

Pirum's Industry-led T+1 Webinar Episode 3 – Fixed Income & Repo

Jon Ford (0:21)

Welcome, folks, to our third of five-webinar series on T+1. I've got a great, great selection of guests today where we will be specifically talking about the fixed income financing markets. My name is Jon Ford. I'm the head of fixed income business at Pirum. And with that, we're going to launch into introductions with the team. We'll start with Scott.

Scott Schroenn (0:53)

Hi there, I'm Scott Schroenn. I'm from BNP Paribas. I represent our Global Markets business in public affairs and regulatory space. I have been mostly involved in post trade, and I have been the co-chair of the trading work stream for the EU T+1 task force most of this year.

Jon Ford (1:15)

Thank you, Scott. Alex.

Alexander Westphal (1:17)

Hi, Jon. Hi, everyone. Yes, Alex Westphal. I'm a senior director at ICMA and I'm heading our work on repo and collateral but also looking after our post-trade work more broadly. And there, of course, T+1 is a very big priority at the moment.

Jon Ford (1:38)

And lastly, Rickie.

Rickie Smith (1:41)

Hi Jon, yeah, Rickie Smith from J.P. Morgan. So I have product management within the trading services business at J.P. Morgan, predominantly focused on securities finance products, but also covering regulatory from a collateral perspective, as well as securities lending and repo.

Jon Ford (1:57)

Excellent. Welcome, gentlemen. Let's jump into it. Okay, Alex, from the ICMA perspective, you have been knee-deep in this stuff with tonnes of committees. Can you set the stage in terms of where we are now?

Alexander Westphal (2:14)

Yeah, sure. As I already mentioned, I mean, clearly T+1 at the moment is a really big priority for us. And that's been the case now for almost three years since that whole discussion kicked off in the UK in December 2022, triggered, of course, by the whole US discussion.

So, we're part of all the groups that have been established. First on the UK side, we have the Accelerated Settlement Task Force, and then similarly on the EU side, of course, where the discussion started much later. But equally, we've been very heavily involved. We're full members of the EU T+1 Industry Committee, which is kind of coordinating the whole transition work and also involved, of course, in the underlying work streams that have been established. And specifically, we provided the secretariat for two of those work streams, one is on trading and one is on SFTs, jointly there with ISLA, which has been a really big priority and has been keeping us very busy since then. Of course, that reflects that the whole initiative is a major, will be a major industry transformation.

Especially on the fixed income and SFT side. I would say that from the start, our members have been rather sceptical, mainly from an EU perspective, and we'll speak more about the complexities there. But we've certainly always cautioned not to underestimate the impact also compared to the US. And again, something we'll probably touch on.

What I would say is that the progress so far, especially on the EU side, has been really very encouraging and frankly to me, quite surprising. Obviously, that work started much later than in the UK. We've seen the industry committee was only established in January this year. And then within six months, the committee, along with all the work streams, produced the EU high-level roadmap. So that was published on the 30th of June. It's a really detailed document with lots of good recommendations.

And that's certainly quite an impressive achievement in that short time frame. And I definitely recommend the read. Again, I think it's quite clear if you look at the roadmap where the priorities are. From an SFT perspective, specifically, we contributed almost 30 recommendations to the report. They're pretty much scattered around the report, so they are not all limited to SFTs. But clearly that shows again how much focus and focused work went into this from an SFT perspective.

And then, I mean, the one thing I've been particularly impressed with and it's worth mentioning is really the involvement from the industry. You've seen hundreds of market practitioners involved in this whole work. So that's been really encouraging, and I think that's been really driving the work,

both on the UK side but also on the EU side, where we also have a really good representation from, I think, almost 20 associations. So that's all quite encouraging, despite all the challenges that of course remain, and we'll talk about that.

Jon Ford (5:56)

So, with regards to the recommendations made, I'll just kind of stroke these things out quickly, but PSETs, SSIs, automation of returns and recalls, particularly from the perspective of securities finance, real-time affirmation, inventory management, liquidity, which we'll talk about, and other really specific things like shaping auto borrow, et cetera.

