Needs must

The hunt for yield and the requirement to comply with a growing list of financial regulations are influencing the way participants in tri-party securities lending and repo structure transactions.

Financial regulation continues to play a major role in how banking and securities financing are evolving. New liquidity guidelines and stress test requirements have encouraged banks to diversify their sources of liquidity. Their ability to mobilise global inventory and make more effective use of their collateral continues to shape the way that tri-party services are developing.

Recent regulatory reforms have created a heightened appetite for the dealer community to utilise a broader range of collateral forms. "We see currents sweeping through, calling for alternative collateral allocations in connection with funding structures, including fully funded swaps and total return swaps," says one service provider. "We've also seen an increased acceptance of equities as collateral."

At the same time, the market is attracting a broader range of participants with a less restricted remit. Traditionally, says one major service provider, collateral providers have shaped the market through their financing needs. Those institutions only funding fixed income tended to be drawn to the services of an ICSD, while those with a broader involvement of different asset types would typically go to a bank provider. This is changing, however. Some firms have merged equity and fixed income financing and are seeking to gain a holistic view of their collateral.

"We are being asked by our customers to be able to cover all of their needs," says one ICSD executive. "Firms want to be able to optimise across equity and fixed income and also derivatives and central bank activities. We are all moving to be able to support all segments of the market. This changes the way we look at optimisation."

"The traditional buy-side – pension funds, asset managers – are becoming collateral providers," notes one custodian. "The larger, more sophisticated buy-side firms are increasingly exploring how to utilise the tri-party model for their collateralisation needs, looking to the techniques that the sell side has been using over the past two decades. As always, the financial market shifts and finds alternative ways to gain efficiencies." He points to the emergence of interest in a peer-to-peer tri-party model, in which buy-side firms are both the collateral provider and receiver. "We think that phenomenon is going to accelerate," he adds.

Regulatory impact

While the post-crisis regulatory pipeline will continue to have an effect on the tri-party securities financing landscape, some impact is already evident. "In Europe, the Alternative Investment Fund Managers Directive (AIFMD) has had a direct influence on the setup for asset managers using tri-party services," says one service provider. "The uncertainty in the market has created an entry hurdle for AIF firms to gain access to liquidity through tri-party collateral management arrangements. It has therefore slowed down the progress for AIF firms to become tri-party collateral receivers and utilise securities finance as a way to generate additional income."

By contrast, another piece of recent European legislation, UCITS V, is encouraging a number of institutions to leverage the existing architecture of their repo and securities finance businesses to address new regulatory requirements and remain operationally efficient.

The multi-year low interest environment has also had an impact on participant strategy. "As banks hunt for yield, there has been a wider usage of equities versus fixed income particularly to cover securities lending activities or total return swap activities," notes one service provider. "Whilst there has been a reduction in traditional bank-to-bank repo, many buy-side participants, in particular corporate treasurers, are entering the tri-party repo market as they seek to reap the benefits of secured financing versus traditional deposit placement."

As financial regulations (Basel III, EMIR, CSDR, SFTR, etc) are implemented, many market participants have also begun to look at the total costs of a Securities Financing Transaction (SFT). In addition to the implied interest rate, the costs of capital and post-trade services such as sourcing of collateral, settlement, substitutions processing and collateral monitoring are also taken into account.

According to a number of service providers, financial institutions are increasingly interested in CCP-cleared products to reduce these costs. As banks continue to deleverage and look for opportunities to reduce balance sheet consumption, the ability to net or offset exposures at a CCP remains an important component of treasury and liquidity optimisation strategy.

The year ahead

Regulation will continue to affect the market in 2016. The month of September is looming large, when exchanging initial margin for non-cleared OTC derivatives will become mandatory.

"The onset of mandatory clearing in Europe and the introduction of new global margining rules for uncleared derivatives is forcing counterparties to comply with new asset segregation requirements, but at the same time look at innovative ways of managing collateral efficiently," says one ICSD. "Robust inventory management remains critical for banks, while the ability to manage collateral in real-time is now becoming an essential part of daily collateral management practice and has thrust tri-party agents into the spotlight."

The use of cash as collateral remains a dilemma for many participants as banks look to alleviate balance sheet pressure and strengthen ring-fencing. "Regulatory pressures will see more financial market participants focus on non-cash collateral and we anticipate that the use of funds as collateral will help banks and their clients secure their derivative obligations whilst mitigating custodian or correspondent bank risk," one ICSD observes.

