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Issue 338 17 October 2023

Accelerated Settlement: evaluating preparations for T+1 in the US and Canada

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J.P. Morgan's TCN facilitates collateral settlement

J.P. Morgan's Tokenized Collateral Network (TCN) has facilitated a collateral settlement for a live-client over-the-counter (OTC) derivative transaction for the first time.

As part of the initiative, BlackRock and Barclays are now live on TCN, an application which sits on J.P. Morgan's Onyx Digital Assets platform, operating as a private blockchain. It is used for tokenised asset movements, including collateral settlements.

This means counterparties can transfer the ownership of the collateral assets on TCN, delivering a frictionless transfer of assets on a near instantaneous basis, says J.P Morgan.

During the transaction, tokenisation occurred within a matter of minutes through connectivity between the fund's transfer agent and TCN. The transfer between BlackRock and Barclays was near instantaneous.

Shares in money market funds (MMFs) were used as collateral between bilateral derivatives counterparts for the first time.

The ability to tokenise assets, and use them under both title transfer and pledge structures, outside of any limiting market operating hours, has the potential to fundamentally change the collateral market, says J.P. Morgan.

BlackRock has tokenised the representation of shares in a BlackRock Money Market Fund through TCN. The use of blockchain settlement technology to transfer the ownership of MMF shares will also bring additional utility to MMFs, which has the potential to increase their resiliency.

The tokenised representation of the MMF shares were transferred to Barclays to cover collateral requirements – the underlying documentation was amended to support the delivery of MMF shares as collateral.

J.P. Morgan has said that it expects to expand TCN's capabilities across equities, fixed income and a range of asset classes in the future.

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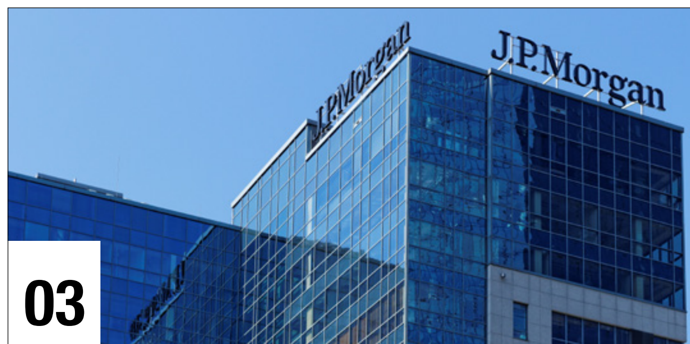

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Latest industry moves

Ben Challice is to retire from his role at J.P. Morgan Chase after six years. Based in London, Challice is currently global head of Trading Services, securities finance

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Trading Apps executes first trade on TA.Link

Trading Apps has executed the first transaction on its latest trading option TA.Link.

South Street Securities, in collaboration with a retail clearing partner, aided with the transaction.

TA.Link is an alternative way to communicate trading activity between securities finance participants. The firm says the option enables users to trade safely, reliably and affordably.

The new trading option is also designed to provide an alternative connection to mitigate the risk of relying on a single messaging service. TA.Link messages are fully end-to-end encrypted.

Commenting on the milestone, Trading Apps CEO Matthew Harrison says: "With much respect and appreciation we would like to recognise South Street Securities, in collaboration with a retail clearing partner, for their insight and cooperation through this breakthrough development as Trading Apps looks forward to providing an alternative facility to engage the securities finance market."

J.P. Morgan's TCN facilitates collateral settlement

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TCN was built jointly between J.P. Morgan's collateral services team and Onyx Digital Assets.

Ed Bond, head of trading services at J.P. Morgan, says: "This first transaction with BlackRock and Barclays demonstrates the power of tokenised assets, particularly in a collateral setting. MMFs can now be mobilised and utilised in a more efficient way, unlocking new pools of liquidity to be used for margining. We plan to add participants and assets to the Tokenized Collateral Network in the coming months."

Tom McGrath, deputy global chief operating officer of the cash management group at BlackRock, comments: "We believe that money market funds play an important role in providing liquidity to investors in times of high market volatility.

"The tokenisation of MMF shares as collateral in clearing and margining transactions would dramatically reduce the operational friction in meeting margin calls when segments of the

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market face acute margin pressures. We're excited to work with J.P. Morgan and Barclays to improve market efficiencies through this first trade."

Matthew Collison, head of resource management group at Barclays, adds: "Barclays has a long history of helping clients navigate change to deliver results. We are therefore pleased to partner with BlackRock and J.P. Morgan who executed this transfer, as this is a terrific example of driving innovation in post-trade settlement."

Pirum trials DLT extension of post-trade solution

Pirum has now tested a distributed ledger technology (DLT) extension of its securities lending and repo post-trade solution.

The firm says the extension provides clients with an 'immutable, transparent and distributable' golden-record of their trades for reference, audit and other purposes.

Further, the extension is designed to build on existing post-trade lifecycle workflow and automation, fed from real-time client books and record data integrations.

Pirum is working with a number of technology stacks to model the stock loan and repo golden-record ledger and smart contract lifecycle flows to benchmark features, performance and interoperability.

The firm says this is driven by the requirement to integrate with multiple industry DLT systems covering collateral, payments and settlement.

Pirum aims to automate the full post-trade lifecycle to provide an immediate and non-disruptive solution to improve operational efficiency.

Its approach is built on existing messaging and integration technologies, while providing participants with the optionality to interact and operate with emerging technologies, such as DLT, and avoid large IT investment.

The financial services technology vendor is also experimenting with how the benefits of DLT can be used today to solve existing industry challenges, including standard settlement instruction (SSI) management to further improve settlement efficiency, reliability and reduce fails, penalties, as well as unsecured credit risk.

Philippine Stock Exchange confirms short selling guidelines

The Philippine Stock Exchange (PSE) has confirmed its guidelines on short selling transactions are to be effective immediately following regulatory approval.

The approval is in regards to critical components of securities borrowing and lending — short selling can only function if a securities borrowing and lending programme is in place.

In September, the Bureau of Internal Revenue (BIR) accepted the filing and registration of the Global Master Securities Lending Agreement (GMSLA).

In May 2023, the U.S. Securities and Exchange Commission (SEC) approved PSE's proposal to offshore collateral for securities borrowing and lending.

The exchange has also updated the eligible securities in its short selling guidelines to include members of the PSE MidCap and PSE Dividend Yield indices.

Initially, only securities comprising the PSE index and exchange-traded funds

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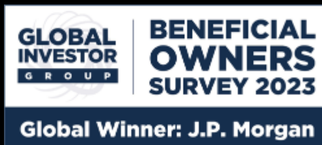

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(ETFs) were considered eligible securities for short selling.

PSE president and CEO Ramon S. Monzon comments: “We are grateful to the SEC and BIR for their approvals on important regulatory aspects of securities borrowing and lending and short selling.

“This development brings us a step closer to the full adoption and implementation of these much-awaited programmes.”

The PSE will make a separate announcement on the official launch date of the short selling programme.

BoE announces plan for Money Markets Code review

The Bank of England (BoE) has outlined an action plan for the review of the UK Money Market Code, which falls due in April 2024.

The BoE’s Money Markets Code subcommittee is required to review this Code every three years. It aims to have a draft Code in place by the year end, giving time for this draft document to be circulated for comment from all members of the Bank's Money Markets Committee, Money Markets Code subcommittee and its Securities Lending Committee in readiness for the April adoption.

The review process will be conducted through four working groups, made up from members from the UK Money Market Code subcommittee and experts from the industry.

Across the Code’s four chapters, the review team will be evaluating steps to improve settlement discipline, messaging and standards of professionalism in the London Money Market.

It will provide guidance on the treatment of unexpected bank holidays and where to seek guidance in instances of non-standard closure of CREST, the UK central securities depository’s settlement platform. It will also discuss steps to standardise the look-back period for floating rate certificates of deposit.

In its dialogue at the 6 September meeting of the UK Money Markets Code subcommittee, participants also reflected on how best to encourage more corporate signatories to the Code.

Earlier this year, the London Money Markets Association (LMMA) re-established a working

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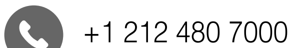
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group to examine settlement fail rates in the repo market, setting in train a programme which will dovetail with work on settlement efficiency by the BoE's Securities Lending Committee and the Repo Working Group of the UK Money Market Code subcommittee.

The LMMA Working Group recently met with the Debt Management Office (DMO) and it will be consulting with its members to ask what changes they would like to see from LCH, Euroclear, the DMO and the Bank of England to improve settlement efficiency in repo markets.

In doing so, the Working Group emphasised that settlement efficiency needs to be taken more seriously by the London Money Market, regardless of the scale of market participants' involvement in repo market activities.

The group hinted that financial penalties may ultimately be introduced, should they be necessary, to drive necessary improvements in settlement efficiency in UK repo markets.

Repo ADV up 38.9% YoY for September, says Tradeweb

Repo average daily volume traded on the Tradeweb platform increased 38.9 per cent year-over-year to US$529.6 billion for September 2023.

Further client adoption of Tradeweb's electronic trading solutions drove record global repo activity for September. This was also impacted by a shift in US market conditions from the Federal Reserve's reverse repo facility to money markets.

The global operator of electronic marketplaces for rates, credit, equities and money markets reports that the ADV across all asset classes for the month of September reached a record US$1.57 trillion, an increase of 30.8 per cent YoY.

For the third quarter of 2023, ADV across all asset classes was US$1.42 trillion, an increase of 29.6 per cent YoY.

US government bond ADV was up 12.4 per

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cent YoY to US$145.3 billion. European government bond ADV was also on the rise by 1.9 per cent to US$42.4 billion.

According to Tradeweb, US and European government bond volumes were supported by sustained rates market volatility.

