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Sec Finance In Transition

Clearstream's Marton Szigeti and Eurex Repo's Frank Gast explain how monetary readjustment is reshaping user engagement

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EquiLend to be acquired by Welsh, Carson, Anderson & Stowe

Private equity firm Welsh, Carson, Anderson & Stowe (WCAS) will acquire a majority stake in global technology, data and analytics company, EquiLend.

The acquisition is set to close in Q2 2024, subject to gaining the necessary regulatory approvals.

In addition, WCAS has committed a further US$200 million investment to support growth initiatives and acquisitions by EquiLend.

EquiLend provides a suite of financial technology solutions which support all facets of the securities finance transaction value chain, including electronic trading, order management and post-trade automation.

The firm was founded in 2001 by a consortium of global banks and broker-dealers to develop technology to create efficiencies for the securities finance market.

Since its conception, EquiLend's client base has grown to nearly 200 asset owners, agency lending banks, broker-dealers and hedge funds.

CEO of EquiLend Brian Lamb says: "EquiLend has experienced remarkable growth over more than two decades of supporting the technological needs of the securities finance market. Our new partnership with WCAS will propel our business to new heights and enable us to do more than ever within securities finance and beyond.

"WCAS shares our client-centric vision and is a natural partner to support our mission of providing outstanding customer service and providing innovative technology solutions to the marketplace."

Ryan Harper, general partner at WCAS, adds: "We are impressed with EquiLend's highly differentiated suite of technology solutions and its sustained, trusted client relationships.

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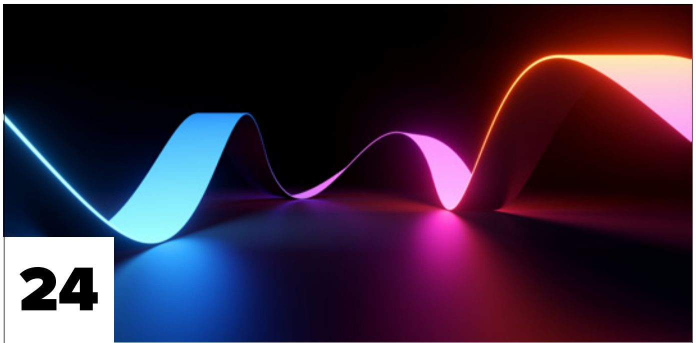

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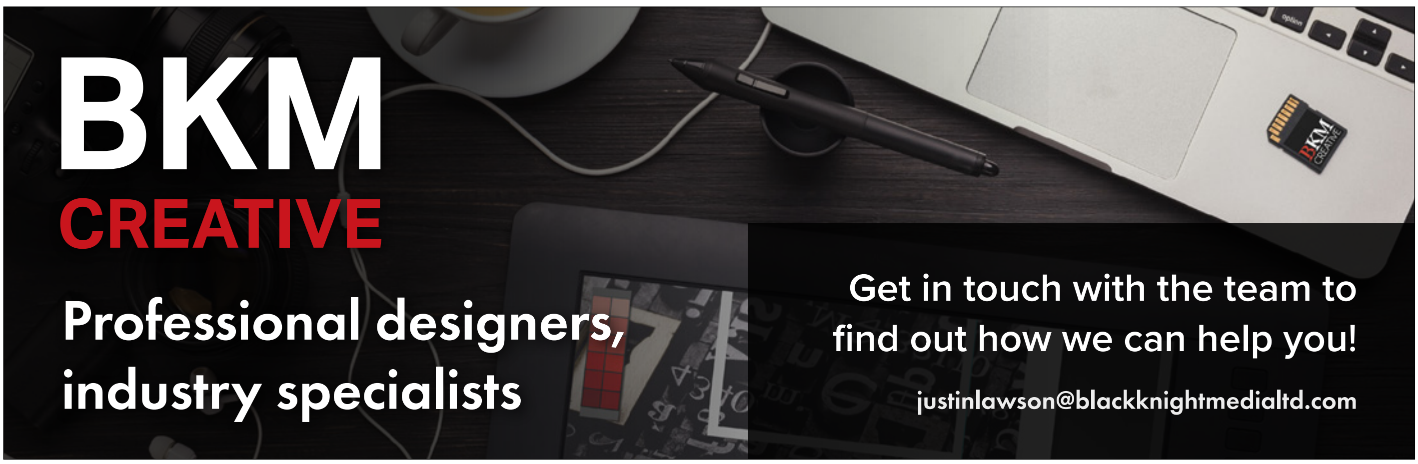

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TradeUP chooses FinOptSys

FinOptSys has welcomed TradeUP onto its securities financing platform.

TradeUP Securities is a self-clearing brokerage firm that offers a suite of financial services including trading, execution, clearing and settlement, and stock loan services on its proprietary platform, TradeUP.

The firm reports significant growth in its retail and institutional client bases, both within the US and globally, and with this expansion came the increasing need for efficiency and scalability.

TradeUP has entrusted FinOptSys to provide its cross-product securities financing technology as a "foundation for the future".

Youqing Liu, chief financial officer of TradeUP, explains: "This partnership underscores the shared vision between FinOptSys and TradeUP Securities to drive innovation, scalability and accessibility within both securities financing and the broader financial markets.

"By leveraging FinOptSys's technological capabilities, TradeUP aims to deliver unparalleled financial services to our clients."

Divyesh Bhakta, founder and CEO of FinOptSys, adds: "Our comprehensive suite of real-time analytics and optimisation modules are the perfect complement to TradeUP's ongoing mission to provide their clients with the best-in-class service and tools necessary to elevate their investment experience.

"This is just the latest example of our vision to provide pioneering technological solutions that will help shape the future of financial markets."

EquiLend to be acquired by WCAS

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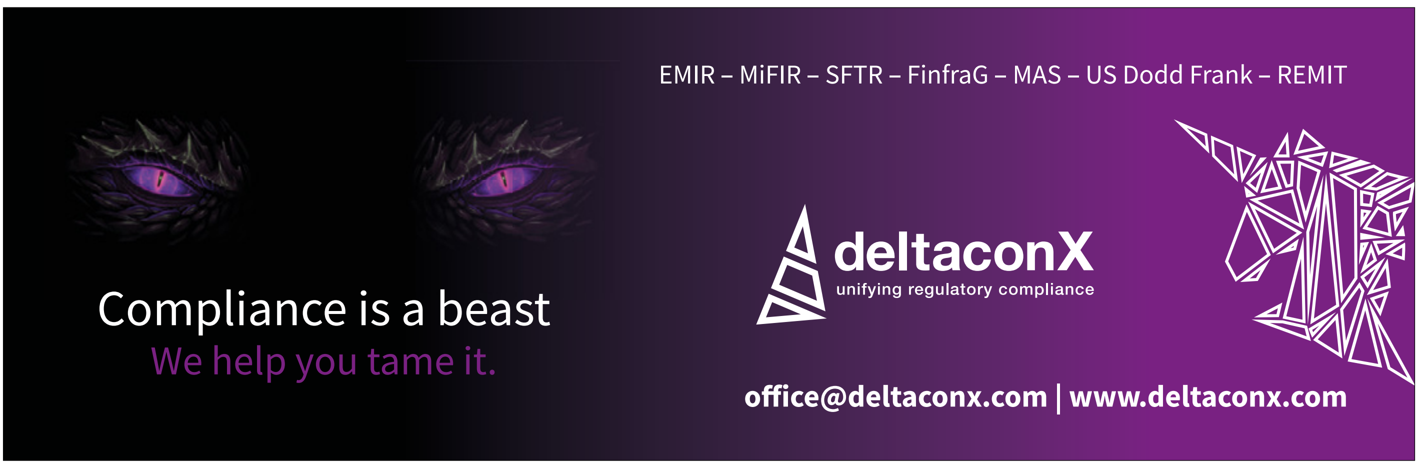
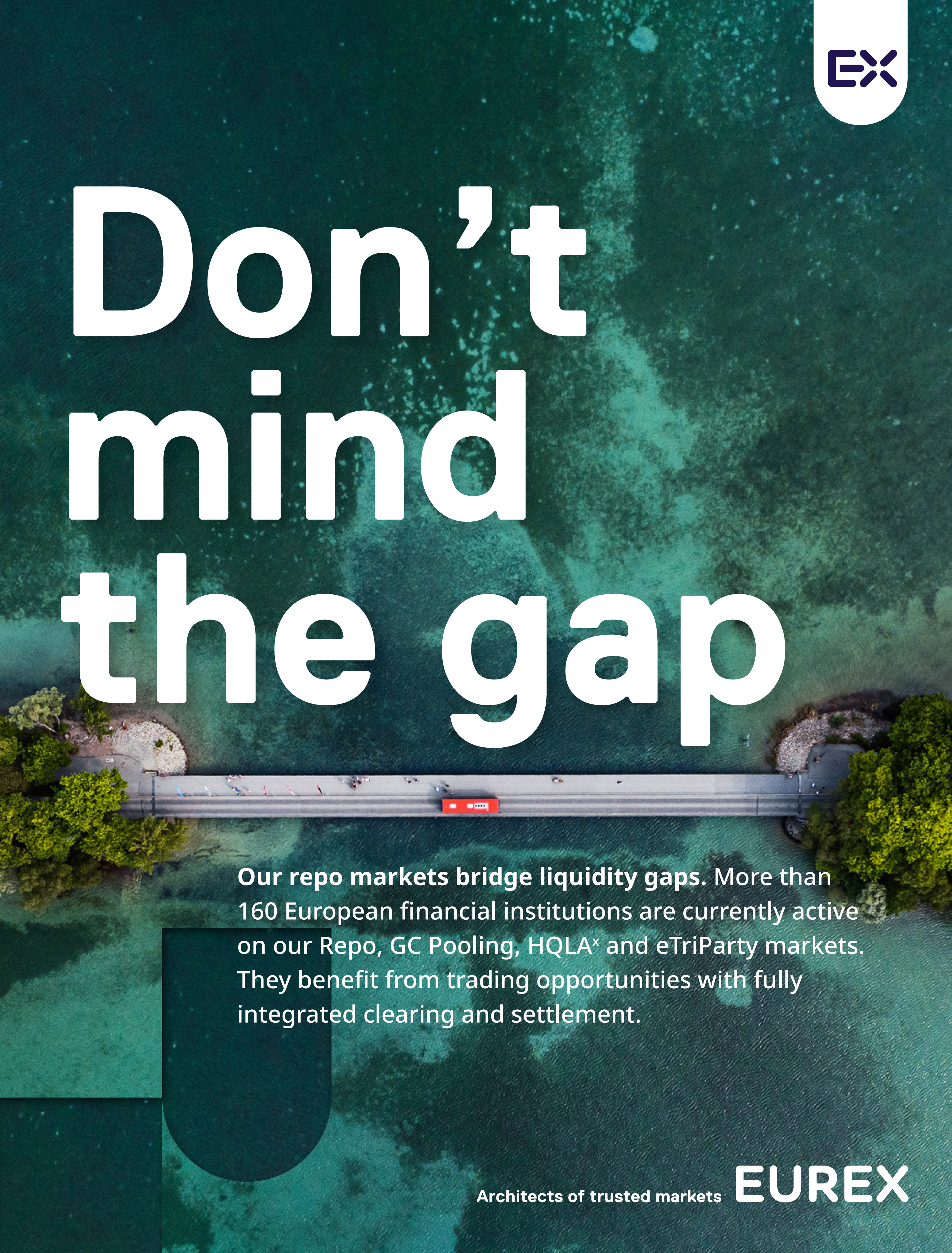
"We believe the company is uniquely positioned to help drive further electronification, efficiency and innovation in its market. We look forward to partnering

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with the EquiLend team in this next chapter of exciting growth."

WCAS is a US private equity firm focused on the technology and healthcare industries.

Founded in 1979, the firm's strategy is to partner with management teams and build value for its investors through a combination of operational improvements, growth initiatives and strategic acquisitions.

Deutsche Börse completes FundsDLT acquisition

Global market infrastructure provider Deutsche Börse Group has completed its acquisition of FundsDLT.

Following regulatory approval from Luxembourg financial regulator Commission de Surveillance du Secteur Financier (CSSF), the Group now owns 100 per cent of the company.

FundsDLT is a Luxembourg-based decentralised platform based on distributed ledger technology (DLT) for end-to-end fund issuance and commercialisation.

The company will operate within the Clearstream Fund Services business segment, but will do so independently from Clearstream, Deutsche Börse Group's post-trade infrastructure provider in Luxembourg.

Deutsche Börse Group announced its decision to acquire the remaining shares of the firm in August 2023, which it said would "complement and strengthen the fund processing and distribution offerings of Deutsche Börse's post-trade infrastructure provider Clearstream".

