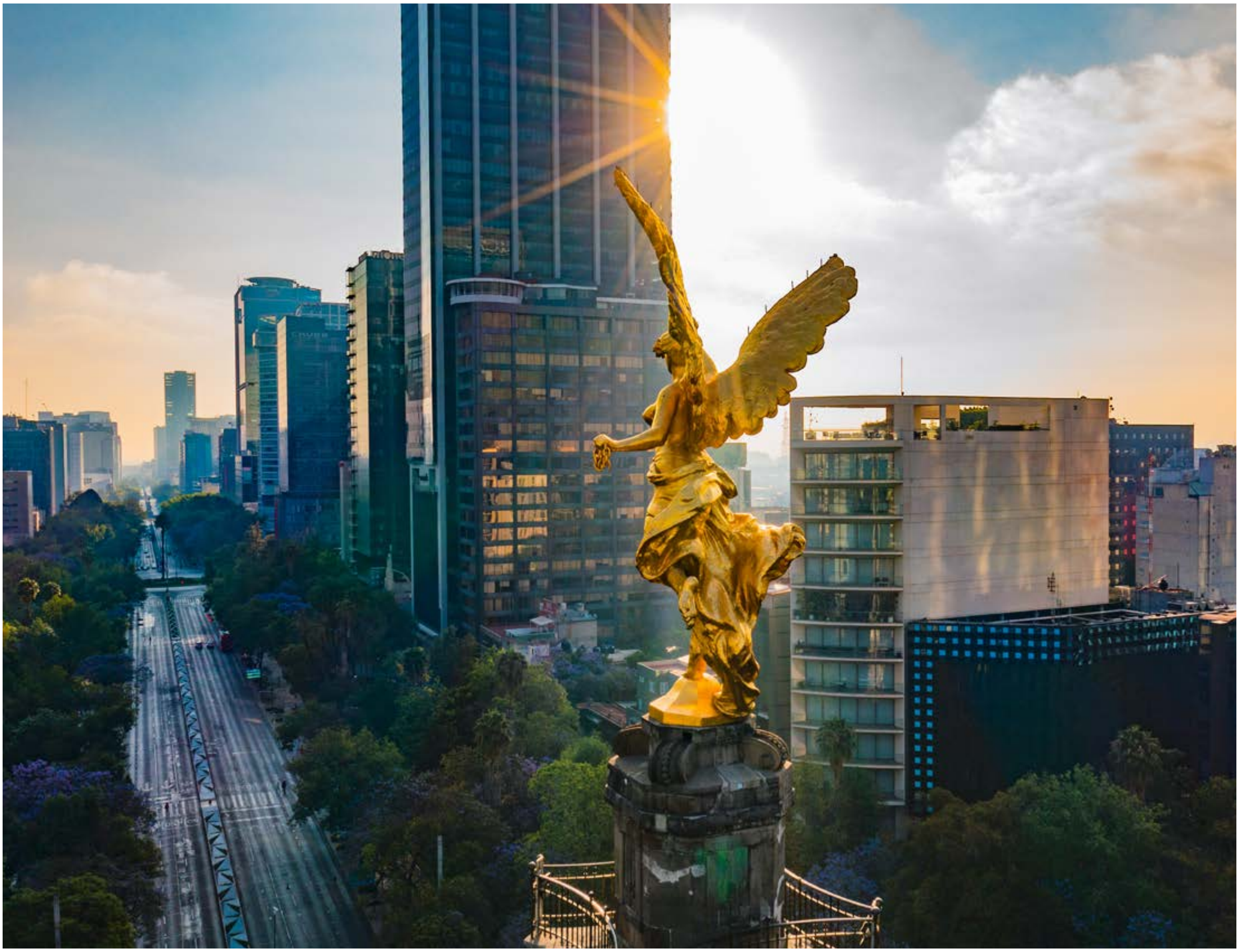
In terms of the client searches, we are optimistic that these searches will be “decoupled” from custody, allowing third-party bidders so that institutional investors can obtain “best in class” service and increased net earnings.