T2S will also continue to shape the European landscape for the next 12-18 months. Banks, dealers and custodians will re-assess how they intend to manage their access to cash liquidity and commercial bank credit under the auspices of Basel lll. "Any tool like a T2S that makes movements more seamless is bound to help," says one service executive, warning, however, that "There's some heavy lifting that still needs to be done and people need to get educated. We're in the middle of an evolution and no one really knows where it's going to end up."

New entrants?

Does this combination of an uncertain market environment and certain regulatory obligations provide any scope for new intermediaries to enter the fray? "If we look at the big wholesale firms, the barrier to entry is extremely high," notes one ICSD executive. "We have all spent millions building this technology and upgrading it." There is a corresponding need for critical mass. "The ability to enter the market with a totally fresh offering would be extremely challenging as you would have to move a large portion of existing customers into your system to be viable," he comments. "But the other side of the coin is that we will continue to see new entrants to the collateral management space from the buy-side, including funds, corporates and asset managers. There may well be opportunities for intermediaries to enable these firms to become active." ●

SURVEY OVERVIEW

A job for steady hands

The world of tri-party intermediary services for lending and financing has remained confined to the same small group of large service providers for several years. The results of this year's tri-party survey suggest why.

In last year's survey commentary, we noted that tri-party financing was attracting increasing numbers of respondents who did not fit into the traditional participant categories of banks and broker dealers. Figure 1 shows the nature of the institutions responding to the 2016 Survey. Banks and broker dealers together account for just under three-quarters of respondents, which is, in fact, an increase of a few percentage points over last year. Nevertheless, the involvement of buy-side firms and corporates is confirmed with 28% of responses coming from asset managers, corporates and other respondents such as clearing systems.

The rationale for using tri-party as opposed to bilateral collateral arrangements is illustrated in Figure 2. Last year showed a near equal split between two core groups of respondents: those looking to mobilise their collateral pool effectively (41.8%) and those seeking to maximise access to counterparties (41.1%). This year, percentages have increased in both camps; to 46.5% for the former and 44.8% for the latter. Those with other reasons specific to their own circumstances more than halved from just under 20% to 8.7%.

A significant divergence from 2015 is the implicit trust in tri-party demonstrated by the asset levels committed to it. Whereas last year 50% of respondents said they used tri-party as the management process for more than 60% of their asset pool, that number has fallen to around 35%. By contrast, the number of respondents using tri-party for less than 30% of their asset pool has risen from around 19% to 34%. This does not necessarily mean that participants are becoming disenchanted with the potential opportunities available from tri-party activity, but rather, that in the current climate, the opportunity cost of relying on that activity, be it for financing or to earn incremental income, may have grown.

Interestingly, the nature of engagement in tri-party activity among survey participants has shifted the number of survey respondents using tri-party as both a provider and a taker of collateral has risen this year from 45.9% to 56.9%. The number of collateral takers only, lending cash against security has fallen correspondingly from around 30% to 27%, while those engaged solely in financing as collateral providers has dropped from roughly a quarter to 16%.

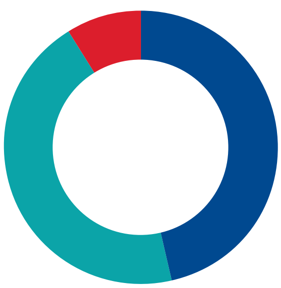
Assets involved

In terms of asset types, the survey confirms yet again that participants using tri-party for equities only remain a tiny minority. Those incorporating both equities and fixed income

Fig 1: Type of respondent

- Commercial bank – 43.9%
- Dealer – 24.5%
- Financial institution – 18.7%
- Other – 12.9%

Fig 2: Tri-party rationale



- Mobilise collateral – 46.5%
- Access counterparties – 44.8%
- N/A – 8.7%

Fig 3: Proportion of assets managed

- 0-30% – 33.8%
- 30-60% – 18.4%
- >60% – 35.1%
- No response – 12.7%

Fig 4: Tri-party usage

- Collateral provider – 16.2%
- Collateral taker – 26.9%
- Both – 56.9%

into their programmes are, however, growing in number, rising by a few percentage points to over 40%.