In addition, the integration aims to drive existing live blockchain-based end-to-end fund transactions, backed by Clearstream's fund processing platform Vestima.

In March 2020, and via Clearstream, Deutsche Börse Group joined forces with the Luxembourg Stock Exchange, Credit Suisse Asset Management and Natixis Investment Managers to invest in and further develop FundsDLT as the first platform to carry out fund subscription on blockchain infrastructure.

Former shareholders Credit Suisse Asset Management, UBS Asset Management and Natixis Investment Managers remain committed clients, the Group says, helping Clearstream to drive the use case development further.

FundsDLT will retain its legal identity and licence under the CSSF.

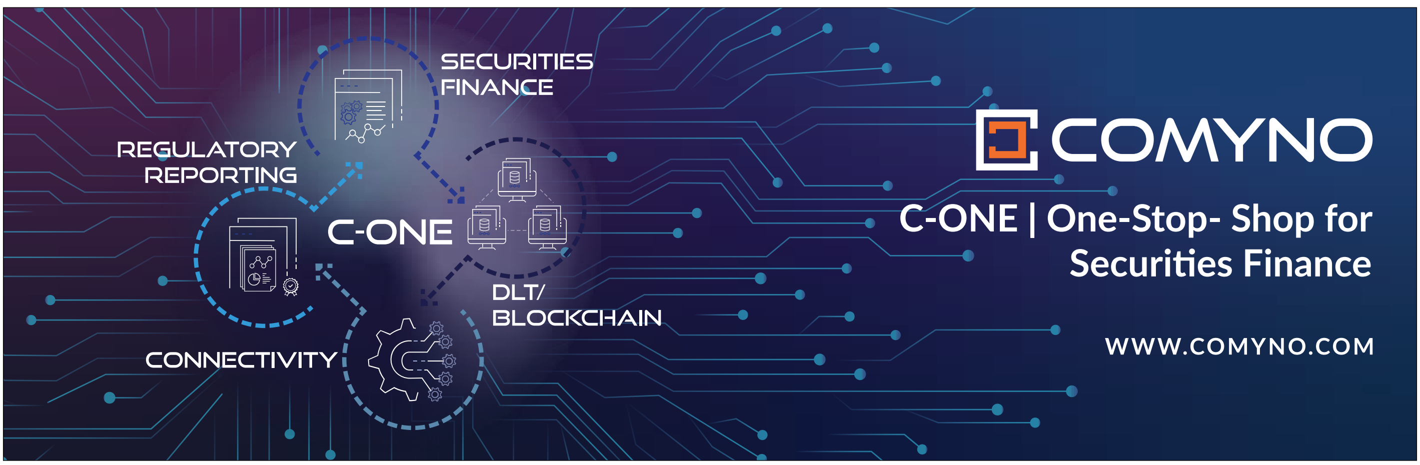
At the time of the August announcement, Philippe Seyll, CEO of Clearstream Fund Centre, said: "The acquisition of FundsDLT is a critical and natural step in our digital strategy. It demonstrates our position at the forefront of innovation and will redefine the overall distribution chain of the fund business."

SEBI introduce new short selling transactions guidelines

The Securities and Exchange Board of India (SEBI) has released new guidelines for short selling in the Indian securities market.

These rules build on SEBI's 'Short-Selling and Securities Lending and Borrowing Scheme' that was implemented in October 2023.

Under the new guidelines, all classes of investors, including retail and institutional investors, are permitted to short sell.



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However, to ensure transparency and increase market credibility, the framework imposes stringent measures around disclosure practices.

Naked short selling is not permitted in the market, and all investors are required to deliver the securities at the time of settlement.

Institutional investors are required to disclose upfront whether the transaction is a short sale at the time of placing the trade order. Retail investors, however, are permitted to make a similar disclosure by the end of the trading hours on the transaction day.

SEBI indicates that failure to comply with the guidelines will result in ‘appropriate action’ from the stock exchanges, in a bid to mitigate risks associated with short selling.

Hruda Ranjan Sahoo, deputy general manager of SEBI, says that the guidelines are issued “to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market".

FCA amends short selling regulation

The Financial Conduct Authority (FCA) has introduced a new notification threshold for shorted stocks and sovereign debt under Short Selling Regulations (SSR).

Coming into force on 5 February 2024, the legislation will increase the notification threshold for the reporting of net short positions in eligible shares to the FCA from 0.1 per cent to 0.2 per cent of total issued share capital of an issuer.

The decision follows responses from HM Treasury's call for evidence on the regulation.

The Authority has requested that firms make the “necessary changes” to their systems and internal processes to allow them to submit notifications at the higher threshold via the Electronic Submission System (ESS portal).

In terms of the new UK sovereign debt thresholds and uncovered positions in UK sovereign debt credit default swaps, new rules were implemented on 15 January.

According to the FCA, UK sovereign issuers will now need to report 0.50 per cent of the amount of outstanding UK debt in addition to

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an incremental level of 0.25 per cent.

Certain shares are exempt from the notification and disclosure requirements in the UK SSR, if the principal venue for the trading of the shares is located outside the UK.

Clearstream sees 32% rise

Clearstream's global securities financing (GSF) business recorded a 32 per cent year-over-year increase in volumes outstanding to €731.2 billion for December, according to recent monthly figures.

Year-to-date GSF volumes outstanding were up 14 per cent to €659.5 billion for 2023, relative to €576.9 billion for the equivalent period in 2022.

Assets under custody held in Clearstream have risen 7 per cent YoY to €17,915 billion for December. Year-to-date, assets under custody have grown 5 per cent to €17,493 billion for 2023.

For Clearstream's investment funds services (IFS), securities deposits were up 8 per cent YoY for December to €3,388 billion. The volume of transactions through the funds division also increased 17 per cent YoY to 4.01 million.

International business securities deposits through the Clearstream ICSD were up 6 per cent YoY for the month to €8,415 billion. The number of transactions through this service have climbed 6 per cent YoY to 6.4 million for December.

Wematch.live surpasses US$250 billion ongoing notional volume

Securities finance platform Wematch.live has reached a new milestone by surpassing US$250 billion in ongoing notional volume in January 2024.

The firm says the achievement "underscores the platform's unwavering commitment to innovation" and its ability to "cater to the evolving needs of its growing clientele".

In addition, the platform announced its recent average daily matched volume (ADMV) of US$5.4 billion.

Wematch offers clients tools and solutions to optimise their securities lending and borrowing activities.

The firm says its architecture streamlines the entire securities finance lifecycle, from order placement to settlement, enabling clients to achieve greater efficiency, transparency and cost savings.

Commenting on the milestone, Wematch co-founder and chief revenue officer David Raccat says:

"This achievement is a testament to our dedication to providing the best possible securities finance marketplace to our clients.

"We are committed to innovating and delivering cutting-edge solutions that empower our clients to achieve their business objectives."

Eurex Repo average daily volume rises 75%

Trading volumes on Eurex Repo, the electronic market for secured financing, have increased by 75 per cent year-on-year (YoY) to €314.0 billion for December.

This YoY growth was driven by a 105 per cent YoY increase in GC Pooling average daily term-adjusted volume to €138.3 billion and 57 per cent YoY growth in special repo average daily volume to €175.7 billion.

These figures supported the total average daily term-adjusted repo volume for 2023, which increased by 70 per cent YoY to €357.8 billion.

The GC pooling market grew by 142 per cent YoY to €158.9 billion for 2023, while the specials repo market grew by 38 per cent YoY to €198.9 billion.

For OTC derivatives clearing, notional outstanding volumes have risen 14 per

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cent YoY to €29,943 billion for the month of December.

This growth has been driven by an 8 per cent YoY expansion in notional outstanding for interest-rate swaps to €13,971 billion for December, of which overnight index swap clearing volumes have risen 24 per cent YoY to €3,140 billion.

Average daily cleared volumes through Eurex Clearing were up 22 per cent YoY for the month to €145 billion.

This features a 28 per cent YoY increase in average daily cleared volume to €28 billion for interest rate swaps, with overnight index swaps average daily cleared volume up 51 per cent YoY for December to €24 billion.

South Street Securities acquires GX2

South Street Securities Holdings has completed its acquisition of financial market software engineering company GX2 Systems.

The mandate also allows South Street to acquire the firm's wholly-owned broker-dealer subsidiary, GX2 Spread Markets.

GX2 specialises in the development and implementation of next-generation US Treasury securities liquidity and related analytical solutions.

It also provides algorithmic, agency brokerage and principal execution liquidity solutions to its network of users, alongside direct exchange connectivity, real-time pricing of cash and futures markets, and post-trade reporting services.

Commenting on the milestone, James Tabacchi, CEO of South Street Securities Holdings, says: "This milestone is not just about growth; it is about integrating GX2's capabilities with our infrastructure.

"This integration will empower us to provide enhanced services to our clients and play a pivotal role in the evolution of algorithmic, agency brokerage and principal market making liquidity solutions in US Treasuries."

Argentina's CSD launches new post-trade platform

Argentina's Central Securities Depository (CSD), Caja de Valores, has launched a new technology platform using Nasdaq's CSD technology.

The platform has been designed to enhance the resilience, capacity and speed of the CSD, and is able to process more than 1,000 settlements per second.

This is more than 300 times faster than the previous system, allowing the organisation both to meet current operational requirements and future-proof itself.

The core version of the updated platform went live in September 2023, with additional asset classes and functionality incorporated before its formal January 2024 launch.

Gonzalo Pascual Merlo, owner of Caja de Valores, says: "Like many countries around the world, Argentina's capital market has been subject to periods of substantial increases in transaction volumes, which has put pressure on its own technological infrastructure.

"At the Buenos Aires Stock Exchange we have prepared for this scenario with a new custody system which responds to the needs of our market."

Magnus Haglind, senior vice president and head of marketplace technology at Nasdaq, adds: "CSDs play a vital role at the heart of the capital markets ecosystem and are increasingly demanding agile infrastructure to respond to incoming regulations, adapt to changing market conditions, and capitalise on emerging growth opportunities."

Tradeweb reports 34.2% increase YoY

Repo average daily volume (ADV) traded on the Tradeweb platform climbed 34.2 per cent year-on-year to US$508.7 billion for December.

The global operator of electronic marketplaces for rates, credit, equities and money markets indicates a shift from the Federal Reserve's reverse repo facility to money markets.

For rates trades, US government bond ADV was up 39.8 per cent YoY to US$159.5 billion, with European government bond ADV rising 21.5 per cent YoY to US$33.4 billion.

Tradeweb reports that trading in the retail market was driven by higher interest rates. European government bond volumes were supported by sustained rates, market volatility and strong hedge fund activity.

For swaps and swaptions, ADV has grown 80.1 per cent YoY to US$336.5 billion, and total rates derivatives ADV increased by 62.0 per cent to US$513.2 billion.

In credit markets, fully electronic US credit ADV has risen 56.4 per cent YoY to US$5.6 billion. European credit ADV has also increased 26.2 per cent YoY to US$1.6 billion.

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Securities finance in times of monetary transition

Clearstream's Marton Szigeti and Eurex Repo's Frank Gast speak to Bob Currie about how monetary readjustment, and changes in regulation and operational culture, are reshaping user engagement in securities lending and cleared repo markets

These are times of transition and readjustment for securities finance practitioners, driven by shifts in macroeconomic policy, geopolitical tensions, and by changes to the regulatory fabric overarching lending and financing strategy.

The European Central Bank (ECB) noted in its November 2023 statement that weaker growth in 2023, coupled with persistent inflationary pressures, underscores the importance of continued consistency between monetary and fiscal policy. While the ECB opted to keep interest rates unchanged at its 26 October meeting, it has repeatedly committed to setting interest rates "as high as needed for as long as necessary".

These factors are driving market participants to reassess their investment strategies, borrowing and lending dynamics, and risk management approaches within the industry. They do so against a background of significant financial uncertainty. It is widely accepted that we are nearing the peak of the tightening cycle — but opinion is split on when central banks will move to policy easing and how aggressively they will cut. This is reflected in wide dispersion in policy rate forecasts from market analysts and the signals on future interest rate pricing coming out of the forwards markets.

Higher for longer

After being negative from 2014 to September 2022, the sharp rise in interest rates and earlier-than-expected repayment of Targeted Longer-term Refinancing Operations (TLTROs) led to an increase in the cost of funding on the capital market.

Against the backdrop of persistent inflation in the Eurozone, the ECB continued its aggressive tightening of monetary policy during 2023, delivering a tenth successive rate increase in September and pushing interest rates to their highest level since the launch of the euro.

Against this background, excess liquidity has fallen from record highs of close to €4.7 trillion in 2022 to around €3.6 trillion in December 2023 as TLTRO tranches have matured and as some market participants have made early repayments of their TLTRO holdings. Its Asset Purchase Programme (APP) is contracting at a “measured and predictable pace”, according to the central bank, as the Eurosystem no longer reinvests the principal payments from maturing securities.