For swaps and swaptions, ADV climbed 30.0 per cent YoY for September to US$335.3 billion. Total rates derivatives ADV also increased, rising 45.3 per cent YoY to US$570.9 billion.

In credit markets, fully electronic US credit ADV was up 14.3 per cent YoY to US$4.9 billion while European credit ADV was up 22.6 per cent YoY to US$2.1 billion.

US credit volumes reflected continued client adoption across Tradeweb protocols, the US-based firm says, including request-for-quote (RFQ), portfolio trading and Tradeweb AllTrade.

BrokerTec provides repo trading as a spread to €STR

BrokerTec, a firm wholly-owned by CME Group, has provided a range of new opportunities to trade European repo as a spread to the Euro short-term rate (€STR).

The electronic trading platform and technology services provider says the new functionality offers further flexibility to clients, with efficient hedging for term repo trading in a fluctuating interest rate environment.

The enhancement allows the trading of repo as a spread to €STR in all European repo markets, except for Italy and Spain. Clients are able to clear trades through LCH RepoClear SA.

This adds to an existing opportunity to trade French repo versus €STR, which is already provided by BrokerTec.

European repo is available for trading on the BrokerTec EU Regulated Market, operated by CME Amsterdam B.V.

Commenting on the announcement, John Edwards, global head of BrokerTec,

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says: "In today's uncertain interest rate environment, clients are seeking new tools to trade term repo.

"This enhancement expands on our central limit order book for trading European repo, with clearing available from day one to support the industry's need for efficient electronic trading."

Securities finance revenue climbs 1%

The global securities finance industry generated US$2.65 billion in revenue for lenders in Q3 2023, a 1 per cent year-on-year increase from Q3 2022, according to DataLend.

In September 2023, the industry generated US$767 million in revenue for lenders, representing a 6 per cent decrease from the previous year.

The dip was largely driven by a cooling in the US equity lending market, where fees declined 43 per cent month-on-month and 21 per cent YoY. As a result, US specials revenue dropped to US$166 million from the US$362 million generated in August 2023.

According to the market data service of fintech EquiLend, global broker-to-broker activity — where broker-dealers lend and borrow securities from each other — generated an additional US$680 million in revenue during Q3 2023, representing a 6 per cent decrease year-over-year.

A 27 per cent YoY rise in APAC lending revenue helped to offset dips in North America and EMEA in Q3 2023, which faced YoY declines of 3 per cent and 12 per cent, respectively.

Global equity performance saw a slight YoY decline of 1 per cent, with fixed income securities revenue rising by 7 per cent YoY during the third quarter.

DataLend says the improvement was fuelled by continued growth in corporate bonds, which were up 24 per cent YoY in Q3.

The top five earners in September 2023 were Ecopro Co Ltd (086520 KS), Fisker Inc. (FSKR US), Country Garden Holdings Co Ltd (2007 HK), Sirius XM Holdings Inc. (SIRI US) and C3.AI Inc. (AI US). In total, the group generated US$43 million in revenue in the month.

Abu Dhabi Pension Fund picks Northern Trust for securities lending

Abu Dhabi Pension Fund (ADPF) has selected Northern Trust to provide its securities lending and global custody services, effective 1 January 2024.

The ADPF is a growing pool of sovereign sponsored pension assets in the Middle East.

Tasked with managing contributions, pensions and end-of-service benefits for United Arab Emirates (UAE) nationals affiliated with the government and private sectors in Abu Dhabi, the ADPF also extends its services to the retirees and their beneficiaries.

Northern Trust will assist the ADPF with investment allocation, liquidity management and portfolio optimisation. As part of the mandate, Northern Trust will also provide ADPF with alternative asset administration services.

James Wright, head of asset owners, EMEA at Northern Trust, comments: "We are delighted that ADPF has appointed us as their global custodian. As a leading provider in the region, with more than 35 years of experience

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in servicing clients in the Middle East, we are excited to continue to grow in the market."

Ali Alqemzi, chief operating officer for investment at ADPF, says: "Northern Trust stood out due to their focus on asset owners, particularly those with sophisticated allocations across public and private assets.

"Their ability to adapt to the evolving financial landscape, as evidenced by their investment in technology and development of solutions that are targeted to funds such as ourselves, is important to us as we grow, and our asset allocation needs evolve."

OCC average daily loan value up

The Options Clearing Corporation (OCC) records a 20.2 per cent year-on-year increase in average daily loan value for securities lending trades, generating US$147.3 billion for September.

However, total securities lending volumes cleared on the OCC platform decreased 1.5 per cent to 200,880 in September, compared to the previous year.

Total volume for all futures and options cleared through OCC has dropped 7.4 per cent YoY to 847.8 million contracts for September 2023.

Year-to-date average daily volume for all futures and options cleared on the platform through 2023 was 44.4 million contracts, up 8.7 per cent compared to YTD average daily volume through 2022.

The platform experienced a 9.3 per cent YoY hike in index options contracts for September to 80.0 million and a 5.3 per cent YoY decline in cleared futures contracts to 4.7 million.

ETF options contracts cleared on OCC have decreased 10.4 per cent YoY for September to 348.8 million. Equity options volumes have also declined 7.5 per cent YoY to 414.4 million.

SmartStream launches new release of collateral management solution

SmartStream has launched the latest version of its Transaction Lifecycle Management (TLM) Collateral Management, V.6.

The release introduces a "modern, intuitive and thin client user interface" according to the London-based firm. The TLM solution is designed for users with different skill sets, including those who are less experienced in the collateral management operations.

TLM Collateral Management, V.6 is designed to assist organisations with data integrity and validation for all collateral management processing.

SmartStream indicates that its updated solution will aid with the demands presented by T+1 settlement. The firm adds that financial institutions must automate all aspects of their collateral management processes in a condensed time frame, including agreement, booking, substitutions and settlement notifications.

Jason Ang, global programme manager, TLM Collateral Management, SmartStream, says: "For this new version, we have worked closely with many customers to design a more intuitive user experience that requires less training so that users can be up and running quickly.

"In response to the demands of the industry we have included adapters that automate the substitution and interest claim processes. This latest version provides improved navigation results that are more accurate, enabling quicker decision making."

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Accelerated Settlement: evaluating preparations for T+1 in the US and Canada

Moderator

Bob Currie, Group Editor, **Securities Finance Times**

Panellists

Sudha Datta, Managing Partner and Co-Founder, **Soterium**

Rebekah Flohr, North America Head of Custody, **Citi**

Ron Landry, Head of Product and Canadian ETF Services, **CIBC Mellon**

Mike Norwood, Director, Global Trading Product Owner, **EquiLend**

Introduction

Bob Currie: Welcome to the Asset Servicing Times panel discussion on Accelerated Settlement taking place here at Sibos in Toronto.

This examines the US and Canadian transition to T+1 securities settlement scheduled for May 2024, with Canada scheduled to begin trading using next-day settlement on 27 May and the US doing so one day later, after the Memorial Day public holiday, on the 28th.

In proposing the T+1 project, market authorities have indicated that the shorter T+1 settlement cycle will reduce credit risk, market risk and liquidity risks associated with settlement failure.

By shortening credit exposure over the settlement period, this is expected to lower margin costs, improve mobility of liquidity and collateral, and potentially reduce the capital costs of trading.

Additionally, this may drive further automation of the transaction lifecycle, encouraging infrastructure modernisation and forcing those firms that are still hanging on to manual processing and communication to upgrade their workflow — including wider adoption of electronic trade matching, confirmation and allocation systems.

That appears to have been one lesson from India's experience with T+1 migration — which was managed via a phased migration beginning with less liquid securities in February 2022 and moving progressively to more liquid names, culminating on 27 January 2023.

One primary message from India's experience was that it was sink or swim for those firms still using manual communication and paper-driven processes — to paraphrase French economist Michel Aglietta, T+1 has forced firms to 'adapt or perish'.

And for those firms making it to the other side, it has been necessary to adapt their settlement culture and behaviour, as well as upgrading their technology.

We will examine the transition proposal in the US and Canada in more detail and in comparative context, examining how this will impact different types of market participants and different transaction types.

To open, let's look more closely at the rationale for T+1 and where this will have the greatest impact. How will this most affect your firm and the clients you support?

Rebekah Flohr: You touched in your question on the key priority, which is in helping the clients to prepare for the T+1 transition. We have a big programme running across the organisation to be ready for T+1. This is not just custody but embraces greater securities services, including securities lending, and we are working with our colleagues in Global Markets and other groups across the firm.

We provide securities services to a global customer base and T+1 will raise questions in terms of staffing, technology and changing operational processes and culture, particularly when supporting the needs of cross-border investors trading in the US market. So the key word in your question was 'clients' and, for Citi, the primary focus is on how we can help clients to prepare for accelerated settlement, engaging consultants where necessary to assist this process.

Sudha Datta: Some client groups are really behind in their technology preparations — some asset management firms and asset owners, for example, continue to rely heavily on manual touch points in their settlement activities.

The transition to T+1 settlement will force firms across the industry to undertake a wholesale review of their operational process, compelling them to improve automation rates and to modernise their settlement

By shortening credit exposure over the settlement period, this is expected to lower margin costs, improve mobility of liquidity and collateral, and potentially reduce the capital costs of trading.

Bob Currie
Group Editor
Securities Finance Times

EQUILEND

processes. In practice, the May 2024 transition is only a short distance away and firms need to act. This time will pass very quickly.

Mike Norwood: The securities lending and financing sector brings specific challenges since it is largely an over-the-counter market. EquiLend currently supports clients' lending and borrowing activities 23.5 hours per day across six days of the week, in terms of systems and operational readiness, facilitating global trading around the clock.