Sackett: We see a strong opportunity to differentiate ourselves in the hard-to-borrow space and through quick, transparent client connectivity. The Automated Trading Locates Allocation System (ATLAS) is our proprietary trading system that allocates stock loan inventory to incoming customer requests. Since launching ATLAS in Q4 2022, our trading desk is much more efficient in serving our clients than it was previously. The team no longer spends precious time sifting through pages of information manually and they can react to market events in real time. We have started to roll this out to some customers, who are happy with the modern user experience.

Intraday during peak market activity, Clear Street sees a throughput of 10,000 locate requests per minute. On the busiest trading days, processing is close to 100,000 locate requests per day, which is significant for a trading system launched less than a year ago. Most automated locate requests are fulfilled in less than 50 milliseconds.

As much as the business has changed over the years, quick responses through ATLAS, competitive rates, stability, market colour, and maximising return on loans through fully paid lending, continue to generate alpha for our clients.





Unlocking Mexico's potential

Mexican market participants are looking to capitalise on the country's steady growth and robust infrastructure to raise the country's profile. Against a backdrop of crucial regulatory changes, Jamie Richards explores how firms are working with local regulators to realise the market's potential

Mexico sits at the centre of two continents, a plethora of trade agreements, and the Latin American securities finance sector. Since the 1990s, Mexico's securities lending industry has grown from a small, tightly regulated environment to the second largest in the region, sitting in a market with two stock exchanges, one derivatives exchange and two securities lending platforms. As of 26 September 2023, the IPC index, which tracks the stock market, is up 5.99 per cent year-to-date.

However, data provided by S&P Global Market Intelligence shows that despite strong year-on-year equities revenue growth, utilisation remains stubbornly low, suggesting that demand isn't yet meeting the increasingly robust lendable supply. From 2012 to 2022, the total value of lendable equities in Mexico increased 64.7 per cent to US$35.7 million, with a median utilisation of 3 per cent in the same period. This hasn't stopped a 97 per cent year-on-year increase in equities revenue for Q2 2023, with the average fee increasing 111 per cent YoY to 1.04 per cent.

In addition, data provided by EquiLend shows that securities lending revenue for H1 2023 was equivalent to 72 per cent of year-end revenue in 2022.

The country has an interconnected system of regulators and financial institutions that handle securities under the supervision of the state. Mexico's securities markets are, in general, controlled by two bodies; the central bank, Banco de Mexico or Banxico, which has some power to set policy and interest rates, and Grupo Bolsa Mexicano de Valores (Grupo BMV), which controls both stock exchanges, the derivatives exchange, and the central securities depository Indeval.

How these institutions face the challenges of changing regulation, increasing utilisation and liquidity, and leveraging foreign interest will have a significant role in shaping this locale's future. The regulatory environment is feeling the effects of the upcoming Bill to Amend, Repeal and Supplement Certain Provisions of the Securities Market Law and the Investment Funds Law, as well as the looming T+1 changeover in May 2024. These shifts present new obstacles — and new opportunities.

A notable feature of Mexico is the relatively small number of international financial firms operating in the North American country, and some divestment seems to be continuing. In July, Deutsche Bank sold its Mexican licence to Citigroup.

Citi occupies a uniquely powerful position in Mexico. The group owns banking firm Citibanamex and is a leader in custody and securities lending. Edmundo Fajardo, Citi's head of securities finance in Mexico, spoke to SFT about how the bank is working with regulators and the central bank to bring the country closer to its potential.

Change on the horizon

For Fajardo, the need to bring Mexico into line with higher-tier international standards is a key requirement for progress. "There's a lot of interest from the regulator and from market participants in aligning the securities finance market with international standards," says Fajardo.