From a BNP perspective, Scott, and you've done a lot of work around this too, what's your lens in terms of the breadth, the scope? And to a degree, obviously we've gone through this in the US, some lessons have been learned. There's a lot of discussion of how different Europe is, 27 CSDs, et cetera. What is your lens around the problem set?

Scott Schroenn (6:51)

Yeah. Well, I mean, I think the fragmented infrastructure is well trodden ground. We've spoken about that a lot. I mean, fundamentally, the key change and difference here versus the US market is Treasuries already on T+1 going back to 2017. So, they had a funding market already in place, well in advance of this that was well established, very liquid. We don't have that in Europe. When T+3 went to T+2, screen liquidity on repos stayed at T+2, which it already was before. So fundamentally, in addition to the fragmentation, funding is a big challenge.

In addition to that, lessons learned, I think we have some ongoing points from the US, which there's been some well-publicised and published reports from the likes of the Value Exchange and Firebrand, I think highlighting particular points of ongoing costs, I think FTE related to T+1 is up around 20%. Project costs post May 2024, when go live, still around 48% of firms still have costs ongoing. And that's not completely unexpected. You'd expect some optimisation. Some things would have been put together over the line, and maybe there's some enhancement going on.

But I think it also maybe highlights a lack of automation, which considering the fragmentation in Europe, is probably not a workable solution. We really need to enhance the industry and think about how we do this a bit differently to make sure we not only meet the minimum, but actually enhance Europe, that we're not just keeping settlements as they are now in terms of efficiency, but actually looking a bit deeper and trying to automate and making this industry not future proof, but more agile and ready for growth to fund the European market.

Jon Ford (9:01)

Certainly from my perspective, in terms of working on automation within the SFT space, I think there's a fairly decent understanding that fixed income is slightly behind the equity markets in trying to catch up.

Rickie, from your perspective, obviously from a global lender, the velocity of collateral cross borders, you guys move a lot of collateral from Europe to Asia, US to Europe. What's your unique lens from the lending perspective?

Rickie Smith (9:43)

Yeah. Yeah, thanks, Jon. I think so, from a securities lending ecosystem side of things, I think what we've got here is a highly sort of interconnected network between the agent lenders, the borrowers, the underlying beneficial owners, with the agent lenders really acting as that bridge in between the borrowers and the beneficial owners. But that complexity definitely gets amplified, I think, as we sort of move to look to coordinate better across those different time zones.

I think if you think of it from a few perspectives, you've got the sort of time zone compression almost that you'd see on the settlement timing side of things, where we've got desks that trade globally in global locations, but aligning cut-off times and ensuring the timely settlement of those trades is increasingly difficult when you've got a model like that, especially as we move to sort of more T+1.

And I think some of the points that Scott mentioned upon manual processes, now most counterparts still do rely on a lot of manual processes within their automation or within their workflows they need to look at from an automation perspective. And that's affirmation, recalls, those types of things and returns even. And even on the loan side of things, I mean, that will only increase the risk of settlement fails that we've seen and operational bottlenecks created.

And I think where Europe is even more complicated than the US is with regards to the settlement discipline regime, you've got that added incremental cost of CSDR penalties. I know the regulators have said, when this initially comes in, there'll be a pause on the penalties just to see how the processing and settlement embeds. I think that's sort of a key challenge.

And then on the collateral side, from an inventory management, you need to have real time availability of data, know where your inventory is and be able to position yourselves. Because I think what happens is here, if you don't have effective control, therefore, over your inventory, you're going to, in these sorts of fragmented systems and different data flows, that's going to really hinder the effectiveness of the T+1 settlement.

And then really, sort of the last thing we see is the communication side of things, ensuring that communication between all parties, particularly within the recalls process, getting those sale notifications to your agent lender as quickly, as quick to trade as possible, and then being able to recall back to the borrower within the prescribed time frames that are set out in the sort of best practices. They're going to be the sort of more, I suppose they're the vital elements perceived within securities lending space.

Scott Schroenn (12:10)

I just wanted to jump in there. Just one quick point of clarification. I wholeheartedly agree with everything you said, Rickie.

One point I would make is that EU authorities haven't stipulated any time frame for a suspension of penalties. They've only given themselves the ability to suspend in specific scenarios, which have yet to be defined. We just want to make sure there's expectations there is that no one's expecting a CSDR temporary suspension. Just very quick point on that.