Figure 6 takes a closer look at the types of assets involved in tri-party programmes. Unsurprisingly, it shows the popularity of sovereign debt (84.5%) virtually unchanged from last year with convertible and corporate debt as well as ABS/MBS and equities included for between 36% and 45% of respondents. While last year's survey threw up a surprising increase in the use of sterling, this has fallen back to 43% from 76%. Dollar use is up to 74% and the euro shows the biggest increase from roughly a third to three-quarters.

Fig 5: Securities traded

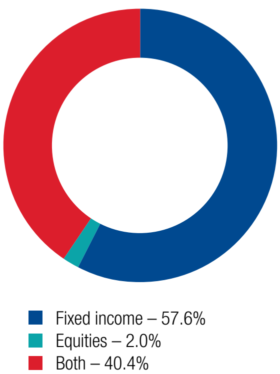


Fig 8: Priorities by category

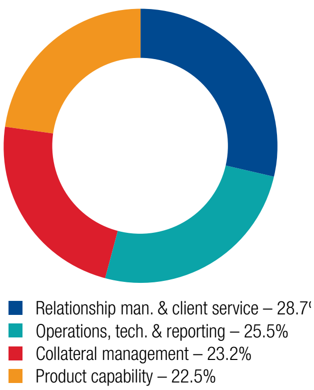


Fig 6: Collateral managed

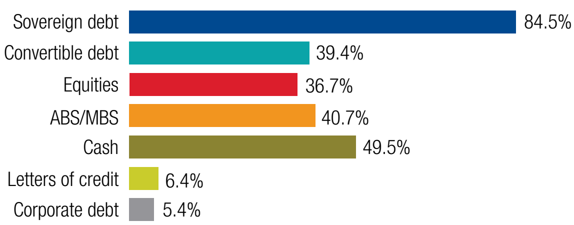


Fig 7: Currencies included

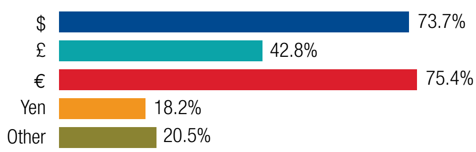
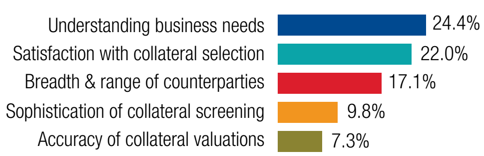


Fig 9: Most important questions



Figures 8 and 9 illustrate the priorities attached to different aspects of tri-party services by respondents, at both a service category and question level. Figure 8 looks at the data across the four main categories of service, which this year reflects a more even spread than in 2015. Relationship Management and Client Service is seen as a top priority by some 29% of the survey participants, up a few percentage points on last year, but Product Capability – the lowest rated category – is still cited first by almost 23% of respondents. In all likelihood this suggests that no single category predominates in provider selection with all providers having to demonstrate robust service capability across the full range of requirements. The investment needed to maintain this is one reason why tri-party service providers remain a small group of large institutions.

At an individual question level, Figure 9 shows that Understanding Business Needs ranks first for almost a quarter of clients. In an environment where a tri-party agent has many responsibilities, knowing the particular concerns of individual clients is hard. Those providers that score well in this regard will be well placed to expand business further in the future. Satisfaction with the Collateral Selection Process has overtaken Breadth and Range of Counterparties as the second most frequently cited priority with Accuracy of Collateral Valuations

Fig 10: Overall survey scores by question

	2016	2015
Relationship management & client service		
Understanding your business needs	5.79	5.75
Quality and experience of front office relationship managers	5.90	5.89
Quality and knowledge of client service personnel	5.76	5.64
Expertise in dealing with exceptions	5.59	5.46
Operations, technology & reporting		
Levels of straight through processing	5.80	5.64
Flexibility in handling substitutions and fails	5.65	5.55
Efficiency and timeliness of margin calls	5.78	5.73
Competitiveness of deadlines	5.74	5.55
Quality of collateral servicing	5.73	5.54
Quality flexibility and timeliness of reporting	5.71	5.46
Collateral management		
Sophistication of collateral screening	5.60	5.41
Ability to exclude collateral	5.64	5.54
Satisfaction with collateral selection processes	5.61	5.54
Accuracy of collateral valuations	5.69	5.64
Effectiveness of collateral reassignment rehypothecation upgrade processes	5.53	5.46
Product capability		
Breadth of range of counterparties given access to	5.69	5.54
Breadth of range of securities asset classes and transaction types	5.78	5.62
Availability of service on a global basis	5.59	5.56
Ability to source lower cost finance and or higher yield	5.51	5.35
Value recieved for fees charged	5.32	5.23

in fourth place behind Sophistication of Collateral Screening. While their order may have changed, however, the same questions appear to top the list of client concerns for the second year running.