Fajardo indicates that part of the gap between Mexico and LatAm leader Brazil is explained in significant part by missed opportunities due to regulation. "I think there are a lot of opportunities in Mexico — the Mexican market is as important as the Brazilian market. We have higher trading volumes from our side than in Brazil, for example. So I think that there is a huge opportunity here that we are missing."

"We have been working with the central bank on a couple of initiatives to address these gaps," Fajardo continues. "One of these has been to provide better information on fixed income securities lending. We have been working with the central bank to start to provide that data."

In fact, it's not just collateral that Mexico has found tough to keep within its borders. Mexico enjoys one of the highest amounts of foreign direct investment (FDI) in the world, but as Fajardo explains, getting traders to remain in the Mexican market has been a challenge.

"I think that it depends on the client," says Fajardo, "those medium names and small names are interested in the local market. We are, in fact, having conversations with a couple of them. It is more difficult to bring the global custodians, the big blocks, the big names, because they already have the whole structure abroad, and there is no need for them to go and look for deals unless there are very specific securities, or SIC securities that might mean they could find additional offers in the local market."

SIC, a Spanish acronym for International Quotation System, is a framework which allows Mexican participants to trade securities listed offshore with the same tax regime and protections as domestic listings, all done in Mexican pesos. Furthermore, according to a 2019 DLA Piper report, there are no more restrictions on foreign lenders lending to Mexican borrowers than there are in wholly domestic transactions. That said, avoiding conversion rates may not be enough of a draw for large multinational firms resident in nations with preferential tax regimes to set up shop in Mexico. For outgoing payments to those same nations, Mexico's current laws allow as much as 40 per cent withholding tax to be collected.

"The securities lending market for Mexican securities exists, but it exists in the two markets," Fajardo says, "it exists offshore and it exists locally. We are trying to make the Mexican market more dynamic and to bring those international participants into a local market as well."

With the aforementioned Bill to Amend, Repeal and Supplement Certain Provisions of the Securities Market Law and the Investment Funds

Law, hedge funds are expected to finally gain permission to operate in Mexico. Fajardo explains: "That is also very important, because we will have an increase of demand on securities lending simply by having these hedge funds in the market. So with all of that, we are preparing the market to adopt better standards. T+1 will lead [to] a more active securities lending market to avoid fails."

Even with this increased demand, Fajardo feels that Citi's experience as an agency securities lender for local clients and its status as one of the largest custodians in the market, puts the company in good stead. "We are working with our clients to provide inventory to the market. By having this huge market share, we can offer a large inventory to cover the needs that the rest of the market might have," he says.

"Now we need people to start opening hedge funds," he continues, "and to get the necessary approval from the regulator. That might take six to eight months." Hedge funds are not the only bodies Fajardo is keen to get moving. He is enthusiastic about the potential that pension funds could bring to the securities lending market. Fajardo continues: "[The market] will be bigger if we manage to bring the pension plans in. That is something that we need to keep pushing with the local regulations. The bad thing is that this needs to be approved by Congress. We have inventory from pension plans on fixed income, but we do not have that on equity — that would change the game, definitely."

Pensions, politics and plans

That needed injection of dynamism might be just over the horizon. In line with the US and Canada, Mexico will switch from the T+2 settlement cycle to T+1 in May of next year. Unlike some of its contemporaries, Mexico is no stranger to the shortened cycle, having used T+1 until 2007. Even so, it appears that the move will be a shake-up to a market that has grown substantially in the last 16 years.

Fajardo says Citi has been making preparations for the change with the Contraparte Central de Valores (CCV), the Grupo BMV-owned clearing house: "We are king with the CCV, because the CCV is one of the vehicles most concerned with T+1. We are having conversations with them to get ready for T+1 next year. So as you see, we have five or six initiatives that we are working on to change the whole market. Additionally, we managed to level the standards between the offshore market on securities lending and the local market. The local market will be able to have higher volumes and higher liquidity on securities lending by allowing the international clients to come to the Mexican market instead of staying abroad and just closing the deals offshore."

