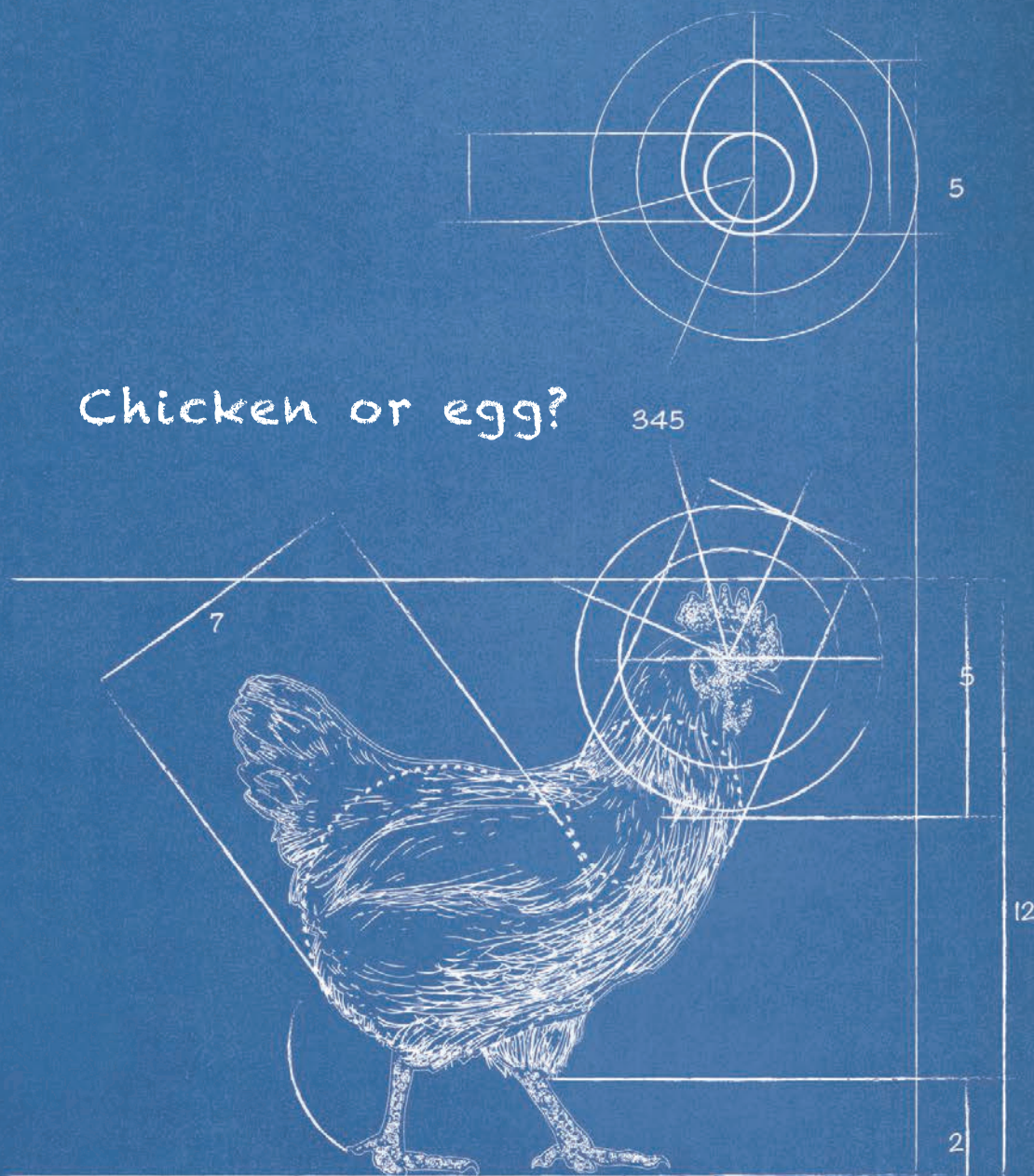


Chicken or egg?



Going global

4sight Financial Software director Edward Cockram and consultant Jérôme Cardon of make the case for a global market view of securities finance

The securities finance transaction (SFT) market, including securities lending and repo, is experiencing a rapid transformation that other, more mature, asset classes have experienced gradually—a transition to electronic markets.

Over-the-counter (OTC) by nature and strongly relationship-based because of the credit risk, SFTs have historically been conducted over the phone or via a broker.

However, several trends, natural or provoked by the recent onslaught of regulations, are driving a transition. They are:

- Regulatory and market pressures to show best execution.
- Technology advances have made the transition to electronic trading a more practical proposition.
- Centrally cleared markets allow netting benefits against a range of regulatory measures and have lower risk weights. These markets are often most easily accessed through electronic trading platforms.
- Firms can leverage centrally cleared markets accessed via electronic trading platforms to maximise operational efficiency gains from straight-through processing (STP).
- The movement towards centrally cleared electronic markets has caused a shift in liquidity to these platforms. In order to achieve best price, it is now essential to gain access to these markets.

The platforms themselves have responded to demand by broadening the product offerings and trading methods available on any given platform. For example, ICAP Brokertec has greatly increased its coverage of markets. These markets now span across most of Europe, overlapping with London Stock Exchange's MTS and Eurex's electronic solutions. A further example is EquiLend's Next Generation Trading (NGT) supporting a wider range of bidding processes in support of securities lending transactions.

This overlapping of liquidity channels increases the need to provide a coherent view on secured financing markets. A first step is the requirement to aggregate market quotes all together, in a single view.

This allows the secured financing professional to get a market-wide view on quote levels and sizes. Combined with a single real-time view of firm and client inventory, this provides a powerful tool for finding the best route to market for financing needs.

Most brokers and electronic markets provide sufficient functionality around displaying, creating and hitting/lifting of quotes. However, they are inevitably restricted to displaying the single market on which they are built.