Client satisfaction

As far as the aggregate scores in the survey are concerned, perceptions have again improved after last year's slight drop. In 2016, all questions score higher than last year. Quality and experience of front office relationship managers has held steady with a simple one basis point increase. As with last year, however, it remains the highest scoring question in the survey, coming in at a very creditable 5.90 in 2016. The largest relative improvement across the board has been in the quality flexibility and timeliness of reporting, the results for which have risen from 5.46 to 5.71.

Compared to many of the other surveys conducted by Global Custodian, customer satisfaction levels overall appear relatively high, suggesting that the potential for winning mandates from rivals is slim. The hope must be that new participants, particularly from the corporate and buy-side segments, can be attracted to raise their involvement in tri-party activity. ●

Methodology

Survey respondents were asked to provide a rating for each tri-party securities financing provider on a numerical scale from "1" (Unsatisfactory) to "7" (Excellent), covering 10 separate functional services. In general "5" (good) is the 'default' low score of respondents. In total five providers received a record number of more than 250 responses from more than 150 individuals yielding thousands of data points for analysis.

Each evaluation was weighted according to three characteristics of each respondent; their size, represented by the value of assets under management; the level of complexity of their business based on the range of services used; and the number of different providers involved. In this way the evaluations of the largest and broadest users weighted at up to three times the weight of the smallest and least experienced respondent.

In 2014 the Survey highlighted in a Roll of Honour for each functional area, two providers who outperformed other providers taking account the number, nature and content of responses received. The small number of providers and heterogeneous nature of respondents and feedback from readers has led us to conclude that such an approach is not appropriate for this survey in 2015. We remain extremely grateful to those respondents who invested the time and effort to complete the survey. Securities financing is a major issue for all market participants in 2015, as new regulations come into play. Being able to present a comprehensive assessment of one key component of the financing equation adds greatly to readers' understanding of the emerging overall position.

BNY Mellon

BNY Mellon's results are somewhat surprising this year. While scores are perfectly respectable, they do not match up to last year, when the bank did particularly well. Though none of the category scores give cause for alarm, Relationship and Client Service records a drop of 45 basis points. Some 30% of respondents rating BNY Mellon this year did not take part in last year's survey and this includes a number of large institutions, who perhaps are more stringent in their service requirements. It is interesting, however, that the bank's scores are significantly higher among collateral takers than collateral providers.

Client comments point to a number of IT-related issues. "Having separate operating platforms is difficult to manage and constrains flexibility of collateral movements across entities. The platform in Europe has known stability issues," says one global investment bank. This view is shared by one US buy-side firm, which notes that, "There is a lack of standardisation between domestic and global platforms. We're hoping to see further attention to this in 2016."

BNY Mellon's best question scores were for the breadth of asset classes and transaction types available and for the accuracy of their collateral valuations. The overall impression, however, is that a little more attention to harmonising the platform underpinnings of the global service would go a long way. ●

Category scores

	2016	2015	Difference
Operations, technology and reporting	5.37	5.76	-0.39
Relationship and client service	5.23	5.68	-0.45
Product capability	5.38	5.47	-0.09
Collateral management	5.42	5.52	-0.10

Best question scores (provider)

	BNY Mellon	Survey	Difference
Breadth of range of securities asset classes and transaction types	5.60	5.78	-0.18
Accuracy of collateral valuations	5.59	5.69	-0.10
Ability to exclude collateral	5.48	5.64	-0.16
Breadth of range of counterparties given access to	5.47	5.69	-0.22
Efficiency and timeliness of margin calls	5.46	5.78	-0.32

Best question scores (survey)

	BNY Mellon	Survey	Difference
Quality and experience of front office relationship managers	5.43	5.90	-0.47
Levels of straight through processing	5.36	5.80	-0.44
Understanding your business needs	5.26	5.79	-0.53
Breadth of range of securities asset classes and transaction types	5.60	5.78	-0.18
Efficiency and timeliness of margin calls	5.46	5.78	-0.32

Clearstream

Clearstream Banking S.A.'s results in this year's tri-party survey confirm its climb to the top in terms of client perception. Its score in all four service areas is the highest of any provider in each category. At an individual question level, Clearstream's best result, 6.12, was for 'Quality and experience of front office and relationship managers'. While this was also the best scoring area for the survey as a whole, Clearstream beat the market average by 22 basis points.