As Gabi Mantle, head of post trade solutions at EquiLend, explains: "The pressures on operational teams have always existed, but those pressures will be exacerbated with a reduced settlement cycle. Lifecycle events need to be identified and actioned in a much shorter timeframe and with minimal margin for error."

Mantle continues: "Time historically spent on manual processing and resolving exceptions needs to be shifted up the chain to focus on accurately mobilising assets, whether new contracts for shorts coverage or recalls to cover client sales or even accurate collateral movements. Now is the time to take advantage of the automated solutions that exist today to support T+1."

S&P Global Market intelligence's Matthew Chessum estimates that T+1 will put some beneficial pressure on Mexico's markets: "In regards to T+1, we are expecting securities finance to play a major role in providing additional short term liquidity to market participants. With the increased levels of settlement and FX risk it seems very likely that securities finance markets will experience an increase in borrowing activity."

Fajardo says Banxico understands the needs of the market, but external political forces are slowing regulatory progress in some key areas. "If we are talking about the central bank, absolutely they understand the business. They understand how this will help, particularly with pension funds also trading in the equities market as well." However, it is not in the central bank's authority to change the rules on pension fund activity; that power belongs to Congress. "Right now, we are feeling that there is no additional interest in pushing this," adds Fajardo. Changes to pension funds' ability to partake in the market are, as Fajardo puts it, "in the freezer".

Ultimately, Mexico's securities finance industry finds itself in a place of steady growth, with complementary aspirations to join the highest tier of the world's markets. As the country strives to meet the highest tier of international standards, the appetite for international cooperation has already made its way into Citi's strategy. Fajardo says: "Being one of the leaders in custody in Mexico, we have knowledge and experience of international market practice that we can share." He adds that Citi has brought this knowledge to the table with the central bank and local clients: "We know what the clients need from international standards, and we have the requisite knowledge, experience and capacity. I think there is a very good mix that we can offer in the market."




Corporate bonds: loan demand builds during 2023

In the securities lending markets, corporate bonds have experienced significant increases in on-loan values and revenues over the last two years. S&P Global Market Intelligence's Matthew Chessum analyses the primary drivers

As interest rates have risen aggressively over the last 18 months, investor interest in corporate bonds has grown. Despite an initial assumption that the rise in rates would put global economies into recession, market data has remained resilient and this has amplified investor confidence in an asset class that is offering increasingly higher yields against a buoyant market backdrop. When looking at investment performance, the S&P high yield corporate bond index has increased 6.95 per cent over the past year, while the S&P Global Developed investment grade corporate bond index has increased by 3.38 per cent.

Corporate bonds have been issued at a record pace throughout the year and September has seen some of the busiest days on record. Not only has September recorded the busiest day since March 2020 for issuance, but the total issuance for the week ending 15 September exceeded US$50 billion. One trend that has been apparent throughout the recent spate of issuance has been the focus on the short end of the curve. As 30-year Treasury yields have been trading at their highest levels in more than a decade, many issuers have been reluctant to lock in the higher funding costs. Shorter duration debt has therefore been the preference in the hope that interest rates fall next year and refinancing can take place to lock in lower rates. A focus on shorter dated debt has also been a theme within the securities lending markets. Eight out of the top 10 highest revenue generating corporate bonds of the year so far from a securities lending perspective have all had maturities of under five years.