The ECB’s adjustment of the remuneration cap for non-bank deposits has also had an impact on European repo markets. Non-banks and new customers have contributed more liquidity to the repo markets, particularly since the ECB, acting through the national central banks, has offered a rate of only €STR-20bp on non-bank cash deposits since May 2023.

In addition, Deutsche Bundesbank has stopped paying any interest on deposits since 1 October 2023. “This development led to a further step up in the use of CCP repo on the part of public authorities,” says Frank Gast, managing director, Eurex Repo, and head of sales for Europe, FIC derivatives and repo sales. After a period of reduced activity, cash-driven repo transactions, especially those cleared through a CCP, are again attracting significant attention.

These macroeconomic drivers are prompting investors to revise their trading strategies and to reassess their positioning in the market. “Previously inclined towards short positions, investors have now pivoted to long positions in government bonds,” observes Gast. “This switch has had a dual impact: it has reduced the need to borrow securities to cover short positions and simultaneously heightened demand for financing.”

The practical effects of this change are evident in the declining average lending fees for core European government bonds year on year, notes Gast, coupled with a significant upturn in balances under collateral management, particularly in sectors where firms act as triparty agents.

Driving up the volume

Against this macroeconomic background of interest rate tightening, TLTRO repayments and further reduction of excess liquidity, Eurex Repo has continued to experience a rise in repo trading activity across its platform, culminating in new record volumes for its cleared repo markets.

Specifically, total average daily term-adjusted volume across all markets increased by 70 per cent relative to 2022, powered by a 38 per cent YoY rise in volumes in the special repo market and a 140 per cent increase for GC Pooling.

In general terms, Eurex Repo has focused its recent strategy on attracting more customers into cleared repo, particularly from buy-side firms, on building GC Pooling trading activity, and on improving market share in the B2B special and GC repo segments.

These initiatives appear to be bearing fruit, with total daily term-adjusted volumes for buy-side clients rising by more than 200 per cent over 2023. “The revitalisation of this cash-driven repo segment was significantly influenced by the momentum in Eurex's buy-side and dealer-to-client strategy,” explains Gast. Sales initiatives designed to boost liquidity in French, Italian and Spanish government bonds in the special repo segment have, in addition, stimulated volume growth across a range of clients.

While there has been a pick-up in shorter maturity trades from overnight to one week, 2023 has particularly delivered a rise in term transactions which continued during the typically quieter trading months of July and August and has extended into Q4. In November, term-adjusted repo volume grew by 70 per cent and, on 28 November, the organisation recorded a new daily record of €1.53 trillion of term-adjusted volume in its repo markets.

"Previously inclined towards short positions, investors have now pivoted to long positions in government bonds. This has reduced the need to borrow securities to cover short positions and heightened demand for financing."

Frank Gast
Member of the Management Board
Eurex Repo

Moreover, as its repo rates move closer to the ECB's deposit rate, Eurex Repo anticipates that an increasing number of banks will become involved as cash providers in 2024. Spreads between the GC Pooling ECB basket and the Deposit Facility Rate (DFR) narrowed from around 14 bps at the start of 2023 to 5-6 bps by year end.

For the GC Pooling EXT basket (the GC Pooling ECB EXTended basket, which covers approximately 10,000 ECB eligible securities) spreads have fallen to 2-4bps. Furthermore, the spread between the two main GC Pooling baskets contracted from about 10 bps during the first half of 2023 to 3 bps by December.

Adding new participants

Eurex Repo has established an expanding community of buy-side firms, supranational agencies, corporates and non-financials in its programme, with new cash providers joining the programme drawn by attractive yields. This has included a growing number of pension funds.

For the sell side, firms continue to be driven by a need to optimise their balance sheet efficiency — meeting their financing requirements in line with risk-weighted asset (RWA), liquidity coverage ratio (LCR) and net-stable funding ratio (NSFR) obligations under Basel III. Under a major update to global capital standards, commonly labelled the Basel III Endgame, firms are still able to apply advanced approaches for their RWA calculations for credit and operational risk, but banks applying internal modelling are now under pressure to adopt standardised modelling for a significant portion of their operations — which must exceed 72.5 per cent by the end of 2026, with an intermediate target of 55 per cent by the first quarter of 2024.

These significant changes to the Basel risk-based capital framework are prompting sell-side firms to examine new liquidity sources and to reassess the viability of principal models and CCP-cleared solutions.

Eurex has also introduced a dedicated programme over several years designed to attract more buy-side clients into European cleared repo and to enhance buy-side clearing access for a wider set of instruments including exchange-traded and OTC derivatives. Through ISA Direct and ISA Direct Indemnified, Eurex Clearing aims to combine the advantages of direct clearing access for buy-side firms with the benefits of traditional sponsored access via a clearing member. This establishes a principal-client relationship between the buy-side firm and the CCP, but with a clearing agent performing additional service functions to enhance the clearing solution.

With these benefits, Eurex added 17 new trading and direct members to its financing programme during 2023, with more than 20 prospect clients expected to join the programme next year. More firms are coming into the market for cleared repo, notes Gast, providing access to liquidity at affordable rates, offering straight-through workflows and an effective risk management framework around the transaction.

“This is attractive from an execution and an operational standpoint, enabling participants to do cash management for perhaps billions of euros against a broad choice of counterparts,” he continues. “By using Eurex Clearing, cash lenders are able to position their cash promptly and efficiently against a wide range of repo borrowers, perhaps taking 20 or 30 minutes to complete these secured lending commitments when it might have taken them the entire morning to do so bilaterally.”

On this point, recent experience has underlined that buy-side firms and banks need to continuously evaluate their liquidity management strategies, both under normal operating conditions and during crisis scenarios. “Recent crises have highlighted the benefits of using a CCP not only for its risk mitigation capabilities, but also for its streamlined settlement infrastructure,” Gast observes. In a bilateral framework, settlement processes can often become unnecessarily complex and more vulnerable to disruptions.

Strategic lending

Building on these observations, Marton Szigeti, head of collateral, lending and liquidity solutions at Clearstream, indicates that Deutsche Börse Group offers a comprehensive portfolio of funding and financing, securities lending and collateral management solutions that are helping users across the financial ecosystem to manage the macroeconomic, regulatory and operational challenges that confront them.

“Clearstream offers a strategic lending programme where we stand as a contractual counterparty to lenders and borrowers,” explains Szigeti, “thereby offering the advantage of trading against an AA-rated financial market infrastructure company as intermediary.”

“We believe that it will become increasingly hard for some firms to access the liquidity they require without intermediation to help them to manage the credit risk,” says Szigeti. “With this, we see growing interest in our strategic lending programme, given the favourable capital treatment this can create.”

In line with this statement, he notes that securities lending volumes through Clearstream’s programme are up approximately 40 per cent over 2023. However, the profile of this loan activity is changing, with a contraction in specials-driven loan activity to cover short positions or to support event-driven investment strategies. Instead, loan demand is being heavily driven by firms sourcing securities to power their financing strategies and to meet their obligations to hold liquid asset buffers under LCR or NSFR.

“In monetary policy terms, there are signs that we are now near to the end of the tightening cycle and, with this, traders are changing short strategies to long strategies, thereby reducing the associated demand for stock borrow to close out short positions,” comments Szigeti.

“In turn, corporates and buy-side firms are being well paid to lend their inventory of stress-compliant assets,” says Szigeti. “With this, many of the corporate entities that we have on Clearstream’s books are becoming increasingly active in the securities lending space.”

In expanding its lending programme, Clearstream is adding ETF lending to its services during Q1 2024. This asset class expansion is not only extending the range of securities and loan availability offered through the fails coverage programme, but also makes a wider pool of securities available to clients via the strategic lending programme.

For lenders, this will, among other benefits, provide opportunities to enhance portfolio yields and to deliver additional liquidity to the market. For borrowers, this will provide access to ETF securities for strategic trading purposes and will extend fails coverage to boost settlement efficiency in ETF secondary markets.

Settlement discipline

With the introduction of the Settlement Discipline Regime component of the Central Securities Depositories Regulation (CSDR) on 1 February 2022, this has reinforced demand to borrow securities for fails coverage purposes. In doing so, it has also motivated firms to review their operational cultures, changing how they monitor and manage

"We believe that it will become increasingly hard for some firms to access the liquidity they require without intermediation to help them to manage the credit risk."

Marton Szigeti
Head of collateral, lending and liquidity solutions
Clearstream

potential fails — particularly by adopting an intraday approach to their fails coverage.

Szigeti observes that prior to SDR — and during an extended period of low interest rates — it was relatively common for firms to autoborrow the securities and then to hold these securities overnight before entering them for settlement in the next settlement cycle. "Whereas in the past, perhaps 50 to 60 per cent of securities borrowed to cover a non-delivery would be held overnight, this has now fallen substantially — to no more than 20 per cent," says Szigeti. "This is a major efficiency consideration, and a major cost saving, when considering that billions of euros of trades are being borrowed on a daily basis."

On balance, many settlement counterparties — particularly on the sell-side — are monitoring the status of their trades much more closely across the settlement cycle, they are identifying potential fails at an earlier stage and are acting more quickly to close out those failed positions or to apply functions such as shaping or partial settlement.

Market outlook

With the expectation that interest rates are stabilising and are likely to fall, Szigeti predicts that buy-side firms will continue to adjust their trading strategies, reducing their short positions and increasing the balance of long positions in their portfolios. This shift in investment strategy implies that fewer special securities, which typically command higher fees, will be in demand, especially in the government bonds sector. Instead, there will be a heightened need for financing solutions.

A key focal point, he suggests, will be the potential leverage employed by the buy-side in basis trades, particularly involving government bonds through central counterparties. The introduction of haircuts as a means to limit leverage could have a significant impact as it can affect both liquidity and cost of financing.

Eurex Repo will continue during 2024 to expand its product coverage and to extend the range of participants active on its platform, indicating that a diverse and well-balanced composition of participants is essential to enhancing the strength of the liquidity pool and to supporting a robust and sustainable funding framework for repos and reverse repos.

"Beyond the current blend of commercial banks, national debt management offices (DMOs), central banks, supranational entities, and, more recently, pension funds active in Eurex's repo markets, our aim is to further extend the pool with the inclusion of entities such as insurance companies, money market funds, and hedge funds," says Gast.

In the case of hedge funds, the ISA Direct Indemnified solution offers direct access to the clearing house and the first pilot clients are expected to complete their onboarding during H1 2024. "We have conducted detailed discussions with clearing agents and have several clearing agents that have, or are about to, upgrade their clearing membership to offer this service to hedge funds," says Gast.

This, he suggests, is an important step for Eurex Clearing in moving its buy-side strategy to the next level. Buy-side clients currently contribute approximately 10 per cent of current volume to Eurex Repo and the firm expects this to grow, with more hedge funds coming on board, to around 20-25 per cent of volume through its programme in the mid-term.

EMIR 3.0 negotiations have also opened a window to remove further barriers for the buy side to access repo clearing through targeted amendments to the Money Markets Fund Regulation and the UCITS directive. In June 2023, the exemption for EU pension funds from the clearing mandate finally lapsed after several years of extensions.

For the bank community, State Street selected Eurex in May 2023 as the first location outside of the US that it will use for trading and clearing repo transactions. In September, the Bank of New York also joined Eurex as its first non-US CCP for clearing repo trades. Commenting on these developments, Gast observes that "onboarding two of the world's largest custodian banks has been an important milestone for Eurex's cleared repo markets in the past year and illustrates the huge opportunities that exist in the European repo market".

Eurex aims to continue to drive momentum through GC Pooling by adding new functions and new participants. In December, it launched a "break-date" term-trading solution that will enable traders to book a term trade, but for this to be segmented and rolled over as a series of monthly transactions, helping the client to maximise balance sheet efficiency over reporting dates. "This provides an example of how we want to support the market, helping banks and broker-dealers to manage their balance sheet more efficiently," says Gast.