Jon Ford (12:40)

I would also add that at least a lot of, if not the majority of the firms that we speak to, CSDR penalties are one cost in the process. Going to Treasury late in the day with cap in hand to borrow cash at today's rates is probably the bigger cost, not to suggest that we're going to see a massive escalation in fails as we integrate, but clearly the risk is there.

And I guess it's worth mentioning that, and Alex, from your regulatory hat, SBL is actually exempt from the regulation, but that really doesn't mean anything, right? Because the cash markets are going to dictate the flows that we in the financing space are basically beholden to.

Anything to comment around that?

Alexander Westphal (13:35)

No, that's definitely an important point to note, Jon. It's been far more discussion around this than we would have hoped around the SFT exemption. So that was an advocacy point we brought to the table quite early on and it has caused quite a lot of discussion. But as you say, it doesn't really change anything in terms of the market impacts on SFTs, given their role in terms of supporting cash market activity.

It was more a point around providing some flexibility for SFTs and, for example, allowing, continuing to allow trading of forward-dated SFTs on platform. So yeah, that's been far more discussion than warranted.

Perhaps also to note on the scope more broadly, there's an interesting mix that we have with T+1, this mix between regulatory compulsion and market practice and that I think is sometimes a bit misunderstood. So, the lines are quite blurred. If you look at the T+1 rule itself, there is some inherent flexibility there. The rule specifically applies to trades executed on a UK or EU trading platform and settled in a UK or EU CSD.

And then there are some exemptions in addition to that. We mentioned SFTs, but also some other trades that are not strictly OTC are exempted. But that doesn't, again, it doesn't change

really the market impact because it is a broad move wherever that gap arises, then market practice comes in. And the same applies equally to all the recommendations that we're putting together. Some of those will be regulatory requirements as imposed by ESMA. Some others will purely remain kind of market practice. So, it's an interesting mix, the whole initiative and something that is sometimes a bit misunderstood.

Jon Ford (15:51)

And actually, yeah, sorry, Scott.

Scott Schroenn (15:53)

I was just going to say, just to add to that, Alex, I think just to hammer that home a little bit, when there's an exemption in CSDR Article 5 for securities lending, but that doesn't mean and shouldn't be confused with Rickie's point on penalties. CSDR cash penalties will still apply because they are based on intended settlement date and not the exemption under Article 5.

So, to be very clear, you will still be liable for penalties. You're still obligated on the new changes in the new RTS on settlement discipline to provide instructions by 11, to provide allocations and confirmations by 11 PM if that RTS is passed. So, let's not confuse scope of the settlement on T+1 with any of the other recommendations, all of those will still apply to securities finance transactions.

Jon Ford (16:50)

Great point. Thank you for that, Scott. And I guess we talk about the burden and the task ahead, but there are some benefits here, right?

I mean, clearly, clearly, we're doing this for a specific reason. Alex, I mean, obviously, the regulators have been fairly vocal, but so have, I think, a lot of the folks that have done analysis around this. Can you speak to some of the benefits?

Alexander Westphal (17:20)

Yeah, I mean, I think on the US side, there's been quite a lot of discussion around it. The benefits in terms of the reduction of risk was always mentioned, the benefits in terms of reduction then resulting of margin requirements.

On the EU side, it's interesting. I would like to be positive, but we've never really dug, let's say, into the details of the cost-benefit analysis. That's been something that we pushed for in the beginning, but then really we were a bit overtaken by the reality of the decision. So that decision

for T+1 was eventually taken and then the kind of the focus switched a bit away from this cost-benefit analysis. There was some analysis in fairness that was done by ESMA on both costs and benefits.

It wasn't particularly conclusive on the benefits, but I think the one point, and I think Scott alluded to that in the beginning, that is important to highlight. I mean, the decision has been taken. We will move to T+1. And I think where the real benefits will be is in terms of what we make of that.

So, if this in the end leads to a more efficient post-trade setup and pushes automation and more generally post-trade efficiency, then I think that will be the big success of T+1 ultimately. But of course, to get there, a lot of work needs to be done, and that's exactly what we're now focused on.