In the securities lending markets, corporate bonds have experienced significant increases in on-loan values and revenues over the last two years. An increased level of certainty behind central bank rate increases and a requirement for additional market liquidity has led to a period of increasing fees for corporate bond lenders as the demand to borrow has grown. By the end of August, corporate bond lending had generated US$787 million. Monthly revenues have been on average 30 per cent higher during every month of 2023, when compared YoY. These remarkable revenues are the result of significantly higher fees. Corporate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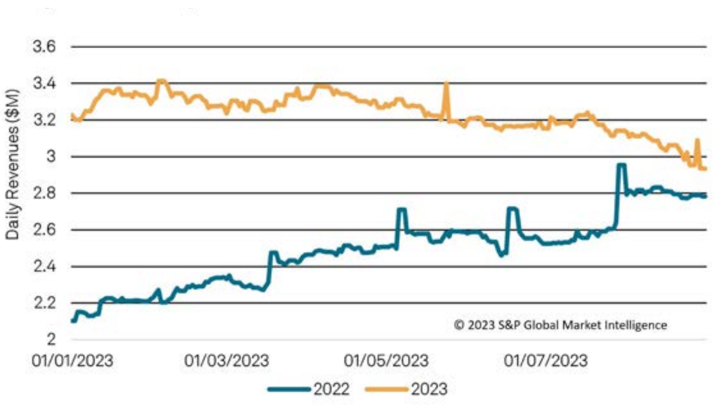
bonds have been trading at an average fee of 45bps throughout the year which is, again, significantly higher than the 32bps fee that was seen during the same period in 2022. These revenues have been generated, despite YoY declines in balances, lendable and utilisation.

Fig 1: Daily revenues - corporate bonds



Corporate bond lending is not just restricted to physical corporate bonds, however. Exchange traded funds have often played an important role in both hedging and gaining exposure to the asset class. HYG, the iShares iBoxx high yield fund, is well known in this space and produces a large proportion of the revenues generated by US-listed ETFs. Over the last three months, securities lending revenues for HYG have been rising once again, which signifies a growing interest in the corporate bond market. Revenues for September are, at the time of writing, likely to be the highest of 2023 so far. According to data provided by S&P Global Market Intelligence ETF solutions, corporate bond ETFs have seen net inflows of circa US$65 billion year-to-date, with inflows targeting those funds offering exposure to shorter maturities.

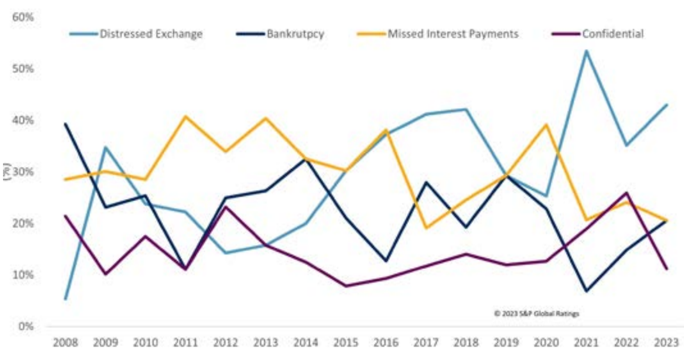
Opportunities for market participants have been created by an interest rate environment that has been defying the normal playbook. Continued hawkish sentiment has ensured that, until very recently, the likelihood that central banks would continue increasing rates has been very high. Given the fact that those short-dated maturities remain very sensitive to any changes in interest rates, hedge funds have been able to take advantage of readjustments in prices as yields climbed higher to reflect the new risk-free rate. In addition, the inverted yield curve in the US has created a similar effect across corporate credit curves. Recently issued Nasdaq bonds were offered with a 3-year coupon at 5.65 per cent and a five-year bond with a coupon of 5.35 per cent. This means that investors are being paid more for taking on less duration risk. These situations are also leading to arbitrage opportunities for end borrowers.

Default rates

Despite the optimism surrounding the corporate bond market, a recent report issued by S&P Global Ratings discovered that defaults during August hit their highest level since 2009. The increase was down to a growing number of distressed exchanges. This is where a company proposes that existing debt holders either take a haircut on their current holdings, or offer a new security that has a longer maturity or lower value to avoid bankruptcy. Most defaults during the period also took place in either the US or Europe, with both regions seeing notable increases YoY. The report noted that, in Europe, monthly defaults in August reached their highest levels since October 2020 as the European default tally reached almost three times the levels seen during 2022. Media and entertainment was the sector most affected by defaults, accounting for one third of all defaults in the US, and consumer products in Europe, which posted a 50 per cent increase on 2022.