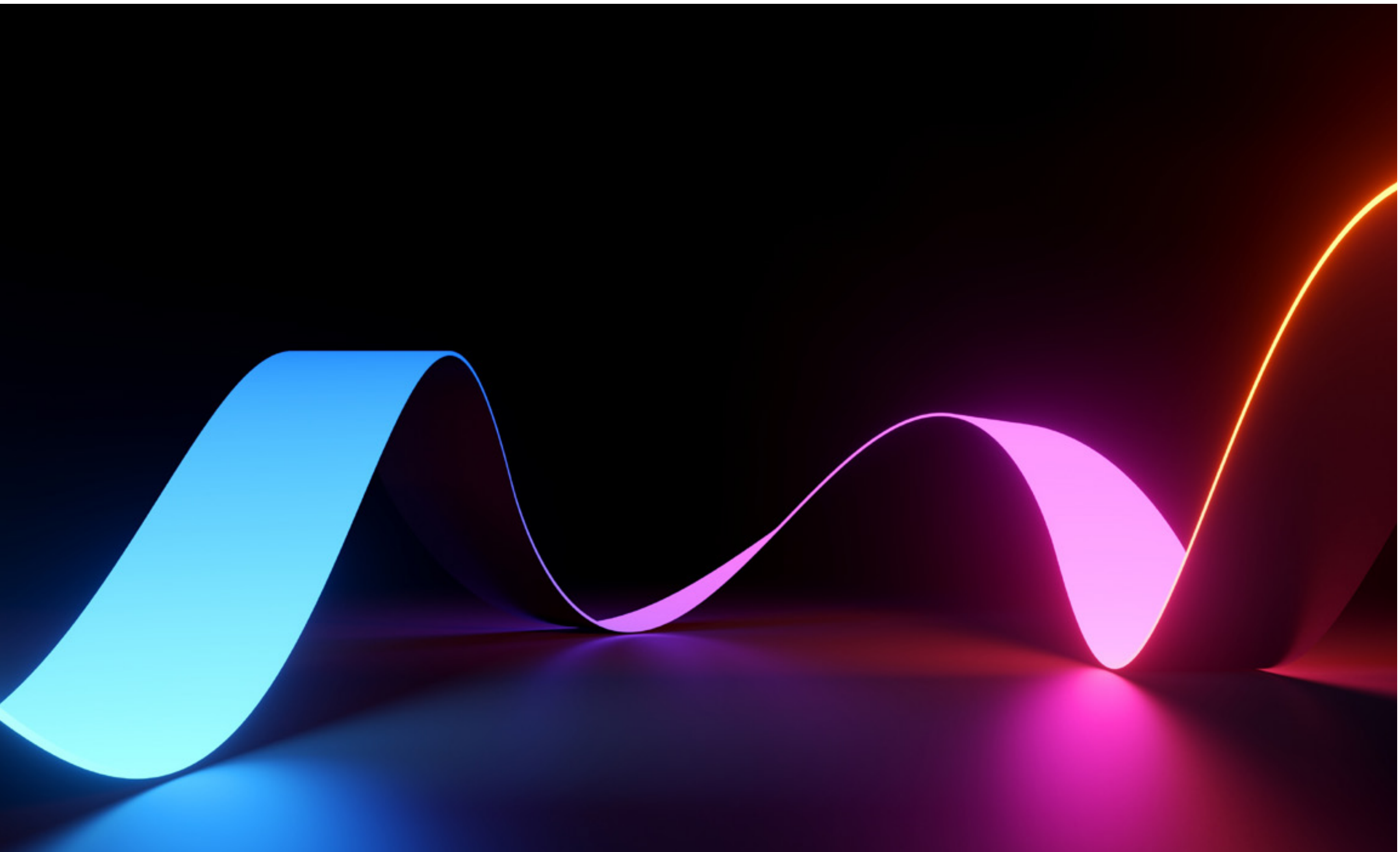
More generally, the focus at Eurex is to be home of the euro yield curve, offering cross-product coverage within the euro currency for repo, exchange-traded and OTC interest rate derivatives. Eurex is one of the few places where participants can trade term repo up to 18 months. Eurex Repo also aims to grow its market share for repo financed against a wider range of EU government bond issuers, including Spanish, Italian and French government bonds.

An important development to watch, notes Gast, is that Eurex Repo will be introducing cross-product margining between its fixed income futures and repo markets. For buy-side clients that are users of fixed income derivatives, this will provide a prime opportunity to extend into repo financing and to benefit from margin offset across these cleared trading exposures. "Eurex Clearing is in prime position to facilitate this, given that we have a lot of buy-side firms already actively trading on Eurex in the futures markets," says Gast.

It also identifies opportunities to expand its solutions coverage for ESG financing and green repo. Deutsche Börse supports a number of issuers — particularly supranationals, development banks and finance agencies — that are keen to build liquidity in secondary markets and to promote an active repo market for green bonds and social bonds. In catering for this appetite, Eurex Clearing and Clearstream have developed green bond GC baskets — which they suggest are the first standardised green general collateral baskets available in the market.

From a Deutsche Börse perspective, the acquisition of an 81 per cent share in governance, ESG and analytics specialist Institutional Shareholder Services (ISS) has enabled the Frankfurt and Luxembourg-based market infrastructure company to make ISS' ESG ratings available for collateral eligibility screening on Clearstream's collateral services platform, the primary collateral engine supporting the ICSD's securities lending and collateral management services. "We believe that ESG as a trading factor will continue to increase and we are continuing to invest to facilitate this expansion," says Szigeti.

Additionally, Eurex plans soon to launch EU bond futures and to support growth in secondary market trading in EU bonds. "The prerequisite is whether there is a liquid cash market and a liquid repo market to provide the foundations for a liquid futures market and to make this successful," says Gast. "We are collaborating on this development with the relevant market players and this will be an important part of our schedule for 2024 and beyond."



Securities lending: 2023 reflections and 2024 market outlook

State Street's Chelsea Grossman, managing director and head of North America client management for agency lending, breaks down the key events of 2023 and how last year's performance will shape the lending environment in 2024

In looking forward to the securities lending landscape of 2024, there are a few key themes to focus on, some carrying over from 2023 and others posing new opportunities and challenges.

We kicked off 2023 with a re-emergence from the pandemic in terms of a return to client events, travel and in-office attendance. This provided a general outlook of improvement from the year prior as it related to lending activity. However, as we neared the end of the first quarter, the US regional bank crisis and its impact on the market quickly shifted sentiment. From there, central banks' efforts to combat inflation, the resulting interest rate environment, and the geopolitical events arising in the Middle East are just a few contributors to what was ultimately a challenging lending environment to close out the year.

Despite the headwinds, opportunities in certain asset classes and trade structures arose where traditional US equity specials may have fallen short. In the following sections, we will elaborate on some of these themes experienced in 2023 across the various global asset classes, their impact on the trading environment and what we can expect moving into 2024.

US fixed income

Starting with US fixed income, this market exhibited considerable volatility in 2023, primarily influenced by Federal Reserve policy. The year began with a series of four rate hikes in the first half, creating "special" situations in various issues. US Treasury bills became the focal point as counterparties preferred the front-of-the-yield curve due to the active Federal Reserve. However, market uncertainties surfaced with the collapse of Silicon Valley Bank and Signature Bank in early March, raising concerns about the survival of regional banks.

This uncertainty persisted into mid-2023 as negotiations surrounding the US debt ceiling created apprehensions about a potential default. Counterparties were cautious about facing securities with maturity dates around the default date. Once the debt ceiling issue was resolved in early June, the threat of default disappeared, leading to a surge in new treasury bill supply. The markets proceeded with another rate hike in the July Federal Open Market Committee (FOMC) meeting and the second-half of 2023 saw limited specials.

As this market looks ahead to 2024, the prevailing theme is expected to be Fed policy yet again. Projections have indicated 150 basis points priced-in for cuts by the end of the year, with the majority anticipated later in 2024. This outlook is poised to increase volatility, both in terms of when the rate cuts commence and their impact on the US Treasury (UST) market.

International fixed income

The landscape of international fixed income in 2023 was shaped by the efforts of central banks, including the Federal Reserve, Bank of England (BoE), and the European Central Bank (ECB), to combat inflation, collectively through 15 rate hikes. Despite these measures, the global cost of living crisis persisted, creating challenges for portfolios and guidelines.

A number of trends resulted from these considerations, with client portfolios diversifying away from core European high-quality liquid assets (HQLA) — as central banks were buying HQLA as part of quantitative easing (QE) — and a noticeable increase in loans of supranational paper (still highly rated, but with higher yields) and US Treasury trades against Japanese Government Bonds (JGBs).

Looking ahead to 2024, the global backdrop of high inflation is beginning to abate and potential easing is coming into the conversation. That said, HQLA demand remains strong and the global trend around unwinding central bank funding facilities leaves more collateral to be funded across the street. A trend of lower money market spreads and a shift towards non-cash upgrade trades might therefore be expected as these considerations materialise.

US equity

In 2023, the US equity market faced challenges amid an initial public offering (IPO) drought and limited M&A opportunities, which impacted lending dynamics significantly when compared with initial expectations for the year. Despite this, revenue attributed to specials resulting from select events was strong to end the year. Notable corporate events, such as Johnson & Johnson with Kenvue Inc (JNJ/KVUE US) and VMware LLC with Broadcom Inc (VMW/AVGO US), contributed to revenue generation.

While corporate activities drove late-year specials revenue, strong directional performance in the first eight months proved favourable for the US equity product. The overall revenue picture was primarily driven on a name-by-name basis in certain sectors.

As we look through to 2024, the move to T+1 settlement in May is expected to increase initial volatility around recalls, returns and fails until the industry acclimatises to the accelerated settlement cadence. This said, third-party vendor solutions and the adoption of straight-through processing (STP) for recalls will hopefully help to ease the burden on all parties involved.

With the FED at terminal rate and uncertainty around the outlook for 2024 with regards to rate cuts, we expect stock picking to become in vogue with an increased focus on sector rotation moving through the earnings cycle. Expectations are for a robust IPO and M&A calendar, where M&A names could include Cummins Inc with Atmus Filtration Technologies Inc (CMI/ATMU US), Softbank Group Corp with ARM holdings (SFTBY/ARM US), Bausch Health Cos Inc with Bausch & Lomb Corp (BHC/BLCO US), Intel Corp with Mobileye Global Inc Class A (INTC/MBLY US). The IPO market has less certainty. However, a backlog persists from what has been an 18-month drought, which could prove to bear some fruit as the year progresses.

EMEA and APAC equities

European, Middle East and African (EMEA) equities presented challenges and opportunities across various markets in 2023, but ultimately returns from this asset class were positive.

In EMEA, economic recovery enabled companies to reinstate or enhance previously reduced dividends, providing for greater yields. Record profits for energy companies, resulting from sanctions imposed on Russian supply due to the war with Ukraine, also helped to boost dividends in the energy sector as demand for supply from western producers significantly increased in the region.

Those companies looked to return some of that revenue to shareholders, often through issuing special dividends on top of already inflated cash dividends that had been planned. On the other hand, while corporate activity in the region was generally less in focus, there were strong revenue opportunities in pockets from companies dealing with debt burdens and supply chain issues (i.e. VLP LN, SBBB SS, and HLAG GY).

A few challenges also developed in this region, particularly in Norway and France. In Norway, positions were reassessed resulting from news that the Norwegian Tax authorities had approached some market participants to claim withholding taxes on historic manufactured dividends. In France, following publication of new regulations by the French tax authority in February 2023, there was some softening in demand across the market. While those rules were challenged and ultimately overruled, there remains a level of uncertainty given the expectation that similar legislative action may be forthcoming.

In the Asia-Pacific region, the Australian economy demonstrated resilience in 2023, despite aggressive rate rises by the Reserve Bank of Australia (RBA). Nonetheless, lending revenues were challenged due to a quieter corporate actions front and a decrease in specials in the mining and exploration sector (i.e. LTR AU, CXO AU).

In Hong Kong, 2023 started with heavy deal flow, along with a large number of capital-raising events. Borrow demand then quickly moved to sector related interest, specifically in electric vehicle (EV) stocks (i.e. 9868 HK, 9866 HK) and AI related companies (i.e. 1357 HK). From Q2 onwards, we began to see securities in the housing sector attract strong demand from borrowers as the Chinese property sector continued to suffer from deteriorating fundamentals along with increasingly stringent regulations.

In Japan, 2023 experienced robust demand, mainly driven by corporate action activity, collateral transformation trades and demand for positions in the Taiwanese market. South Korea, however, was impacted by a short-sell ban effective until June 2024, resulting in muted activity to end the year.

In summary, given all of these dynamics in play across the globe, there are a few points that permeate throughout as we look forward to 2024. The health of global economies and resulting actions by central banks, plus events such as the US election coming up in late 2024, will continue to set the stage. From a regulatory standpoint, automation and tightening of processes are top-of-mind as the market moves into a T+1 settlement cycle in the US and Canada. Capital-efficient trade structures also remain in focus as Basel III endgame approaches and counterparties look to lessen their risk-weighted asset (RWA) usage. With that, initiatives such as CCPs and alternative pledge structures are being developed to address these growing considerations on top of existing peer products and alternative forms of indemnification.

On the demand front, a strong M&A pipeline provides a glimmer of hope for an uplift of equity specials, which would be a welcome positive given some of the challenges mentioned. HQLA demand is also expected to remain strong. Against this background, 2024 should prove to be another eventful year for lending.