Additionally, each of them have in-built idiosyncrasies, visibly inherited from their platform DNA. MTS, for example, is strongly influenced by its historical background in the cash bond markets, which is reflected in how the MTS market view shows pricing. Conversely, Brokertec displays its exchange-based background in the style of 'matching' incorporated into the platform.

The power of bringing the markets together in a single interface is that the user can now trade the best of all markets. This allows

us to introduce the concept of the Global Market View. This is the combined market as seen in the consolidation of activity across all secured financing markets.

A view on the global market allows the secured financing professional to review inside spread as well as size, increasing visible liquidity. This has important consequences. Regulations such as the Markets in Financial Instruments Directive II in Europe require improvements around demonstrating best execution and liquidity in funding markets.

Most activity in the secured financing markets occurs early in the morning or mid-afternoon as cut-offs loom. This often leaves the secured financing professional with limited time to scour the markets to assess levels and spot trends before executing. Therefore, any tools that provide global views across markets, and that can be prepared ahead of time, can aid in achieving best execution and reducing operational risks.

To further support these aims, combining with firm and client inventory can help to reduce the market noise. It allows the rapid assessment of the global market against only the inventory positions of which the firm currently has need.

For such a solution to be valid, however, it is vital that the user can be certain the market view is current and active, especially at the height of the trading day as quotes and orders move at a furious rate.

Added to this is a need to ensure that any allocations and settlements can and will be fulfilled in a timely manner, according to market conventions. Inventory views must update in real-time to keep the professional up to date as he/she trades. This requires being able to communicate directly with the central counterparts that will increasingly back up the marketplace, fulfilling orders and settling securities and cash as required. Otherwise, it requires checking credit limits with counterparts, ensuring that the trade stays within institutional credit policies before final execution is confirmed.

Where we are now

There are a few limited options out there currently that attempt to provide this global view on secured financing markets. Some focus on introducing broker quotes and providing them to their clientele. Others provide trading systems embedded with market views, bringing the global view right on to inventory and trading screens.

These are all-powerful solutions and provide huge added value for the user. However, most solutions remain isolated by product, focused on repo, securities lending or synthetic financing markets. But the lines continue to blur between these products with market participants increasingly willing to switch products to maximise their all-in return or provide best possible pricing. This means that demand for a cross-product view on global markets will only increase with time.

While still perhaps some way off, the day will come where a trader can get a single coherent view on all markets, whether electronic, voice brokered or direct to counterparts, across all secured financing

products. From there, they can achieve best execution and, importantly, demonstrate to clients that the firm has robust systems in place to achieve best execution.

Supporting this will also require the continued expansion of pre-trade analytics, assessing the all-in trade costs against the quoted levels prior to execution.

Getting there might be tough

There are several barriers to be breached before this view on the future is realised. The authors predict this will all be resolved, but it will take some time. The future of the real-time aggregated global market view is definitely a few years away.

Currently, there are few systems available that offer truly cross-product single solution software. While there is a tendency between the vendors to converge on the holistic solution, there is still some work yet to be done.

In addition, the markets themselves are evolving more rapidly than ever before. The providers of electronic markets are responding by improving their services as the underlying markets themselves adapt as a reaction to regulatory and financial pressures.

How the different models of the central counterparty of the future will look remains an unknown. As the efforts continue to find a solution that will allow both the buy and sell sides to be members of the same central counterparty, the changes required to the model could disrupt how the markets work. Technology budgets are constrained and more often than not absorbed by complying with more immediate regulatory requirements. Although most financial institutions can acknowledge the need, few have the spare budget or human capital to spend on the projects necessary to implement or build such a solution.

Many financial institutions are still at the stage of collating inventory or indeed the entire trading processes into a single space, a task that is often underestimated for its complexity and difficulty. While the benefits are typically worth the investment, it takes time to fully implement.

This is coupled with the need to improve pre- and post-trade analytics and transfer pricing to reflect the new regulatory regimes and their effects on resource pricing. While this can be developed in parallel, it often puts pressures on the very same resources required to implement a global market view.

Preparing for the future

However, just because you can't turn the key today doesn't mean we need to turn our backs on a global market view. Several important preparatory steps can be taken to make this outcome easier to achieve in the long run.

For a start, technology solutions must be product-type agnostic at their core. Even though important differences exist between different products, secured financing products share key common components that allow the professional to switch between them as required.

Systems must be able to collate firm-wide inventory. Attempts to optimise trading against partial inventory will lead to sub-optimal results.

Systems must also be able to execute trade flows from a single source. Whether using a single trading platform or providing for full integration between platforms, a global market view loses potency if execution is required to occur out of disparate platforms.

In addition, it is essential that settlement paths are organised around STP and are timely and efficient in order to meet the often tight timelines required by centrally cleared markets. Again, the global market view loses effectiveness if the user has to dissect the information into markets before execution, in order to be sure execution and settlement can occur before any deadlines.

Lastly, most institutions are still busy building out analytics and transfer pricing models that assess the effects of new regulations on firm resources. To support pre-trade analytics, these models must be able to estimate resource usage at the trade level, a simple sounding but confoundingly difficult task to complete.

To meet these needs, 4sight is releasing solutions for repo electronic markets and for EquiLend's NGT clients later in 2016. 4sight's ROQ (Repo Order and Quotation) module provides linkages to multiple electronic markets, allowing users to tailor their views, collate quotes from multiple markets into a single view and compare all of this to their inventory.

Although initially standalone from the work to support EquiLend NGT, reflecting client needs that currently remain diverged by product lines, the future will surely see the two merging. With the growth of offerings, such as in the synthetic financing space with the Options Clearing Corporation in the US, equity and fixed income derivative market views will surely follow. **SLT**