For securities financing transactions (SFTs) that are actively traded on EquiLend's NGT platform, the bulk of this volume already settles on a T+0 basis. So in preparing the US and Canadian markets for T+1, we are confident that the tools are available to meet this accelerated settlement timeframe.

We do still hear a range of concerns from across the market. What will T+1 do to our operational processes? Are we accurate enough in terms of matching rates? Will we have enough time to source liquidity to cover short positions?

But the tools are available to manage these challenges. In this environment, firms will come under ever greater pressure to address their manual processes — and T+1 settlement will ramp up the momentum that has already been established through implementation of the Securities Financing Transactions Regulation (SFTR), the Settlement Discipline Regime component of the Central Securities Depositories Regulation (CSDR), along with the proposed SEC Rule 10c-1.

Firms that continue to apply a lot of manual touch points across the settlement lifecycle will need to reconsider how they structure their workflow. In contrast, the firms that are best placed are those that have already addressed many of these operational risks and bottlenecks in response to these earlier regulatory initiatives.

Ron Landry: The challenge is particularly in getting clients 'technology ready' for the transition to T+1. As a custodian, we are prepared and largely ready to go. But some firms across the industry are lagging in their preparations and we will be spending the next few months providing education around what is required.

Many of the larger asset management and asset owner clients are already supporting electronic settlement communication, via the Swift network, via vendor-based order management and workflow solutions, or using our own internal trade capture tools.

But, like other custodians, we still have some clients that prefer to send settlement instructions by email or fax. That needs to go away. These clients genuinely need to embrace effective technology solutions to help them to manage this transition. If they do not, they are likely to face some real challenges.

Is the panel's feeling that there is a sizeable cohort of firms that are still not on track with the T+1 migration schedule?

Flohr: There are clear geographical challenges. The transition demands a full review of technology and any manual touch points — and there are certainly a lot of these still out there.

Migration to next-day settlement demands changes in behaviour. It also raises questions around staffing. For international clients, for example, the DTCC's 21:00 EST affirmation deadline falls after midnight in Europe and the Middle East and it occurs at the start of the next working day in the Asia-Pacific timezone. So for trades that need to be affirmed on a Friday evening in the US market, for example, staff will need to be monitoring the status of these settlement positions on a Saturday morning in Asia. Firms need to be planning carefully for how they adapt their processes and operational behaviour to make this happen, taking into account relevant employment legislation across their global markets.

Although clients are actively thinking about these considerations, many still have a lot to overcome before they are ready. At Citi, we are engaged in a major communication initiative with our clients to ensure they are aware of the key implications and preparing effectively to make this work.

Learning from the past

This is not the first transition to a shorter settlement cycle that we have witnessed in our working careers. The European Union migrated to T+2 equities settlement in 2014 in the first tranche of the Central Securities Depositories Regulation. The US migrated to T+2 in 2017. To what extent did those migration efforts create pressure to strip out manual inefficiency?

Landry: The transition to T+2 did not have a big impact in forcing firms to eliminate manual interventions. In transitioning from T+3 to T+2, firms still had a day to work with to ensure that trades settled on time. For this

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reason, settlement culture did not substantially change and some firms postponed the need to upgrade processes that should be automated.

In transitioning to T+1, firms will need to change their operational practices as well as upgrading their technology. Offices at many buy-side firms have traditionally closed at 17:00, while settlement issues often tend to arise after hours. If investment companies maintain these same working hours in a T+1 environment, their operations teams may not identify potential settlement breaks until the following morning, leaving one working day and no overnight to take remedial action.

In short, with only 6-8 hours to deal with any settlement issues in a T+1 environment, automation will play a prominent part in ensuring that the transition to T+1 is successful.

Flohr: Looking retrospectively, it is evident that some firms managed the move to T+2 by allocating extra staff to certain processes, rather than by upgrading their technology and improving levels of automation across their settlement workflow. With T+1 migration, that approach — throwing more staff at the problem — becomes close to impossible.

Datta: This requires a change of culture. Sending trade confirmations by email has become a habit in some organisations. So there is likely to be resistance to change from certain parties that have become accustomed to working with these inefficient post-trade practices.

The challenge is not the same for every type of firm. For a large Tier 1 asset servicer, the technology investment may be large but manageable. But for a small investment management company, it is a huge undertaking to install new systems to meet this transition requirement.

Initially this will be an expensive migration — and it will be challenging, particularly for smaller investment firms, to find the resources to upgrade their technology and settlement processes. But, relatively quickly, these firms will experience the benefit of this transition in terms of greater automation and reduced operational overheads.

Norwood: That is the natural order of things. The longer that a firm waits to make these transformative technology changes, the longer that it will need to normalise its data and to establish the data quality required to support process automation. Typically, the sooner that a firm moves to digital, the cheaper and more efficient its operational processes will become. For those that delay, it will be harder to change established institutional behaviour and to force out ageing and inefficient trade processes.

This is also not the first time that the US has embarked on a transition to next-day securities settlement. In October 2001, the Securities Industry Association pushed back the release date for T+1 implementation because the industry did not feel that it was ready — and it has taken more than two decades to be actioned. Has the industry changed sufficiently to be confident of a successful T+1 migration in 2024?

Flohr: The transition to T+1 scheduled for May 2024 is a little

May 2024 is not far away. I have been telling clients to start early. If you are only starting now, you are already behind.

Sudha Datta
Managing Partner and Co-Founder
Soterium

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different because this is now being driven by the regulators, by the US Securities and Exchange Commission and the Canadian Securities Administrators. In contrast, in 2001 the transition to T+1 equities settlement was driven principally by the industry. Now firms have no choice but to commit to the transition approaching next May.

Landry: Technology has also advanced a long way since 2001. The industry is better equipped than it was 20 years ago in terms of adoption of technology and electronic messaging standards. If an asset manager does not have suitable technology to manage its portfolio, and the associated investment operations, then regulators will be taking a close look at that firm's operational and risk management practices.

The pandemic also changed things greatly. Trading, operations and risk management teams were forced, at short notice, to move to remote working and to operate without access to fax machines, to printers and to other mechanisms that sustained manual workflow. This helped to displace outdated practices.

However, there are still some stragglers that are holding back and think that they can find manual workarounds to manage their settlement commitments in a T+1 environment.

Transition priorities

Let's look more closely at the steps that firms need to set in place to move to a T+1 settlement regime. We have already mentioned electronic trade matching, confirmation and affirmation. DTCC has an affirmation cutoff of 21:00 on trade date, with allocations to be completed by 19:00 on trade date. What steps are needed to operate efficiently in this environment?

Flohr: We spoke about the need to review any manual processes. Firms need to familiarise themselves with the range of automated tools that are available — automated FX solutions, for example, and solutions available to provide automation across the trade lifecycle for securities lending and financing transactions. In the US market, DTCC, as a market infrastructure company, offers a number of tools that will facilitate accelerated settlement — and Citi and other leading custodians also offer a range of solutions. Firms are likely to draw on a combination of these solutions in their move to readiness.

Norwood: Even if firms are using an automated process, we need to look more closely at whether this is real-time or batch driven. Working with 30-minute batch processing in a T+2 environment may not be a major problem. But on moving to next-day settlement, batch cycles will present a greater challenge in ensuring that settlement instructions are matched and that required securities, funds or collateral are in position to settle.

For securities lending trades, this consideration is attracting a lot of attention for recalls in particular. Firms will be looking carefully at how close to real-time notifications are coming back from the investment manager. At how regularly these are being processed. And at how soon the firm can compare these against its outstanding inventory to identify whether it needs to issue a recall.

For highly-liquid loan securities, the GC names, the industry can be fairly confident that securities will come back on time when they are recalled. But there may be problems with recalling hard-to-borrow securities where there is a high level of short interest. These are largely the same problems that the industry is facing currently, but the temperature around these recalls is likely to rise with the move to next-day settlement.

A recent ISITC Europe report has highlighted that the challenge around recalls may make some asset owners more reluctant to lend their stock. Is that a genuine concern?

Norwood: If lenders find it necessary to hold back inventory and do not feel that they can lend the full position that they wish to lend, this changes the economics of their lending strategy.

This is not the first time we have confronted concerns that a regulatory change may impact loan supply. Some commentators speculated that the settlement discipline regime under CSDR may discourage lending for example. There were also potential concerns around Agency Lender Disclosure (ALD).

On balance, we expect that lenders will stay in the market and will continue to lend. Securities lending provides an attractive source of risk-adjusted return and technology is available to help them to manage any associated risks. As long as their service providers offer a high-level of automation, we believe that many lenders will be confident that these risks are well managed.

Flohr: This is likely to be similar to a number of regulatory changes and industry transitions that we have witnessed historically where there

has been an adjustment period, with a temporary rise in settlement fail rates, and then this has normalised. This will cause friction and concern initially, but the market is likely to adapt relatively quickly.

Landry: In response, we are encouraging clients to report their trades earlier and more often. Some fund managers in the current T+2 environment tend to sit on their trades until the end of the day, then to run these trades through their systems and to submit their settlement instructions the following morning.

In the T+1 settlement environment in Canada, counterparties are required to be matched by 03:59 on T+1. To meet this, we are requiring clients to have trades in by 03:00 on T+1. By association, the sooner that the firm gets its trades in, the easier it is to manage recalls.

We have been doing this for exchange-traded funds (ETFs) for some time. With ETF trading, settlement is typically in-kind against a basket of securities and so, from a lending perspective, you will typically need to maintain a buffer. Firms will increasingly start to set natural buffers in place to manage their settlement risk as they move to T+1. As technology solutions improve, moving settlement gradually closer to real-time and enabling more real-time information and analytics, this will further reduce settlement risk.