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Fostering accessibility in the repo market

By breaking down traditional barriers, embracing peer-to-peer lending and leveraging new technologies, Ed Tyndale-Biscoe, head of secured funding product development at ION Markets, believes that the repo market is on the brink of a transformative era

Amid increasingly volatile and tight market conditions, interest in access to the repo market has grown among the investment community and central banks alike. This is evidenced by data which shows that trading volumes increased by almost six per cent in 2023.

Repo trading has traditionally been the preserve of large financial institutions as a result of complex collateral assessments and compliance requirements. But the desire for broader access to this asset class is slowly being realised. This, in part, is due to its ability to act as a more efficient source of short-term funding, a way to deploy capital and the hedging of derivatives, among other reasons.

The emergence of new trading models such as peer-to-peer lending, coupled with investment in, and adoption of, new technology, has been a key enabler of the more accessible repo market we see today. As new technologies come to the fore, this more democratised repo landscape could bring several advantages for the wider financial system.

A squeeze on smaller entities

Historically, dealers and brokers played a pivotal role in the repo market, serving as intermediaries between borrowers and lenders. This structure has inadvertently restricted access for smaller-sized firms due to the stringent entry requirements and collateral demands imposed. Such an exclusionary paradigm hinders market inclusivity and innovation — the reduced trading options for these firms dampens their ability to grow and compete.

One promising avenue to help minimise these barriers lies in peer-to-peer (P2P) lending models. This approach bypasses the traditional framework, fostering direct borrowing and lending relationships. Enabling transactions between smaller entities, this model streamlines complex trading processes and minimises costs, easing participation for the smaller firms that lack the resources to adopt advanced, trading infrastructures. What's more, P2P models also improve access to liquidity and competitive financing costs across a range of collateral types, opening new opportunities.

Broadening participation

Diversifying the pool of participants in the repo market has many benefits. Most importantly, reducing the barriers to entry enables smaller firms and individuals to participate in the market. This encourages greater competition and diversity in the repo market and, in turn, fosters a more robust financial ecosystem. With increased participation, liquidity provider proliferation increases, which reduces dependency on a handful of major players and thereby mitigates systemic risks.

A greater presence of smaller firms heightens agility and adaptability in the market. Their active involvement could introduce fresh perspectives, innovative strategies and risk-mitigating approaches. This diversity of thought and action not only benefits the customer but also builds a more dynamic and competitive landscape, which contributes to overall resilience for the market.

Democratising the repo market

Technology has played an integral role in levelling the playing field and ensuring these benefits are realised. The adoption of automated platforms and electronic trading systems helps firms to streamline operations and lower transaction costs, further reducing barriers to entry. Platforms able to seamlessly integrate with existing infrastructures and enhance data aggregation will be crucial to realising the benefits of the P2P approach.

While further democratisation allows more firms to tap into the trading opportunities of the repo market, engaging in more market activity can also expose them to greater volatility and risk. Technology is key to mitigating this risk and ensuring newer participants can exercise effective due diligence. Platforms with advanced risk management and real-time monitoring — which promote transparency — can provide firms, traders and investors with a full view of their activity to ensure pain points and compliance issues are addressed before they materialise, negating the risk of knock-on, negative effects on the wider market.

The road ahead

Industry initiatives, such as the Fixed Income Clearing Corporation (FICC's) sponsored repo, signify a concerted effort to democratise the market. By opening up direct access for smaller firms to central counterparty clearing, for example, such initiatives pave the way for a broader section of the market to participate more seamlessly. Developments in the digital assets sector, specifically the utilisation of blockchain and distributed ledger technologies (DLT), provide further reason for positivity about the future of the repo market.

DLT will likely be a key enabler of intraday repo, providing the high transaction speeds needed to keep up with the fast-paced nature of today's capital markets. In particular, if intraday repo becomes a widespread reality — facilitating uninterrupted and real-time oversight of trading activity — DLT could greatly improve market transparency and liquidity access. By saving banks, brokers and other participants millions, this could potentially pave the way for a more robust, simplified system where firms can reap the true benefits of democratisation.

By breaking down traditional barriers, embracing peer-to-peer lending and leveraging new technologies, the repo market is on the brink of a transformative era. Looking ahead, focus must be on continued innovation and collaboration. Regulators and industry bodies need to adapt and work together to accommodate evolving market dynamics, ensuring broader participation while not compromising market integrity. If effectively coupled with investment in technological infrastructure, a truly efficient, transparent and accessible repo market will become the norm.

Making a Mark

TP ICAP's Nichola Hunter and Adam Southern speak to Carmella Haswell about the firm's new "front-end refresh" and wider plans to drive the growth of its eRepo platform

Global financial market infrastructure firm TP ICAP is working to establish its place in the market following "significant growth" on the platform in 2023. With Germany and France becoming its strongest performing regions in Europe, the team aims to build on this success within the gilt market.

Headquartered in London, the firm recorded a 132 per cent year-on-year increase in notional volume traded on the TP ICAP platform for 2023. This trend has improved through the year, with December up 167 per cent compared with the same period in 2022.

TP ICAP acts as an interdealer broker, energy and commodities broker, and provider of over-the-counter (OTC) pricing data. It aims to provide clients with access to global financial and commodities markets, improving price discovery, liquidity and distribution of data through responsible and innovative solutions.

According to Adam Southern, eRepo manager at TP ICAP, last year was "a significant year for us on the platform in terms of establishing ourselves in the market". In November, TP ICAP's average traded daily notional in Germany was €37 billion, with France reaching €30 billion per day. "The two countries are some of the biggest within the repo market. It is great that we now represent a solid market share," he adds.

As the firm reviews next steps for 2024, it strives to build on this success in the gilt market, which it describes as "important and concentrated". The TP ICAP team will be focusing on building liquidity, working with key market participants, and creating the necessary incentives to get participants trading gilts on the eRepo platform.

A competitive landscape

eRepo is a high availability, low latency central limit order book platform that services the inter-dealer market. Offering core and semi-core government bonds with straight-through processing (STP) connectivity, eRepo also provides connectivity via a graphic user interface (GUI), as well as API integration. According to Southern, the firm trades 12 country debts, all either cleared by LCH or bilaterally. The company aims to expand the number of debt instruments offered on the platform in the coming year.

The platform — designed to help market participants manage high volume demands in the European repo market — celebrated a milestone in September when it recorded a volume of £100 billion in one trading day.

TP ICAP's Nichola Hunter, global head of fixed income sales and trading, and chairman of iSwap, comments: "With any order book in the market, there is a tipping point. eRepo has been around for quite a while. We historically carved out a niche as being a disaster recovery alternative to the main incumbent. We would see increased volumes on days where our main competitors had a system issue, for example. The market demands competition — competition drives innovation."

The repo market has grown exponentially, as evidenced by the International Capital Market Association's (ICMA's) European Repo Market Survey. The survey measured and analysed the value of outstanding repo and reverse repo on the books of 62 participants at close of business on 14 June 2023. The total size of the survey grew 11.5 per cent YoY to a record €10,794 billion.

For its clients, TP ICAP identifies Germany, France and Spain as hosts of opportunity in a growing repo market. According to Southern, Germany was once ahead of France in terms of traded notional volumes on the TP ICAP platform, but notes that there is now a more equal footing between the two regions. As a result, Southern indicates that "banks may now see this as an equally safe asset to Germany".

Similar growth has been identified in Spain. In 2024, Southern expects that this region will move from a buy and sell back market to 'classic repo', "joining the rest of the EU countries in streamlining the process for banks". He anticipates opportunities for clients in Euro GC+ in the region, which look to gain popularity this year.

A drive in technology

Technology is core to the functioning of the securities finance industry, with regulatory authorities pushing for further automation to streamline the trade lifecycle process. This has become evident through the introduction of the Central Securities Depositories Regulation (CSDR) and the impact of the Securities Financing Transactions Regulation (SFTR), which caused firms to alter their operational processes.

Southern indicates that with advances in financial technology, banks have an appetite to streamline the whole trade lifecycle process, from price discovery, order entry and into post trade and analytics. "[Banks] are using algorithms to assist the traders, as well as using STP," he continues. "In addition, we are now seeing more integration with settlement — which will continue in 2024." Southern remarks that banks will look to automate the trade lifecycle process as much as possible to reduce risk and optimise execution.

From a TP ICAP perspective, the firm is focused on migrating to its technology platform, Fusion, which has become a key objective for the company on the eRepo platform. Fusion is an electronic platform that aims to provide more client-led technology and deeper liquidity. Its purpose is to give traders an improved trading experience in terms of speed, reliability and ease of trading. Fusion provides a number of features including single login access and access to aggregated liquidity for specific asset classes.

Moving forward, the team plans to incorporate additional features into the platform, such as giving traders the ability to click on an ISIN and review the historical pricing data of that particular bond. TP ICAP will also introduce new order types, such as switch trading, for mid-year 2024.

"Technology is such a major component of the TP ICAP strategy, specifically our Fusion distribution, which encompasses a whole host of things including front end, API connectivity, and post-trade services," says Hunter.

From an eRepo perspective, TP ICAP's focus will be on refreshing its front end to reach a broader spectrum of dealers — including smaller regional dealers. Hunter adds: "Ultimately, Fusion is the window into TP ICAP across all of the asset classes. Getting eRepo distributed through a new light weight, functionally rich GUI will be highly beneficial for the end users."

TP ICAP will continue to focus on its "front-end refresh" — Fusion — which is of "critical" importance for the eRepo platform. The firm will also continue on a partnership path with third-party integrators to collaborate and integrate its APIs.

Concluding, Hunter remarks: "It is important to have competition in a marketplace, it drives innovation and pricing, which is healthy in a market. There needs to be liquidity and critical mass in an order book environment — that takes time, effort and trust from participants. For 2023, we exceeded expectations and put foundations in place that put us in a good position to continue that growth trajectory for 2024."

The digital future of securities finance

Technology investment is crucial to maintain pace with the accelerating speed of modernisation, says Rob Sackett, head of prime financing at Clear Street, who discusses how firms can work to build the modern, scalable future of capital markets

In 2023, reverberations from bank failures and liquidity shifts due to rising interest rates shook up the balance sheets of numerous financial institutions. The shrinking prime brokerage industry, coupled with the regional banking crisis, the meme stock saga and the collapse of Archegos Capital, has posed a challenge for hedge funds in formulating their prime brokerage strategy. Market turbulence and heightened volatility are pushing managers to review prime brokers' core services and value propositions to find a partner that can give them a competitive edge.

Securities finance is essential to a healthy market, but much of the market is burdened with heavy cost structures, outdated technology and inefficient organisational designs. Over the past 20 years, financial institutions have begun to progress beyond ageing legacy infrastructure, applying new technology on top of outdated systems or turning to providers for support. The result is that many firms operate on a patchwork of solutions underpinned by decades-old mainframes.

Over the last decade, the securities lending industry has successfully responded to both regulatory and market challenges including Basel III, Dodd-Frank and the Capital Requirement Regulation. This year, the industry will continue to be challenged by the Federal Reserve's interest rate decisions and the Securities and Exchange Commission's (SEC's) rules and proposals, particularly those around transparency.

As the securities finance industry continues to respond to these substantial changes, participants will demand more straightforward access to data and real-time information, and the reliance on highly manual processes will pose a challenge. The solution is to reimagine the legacy workflows and silos in the financial markets to improve access for all participants.

Drivers of innovation

Regulation in industries such as technology and medicine often follows innovation, and governing bodies must keep up with the latest developments. In finance, the opposite can be true — new regulations sometimes drive innovation, challenging the industry to develop solutions that meet rising standards in reporting and processing.

For example, mandated central clearing of US Treasury and repo through the Fixed Income Clearing Corporation (FICC) will place a greater emphasis on optimising the cash equity and fixed income inventory across the firm. Firms must centralise inventory from different desks through an integrated, centralised platform. A Securities and Exchange Commission (SEC) study of the impact of this rule on markets and market participants found that technology will be the most considerable cost to market participants adopting the rule and that outdated systems would be a significant constraint. One firm noted: "It would be very difficult to incorporate this change at scale and we could choose not to participate."

At the end of last year, the SEC approved the new Rule 10c-1a, which will require certain entities to report information about securities loans to a registered national securities association (RNSA) and require RNSAs to make publicly available certain information that they receive regarding these lending transactions.

By mandating more transparent and efficient reporting, regulators hope to better understand systemic risk and prepare to make decisions during future market events. Around the world, regulators are tightening their rules and guidelines to oversee the market more effectively, particularly in traditionally opaque businesses such as securities lending.

Rule 10c-1a does not come into effect until 2025, but the industry must begin preparing for the sheer volume of data and reporting requirements. Firms investing in modern and cloud-native technology will be better positioned to deliver new products and services quickly. Technology-forward firms can offer clients game-changing services and more reliable, real-time access to locates and often have more flexibility to take on clients left behind by legacy banks burdened by capital constraints.

