Technology takeover

Jerry Friedhoff, managing director of securities finance and collateral management of Broadridge, talks regulatory changes and emerging technologies

What regulatory changes are currently impacting the industry?

The Securities Financing Transactions Regulation (SFTR) is currently high up on priority lists, along with Central Securities Depositories Regulation (CSDR) and Brexit in Europe. We also expect to see additional securities finance trade reporting mandates in other regions once SFTR is behind us. In the US, Regulation Rule SHO204 is a real concern that many brokers are seeking to address.

A recent International Securities Lending Association (ISLA) market report suggests that high-quality liquid assets (HQLA) driven trades remain prevalent due to liquidity coverage ratio needs and the slowing of quantitative easing (QE). As more firms fall under the uncleared margin rules in 2020, the role of securities finance in sourcing larger quantities of high-quality collateral should also become more prominent. The International Swaps and Derivatives Association (ISDA) is currently lobbying to reduce the number of firms that will need to exchange bilateral initial margin. The amount of additional collateral required could, therefore, vary widely if this is successful.

In the repo markets, firms are evaluating their front-office trading tools to manage the complexity of increasing electronic trading and fragmented liquidity. This is linked to a broader role for repo in managing balance sheet, liquidity and capital, along with centralising the sources and uses of collateral across financing and margin-based activities.

Are you seeing new or different types of market participants, services and routes to market emerging in the industry?

On the buy side, more beneficial owners are recognising the benefits of securities finance. We are seeing a trend for some of the more active participants to consider lending directly and in some cases, setting up in-house stock loan and repo desks.

This is largely driven by a growing awareness of the alpha generation opportunities provided by financing their assets. A desire for greater control over collateral and the value of central collateral desks is also a key factor for the buy side, as firms look at how to adapt to central clearing of derivatives and uncleared margin reform.

We are also seeing new sources of supply coming to market through clients engaging in fully paid lending in North America to unlock retail inventory in brokerage accounts. Likewise, in Europe, the provision of lending services to a wider market of investors is a trend to watch. More firms are seeking to add new revenue streams to their securities lending activities by reaching further into their relationships with retail/institutional clients and the assets they control.

How will new technologies affect the industry?

The impact of disruptive technologies such as blockchain and artificial intelligence (AI) is a topic for discussion at every industry conference right now. There is a growing understanding of these technologies in the market and various pilots, use cases and production ready systems are also emerging. However, we have not yet reached a tipping point in terms of widespread adoption. Electronic peer to peer/all to all markets and, in some cases based on blockchain platforms, are another area where innovation in market structure and technology is taking place.

There is a more general trend for firms to look at ways to reduce their IT costs. They're evaluating existing technology stacks and replacing ageing legacy solutions with a more modern front to back single system approach. This allows them to meet the new demands of the market environment while lowering total cost of ownership. This includes an increasing preference for vendor-hosted solutions as cloud and software as a service (SaaS) models become more widely accepted.

How are you helping clients adapt to regulatory trends?

The acquisition of 4sight and Anetics in 2016 has greatly enhanced Broadridge's global front to back securities lending, repo and collateral solutions and increased our ability to help clients adapt to the changing environment.

Firstly, in Europe, we are working closely with customers to help them prepare for SFTR. Broadridge has in-depth expertise in both securities finance and trade reporting regimes such as European Market Infrastructure Regulation (EMIR), the first and second Markets in Financial Instruments Directive (MiFID I/II), and the US Commodity Futures Trading Commission (CFTC). This will enable clients to adapt to SFTR smoothly while minimising operational disruption and reducing the resource impact of complying with multiple concurrent reporting mandates.

From a CSDR perspective, helping clients to minimise the impact of settlement fails and mandatory buy-ins through the use of technology is also a key priority for Broadridge.

In terms of the buy side, we recently implemented our front to back office securities lending solution at both a large European investment manager and a sovereign wealth fund that both set up internal lending desks. We are seeing interest in this model from others, although it is not for everyone. Many beneficial owners continue to place a high value on the services provided by their lending agents and the indemnification they receive.

In the US, a large broker-dealer went live with our RegSHO 204 solution last month. This resulted in reduced regulatory risk and significantly less manual effort required to maintain RegSHO 204 compliance for the client.

In the repo space, we are seeing an uptake in our repo order quote market aggregation and execution solution. One of Europe's top 15 largest banks recently went live with the product, and more are in the pipeline as firms seek to maximise trading opportunities and make sense of increasingly complex data with the latest trading tools.

What's next for Broadridge in terms of emerging technologies such as blockchain and AI?

Broadridge has been actively investing in emerging technologies. We recently conducted a blockchain pilot with Natixis and Societe Generale to transact bilateral repo and found the solution resulted in several operational efficiencies and a more streamlined process. In the securities finance industry, there is still widespread debate over the benefits of blockchain versus the current market infrastructure and there are pros and cons to either side of the argument. While there are a number of hurdles that must be overcome, we expect to see more blockchain-based platforms appear over time.

With regards to AI, there are myriad use cases for these technologies such as trading automation and decision support, collateral optimisation and streamlining back-office processes. We believe AI has the potential to greatly benefit the industry and our clients in the long term. We are therefore actively investing in AI, including machine learning (ML) and robotic process automation (RPA) to assess where we can combine ML and RPA to drive benefits for our clients.

All of this means it is an exciting time for the industry. While we may not see a radical change in the next two years, in 10 years' time the market and technology landscape could look surprisingly different than what it looks like today.

In 2008, Google started its self-driving car project and the iPhone had recently launched. By 2018, Google's self-driving cars have clocked over two million miles and are being tested on the streets of major cities across the US and there are around two and a half billion smartphone users globally. Perhaps we will see similar leaps forward in the securities finance industry. **SLT**