Datta: Mike has raised the point about batch processing versus real-time processing and this demands a huge change of behaviour. In the batch process, as we have noted, clients may wait until the last minute to send their instructions. In a T+1 environment, firms will be forced to change this mindset and that will be positive for the industry.

For cross-border transactions into the US, there will also be a crucial need to re-examine foreign exchange settlement and for international firms to ensure they can align their FX settlement to meet their funding requirements in a T+1 settlement window.

Product solutions and technology

What solutions are you offering as banks and vendors to help the client to manage these adjustments?

Norwood: At EquiLend, we are not building new solutions specifically for T+1. For the securities lending industry there has been a drive for automation over the past 20 years. The company was formed in 2000, starting with an autoborrow platform to automate general collateral (GC) trading, but we are now offering solutions across equities lending and hard-to-borrow securities, fixed income and GC.

This move to electronic trading has required a significant behavioural shift for our clients. The role of the securities lending trader has moved from trade input and execution to more one of book management. Automated trading solutions are in no way replacing the trader — they are simply making traders better at their job.

In parallel, EquiLend has launched a distributed ledger technology (DLT)-based solution that eliminates the need for reconciliation across the securities lending industry. This is more of a strategic

For securities finance, we are in a good position. The solutions are available. Firms are aware of these solutions and increasingly they are adopting them. We have seen automated return processing across our platform grow substantially.

Mike Norwood
Director, Global Trading Product Owner
EquiLend

play than explicitly a T+1 play, but this all ties together. As we have noted with CSDR, SFTR, the proposed SEC Rule 10c-1, these regulatory drivers provide an incentive to support a greater velocity of information, ensuring that trades are matched, that counterparties are reconciled and therefore ensuring that contracts will settle with a high degree of efficiency.

We are currently trading 115,000 to 125,000 contracts per day. On comparing our execution data and reconciliation data, we find that trades executed on platform have a break rate of less than 1 per cent. In contrast, trades that are executed through voice trading or chat typically have a break rate of 25-30 per cent. A large number of data points need to be entered to populate the settlement instruction and associated trade reporting — SFTR requires reporting for close to 160 data elements — and the associated static data needs to be accurate to make this possible. It makes sense to embrace the technology solutions that are available to meet this challenge. Firms that fail to do so in a T+1 environment, do so at their peril.

So is this a tipping point, where firms will no longer be able to sustain manual processes and will be forced to automate settlement workflow?

Norwood: We may be approaching the time when this becomes a tipping point. In Canada, there has been slightly less runway to prepare than in the US, so when I am up here in the Canadian market, the transition to T+1 comes up in almost all of our conversations. But for securities finance in general we are in a good position. The solutions are available. Firms are aware of these solutions and increasingly they are adopting them. We have seen automated return processing across our platform grow substantially — and the same is true for automated recalls. We are running 40,000 returns and 1000 recalls per day on average, so things are trending upwards.

Flohr: At Citi, we also have the technology in place to support clients' T+1 requirements across the asset servicing spectrum. The focus is to make this broad portfolio of services available to clients to assist their T+1 transition.

We do not view this T+1 migration simply as a US project. India has migrated to T+1 during 2022, completing in January 2023. Canada is migrating over the same Memorial Day weekend as the US. So is Mexico. European countries have also started looking closely at the potential for T+1 migration, so we view this as one of the first steps in a global move towards T+1 settlement.

On that note, making better use of timezones is crucial to making this process efficient. It is not a case of employing more staff globally, but moving support functions around our global coverage to make most efficient use of these resources. By providing support for the DTCC's 21:00 affirmation deadline out of our Kuala Lumpur service centre, we will be able to deliver the coverage we require to address any exception management and client queries. For securities lending, we will draw on our Singapore service desk to initiate recalls before the start of the US working day.

We are also making the best use of our own technology to support this client activity. Through our Execution to Custody solution, for example, we are able to address challenges around timing of instructions and management of operational resources, removing the uncertainty for clients in meeting affirmation deadlines. Similarly, clients that face foreign exchange and cash funding challenges can apply Citi's FX execution tools — including FX tools, FX Pulse, Auto FX — which provide both next and same day FX capabilities.

Landry: CIBC Mellon has developed a trade lifecycle analytics tool that enables clients to see where they are in the trade lifecycle and to monitor the risk that a trade may fail. This allows them to proactively address these inaccuracies at the earliest point.

We also offer an instruction capture tool, enabling firms that cannot send instructions via the SWIFT network or other electronic formats to use this tool to upload instructions.

CIBC Mellon is part of a global organisation and is therefore able to take advantage of global centres of excellence. The group is reflecting on how it can change its hours of operation to meet clients' settlement requirements more efficiently. When we need to process trades overnight in the Canadian timezone, for example, we are able to draw on these global resources to manage the bulk of our settlement volume, such that our staff in Toronto only expect to be dealing with the exceptions in the morning.

Datta: Reflecting again on India's migration to T+1, the market experienced a spike in settlement fails immediately after transition.

Processes then quickly stabilised and the initial rise in settlement fails has reduced significantly.

There is no shortage of technology, with custodians offering tools to their clients. But, again, this has demanded a change in behaviour. We have observed situations in this T+1 environment where traders execute trades and then pass on the trade tickets to the settlement team when they feel like it. Technology upgrades are key, but the process change — the change in mentality — is crucial.

Norwood: Human behaviour is one of the primary challenges that we face as a technology specialist in trying to get solutions adopted. If the benefits of the solution are not communicated clearly, and the clients are not educated properly in how they can apply this technology, potential users may persist with their inefficient manual processes and fail to recognise the value of adhering to industry standards and best practice.

End-to-end Integration

Is pre-trade analytics becoming increasingly important? The ability to identify risk of settlement failure at an early point and to address this to prevent a trade failing?

Norwood: The end-to-end integration of these elements is massively important. The ability to evaluate millions of lines of data and to pull out relevant insights from this data is key, providing early warning of settlement failure and guidance on why trades are failing. With this information, the counterparty can request to borrow securities to cover the failing trade, or it can take other forms of remedial action.

At EquiLend, we are working with other service providers to deliver this integrated view across the transaction lifecycle. EquiLend offers an integrated trading and post-trade solution, but we also need to support clients that may draw on services of other vendors across their trade lifecycle — and we need access to the required data to provide these trading and post-trade analytics.

Datta: The front-office, middle-office and back-office concepts will eventually change — as these working areas become more integrated. Traditionally, each of these silos has had its own individualised processes and it has been difficult to integrate across these service areas. Eventually this delineation will start to disappear, with front, middle and back-office interlinking more effectively so that matching can be done very quickly and any problems can be identified at an earlier point in the trade lifecycle.

Where are the primary barriers to this advance? Is it cost? Refusal to change existing culture?

Datta: Again, this particularly comes down to behaviour. Firms have become accustomed to processing trade settlement this way, they have done so for years and they question why they should change. This mentality needs to be replaced.

Looking retrospectively, it is evident that some firms managed the move to T+2 by allocating extra staff to certain processes, rather than by upgrading their technology and improving levels of automation.

Rebekah Flohr
North America Head of Custody
Citi

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Flohr: It has been slowly changing. But regulatory drivers such as T+1 will serve as a catalyst to accelerate this transition.

Datta: We have now seen examples of successful T+1 transitions, for example in India. Taiwan has operated a T+1 cycle for securities settlement for more than 20 years. This sends an important message to other jurisdictions, encouraging other countries to follow the lead of markets that have become early adopters of T+1.

Landry: This regulatory change will motivate firms, even more than previously, to identify their specialist position in the trade lifecycle and to pinpoint what they are truly good at. They are then likely to be motivated to specialise in these areas of comparative advantage and to outsource functions where they are less effective and add less value.

Aggregate cost of trading

Is this forcing firms to look more closely at the aggregate cost of trading, including capital costs, cost of settlement fails and other post-trade costs? How adept are firms at allocating the post-trade costs and balance sheet costs across the organisation?

Flohr: This is becoming more important. CSDR has imposed penalties for failing a trade and firms are applying their analytics to identify the source of these fails and the associated cost. The tools are in place to monitor penalties and to allocate these costs within the firm. This is a key part of the educational process as firms adapt to T+1 settlement.

Norwood: The entire lifecycle of a securities lending trade is under pressure. We are doing a lot of this on a T+0 basis today. But the transition to T+1 settlement is likely to increase demand to borrow securities, from a fails coverage perspective, and it will potentially increase the number of returns.

Looking across the securities lending industry, not all of this activity is processed real-time. However, the EquiLend Spire platform gives us the capacity to offer real-time inventory management. With NGT, we have exposure management that is linked to the triparty providers for the exchange of required value (RQV) and the settlement of that collateral instrument.

We have tools in place to monitor the settlement of collateral. But, there may still be challenges — for example, for lenders that are reinvesting cash collateral. Settlement fails will delay receipt of cash when redeeming from a fund and may create problems in reinvesting that liquidity at an attractive yield, particularly later in the day.

Given that a client may select tools on a modularised basis from different providers, it is essential that these are interoperable. With our DLT-based solution, this interoperability is key to maintaining a single centralised record, a single source of truth for the contract, when a client is utilising different tools sourced from different service vendors.

Flohr: The technology solution is one element. Then we go back to location optimisation and use of our operational capability worldwide so that we can take advantage of processing centres in different timezones to support clients' investment activities. With this, you do not need to wait for staff in the US to wake up to commence the recall process for example.

Norwood: The recall challenge has received the lion's share of the attention within the securities lending community, but the collateral management element may be more significant. We issue recalls and can get recalls back in a timely fashion for probably about 99 per cent of loans that we process. It is the 1 per cent that will always be the problem.