Finally, the May 2024 shift to T+1 settlement will challenge legacy and fragmented technology, entrenched manual processes, and siloed data across capital markets. Firms must build certainty into their payments and settlements to effectively prepare for the change.

This deadline puts increasing pressure on in-house operations teams. Shorter timeframes mean more work for teams, particularly for those funds trading overseas and at high volumes. Fund managers must thoroughly review their systems and counterparties to ensure a smooth transition.

The stability of a counterparty during market and regulatory changes, along with considerations such as product offerings, securities lending supply and financing capabilities, are key differentiators. Specifically, as Common Equity Tier 1 (CET1) ratios face pressure under Basel III regulations, banks may need to scale down their balance sheets, potentially reducing hedge fund lending. A provider's regulatory oversight and strengths play a crucial role in determining the potential impact on a relationship when there are changes in business strategies or commitments to a business line.

A roadmap for modernisation

The entrenched nature of traditional legacy systems has continued to pose a significant challenge to the securities finance industry's digital transformation efforts. Starting with their traditional architecture, firms operate on fragmented platforms based on deep and inflexible technology. In many cases, large amounts of custom code have built up over time to manage tasks that legacy systems were never designed to support.

This means that near-obsolete technology may still be in use because data cannot be changed, application programmes cannot be upgraded, or it is heavily integrated into a firm's functions. Over time, some firms have acquired technology from newer vendors to live on top of legacy systems. Still, these pseudo-modern solutions are awkward and difficult to update, often with poor visibility.

Other firms might combine multiple vendor solutions to meet the needs of today's markets, but that often leads to lengthy integration processes, high ownership costs, and fragmented data stored across multiple systems. Others may have installed a single-source vendor solution capable of supporting numerous activities. However, installations and custom modifications can be expensive and are at the vendor's mercy.

The long-term solution is a cloud-native, horizontally scalable capital markets ecosystem that adds considerable efficiencies to a business and can be continuously developed to meet changing market demands.

Despite its importance, securities finance is an area of the financial services industry that has only seen limited innovation. Like much of today's capital markets infrastructure, it depends on antiquated technology, such as mainframes, which can create data challenges for clients.

Modernising the trading technology stack can reduce costs in critical areas including reference data management, reconciliations, clearing and settlement, middle office, regulatory reporting and overall application footprint. A nimbler, more agile firm can grow through innovation and deliver higher-quality returns for asset owners and stakeholders through easy-to-use APIs, access, automation and insights.

One central solution

Progress does not occur in a vacuum. Vendors in the trade space have launched developments and enhancements in an effort to increase automated trading functionality by systematically integrating trading platforms. However, efficiencies will be hindered without similar developments in the pre-and post-trade space, such as within onboarding, trade settlement, or loan allocation.

These challenges are met by varying solutions for workflow efficiency, regtech, analytics and more, all developed by different market vendors. As discussed, this piecemeal approach can result in fragmented data and heavy operational burdens. It also means that development happens at different paces as each participant adopts enhancements suited to their own existing infrastructure.

The solution is a central platform that de-silos key inputs and leverages advanced analytics and machine learning to optimise the balance of inventory, collateral and margin against customer demand — with the goal of more liquidity, better economics and reduced systemic risk.

Investing today for tomorrow's success

To operate at peak efficiency, banks and brokers must reduce the manual processes that increase risk of error and operate in silos in favour of technology that empowers users to make smarter decisions and to identify potential risks throughout the trading process.

A prime example of this is locating. Traditionally, allocating locates has been manual and inefficient, requiring traders to navigate multiple pages of information and negatively impacting efficiency. New, high-tech developments in locate allocation systems allow customers to submit orders directly through their order management system, reducing manual labour and providing a more reliable customer experience.

Simplifying the technology behind trading and post-trade functions can transform it from a cost centre to a competitive advantage. But for many firms, upgrading would require rewriting many systems with significant technical debt, massive resourcing and high planning costs — a daunting project with low chances of success.

Modern, high-performance computing coexists with mainframes. But as the value of data continues to rise, those who invest in the technology and capabilities to keep up with fast-paced, intraday market changes will come out on top.

It is time to update the infrastructure powering capital markets. A single-source platform can potentially optimise operations across teams, asset classes and geographies, reducing cost, complexity and risk. In turn, this makes it easier for emerging managers, professional traders and institutions to access capital markets.

To keep up with the accelerating pace of modernisation, firms will need to invest in technology to meet the needs of investors and regulators. Those who do will be part of building the modern, scalable future of capital markets — improving access, speed and service for all participants.

"As the value of data continues to rise, those who invest in the technology and capabilities to keep up with fast-paced, intraday market changes will come out on top."

Rob Sackett
Head of prime financing
Clear Street

A new dawn for securities lending technology

The regulatory landscape is evolving in ways that require the market to decide how technology will enable them to satisfy their obligations, while optimising how they execute their business. GLMX's director of business development, Anish Patel, and securities lending product manager, Dan Long, sat down with SFT to discuss their expectations for the year ahead

How do you assess the current state of the market in terms of electronification?

Dan Long: From the perspective of a lender, the securities lending market has come a long way since I first started on the trading desk 24 years ago. The days of hand-writing trade tickets and faxing instructions have (thankfully) long since disappeared. However, there is still some way to go before the securities lending market can claim that it has fully embraced technology and digitisation.

I joined GLMX in 2022, having spent more than two decades as a securities lending trader — at BNY Mellon and then managing the trading desk at AXA Investment Managers. From my experience, there is still an unnecessarily large amount of trading activity being executed manually over voice, whether that be for asset classes such as government bonds or workflows such as non-GC, hard-to-borrow securities and post-trade lifecycle events. All of these are underserved by technology and are a perfect fit for the solutions that GLMX offers.

Anish Patel: I have a similar view, although from the perspective of a borrower. Before joining GLMX in 2018, I previously spent more than a decade on the fixed-income government repo desk at Credit Suisse and have had first-hand experience of the inefficiencies and pain points that manual interaction with trading counterparts can bring. As a borrower, sourcing collateral, either HQLA for the liquidity buffer or for short covering, need not be a complicated process to manage. However, this was predominantly accomplished using chat and emails. This was followed by manual booking and then the same manual interaction for any subsequent lifecycle event. This always struck me, similar to the incoming client flows, as an area ripe for electronification.

Long: Having sat in the seat as a user of technology in this market for many years, one thing that always struck me was how little had changed over that time in terms of technology and innovation. Ultimately, this is why so much pre- and post-trade activity was — and still is — performed manually. Various post-trade technologies emerged which help to manage the impact of this, but these help to identify problems after the fact rather than at the point of negotiation or execution.

This is one of the things I find most exciting about being at GLMX — having the opportunity to help drive innovation and change.

How is GLMX helping the market to accelerate the adoption of technology?

Patel: You need only to look at what has happened in the repo space to date. For trading desks, there has been a step change in how client business is now managed. What was almost entirely manually negotiated a few years ago is now increasingly managed electronically. In December, we announced a record balance of over US$2 trillion and our daily volume hit a new high of US$790 billion in early 2024. This reflects how GLMX technology has become integral to the client-to-dealer financing business.

From the origins of simple negotiation, it now covers price discovery, complex multi-stage and multi-variable negotiation and post-trade lifecycle management. These features are now available for lending flow too. What is then interesting for a borrower is to be able to manage incoming demand on one side, while accessing supply from lenders directly in the same screen.

Long: My remit since joining GLMX has been to build out the platform's securities lending offering, in terms of the functionality and user experience as well as the ecosystem of lenders and borrowers executing on the platform. It has been fascinating for me to observe the technology that has already been deployed with such enormous success for the client flow on the repo side.

However, that does not mean that we have simply repurposed our repo technology for the securities lending product. An enormous amount of my focus since starting at GLMX has been in collaborating closely with clients to understand their specific securities lending workflow requirements, as well as utilising my own trading experiences so that the engineering team we have at GLMX can realise the vision. As with repo, this means the lending features have been designed by traders for traders so that they can achieve real world value.

> **"Regulation that looks to improve transparency such as SEC Rule 10c-1 will naturally push manually booked activity towards platforms."**
>
> **Anish Patel**
> Director of business development
> **GLMX**

How do you see the market reacting to upcoming regulatory changes?

Patel: As always, the market is sensitive to how regulation will impact their business. Regulation that looks to improve transparency such as SEC Rule 10c-1 will naturally push manually booked activity towards platforms. We saw this dynamic play out with the second Markets in Financial Instruments Directive (MIFID II) and then the Securities Financing Transactions Regulation (SFTR) and I think this will be no different.

To be able to accurately report trading data, capturing all the details of what is agreed at the point of execution, is key. I think this is particularly relevant for the type of flows I engaged with as a trader — they need to be moved off chat and email and into a structured form where both sides have a single view of what is agreed.

Long: I think that the US T+1 accelerated settlement timeframe is front and centre right now. For this, management of post-trade lifecycle events such as recalls and returns is key. At GLMX, our view is that this needs to be managed in the same place as new trade negotiations. While there can be feeds in or out to manage the operational aspects, having the ability to immediately trigger and manage an onward action from the trading perspective — whether that be a borrower trying to locate recalled securities from another lender or a lender offering out returned securities to see where there is a bid — is very straightforward.

"Regulation is focusing minds once again and this will act as a catalyst for the securities lending market to adopt and extend new technology solutions."

Dan Long
Securities lending product manager
GLMX

Patel: For me, being able to tie the different flows together is where the solution goes beyond solving for regulation and delivering real efficiency. For example, if you are short a bond as a result of being lifted by a hedge fund client, the ability to subsequently, perhaps even simultaneously, raise a borrow request to send to multiple lenders on the same screen becomes a powerful tool. With full integration, the need to book both trades in internal systems no longer exists, thereby saving time and all but eliminating the risk of booking errors and subsequently reducing fails along the settlement chain.

How important is integration into the wider technology ecosystem?

Long: It is vital. From my perspective, moving from a seat at a single lender to now speaking with multiple lenders across the street, it has been fascinating to see the range of technology deployed and also the disparity between the sophistication of each of their internal technology stacks. One thing that has become evident is that even where a given lender has a highly automated process for managing incoming requests, they can only solve for their side of the equation. If the borrower is still manually booking their side of the trade, then the benefits of full operational efficiency cannot be realised — this is where GLMX fits into the picture. To this end, we have already integrated several participants on both the lender and borrower side, with plenty more working through this as we speak. We have been working with a whole host of vendors to help accelerate this process too, meaning GLMX clients get plug and play benefits.

Patel: The connectivity into the vendor ecosystem was the key to the rapid growth phase in repo, especially when there was a critical mass with full lifecycle integration. Anecdotally, we heard from our clients that their operations teams were saving hours each day as breaks were virtually eliminated. This also reduced the need for separate post-trade matching.

What are your predictions for 2024?

Patel: I am bullish that the rapid progress we have seen in the repo space will translate to the securities lending arena. It is clear from my conversations with the borrower community that there is a desire to bring the range of workflow tools they enjoy when interacting with their repo clients to their dealings with the lenders. Right now, there is a bifurcation of experiences which is an increasingly glaring difference!

Long: The pace of change will accelerate. Regulation is focusing minds once again and, together with a growing desire to electronify more of the flow for efficiency reasons, this will act as a catalyst for the securities lending market to adopt and extend innovative new technology solutions such as those offered by GLMX.

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

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The move to T+1: short-term pain will lead to gain for securities lending

Firms already operating in an STP environment are well positioned for the shift to a shorter settlement cycle, according to Ryan Barrett, head of securities finance, North America at Northern Trust, who breaks down how market participants can best prepare for the transition

The May 2024 transition to T+1 in North America will have a significant impact on a wide range of financial services functions and products. With this shift, securities and cash transactions will settle within one business day after trade-date versus the current two-day standard. This will have the benefit of increasing market efficiencies and reducing settlement and counterparty risk. However, industry participants need to be prepared for the changes to daily trading functions that will likely result.

For securities lending programmes in particular, T+1 will create an immediate need for streamlined processing. The most poignant example of this is when securities on loan need to be returned to meet sale obligations that fund purchases. Timely notification, standardised communication and efficient collateral management are of paramount importance. Facing a shorter settlement window means market participants will have to expedite their processes, including establishing earlier instruction deadlines and intraday trade notifications, to improve their efficiency.

As market participants grapple with this shortened timeline, those that currently operate in a straight-through processing (STP) environment are well positioned because they have automated systems that allow data to flow between multiple parties. Those that do not may struggle with the shortened settlement window and will need to quickly ramp up their automation, either by making changes to their systems or by working with providers that already operate in a straight-through environment. These short-term pains can lead to efficiency gains that help market participants reap the benefits of T+1.