Jon Ford (19:10)

And from a J.P. perspective, do you guys talk about the benefits, Rickie, or is it just like, oh my God, this is such a heavy lift? Does that come up?

Rickie Smith (19:21)

Yeah, no, I think getting access to more real-time data and making that more readily available to different, to all the parts and facets of the business, to our clients as well, but also to our trading desks and operations teams. I think we're looking at it from a, what do we currently do after the trade has happened that we can potentially do before the trade actually gets struck, where we can minimise those breaks that happen after the point. And we're seeing the benefits there around, it comes back to the point Alex mentioned about this regulation is effectively driving those automation changes that we're looking to make and gives us a really good sort of going into the investment planning season to lock in funding for next year, some good key things that we want to really be hitting and delivering to the business, which will, in a T+2 scenario, would offer great benefits, but T+1 makes it critical that they do happen next year.

And so that's really where we see the main benefits. Yeah, and leading, hopefully, as we say, to a more efficient settlement space within the post trade.

Jon Ford (20:26)

100%. I think that's probably the most obvious objective in the long game of this whole exercise is really to introduce more automation and less friction in terms of the movement of collateral.

Just pivoting. So, we've talked about this prior, but we used our internal data and just looked at what the settlement cycles are currently within the repo and the SFT space. Not surprisingly, but there is some interesting stuff.

So, in terms of European repo in euro, 80% of the settlements are T+2, whereas largely in sterling and dollars, T+1 or T+0. And then related to the euro repo, euro SFT activity, the majority of that is T+1.

So, the way I think about it is if I'm lending a security out to a hedge fund, and then I'm turning around and borrowing it from a lender, the first action is that hedge fund shorting the stock or bond, feeding that to the prime broker. Again, that process can take minutes, if not hours. Then that gets to the financing desk at the hedge fund, who then goes to the financing desk at the bank. They process that, and then you're looking at your collateral stack, and then you're going to your lenders to cover shorts and maybe upgrade your collateral. So, it really speaks to the fact that this cycle is really going to get short.

And I think, Alex, some of the ERCC work suggests at least 25 percent of the European market's going to go T+0, which obviously has impact on how you're managing intraday liquidity from a bank's perspective, from a lender's perspective how quickly you can process, and from a repo desk perspective, how nimble you are in terms of visibility of collateral. But perhaps, Scott, I know we've talked about this from the intraday liquidity perspective, how's a bank like yourselves viewing this?

Scott Schroenn (22:46)

It's very difficult because the estimates from ERCC and the work we've done are very interesting, but we simply don't know how much shift there will be because a lot of the transactions, a significant portion of the repo market is based on rolls. So, at times, there's potentially no real justification for parts of the market's movement. I mean, you have that funding available, but it may settle on a T+1 basis, those rolls now versus T+2. So, you have to find additional sources of liquidity to maintain what you currently have in terms of those rolls, which at times may mean you have to tap into your credit line.

So, if you, the estimate you said around 25%, I think currently it's around 5% from your data. That's a big shift of a \$3 trillion daily industry that you now need to fund earlier in the day. And whether you're tapping that from your own treasury desk, from T2S, Clearstream, Euroclear, et cetera. You have to have those credit lines in place, but if you're also using them earlier in the day, you might get trigger warnings, you may have more transactions with less providers, you have a bit more concentration risk, you might have to hold more HQLA assets because of your own LCR and your NSFR ratios, so all of this comes at cost.

So, your ability, what Rickie mentioned around inventory management, knowing exactly where your positions are, these things are critical. But then also that allows you to manage that, but you need to be prepared for a significant shift in order to have the credit lines in place that your utilisation isn't so high that you actually have massive cost increase as well as potentially additional settlement costs due to a loss of netting.

And Alex, I know you'll come to this particular point, so I won't touch on it. But there really is a lot of interconnection in terms of your intraday liquidity across your rolls, your credit lines, your agreements that you have in place with your funding desk and the CSDs that need to be thought

about now to make sure that you are prepared for a big shift because it really could have a significant impact if we're not prepared for this shift.