Fig 2: The percentage of distressed exchanges is rising

Year-to-date percentage of defaults by default type



Despite the recent increase in default rates, an assumption of higher for longer is bound to benefit the corporate bond market. Higher coupons will remain attractive to investors as the underlying growth outlook and economic data remain healthy. This will encourage selective risk taking and is likely to lead to greater inflows into corporate bond funds.

Key risks do still exist for the asset class, however. These include the future trajectory of inflation, overtightening by central banks leading to a slowdown in economic growth, the ability to refinance debt and any potential flare up in geopolitical risk.

LRH hires De Vidts

London Reporting House (LRH) has hired Godfried De Vidts as a senior advisor.

De Vidts will advise on product and client strategy, with a particular focus on continental Europe.

De Vidts brings more than 50 years of experience in financial markets to the role. He most recently worked as a senior advisor to the ICMA's European Repo and Collateral Council (ERCC), where he chaired the Council from 2000 to 2019.

He has also served as a member of the European Central Bank (ECB) Contact Group on Euro Securities Infrastructures (COGESI).

Prior to his tenure at ICMA, De Vidts served as director of European affairs at NEX Group, created out of ICAP, for 12 years. Before that, he worked as head of global liquidity and collateral management at Fortis Bank for 18 years.

De Vidts began his career in finance at KB OBU, a branch of Kredietbank Brussels, as a control officer between front and back office.

Holmes becomes BBH 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.

Commenting on her appointment, Holmes says: "I am excited to join the premier agent lending team in the business. We aspire to provide global investment managers with superior risk-adjusted revenue combined with an outstanding client experience.

"I am focusing first on advancing our industry leading e-trading capabilities and adding technology, product features and functionality that will benefit our clients and drive efficiencies across our programme."

Clear Street appoints Daplyn CIO

Independent prime broker Clear Street has expanded its technology leadership team with the hire of Jonathan Daplyn.

Daplyn will report to the firm's co-founder and CEO Chris Pento and Matthew based in New York.

In the role, Daplyn will lead the firm's 150 technologists as chief information officer (CIO). He will also manage and implement the firm's future roadmap.

Daplyn joins Clear Street from Morgan Stanley, where he was instrumental in building a global prime brokerage business as head of prime brokerage technology.

Daplyn adds: "I am excited to join the Clear Street team at this pivotal moment. With its cloud-native clearing and custody system, Clear Street is setting the standard for technology in risk management, execution management, portfolio management and more."

M1 Finance hires Barros

M1 Finance has appointed Anthony Barros as head of securities lending.

Barros joins the Chicago-based firm from Velocity Capital, where he worked as executive vice president of securities lending for three years.

Based in New York, Barros will report to Ryan Burke, general manager for investing .

Previously, Barros served as vice president of securities lending at E*Trade Financial for six years. Prior to this, he was managing director at RCap Securities for two years.

Pirum appoints Koopmans

Pirum has selected Jacob Koopmans as chief revenue officer to take on sales responsibilities from Karl Wyborn, who will be taking some time out of the business.

In his new position, Koopmans will be responsible for fostering strong partnerships with Pirum clients and enhancing the firm's marketing capabilities.

Koopmans brings more than 20 years of experience in capital markets to the role, alongside a distinguished career in sales and sales management.

He joins Pirum from fund data provider Kneip where he was chief commercial officer. During his career, he has also worked for Refinitiv, Thomas Reuters and EcoWin.

Commenting on the announcement, Koopmans adds: "I am thrilled to embark on this new journey with Pirum and I am committed to furthering the innovative spirit and collaborative environment that the company stands for."

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