But it is the cash management challenges that we have discussed that may present a more significant problem.

Flohr: Most certainly. The complexities presented for cash reinvestment in a T+1 environment, and the implications for clients' funding models more generally, have featured prominently in the conversations we are having on this issue.

Landry: In accordance with Rule NI 24-101 in Canada — referring to National Instrument 24-101, which is the securities regulation that governs institutional trade matching and settlement in Canada — counterparties are required to match transactions before 12:00 on T+1. We are currently at a 98 per cent success rate in meeting this requirement. One outcome is that this puts considerable pressure on the latter half of the business day to get things done. When it gets past 14:00, that is when pressure really builds on the CSD to get those settlements processed.

Providing that we receive the settlement instructions early, we are confident in our ability to get the job done.

ETF settlement

Some elements did not appear to be fully worked through when the SEC announced the requirement to migrate to T+1 in May 2024. This may generate some unintended consequences for ETF settlement for example?

Landry: The Canadian Capital Markets Association (CCMA) has a taskforce around T+1 that is dealing with a lot of these challenges. In moving from T+2 to T+1, settlement practices for collective investment funds and ETFs are governed under the Rule National Instrument 81-102 — NI 81-102, the securities regulation for investment funds in Canada. The legislation for these instruments will not be changing, enabling ETFs to remain at T+2 for primary market settlement if their underlying assets do not settle predominantly on T+1.

This will have an impact on Associated Participants (APs) that have sold ETF shares to investors in the secondary market, for example, and do not have the inventory on hand to deliver to the issuer in the primary market to create additional shares.

To address this situation, the CCMA Task Force has proposed to the Canadian Securities Administrators (CSA) to introduce an exemption under NI 81-102 to enable collateral to be used to facilitate settlement in the primary market, without causing disruption to secondary market settlement.

Without this exemption, APs may be forced to carry excess inventory, thereby increasing the associated cost of settlement and potentially impacting bid-ask spreads. Alternatively, they may be forced to rely on cash-only fund creation and redemptions, which will again impact overall costs for trading ETFs.

More broadly, the Task Force is also examining potential to introduce central settlement for ETFs, like that offered in the US by the DTCC-owned National Securities Clearing Corporation (NSCC). Here in Canada that will be many years out from now, but these are all steps we are taking to prevent any downstream impact of moving to T+1 in the secondary market.

It might be fair to say that policymakers did not fully work through the implications of this decision for how the primary and secondary markets interact. We are working to obtain broader industry agreement that this is the best step forward. I do not believe any AP firm or issuer would want the implications of remaining with T+2 settlement in the primary market to impact trading with ETF investors in the secondary market.

Flohr: That is an important point. Similarly in the US, ETFs that are domiciled in the US but which invest in underlying securities issued in international markets may experience a settlement misalignment. More generally, there will also be timing implications for investors that are looking to redeem securities settling on T+2 in an international market in order to fund positions in the US.

Towards real-time settlement

Will T+1 settlement be the intermediate step in an advance to T+0 and towards real-time settlement?

The challenge is particularly in getting clients 'technology ready' for the transition to T+1. As a custodian, we are prepared and largely ready to go. But some firms across the industry are lagging in their preparations.

Ron Landry
Head of Product and Canadian ETF Services
CIBC Mellon

Flohr: You highlighted that T+1 was first proposed in the US in 2000-1. It will take until May 2024 to implement this transition from T+2 to T+1 for equities settlement, but I do not anticipate that it will take more than 20 years for the market to transition to same-day settlement.

Landry: However, we will not be transitioning to T+0 with our current technology and settlement processes. Something will need to shift before we can support real-time settlement. In dialogue with my US counterparts, we are discussing what operational structures should look like for Associated Participants to settle ETF shares on T+0. Early indications are that processes will be manual and cumbersome, valuing shares by making intraday adjustments to a prior-day valuation, involving warranted deliveries of collateral and potentially resulting in a rise in buy-ins. If this is an example of how T+0 will operate on a small scale, we are a long way from moving to same-day settlement for ETFs without adopting new technologies and substantially different ways of working.

Norwood: A lot of what we can do now represents building blocks that may enable us to get to T+0. I do not look at T+1 settlement as a massive headache for the securities lending industry. T+0 will be a lot more problematic. Significant steps have been made with technology development, but there will be a need for integrated technology development for analytics, through settlement, cash management, books and records.

There are so many associated touch points and integrated processes that have not yet been thought through in detail. These will need to be substantially modernised before getting to a position where we can really talk about integrated settlement. Tokenisation can potentially help with this, but we are not ready to implement this at scale as a global industry.

Landry: There are still some pressing questions that will still need to be addressed. How will short-selling be managed in a same-day settlement environment for example? How will short-sellers source the borrow before they short the stock — and how will this 'locate' obligation be structured in a T+0 environment?

I envisage that the industry will move in small steps in the first instance — testing T+0 for transactions where we know this is workable and then expanding this to a wider set of instruments.

Datta: In theory this looks good. But in practical terms it is by no means certain this will be good for the US and Canada as large international markets. If we take the situation of an investor from the Middle East for example, they are executing trades when the US is sleeping and it will be challenging to execute these cross-border trades in real-time.

Closing thoughts

What advice do you have for clients to help them to be ready for the May 2024 transition deadline?

Datta: May 2024 is not far away. Seven months will pass very quickly. I have been telling clients to start early. If you are only starting now, you are already behind. If you need to change your technology and your processes, this will take time and you should be acting immediately.

Flohr: Review all your processes globally, looking out for any manual touch points. Look closely at each different part of your business, including funding relationships, FX, treasury, trading, broker relationships, risk management and credit teams, communicating with each of these divisions to ensure they know exactly what is needed to be T+1 ready and compliant.

Norwood: I reinforce those points. It is about reviewing each of these processes and ensuring that you understand the technology solutions available to you. This dialogue needs to involve potential technology partners, counterparties and your peers in the industry, identifying best practices that can benefit each of the relevant stakeholders to the T+1 migration. This forum provides a good example of that.

We also need to understand the implications of making changes in one part of the organisation and how this will play out elsewhere.

Landry: For our clients, the key message is to keep speaking to us, identifying how we can help them and what additional tools that we can offer that they have not been using until now. Even API connectivity can be important, for example, in enabling systems to talk machine-to-machine and to remove manual intervention when communicating instructions and communicating data. At CIBC Mellon, we know that we are ready to go. Now it is a question of sharing this information and helping our clients to transition as effectively as possible.

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T+1

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Canada: growth in the face of global uncertainty

Jamie Richards examines growth opportunities in Canada's securities finance markets, finding that lending revenues have remained strong through recent periods of global economic and geopolitical instability

As the world moves on from the aftershock of the pandemic, Canada has retained its status as a dynamic and attractive locale for securities finance institutions. America's largest nation by area is home to its second-largest equities market, according to S&P Global Market Intelligence. In Q2 2023, Canada's equities market generated US$104 million in revenue — a fair way behind the US, but miles ahead of any other Americas nation (Brazil comes in third with US$8 million in revenue). New regulatory initiatives, the upcoming switch to T+1 in May 2024 and technological developments promise to bring change to a location that has continued to offer a vibrant securities lending market.

According to data provided by S&P Global Market Intelligence, Canada's revenues compare closely with Hong Kong, South Korea, and high-performing European countries for Q2 2023. Its high rank on the world stage has been cemented this year by strong equities and government bonds performance. Canada's economy is large and diverse, with five non-banking equities making the top 10 by revenue from January to April 2023, representing the energy, mining, software and pharmaceutical sectors. Further to this point, the highest-paying equity was Canopy Growth Corporation, which trades on the Toronto Stock Exchange (TSX) as WEED. This highlights a unique aspect of Canada's laws and markets.

In 2018, the federal legalisation of marijuana triggered an explosive growth in the cannabis securities market, so much so that SFT called 2019 "the year of the pot stock". However, the years since have been tough on the once promising segment. Canopy Growth Corp peaked at CA$67.74 per share in September 2018, just before legalisation. It now sits at CA$0.55 per share. Despite this, Canopy generated close to a tenth of all equities revenue in Q1 2023. Short interest in Canopy is substantial. As of 25 September 2023, Canopy has 35.3 million shares

short, which is 7.2 per cent of float and 1.3 times average daily trading volume, according to StatMuse. Similar contractions have affected fellow cannabis stocks Aurora Cannabis Inc., Cronos Group Inc., and OrganiGram Holdings Inc.

However, today, the cannabis securities market is falling to the wayside as new trends emerge. Canada has done well across the last few years in the recovery from the pandemic era. S&P Global Market Intelligence data shows that revenues are strong, even in the face of geopolitical instability. In the equities market from 2021 to 2022, value on loan ex-financing rose 23.3 per cent to US$57.1 million and utilisation climbed 16.7 per cent to 6.4 per cent. In that same period, revenues increased 17.5 per cent to US$353.6 million. Although it is not yet on par with pre-pandemic levels, it does suggest solid recovery. Additionally, the weighted average fee was 0.7 per cent as of Q1 2023, up from 0.6 per cent across all of 2022.

Strength and change

Rob Ferguson, chief capital markets officer at CIBC Mellon, says: "The Canadian securities lending market has remained resilient and continues to show encouraging signs of growth, driven particularly by stronger demand from institutional investors seeking to enhance returns." Ferguson highlights a shift in demand out of equity collateral and into cash collateral from US participants, as well as an uptick in demand for cash on the Canadian fixed income market.