The impact on securities lending

The securities lending industry is anticipating unique challenges as it transitions to T+1. The shift means that borrowers and lenders will have to shorten notification timeframes to process transactions within hours instead of days. For example, the current cut-off time for recalls is up to 15:00 Eastern Time on trade date + 1, but this will be incompatible with the compressed settlement cycle. It will be important for investment managers to relay sale notifications as close to market execution as possible so that, in the case of recalls, the recall due date and contractual settlement date align. Without timely sale notifications, there is a risk of delay or settlement failure, which can have financial consequences.

Communications standards will go a long way in easing the transition to T+1. Establishing industry standards for recalls, for example, would cater to the needs of lenders and borrowers. This means agreeing on cut-off times, across different time zones, and receiving more real-time information to complete multiple automated security recalls within a single day.

The shift to T+1 also puts collateral management under the spotlight as borrowers may be required to put up collateral more quickly to meet margin and settlement requirements. Market participants with automated collateral management systems will more easily adapt to the shortened timelines, with access to more efficient processing and improved data tracking.

While the transition to T+1 may create short-term pains for securities lending, the shortened settlement window has the potential to create long-term gains. First, the shift to T+1 is driving industry wide automation, improved communication standards and heightened use of technology to help minimise challenges. This will make markets more efficient to better serve investors.

Second, T+1 may drive counterparties to consider securities lending to source securities to meet a compressed settlement window, increasing securities lending volumes. Finally, the shift may alleviate associated market risk, since the time one party is exposed to counterparty risk will be shorter than before, therefore reducing the potential exposure to a default or other adverse events.

How to prepare for T+1

The goal of T+1 is to create a more efficient market environment by enabling more thorough STP. Improving automation and communicating more efficiently will be of the utmost importance for a smooth and successful transition.

As the shift to T+1 nears, it may be helpful for market participants to review their preparedness — the following questions are important to consider.

Considerations for beneficial owners via their investment managers:

- Do you operate in a straight-through processing environment when instructing trades?
- Have you considered any technology upgrades to meet the

condensed settlement window?
- Is your sale notification process automated and aligned with trade execution?
- Have you assessed the impact of T+1 on your liquidity management?

Considerations for borrowers:
- Does your securities lending programme utilise automated processes?
- Is your recall communication process automated?
- Do you operate in a straight-through processing environment for recalls?
- Have you considered any technology upgrades to meet the condensed settlement window?
- Have you assessed the impact of T+1 on your liquidity management?
- Are you prepared to provide collateral more quickly?
- Are you currently using a service provider to manage non-cash collateral?

If the answer is 'no' to any of these questions, market participants should seek to improve their processes and technology or find a service provider that can help them to automate more quickly. For instance, borrowers that manually manage their non-cash collateral will benefit from automated collateral management capabilities. In addition, it is vital for market participants to assess the efficiency of their middle and back-office procedures as they undergo the shift to T+1 since the success of securities lending is dependent on timely notification and accurate communication. A service provider with efficient investment operations that is prepared for the changing market environment will be best suited for this transition.

Embracing automation

The move to T+1 is quickly approaching, and market participants need to adapt to ensure they are prepared. It will be critical for post-trade processes to be timely and automated, considering the significant narrowing of the window between trade communication and settlement. T+1 will reconfigure a number of the ways the securities lending market operates, leading to short-term pain — but participants in securities lending programmes will ultimately gain from the improved efficiency and increased automation that will result.

"T+1 will reconfigure a number of the ways the securities lending market operates, leading to short-term pain."

Ryan Barrett
Head of securities finance, North America
Northern Trust

Xceptor

Industry sentiment survey:
Digitisation of unstructured data

This six minute survey focuses on crucial themes: challenges in implementing automation technology, hurdles in adopting AI/machine learning tech, and difficulties in managing unstructured data.

We would really appreciate your time in answering this short survey.

Transparency works both ways — is 10c-1a the wrong type of transparency?

Rule 10c-1a will increase transparency in the US securities lending market but not necessarily in the ways everyone wants or anticipates, says Broadridge's Martin Walker, head of product management at SFCM, and Valarie Thorgerson, senior director of product management

A chief data officer at a bank once told us she was going to create a data lake, where data scientists could use data goggles to look for insights. This may sound like the worst of management speak and the proposed data lake project may have been a failure, but it did contain a genuine insight. Simply having more data does not guarantee better decision making. The data needs to be in a usable format and those using the data need to understand the context of the data to use it effectively.

The Securities and Exchange Commission (SEC) has been very clear about its objectives in introducing the compulsory reporting of securities lending transactions under Rule 10c-1a. It sees an urgent need to improve transparency in securities lending.

"The gaps in securities lending data render it difficult for end borrowers and lenders alike to ascertain market conditions and to know whether the terms that they receive are consistent with market conditions. These gaps also impact the ability of the Commission, registered national securities associations (RNSAs) and other self-regulatory organisations (SROs), and other Federal financial regulators, to oversee transactions that are vital to fair, orderly and efficient markets.”

The European Union’s equivalent rule, the Securities Financing Transactions Regulation (SFTR) mentions transparency 31 times. The final version of the SEC’s equivalent rule, 10c-1a, mentions transparency 353 times.

However, some market participants still claim that 10c-1a may introduce the “wrong type of transparency”. Different loans for the same security booked at the same time can have significantly different rates for a variety of reasons. These include the credit rating of the lender, the type of collateral provided, the stability of supply (i.e. the tendency of the lender to recall securities) and efficiency of the parties’ operational processes. Context is very important to make sense of market data in an area such as securities lending.

The lessons from SFTR

In terms of increasing transparency, SFTR has arguably been, if not a failure, a grave disappointment. Though reporting under SFTR started in 2020, it has so far had little impact on transparency in the EU and UK securities finance markets. Data quality for SFTR is a major issue as unusable data certainly would be the wrong type of transparency. Anecdotal evidence suggests regulators can make little use of the data. An analysis performed last year by regulatory reporting consultants Kaizen stated:

“Our SFTR testing experience indicates that there is a sea of price unit errors, haircut issues, incorrect quantity, incorrect price, incorrect type, under-reporting (collateral, re-use, cash reinvestment and funding sources) among a litany of other errors. On top of that, many aspects of SFTR remain only partially defined or undefined, such that the resultant data is of dubious value, full of uncertainty and contradiction.”

The reporting rules imposed under SFTR are inherently harder to comply with than those under 10c-1a. Up to 155 fields have to be reported for each trade and trade event. Both parties to a trade have to report it, leading to reconciliation issues. In comparison, a much higher degree of pragmatism went into drafting 10c-1a. For one thing, only 12 core data points are required. Sometimes less really is more because the dozen fields required by the SEC are the fundamental trade fields. The SEC, as explained at length in the final version of the rule, took on board much of the industry feedback, notably moving to end of day reporting and dropping requirements that would have been impossible to meet with existing infrastructure.

Comparison to existing market data sources

Some vendors already provide market data on an intraday basis, though the SEC in general has been critical of the completeness and accuracy of data provided by vendors.

“...currently available data on the securities lending market are incomplete, as private vendors do not have access to pricing information that reflects all transactions. This, in part, reflects the voluntary submission of transaction information by subscribers to vendors and is compounded by the uncertain comparability of data due to, among other things, the variability of the transaction terms disseminated, as well as how those terms are defined.”

Most data vendors providing market data available intraday do so at an additional cost. Firms willing to pay the extra costs and potentially source market data from multiple data vendors already have a more timely set of data than what will be available from 10c-1a. Even if it is less complete.

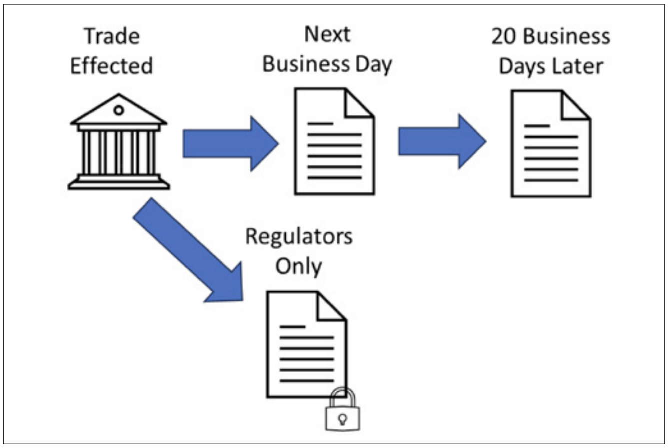
The regulation requires the relevant RNSAs to release the following data by the morning of the business day after the trade is effected:

1. the unique trade identifier (UTI) assigned to a covered securities loan by RNSA
2. the security identifier
3. all other data elements, except for the loan amount
4. aggregate transaction activity and the distribution of rates among loans and lenders (distribution of loan rates) for each reportable security

The RNSA is also required to make publicly available any modification to the data elements, except for modification to the loan amount, on the morning of the first business day following the modification.

Twenty business days after the loan is effected, the RNSA must release the securities quantities for each of the trades. This is to avoid releasing too much information about the trading positions of short sellers that have borrowed stock to cover shorts.

Fig 1: Release of trade data collected under 10c-1a



Certain data elements are only available to regulators and SROs, including:

1. the legal names of the parties to the loan
2. when the lender is a broker-dealer, whether the security is loaned from the broker-dealer's inventory
3. whether the loan will be used to close out a fail within the scope of Rule 204 of Regulation SHO or whether the loan is being used to close out a fail outside the scope of Regulation SHO

Note: There will be many times where the lender will never know if the loaned positions were due to Regulation SHO or fails on the receiving (borrower) side.

The time delays in disclosing data means that some of the larger firms are likely to continue paying for intraday data. The playing field will not be completely levelled for all participants and 10c-1a will not contribute to speeding up the overall operation of the securities lending market. The securities lending world will still be a long way behind the US cash equities market, which has the consolidated tape — a high-speed, electronic system that reports the latest price and volume data on sales of exchange-listed stocks.

Perhaps the securities lending market will never reach that level of transparency unless compulsory clearing, standardised collateral and fixed term trades remove the variables that can lead to different rates being agreed for the same security by different counterparties.

Impact of transparency

10c-1a will mean that beneficial owners of stocks, whether they lend through an agent or via a fully paid lending programme, will get an indication of how well their agents or brokers are working on their behalf. Those beneficial owners directly lending their securities will be able to see how the rates they receive compare to the market levels. In designing the regulation, the SEC has considered the context problem, raised by "wrong type of transparency" critics. One of the key pieces of data that will be made publicly available on the morning after trades is a distribution of loan rates, i.e. the range of rates for a given security. The SEC explained why in their final version of the rule:

"Information about the distribution of loan rates recognises that the cost-to-borrow securities can be influenced by a number of factors and can give market participants information to help compare the pricing of their loan against other loans."

Perhaps this is not the perfect solution to the context problem, but any lender will be able see how well they are being rewarded for lending out their stocks, even taking into consideration other factors that can influence rates — are they receiving average returns? Above average or below average? This will inevitably lead to some difficult conversations and, if the SEC's intentions are fulfilled, a more competitive market.

There is a potential downside to beneficial owners, since for many securities there is already an oversupply for lending purposes. Will agent lenders become choosier about who they add to their lending programmes? Beneficial owners may benefit from more keenly priced specials but lose revenue on other securities.

Another area where the drive for transparency may have an impact is from the data fields that will not be publicly released — notably the source of lent securities and the relation between lending activity, Regulation SHO and fails. Providing this type of information accurately and in a timely manner will require a joined-up system infrastructure that ideally integrates trading, inventory management and fails management.

Even with end of the day reporting deadlines, manual processes that integrate these types of data are likely to be impractical. Though the temptation will be to simply try to achieve compliance with 10c-1a by investing in trade reporting infrastructure, a wiser investment would be initially to look at their overall set of systems and business processes related to generating the complete set of data that needs to be reported. Getting those right, and providing transparency to regulators, should be relatively painless. If participants start trade reporting with unresolved issues in these areas, it really could turn into the wrong kind of transparency.

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Catching up with South Africa

SASLA chairperson Michael Wright speaks to Carmella Haswell ahead of the Association's annual Securities Finance and Collateral Management conference, where he explores the Association's evolution and how the group is working to open up the South African market

Michael, having been with SASLA for almost two decades, how have you seen the Association evolve over this time?

SASLA started in the 1990s as the Securities Finance Committee within the Banking Association of South Africa (BASA). Four large local banks and a few local branches of international banks were the founding members on the committee. New members joined the committee as the product expanded in the South African markets. The members were from various sectors of the financial market, including brokers, exchanges, central securities depositories (CSDs), asset managers and pension funds.