Jon Ford (25:21)

And pivoting from that, or I would say just feeding onto that, for the sake of the folks, I think it was the Firebrand piece that you had mentioned earlier, Scott, and this was maybe June or July, but 28% of the firms that they had polled had not even started prepping for T+1, which is kind of crazy, but neither here nor there.

In terms of the structures, to give the listeners some sort of guide in terms of how to start thinking about this, I think a lot of folks have established governance structures. But could you give us a sort of a high level? I think Rickie and Scott, you're both on T+1 committees. Can you give us sort of high level in terms of what folks should be thinking about there?

Scott Schroenn (26:13)

Yeah, I mean, internally, it's a real production. We have, I think, 9 different streams, just what we call vertical streams. And then you have your focusing on specific asset classes. But there's overlap, particularly here, where you've got repo and SBL, which hit both equity and fixed income.

So, there's a lot of interplay, but potentially different systems in a big bank like ours. That is the case at times, even though transactions are similar. We still rely on different systems. So, the uplift in terms of inventory management, can we have one unified solution or do we have to have multiple? Then you have to make sure you have consulted with your legal, your compliance, to make sure you understand the regulations.

So, we, yeah, as I said, we've got 8 or 9 vertical streams. We also have our custody business and our treasury business that are onboarded to make sure that they are part of this process because there are lots of handoffs and interconnection. And there's a lot of other change going on in the market also to consider that both resources may be constrained and also that your budget may be constrained, so it's not something you can just kick off in a couple of weeks.

It takes a full review of your processes, and we keep talking about automation when we started this process, a lot of people kept saying, we are fully automated. But it's a part of the process that's automated. There's still a touch point in between this step and that step, which means you're not STP. So, it's not a quick process.

And we really would stress to everyone that starting early is essential, not only for obtaining budget, but really understanding this process so that you can work with your banks, your vendors, your providers to think of solutions and also accompany them on this journey, right? So, they're going through this the same time as you. You can work through these problems together

so your bank understands your needs when they're doing their project and making sure that they are able to help you and what you come up with works with them. So, it's important to start now.

Jon Ford (28:22)

Yeah. I think there was one of the, it was either Value Exchange or Firebrand, a great quote, which was 2025 is a year for planning, 2026 is a year of execution. Rickie, from your perspective, also knee deep and part of the T+1 task force within your own bank, what would you add?

Rickie Smith (28:58)

Yeah, a lot of the stuff really resonates there with what Scott was saying, similar type banks and institutions. So, where we are, we're more on the custody side of the business. So, we're part of the security services side of J.P. Morgan. So, we have our own governance at that level. But there's also the cross CIB governance structure as well, Steering Committee, which we report and feed up into. And then we've got a host of people that were part of the advocacy side of things, and then now the ongoing regulatory support as well within the business.

But I think one of the key things that Scott hit upon, it's not so we can do this and we're doing this internally and we're getting to the point now where we've locked in what our funding is for next year. So, Jon, to the point you just mentioned, right, this year was making sure we knew what the impact was, we know what needs to be done. Next year is going to be full on with executing against that investment spend. And then hitting into the start of 2027 when we start to really look to, I think, test all of that functionality that's been built and automation.

And the one thing that is key that Scott had alluded to as well, we're doing this internally with J.P. Morgan, but we need to make sure our clients and our counterparties are coming along at the same pace and are there along with the journey.

Because for this to be successful, J.P. Morgan can get itself ready as best they can. But if the other players within that transaction are not at the same pace or at the same level, then you're still going to have some form of manual steps, manual processes, and it's just not going to lead to a more successful outcome.

Jon Ford (30:33)

Yeah, I think cross-referencing yourself against the automation of your counterparties and clients is part of that process. So, just at a high level, you establish a governance structure, you do impact assessment, tech architecture review, which obviously in the automation process comes in here. Operational designs, gaps, communication strategies, leaning on your sales and trading for client outreach.

So, what, and you guys alluded to it, what does success look like? And what are the things you start to measure over the course of the next year and a half to make sure that you're on track and that you're actually reaching your goal? Thoughts, observations?