Data provided by S&P Global Market Intelligence speaks to solid lending performance for government bonds. In 2022, utilisation saw little change compared to previous years, but value on loan ex-financing increased 11.2 per cent to US$120.9 million and revenues rose 16.8 per cent to US$139.8 million. In April, the Government of Canada issued a five-year US$4 billion global bond, aiming to diversify sources for the country's liquid foreign reserves. At the time, the Government said that the bond's tight pricing reflected strong demand, with a final order book upwards of US$13 billion.

"The Canadian government's commitment to promoting a stable and secure financial market has further bolstered the outlook for the securities lending sector," Ferguson continues. He credits the government's proactive regulatory approach for engendering a favourable investment climate. "In February," Ferguson explains, "Canada's Office of the Superintendent of Financial Institutions raised its Domestic Stability Buffer requirement 50 basis points to 3 per cent. As organisations adjusted their capital planning to the revised requirement, we saw greater activity in dividend reinvestment programmes. Looking ahead, we anticipate that this activity may subside as domestic banks readjust to the macroeconomic environment."

For Broadridge's vice president of product management Mary Beth Law, there is further potential to unlock with greater infrastructural modernisation. Law says: "Most dealers have been relying on legacy applications that are impeding their capacity to adapt to digital and straight-through processing (STP) requirements. Modernisation and transformation will be significant themes for the industry on a go-forward basis." Law also highlights the firm's ongoing investment in its capital markets and wealth platforms.

"There are three general drivers we see in the market," Law explains, "the first being convergence and consolidation. The market structure of the securities industry is changing. The capital structures consolidating the industry are now being felt in convergence of services focused on the advisor and client as large firms drive wallet-share and cross-selling opportunities." She goes on to list integrative digital user experiences and also keeping operating expenses and productivity in check as essential for growth.

Part of that modernisation may be around the corner. TMX Group, which owns and operates the Toronto Stock Exchange, has partnered with Clearstream to develop the Canadian Collateral Management Service (CCMS), the first triparty service in what is currently the world's largest bilateral-only market. Clearstream's head of collateral, lending and liquidity solutions Marton Szigeti spoke to SFT about how CCMS will benefit clients and Canada's securities market as a whole. Szigeti says: "The underlying driver is to increase the velocity of collateral in the Canadian market. We will see the need for alternative forms of liquidity as the bankers' acceptance benchmark fades out." Szigeti also references the upcoming shift to a T+1 settlement cycle in Canada as calling for increased velocity.

Szigeti calls the demand for CCMS "enormous": "We have had fantastic support from the main market participants," he explains. "We're pushing to go live in Q4. It feels like a very positive environment where we are launching a product that has had a large amount of market support."

Even if revenues are not yet at pre-pandemic levels, the impact of the global geopolitical shake-ups of the last two years cannot

be underestimated. Through this lens, Canada comes out looking remarkably strong. Ferguson says: “Typically, we see global investors looking to Canada as a source of stability during times of global uncertainty and volatility. With increased volatility comes increased securities lending volume.”

TMX Group has partnered with Clearstream to develop the Canadian Collateral Management Service (CCMS), the first triparty service in what is currently the world’s largest bilateral-only market.

There are naturally a fair number of challenges facing Canada’s securities finance industry as it adapts to keep pace with global trends and maintain its strength. Law names higher rates, decreasing supply opportunities, ongoing frictions in selling and loan management resulting from processes between lenders and dealers as challenges facing the securities lending market.

Another fixture of Canada’s economy in the last two years — in line with many leading global economies — has been rising interest rates. Policy interest rates have increased tenfold in the last 18 months, and rates for treasury bill yields, bond yields, and overnight repo are also increasing. Ferguson notes: “One immediate consequence is the shifting landscape of securities lending profitability. Additionally, rising interest rates affect the cost of financing for market participants engaged in securities lending. Margin requirements and funding costs may increase, potentially impacting the profitability of lending.” Szigeti, on the other hand, notices a stabilisation around government bonds and slightly elevated spreads on corporate bonds.

As a financial regulator, the Canadian Securities Administrators (CSA) face the task of balancing shifting climates with fairness and stability. The CSA is a coalition of Canada’s territorial and provincial securities regulators which aims to improve and coordinate regulation of the country’s capital markets. It also sets policy for disclosure and monitoring of diversity, equity, and inclusion within the capital markets; currently the CSA is consulting with stakeholders to build on current disclosure guidelines for women on boards and in executive officer roles. A spokesperson for the CSA suggests that, currently, reducing regulatory burden is high on the organisation’s agenda: “The CSA and its members strive to adequately protect investors while reducing the regulatory burden on issuers and the investment industry.” The spokesperson mentions the recent passing of the National Instrument 45-106 Prospectus Exemptions: “[This] allows smaller issuers listed on a Canadian stock exchange to raise smaller amounts of capital from the public without having to prepare a prospectus.”

Bracing for T+1

One defining change on the horizon is the upcoming move to T+1 settlement next year. Alongside its continental neighbours, the US and Mexico, Canada will switch from the present T+2 settlement cycle in May 2024. The launch date has garnered some discussion as it falls on a long weekend in the US, creating a one day discrepancy between the Canadian launch on 27 May and the US switch on 28 May. Despite this ostensible lack of parity, the Canadian Capital Markets Association reaffirmed its commitment to the date in February.

Naturally, this has pushed companies to prepare and adapt. Mike Norwood, head of trading solutions at EquiLend, says he expects trading desks to be well prepared: “With the pressures put on settlement and other operational functions it will be advantageous for desks to embrace automated trade execution and ensure their trade details are ingested into their downstream systems in a clean and matched manner.”

Law tells SFT that Broadridge is making changes to its platforms to be compliant with regulation and upgrading realtime and STP capabilities. “We are actively testing with the Depository Trust and Clearing Corporation,” she explains, “and will test with the Canadian Depository for Securities (CDS). We believe that industry testing and readiness of all stakeholders will be key to success.” Law states that resolving the friction present in current processes will be key to avoiding fails when T+1 arrives.

Ferguson anticipates pressure particularly in the warm and hard-to-borrow space. He explains: “Often, the agent lender will receive the sale notification either late in the day or on the following day, resulting in the recall being processed a day late. Under T+1, this would

result in the recall being sent out on a T+0 basis, without giving the borrower time to source additional supply elsewhere or to buy back the position." He adds that agent lenders may need to hold larger buffers to accommodate late sales in less liquid names, reducing maximum potential revenue, and suggests the industry may need to modify deadlines for recalls to remedy the issue.

Tech advancements

Common across the industry is a push for new technology to help alleviate the transitional pressures T+1 brings, as well as to modernise and boost the existing market infrastructure. Clearstream's CCMS promises to bring triparty functionality to the Canadian market — a technological leap which the firm says will allow clients to automate collateral management movements. The firm is working further on new innovations in the collateral management space. The Own Selection Criteria with Automated Reasoning (OSCAR) application combines machine learning, natural language processing, and automated reasoning to automate collateral management. "It is [currently] a fairly arduous process to get collateral schedules set up," explains Szigeti. "OSCAR is a graphic user interface that connects to our platform. It understands what you are entering in plain English and creates an eligible collateral schedule for you and your counterparties. You then select your counterparties and click match. The counterparties receive a message and you are done." Szigeti estimates that OSCAR reduces a three week process to a three minute process.

Ferguson predicts that increasing automation and the attendant increase in efficiency will translate to cost savings for clients, with CIBC Mellon actively investing in new technology capabilities. He explains: "The rise of technologies like distributed ledger technology (DLT) and automation ensures that transactions are recorded transparently and securely. It also speeds up transaction processing and significantly improves operational flexibility." DLT is the basic principle of blockchain technology, decentralising transaction records for near-instant and simultaneous record keeping across multiple organisations.

Luxembourg-based fintech HQLA^X, for example, uses DLT to enhance collateral mobility across disparate collateral pools. A spokesperson for the company says: "The HQLA^X platform is well positioned to help streamline and synchronise cross-border collateral management activities for global market participants. For example, in the case of Canada and Europe, the time overlap for when both markets are open for settlement is narrow, therefore making it operationally challenging to settle securities finance transactions in such a short window. Using the HQLA^X platform means that market cut off times are no longer an issue, with ownership transfer occurring at precise moments in time on a 24/7 basis, regardless of the location of the underlying securities."

Broadridge stands as a major player currently making significant use of DLT in its Canadian operations. Law highlights the firm's Distributed Ledger Repo offering, which uses DLT to manage repo transactions to boost liquidity. She says: "DLT (in particular the use of smart contracts) continues to gain traction with broker dealers and market infrastructure players. Most recently, the value being generated is primarily in lowering transaction costs and balance sheet relief due to enhancements in post-trade processing."

Common across the industry is a push for new technology to help alleviate the transitional pressures T+1 brings, as well as to modernise and boost the existing market infrastructure.

Separately, Law explains that Broadridge is harnessing the potential of AI, another recent technological breakthrough: "Generative AI has shown capital markets that the promise of AI is real. At Broadridge, we have put this into practice with the launch of BondGPT, a co-pilot solution that enhances bond trader experience on our LTx platform."

Canada's securities finance industry has the robustness and flexibility to weather present challenges; that much is clear from increasingly strong performance in the last two years. This is a time of much more than survival, however. If firms can leverage the power of new technologies to push through rising rates, T+1, and other challenges, then an era of extraordinary technology-powered potential may be just over the horizon.

South Africa: finding a place in the global financial arena

Carmella Haswell explores South Africa's transition from its first securities finance transaction in 1988 to its current status as Africa's largest securities lending market

Despite the emergence of new pockets of securities lending activity across the continent, such as in Kenya and Nigeria, South Africa continues to be the largest securities lending market across Africa. This is a well established activity in the South African market that brings key benefits of liquidity, fails coverage and greater market efficiency in this location.