Eventually there were more non-banking members than banking members and the decision was made that we needed to create a separate association to look after all interests in the securities lending market. BASA retained a permanent non-voting seat on the SALSA executive committee with the Johannesburg Stock Exchange (JSE) and Strate. Today, SASLA has more than 20 members, comprising banks, insurance companies, pension funds, asset managers and service providers.

How are advancements within the securities finance industry shaping the attitudes of market participants in South Africa?

The Global Financial Crisis highlighted several shortcomings in the policies and practices of both financial institutions and regulators. In response to these shortcomings, the financial authorities initiated regulatory reforms in several areas to increase the resilience of the financial system. These reforms contributed to significant change in the equity securities lending markets internationally, and for the South African market.

At a high level, these reforms had implications in three main areas: the transparency of the securities lending market and participants' risk management practices; the cost of intermediation in the lending market; and the management of collateral.

With market participants witnessing an increase in demand domestically and abroad for securities financing activities in South Africa, how is the Association helping to open the market to foreign investors?

The limitation on accepting non-rand securities as collateral has made the onshore market less attractive to offshore clients. This restriction is still in force, with between 40 per cent to 50 per cent of the ZAR market being traded offshore. The industry has been in discussions with regulators regarding potential relaxation of some of these restrictions on non-rand collateral. The adoption of a global triparty system has the potential to address some of these challenges and contribute to the market's further development.

With one month to go until SASLA's Securities Finance and Collateral Management Conference, what can delegates expect from the event?

The SASLA Conference offers a chance to network with industry experts, discover the latest trends and innovations, and gain insights into the status of the securities lending market, as well as where it may be heading.

With expert keynote speakers, interactive panel discussions led by industry peers and networking opportunities, we will be tackling some of the more pertinent topics impacting the securities lending market in South Africa.

What will be the key talking points among speakers at the event? What are you most looking forward to at the conference in February?

The two main themes of the conference are diversity in the industry and the ability to adapt to survive in the digital age. In saying that, the key issue in the market at the moment is collateral management and the need to unlock liquidity through securities lending and repo.

I am looking forward to our guest speakers. We have managed to secure some amazing speakers from outside of the industry that will talk to the themes of the conference. The Association has also secured, as our keynote speaker, one of South Africa's top-rated economists, Goolam Ballim, the chief economist for Standard Bank Group.

Michael Wright
Chairperson
SASLA

Short selling in the Philippines: regulations, opportunities and challenges

Nearly three decades after short selling was initially proposed, Sophie Downes explores the impact of the new guidelines on the Philippines stock market and why the time is finally right

“Short selling is integral for securities lending,” says Hannah Nunez, head of financing and securities services for the Philippines at Standard Chartered.

Be that as it may, the introduction of short selling has been a protracted process for the Philippines Stock Exchange (PSE). First proposed in 1996, the move has been beset by regulatory changes, Covid-19 and multiple revisions from market participants. As a result, the immediate implementation of short selling on 6 November 2023 marked an eagerly anticipated development in the Philippine market. Nunez believes revisions between the local market and policymakers were necessary for improving the current equities landscape. In contrast to previous iterations, the short selling guidelines include enhancements such as allowing offshore collateral, and a lending agency service through the depository.

The guidelines, published by the PSE and subject to the advice of the Securities and Exchange Commission (SEC), the securities market regulator, demonstrate the conservative manner in which the PSE is adopting short selling. These allow short selling for 52 stocks and one exchange-traded fund, along with select equities from the PSE MidCap and PSE Dividend Yield Index constituents. The guidelines also include further stipulations to ensure fair practice, including the application of the uptick rule and conditions about who can trade.

Under the uptick rule, the last trade price of a stock has to be higher than its previous trade price to be shorted. This prevents the price of a declining stock being driven down even further. Moreover, in a bid to prohibit ‘naked’ short selling, the SEC has set out clear guidelines about the format and wording used to record securities borrowing and lending (SBL) in legislation. A depository participant that transfers shares to another depository participant shall indicate ‘SBL Borrow – Short Selling’ or, for buyback transactions, ‘SBL Return – Short Selling’ in the depository’s system in a bid to increase transparency around transactions.

Similarly, trading participants must enter the short selling on behalf of their client, even if this client already has direct market access (DMA). The DMA client is allowed to trade on its own behalf if the trading participant verifies that they have borrowed the subject securities prior to the entry of any short selling order, and upon compliance with possible further requirements imposed by the SEC. Failure to comply with the new guidelines will result in penalties sanctioned by the PSE and, according to trading rules, may risk “restrict(ing) or prohibit(ing) short selling indefinitely or for such period as it may deem necessary or advisable for the protection of investors”.

The time is right

Timing was key in shaping the introduction of short selling to the Philippine markets. “There is never not a right time, but there are times that are going to be more optimal than others”, observes Stephen Howard, CEO of the Pan Asian Securities Lending Association (PASLA).

Against a backdrop of low volumes and valuations in equities in the Philippine market, there have been various discussions on necessary reforms, spanning foreign investments, taxation and a lack of robust facilities for stock borrows and shorting, among others. Nunez describes how “there was resounding support from policymakers to push reforms, and those that have been underway, such as SBL and short-selling, were prioritised and addressed”.

For Nunez, the question of timing comes down to the numerous revisions the PSE were subject to and she suggests that the guidelines were implemented as early as they could have been. “Efforts to improve and simplify guidelines took longer and had to be queued for regulatory approvals, which in some areas were subject to changes in existing laws,” she explains. These include approval for offshore collaterals for SBL transactions and the agency lending licence of the equities depository, which were only granted in 2023. The PSE also needed to ensure the operational readiness of the central depository, the Philippine Depository and Trust Corporation (PDTC), to participate in the short selling programme as a central lending agent.

For Howard, it was also crucial that the wider market was prepared. “When you look at the arc of progression of a capital market and equity capital market and its structure, there are certain component pieces that need to be in place.

“Looking at that arc of travel, now could be the opportunity for the Philippines to test that water and see how short selling it can be applied, with the aim of growing the market structure further.”

Market impact

So what impact can we expect on the market? For Howard, "it can only be constructive".

Indeed, a significant benefit of short selling is that it opens up new opportunities for hedge funds and traders. "By providing that market structure change, you are inviting different market participants to enter the Philippines market," says Howard.

Standard Chartered is one bank that has already seen increased interest from various participants. According to Nunez, the firm has been fielding queries from foreign market players on securities borrowing and lending, demonstrating a foreign interest both to borrow and to lend. She explains that "domestic real-money players such as insurance companies and asset managers have interest to lend stocks. SBL is primarily eyed to support facilitation of settlements and for hedging".

"There is never not a right time, but there are times that are going to be more optimal than others."

Howard is confident that the "sensible" approach that the PSE has adopted to the introduction of short selling is likely to protect against a proliferation of short-bias funds destabilising equities prices. "If you look at the range of investment strategies that can be conducted that use short selling as a part of their investment thesis, [this] is just one component piece of the portfolio," he says.

This may mitigate commonly held criticisms of short selling by those who believe it encourages opportunistic behaviour at the expense of the general market. APAC markets saw this play out in real time in November 2023, when South Korea reinstated a short-selling ban due to illicit trading practices by foreign firms. The framework issued by the PSE, particularly the application of the uptick rule, aims to mitigate potential market volatility in response to short selling.

While the new guidelines may precipitate greater activity, it will take some time to see a definitive impact on the market. Howard comments: "I do not expect a sudden surge in volume and activity, but what I would expect to see is a gradual progression of business activity, calibrated based on the underlying market liquidity."

With current market conditions reporting multi-year lows and a lack of liquidity, opportunities for short selling are not immediately available. Currently, there are no volumes reported on both facilities, except for the occasional stock borrow — mainly for the management of trade settlement fails. Instead, Howard argues that the region can expect a "gradual growth (in market liquidity) as it attracts new capital, new investors and supply is then brought into the market by other participants".

Looking forward

Both Nunez and Howard agree that the new guidelines are a source of optimism for the future of the Philippine stock market. While Nunez concedes that the current market conditions may not readily present opportunities for short selling, "the advantage is that the facility is now available to assist investors' trading strategies, and local discussions are ongoing to continue fine-tuning the mechanisms and guidelines and to ensure wider participation".

Standard Chartered believes that educating market participants may be a step in the right direction. "We are seeing ongoing discussions and seminars to help more local participants to be aware of the opportunities and requirements to engage in short selling and SBL transactions since their re-launch in late 2023," says Nunez.

For the PSE, short selling is only the beginning of further expansion in the Philippine market. Commenting on its plans for the future, PSE president and CEO Ramon Monzon says: "The exchange will continue to introduce new products and push for new laws and regulatory reforms that will promote and encourage wider stock market participation and entice foreign investors back into our market. We will likewise continue to pursue our various initiatives to help and attract companies to list their shares in the exchange."

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Govender joins VERMEG

VERMEG for Banking and Insurance Software has appointed Joshua Govender as business development lead for Africa.

Based in South Africa, Govender will expand VERMEG's footprint in the African region among the banking, capital markets and financial services sectors.

He will focus on collateral management and post trade, as well as VERMEG's industry solutions MEGARA, COLLINE and Digital offering - Fast Track.

Govender joins VERMEG from fraud detection platform Dark Pools AI/ML, where he was a director of business development.

Prior to this, he provided consultation services to ORG Corporate Solutions, and held a 15-year tenure at HSBC as director of prime finance for South Africa.

Commenting on the appointment, VERMEG says: "With over two decades of industry experience, Joshua's appointment marks a significant stride for VERMEG's expansion across the banking, capital markets and financial services sectors in South Africa and African regions."

Griffiths arrives at ISLA

The International Securities Lending Association (ISLA) has appointed Alistair Griffiths as director of business development.

In this newly created post, Griffiths will focus on strengthening relationships with ISLA's current member firms and developing partnerships to enhance ISLA's membership offering.

He will also be responsible for identifying new growth opportunities across the securities finance landscape and associated markets.

Griffiths brings extensive experience in securities lending from both a buy and sell side perspective. Previously, he was a director of EMEA sales at Baton, where he was responsible for growing the firm's solutions in the region.

Prior to Baton, Griffiths built experience across financial services, working at multiple institutions including BNY Mellon, BlackRock and UBS.

Haswani moves to HSBC

HSBC has appointed Bhavna Haswani as director of digital assets and currencies.

Based in Hong Kong, Haswani will focus on the firm's digital strategy, investigating business opportunities to move from traditional finance (TRAFI) into decentralised finance (DEFI).

She brings extensive experience in trading, quant analytics and product management, having held multiple senior positions across the APAC market.

Prior to HSBC, Haswani held a five-year tenure as vice president of J.P. Morgan.

Before this, she was an executive board member of the Pan Asian Securities Lending Association (PASLA) and was vice president of BNY Mellon between 2015 and 2018.


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Deutsche Bank selects Vento

Deutsche Bank has appointed Brett Vento as product business development lead within its agency securities lending team.

Based in New York, he will report to Vikas Nigam, head of Americas, agency securities lending, and to Paul Fahy, head of agency securities lending product and EMEA head of client management.

Previously, Vento was a senior fixed income trader for securities lending at Wells Fargo, where he held a 17-year tenure with the financial services company.

Prior to this, he acted as an operations analyst at Credit Suisse during his five years with the firm.

Jarvis joins Sharegain

Global capital markets fintech Sharegain has appointed Stuart Jarvis as head of strategic partnerships.

Based in London, he brings more than 25 years of prime brokerage and agency lending experience to the role.

He joins the firm from a 16-year tenure at Citi, where he ran both trading and sales trading teams within Citi's prime and delta one businesses.

Most recently, Jarvis led Citi's agency lending and collateral business for EMEA.

With three decades of experience within the financial services sector, including commodities and private wealth, Jarvis also held positions at Goldman Sachs and Barclays Capital.

Commenting on his new appointment, Jarvis says: "I had the privilege of working with the Sharegain team during my former role at Citi and have been tremendously impressed by their solution, but moreover by their unique culture and big vision.

"I look forward to leveraging my experience and network to forge and deepen strategic partnerships that will propel Sharegain to new heights."

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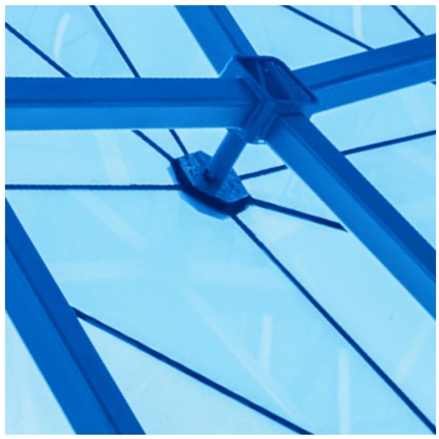

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