Scott Schroenn (31:29)

I would say there's minimum requirements. The EU authorities have been very clear when we transition to T+1 that settlement efficiency should not be compromised. They do have this ability to suspend because there will be volatility, I think, particularly in potentially the SBL space that needs to adapt. There's other parts of the market, ETFs, which are also being looked at. The key point is make sure what you do today, you can do in a T+1 environment, which means you have resilience, what happens in times of market volatility.

But what success really is, is looking at the overall European landscape at the moment that's focused on what they call the SIU, the Savings and Investment Union, and preparing for growth going forward. So, this gives, this is a pillar. It's not the be all and end all of the SIU, but it's one of the pillars is how do industry improve their infrastructure to allow more growth and automation, reviewing your processes, working with your clients. It gives us an opportunity to engage with our clients on a specific topic very openly that we don't always have. I mean, we speak to them about various points, obviously, but this is a key driver here to speak to our clients.

So the point here long term is growth in Europe, and that's real success. Minimum requirements is settlement efficiency. But real success is how we make sure that we are improving industry as a whole. And as you said before, fixed income is a little bit behind on the automation front than the equity side.

Jon Ford (33:09)

Yeah. Welcome to my world.

Scott Schroenn (33:12)

We can change it. I believe in us.

Jon Ford (33:15)

Well, you know what, and it's a great point. There's a much, much bigger picture here in terms of the resilience of the European capital market. Certainly, Trussonomics exposed some clear shortcomings in terms of the mobility of collateral during the mini-budget crisis from a few years ago. And there's a tonne of recommendations out there that ICMA and the ERCC are making.

Alex, from your perspective, any final points that we've kind of missed here? I mean, we haven't talked about, we haven't spoken about pair-offs and netting and batch cycles. I mean, there's a tonne of additional stuff out there to really get into the minutiae of settlements and making that more efficient.

Sort of from closing points, where are you at?

Alexander Westphal (34:04)

Yeah. No, definitely agree. I think that's an important message. There's still a lot of work ahead of us, even still to define the key requirements as Scott alluded to. So, a lot of these recommendations are still open and are still being discussed. You mentioned auto partialing, shaping. These are all key points that are still not fully clear how we implement them.

Also, there's the whole discussion around intraday liquidity. Scott explained that, but of course, it's all around what are the mitigating measures and then how far that can be achieved. It's very, very much a question for the infrastructures and the market together to figure out, because there will be some changes to the infrastructure needed in order to address those points.

But I think more broadly, I would very much agree with Scott. I think it's important to keep in mind T+1 itself doesn't really solve any of our issues and certainly doesn't get us to a more integrated market, but it certainly creates a focus, and I think, and momentum to make progress on all of these fronts. All that work will allow us to move to T+1 but hopefully will also have some very important positive externalities, let's call them, that will create something very positive beyond T+1, and hopefully lead to a more efficient and competitive European market.

Jon Ford (35:48)

The United States of Europe. Rickie, final comments there.

Rickie Smith (35:56)

Yeah, we've spoken quite a lot about the automation side of things and the investment side and then what we're going to look to do to develop.

I think probably the final point to lean on, not spoken too much about, is that participation in these industry association working groups are key and critical, I think. And in particular, if your firm feels strongly about the way things are done in a certain way, and you want to get your voice across, it's making sure you've got the right people at those working group calls as well, and not just sending people along to fill time. It's making sure you're going to send people there that have an impactful contribution to the discussion.

Because what's going to be defined in the best practices within these associations will really sit there and stand the test of time. So, it's very important that the right level of people are engaged.

Jon Ford (36:46)

That is a great point. I think my experience moving into the vendor world over the last two years is, and doing a lot more work with ICMA and Alex's group, is that there's a tonne of expertise on these calls. There's great conversation that gets into the weeds of what needs to happen. And it's readily accessible to everyone.

So, with that, I think a lot of work to do. Automation. If you've got problems today, they're not getting better under T+1. So, start preparing, start executing. And most firms will have a regulatory budget that you can tap into to start automating.

So, with that, I'd like to thank the group today. Thank you for listening, audience, and stay tuned for our next episode coming up on collateral.

Thank you very much, gents.

Scott Schroenn (37:48)

Thank you. Thanks for your time.

Alexander Westphal (37:50)

Thank you.

Jon Ford (37:51)

Cheers, bye.