Known for its cultural diversity, topography and natural beauty, South Africa is situated on the southernmost tip of the African continent and is host to three capitals — Cape Town, Pretoria and Bloemfontein.

The South African Securities Lending Association, otherwise known as SASLA, is an industry body that represents the common interests of South Africa's securities finance market. Chaired by Michael Wright, senior manager of securities lending at Nedbank, the Association assists in the orderly, efficient and competitive development of this market and works closely with regulators to provide for industry participants.

With an average lendable value of ZAR 1.3 trillion (US$68.3 billion) and lender-to-broker loan values reaching ZAR 137.6 billion (US$7.2 billion), SASLA says the South African securities lending market can no longer be ignored in the global arena.

Positioning for success

In the past, this market has primarily served domestic needs, due to the influence of the regulatory environment, market infrastructure and the overall economic landscape. However, market participants have witnessed an increase in demand domestically and abroad for securities financing activities in South Africa.

Hitesh Harduth, head of securities lending at Standard Bank, notes that to further the development of the market, participants would need to consider the eligibility of foreign currency as collateral, as well as foreign equities, classic repos and equity repos.

South Africa's first securities lending transaction took place in 1988, with the local industry only starting in 1992. South Africa's return to the international financial arena in 1994 provided the opportunity for several domestic companies to raise capital offshore — achieved through the issuance of offshore convertible bonds.

SASLA chairperson Wright explains that this movement gave rise to arbitrage opportunities between the two instruments — the convertible bond and the underlying equities — with additional opportunities arising due to the introduction of the ALSI 40 and other indices, as well as through the increased use of futures-based hedging by pension funds.

"The steady growth of the South African securities lending industry can be attributed to a number of measures that effectively reduced the transaction costs associated with securities lending and borrowing," says Wright. These measures include the Securities Transfer Tax (STT) relief for securities lending transactions in 1996, SASLA's development of the first South African market standard schedule in 2008, and VAT exemption on securities lending transactions in 2022.

Today, securities lending has been rebranded as 'equity finance' at a number of South African agent lenders, reflecting the broader diversity of services that agents can offer to provide holistic solutions to clients. According to Wright, several agents provide a full suite of financing products alongside traditional securities lending. "There is a move to utilise assets as efficiently as possible, whether in securities lending, as collateral, to lend or raise cash, or to provide additional leverage," he adds.

According to data collected by S&P Global Market Intelligence Securities Finance, securities lending activity in South African equities generated revenues of US$21.27 million during H1 2023 — a slight dip from the previous year's revenue figure of US$21.4 million (fig 1). Over the course of 2022, securities lending revenues in the region generated US$44.5 million following a standout year in 2021, which delivered US$91.5 million in revenue generation.

The bumper revenues experienced during 2021 were largely due to one stock, Naspers Ltd (NPN). Chessum indicates that this trade was very popular among securities lenders and borrowers as it allowed owners of Naspers stock to tender their shares for 2.27 shares in Prosus (PRX). "Subsequently, this led to an arbitrage opportunity between the two stocks, pushing both securities lending fees and revenues higher. This one stock generated more than US$50 million of securities lending revenues during 2021 with US$49 million being generated during the month of August alone," says Chessum.

"The positioning of the region's securities lending market within the global securities finance arena has been characterised by specific challenges and opportunities," comments Natasha

Williams, equity finance, Absa CIB. Speaking to SFT, Williams highlights that the adoption of a global triparty system has the potential to address some of these challenges and contribute to the evolution of the market.

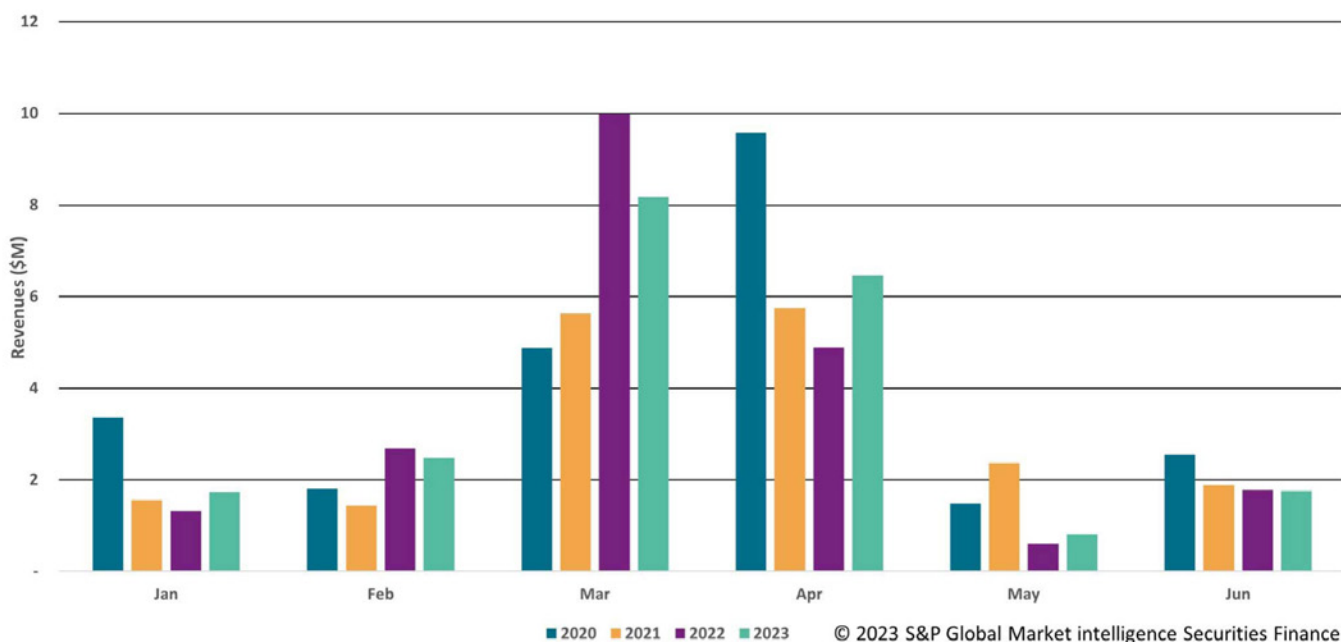
According to Williams, the adoption of a global triparty system could bring the South African market further into line with global standards and practices in securities lending, potentially elevating its position in the global arena. Through this alignment with best practices, the market could attract a broader spectrum of international participants, increasing its global reach and relevance to the global financial arena.

“Triparty services can enhance market transparency, risk management and operational efficiency, making the South African market more appealing to both domestic and foreign investors,” Williams comments. “In essence, the integration of a global triparty system represents a potential step forward in the market’s development, helping it to bridge the gap with global securities finance businesses and positioning it for enhanced competitiveness and growth on the global stage.”

On a similar note, Wright believes technology innovation and process standardisation will drive greater efficiency within the securities finance industry. The streamlining of operating models has been accelerated by the remote working environment that was created by the Covid pandemic. Wright explains: “South African financial institutions are rethinking the old practices of collateral management and breaking existing silos. Market participants are seeking more sophisticated and comprehensive collateral solutions.”

Key regulatory developments

A number of key regulatory movements in the South African securities lending market have made their mark on participants with respect to collateral, securities lending and short selling. For instance, the region’s Taxation Laws Amendment Act No.21 of 2021 (TLAA) — which came into effect on 1 January 2023 — redefines ‘collateral arrangement’ parameters by limiting the ways a collateral taker can re-use non-cash collateral assets within the STT and Capital Gains Tax (CGT) exemption.



Previous tax legislation provided a 24-month-long exemption to the charging of STT and CGT, where non-cash assets as collateral were re-used in line with the 'collateral arrangement' parameters. With regards to the new regulation, Melissa van der Merwe, director of DeriviDoc CC, says: "Should non-cash collateral be used in ways other than those permitted, then STT and CGT will be applied to the poster of those non-cash collateral assets."

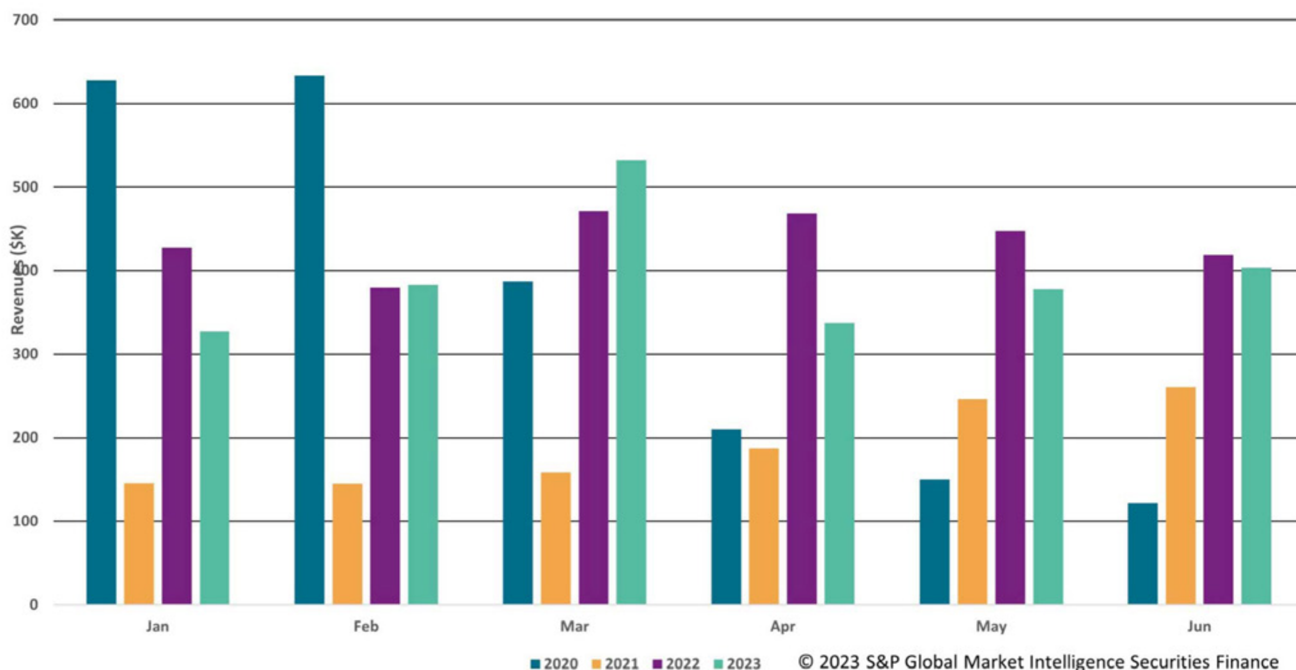
SASLA has worked alongside market participants to amend the Schedule to the Global Master Securities Lending Agreement (GMSLA) to ensure that the collateral poster is indemnified in cases where STT and CGT is applied when the collateral taker uses non-cash collateral assets outside the remit of the exemptions in the TLAA. van der Merwe says this has provided a market standard way in which tax risk mitigation for the collateral poster can be achieved.

Another key regulatory development in the South African market is the draft bill on the Conduct of Financial Institutions (CoFI). Once published, van der Merwe says this act will provide various different conduct standards to regulate the products and market participants in the financial markets, aligning them to international standards. Conduct standards pertaining to short selling, securities lending and collateral are a few of the areas which will be governed by new conduct standards.

With the advent of electronic settlement in South Africa in 2000, the exchange and clearing house JSE produced rules and directives which prohibited naked short selling, says Brett Kotze, head post trade services at A2X Markets. Should this practice be used, participants will be subject to penalties.

SASLA and a number of industry groups have worked with regulators over the last year to ensure that the regime for resolution of financial institutions would treat securities finance transactions in a manner similar to offshore regimes.

According to Kelle Gagné, counsel at Allen & Overy, that experience reinforced the view that the regulators seek to maintain a level regulatory playing field for the South African securities



lending market where possible. "Consistent and clear regulation, including with finalisation and promulgation of the long-anticipated CoFI Act, will enhance South Africa's position in the global markets," Gagné notes.

Taking control of collateral

Lenders and borrowers are actively involved in managing their collateral — with lenders demanding a liquid basket with less concentration risk, and borrowers focusing on the cheapest to deliver with optimisation top of mind. From a risk perspective, and given the STT exemption granted on the outright transfer of collateral, Harduth notes a shift to outright transfer versus pledge in the region, as lenders look to have further control of their collateral.

For Gagné, South African lenders have been gaining further control over non-cash collateral by moving towards title transfer, "given the restrictive nature of the South African law of pledge where securities must remain in the borrower's custody account and any reuse results in a loss of security for the lender".

She continues: "The manual flagging of pledges within custody accounts contributes to the inefficiency of pledge in a modern financial market. However, recent restrictive tax changes affecting title transfer, automation and international trends may send market participants back to pledges of non-cash collateral."

In the fixed income markets, loan balances of South African government bonds averaged just over US$2 billion during H1 2023, says Chessum, which represents a 16 per cent increase YoY. Information from S&P Global Market Intelligence reveals that the average fees across South African government bonds have been in decline over 2023, standing at an average of 24bps during the first six months of the year.

Chessum indicates that utilisation has been 6 per cent higher on average throughout the period, as the lendable value has declined and balances have increased. Utilisation has been fairly consistent over the last 12 months, according to Umesh Vaga, director at Zarclear Securities Lending. However, the local market has seen new asset managers entering the securities lending space, leading to an increased supply of lendable assets.

With a number of large international banks exiting the country over the last three to five years, this has led to reduced demand and oversupply. As a result of this, the market has seen a down-turn in the general collateral (GC) lending fee, adds Michael Terry-Lloyd, head of Sygnia Securities at Sygnia Asset Management.

For Williams, the GC market "typically exhibits an abundance of readily available securities for lending or borrowing, making it an area with lower competition and, potentially, lower fee rates compared to the high-demand stock lending segment". This pattern can be influenced by various factors including market sentiment, investor strategies, and the prevailing economic and regulatory conditions within the South African securities finance landscape.

Pursuing future initiatives

Looking ahead to 2024, the South African market continues to watch closely as the US, Canada and Mexico move to a T+1 settlement, which is set to take effect in the first half of next year. Of further regulatory importance, the draft bill on CoFI will provide "various conduct standards to regulate the products and market participants in the financial markets, aligning them to international standards", according to van der Merwe. This regulation will be under the watchful eye of the region's market participants.

South Africa continues to provide meaningful revenues for market participants through its role as the regional hub for the securities lending markets, indicates Chessum.

Wright says that the market is identifying interest from African countries, both as lenders of SA stock and lenders of local equities. He adds: "The growth is limited in the short term, but there will be opportunities to scale the business in the future."

As more African jurisdictions adopt netting laws, opportunities for trading with African neighbours is expected to increase, according to Gagné.

In his concluding remarks, Chessum says that the work of SASLA continues to support the market to the benefit of both onshore and offshore investors. "Through its representation in the Global Alliance of Securities Lending Associations (GASLA), SASLA provides an important voice for the African continent which remains critical in the pursuit of global initiatives."

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Challice to retire from J.P. Morgan

Ben Challice is to retire from his role at J.P. Morgan Chase after six years.

Based in London, Challice is currently global head of Trading Services, securities finance.

At the firm, he has overseen a strategic transformation and a period of sustained growth of the business, with the bank reporting that 2023 is set to be another record revenue year across securities financing and collateral management.

Challice joined J.P. Morgan from Pirum Systems in 2017, where he was most recently chief operating officer.

Patrick Moisy, head of Liquidity and Trading Services at J.P. Morgan, says: “The business has consistently hit key strategic milestones in support of our clients as their collateral and financing requirements have evolved, including solutions for impactful regulatory change, increased platform functionality, and notable innovations such as Collateral Transport and the launch of the Tokenized Collateral Network. I am incredibly grateful for his leadership, candour and friendship — he will be missed.”

FinOptSys welcomes DiMaggio

FinOptSys has appointed D.E. Shaw group’s Salvatore DiMaggio to its advisory board.

DiMaggio, senior vice president of D.E. Shaw and a member of the group’s treasury department, joins the board to accelerate FinOptSys’ solutions in global buy- and sell-side markets.

He will use his extensive experience across capital markets, including in collateral lending, liquidity and financial resources management, as well as securities lending and asset-backed securities repo.

DiMaggio joined D.E. Shaw in 2008 after a 25-year career at Bear Stearns, where he acted as senior managing director and global head of bank relations and business development.

At Bear Stearns, he managed the firm’s financing relationships with more than 100 banks in support of its trading activities in equity and fixed-income markets.

In addition, he led Bear Stearns’ efforts in issuing long-term debt in a number of markets and developed new business in structured products and loan syndications.

eSecLending hires Reeder

eSecLending has appointed Ben Reeder as vice president of trading.

Based in London, he will be responsible for securities lending trading of client lendable portfolio holdings across all Asia-Pacific markets and asset types.

Under Reeder’s leadership, the firm plans to increase its footprint with global partners for its auction and exclusive side of the business, as well as its discretionary securities lending on loan balances.

Reeder joins the firm from EquiLend, where he was part of the company’s relationship team in London.

Prior to this, he held positions at Lehman Brothers and BNP Paribas in Japan before relocating to Hong Kong, where he worked for CommerzBank, Citi Agency Lending and SBI Securities Hong Kong.

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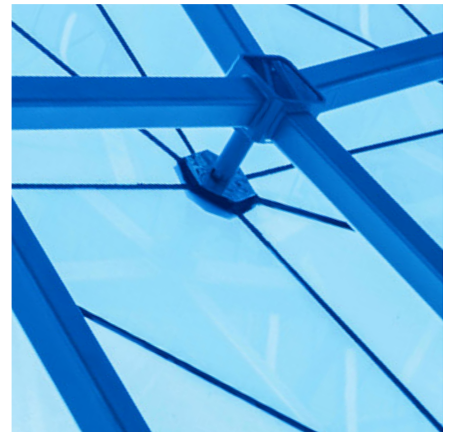

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MarketAxess appoints Pavan

MarketAxess has appointed Neelan Pavan as technical product manager within its post-trade product team.

Based in London, Pavan will report to Colleen Stapleton, product manager for MarketAxess Match, and Nick Moss, head of post-trade product management.

He joins the provider of trade matching and regulatory reporting services from Pirum Systems, where he was product manager for fixed income and repo between 2017 and 2023.

Previously, Pavan worked at Commerzbank AG between 2009 and 2015. Most recently, he served as assistant vice president for short-term interest rate and repo.

In a financial services career spanning more than 15 years, Pavan has also held positions at Dresdner Kleinwort, Deutsche Bank and Bank of England.

Banerrji to lead State Street India

State Street Corporation has appointed Arindam Banerrji as India country head. He will report to Lou Maiuri, president, chief operating officer and head of investment services.

In the Bengaluru-based role, Banerrji will be responsible for the growth and transformation of the firm's operations in India.

Banerrji has almost four decades of industry experience and joins State Street from Wells Fargo, where he spent more than five years as an executive vice president and managing director for India and the Philippines. Prior to this, he was a partner at EY.

Earlier in his career, Banerrji spent 12 years with Deutsche Bank. He held a number of roles at the firm, including managing director and head of global service centres. Before this, he was a vice president at J.P. Morgan for more than a decade.

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