Client comments tend to back this up. "Proactive, dynamic, willing to help, reliable and a valuable business partner," says one very large European bank. One UK client points out that, "Clearstream were excellent with assisting with expert knowledge and attention for a large deal we completed in February." There was the odd grumble. "Product and service delivery promises are sometimes ahead of delivery timeline," noted one global custodian. "Quality of collateral servicing" was another high scoring area for Clearstream, It surpassed its 2014 score by 31 basis points and the survey average for that question by 26 basis points. According to the firm itself, the ability to mobilise collateral within Clearstream's Global Liquidity Hub or via any of its Liquidity Hub Connect partners has created opportunities for more effective management of customers' global inventory pool. ●

Category scores

	2016	2015	Difference
Operations, technology and reporting	5.93	5.76	0.17
Relationship and client service	5.97	5.68	0.29
Product capability	5.78	5.47	0.31
Collateral management	5.78	5.52	0.26

Best question scores (provider)

	Clearstream	Survey	Difference
Quality and experience of front office relationship managers	6.12	5.90	0.22
Understanding your business needs	6.04	5.79	0.25
Quality of collateral servicing	5.99	5.73	0.26
Breadth of range of securities asset classes and transaction types	5.98	5.78	0.20
Efficiency and timeliness of margin calls	5.97	5.78	0.19

Best question scores (survey)

	Clearstream	Survey	Difference
Quality and experience of front office relationship managers	6.12	5.90	0.22
Levels of straight through processing	5.94	5.80	0.14
Understanding your business needs	6.04	5.79	0.25
Efficiency and timeliness of margin calls	5.97	5.78	0.19
Breadth of range of securities asset classes and transaction types	5.98	5.78	0.20

Euroclear

With a few more respondents rating Euroclear this year, results for the ICSD have risen across all service areas, most notably for Relationship Management and Client Service. "We receive pretty strong coverage from our relationship manager and the dedicated triparty team," says one large global bank. The quality of front-office relationship managers brings Euroclear its highest question score, where it is rated above 6.00 (Very Good) and surpasses the market average by 17 basis points. The quality and knowledge of client service personnel also scores particularly highly. When it comes to client priorities, understanding client business needs is frequently cited as key and, here too, Euroclear's expertise is clearly appreciated by respondents.

Although the ICSD's scores in all categories are impressive, a few of the comments suggest that there is some systems work to be done. "It would be better to have a dynamic way of managing baskets, transaction priorities, exclusions, etc", says one large client. "It's currently quite manual and not efficient when compared to technology available." One buy-side firm suggests that, "As a collateral taker, there should be an easier way to make certain securities ineligible for market circumstances." On the plus side, a large investment bank expresses satisfaction that, "the global platform assists with on-boarding clients across asset classes that we need to fund globally." ●

Category scores

	2016	2015	Difference
Operations, technology and reporting	5.8	5.44	0.36
Relationship and client service	5.92	5.5	0.42
Product capability	5.74	5.38	0.36
Collateral management	5.7	5.57	0.13

Best question scores (provider)

	Euroclear	Survey	Difference
Quality and experience of front office relationship managers	6.07	5.90	0.17
Quality & knowledge of client serv. personnel	5.94	5.76	0.18
Understanding your business needs	5.93	5.79	0.14
Quality flexibility and timeliness of reporting	5.90	5.71	0.19
Breadth of range of counterparties given access to	5.87	5.69	0.18

Best question scores (survey)

	Euroclear	Survey	Difference
Quality and experience of front office relationship managers	6.07	5.90	0.17
Levels of straight through processing	5.84	5.80	0.04
Understanding your business needs	5.93	5.79	0.14
Efficiency and timeliness of margin calls	5.86	5.78	0.08
Breadth of range of securities asset classes and transaction types	5.86	5.78	0.08

J.P. Morgan

Despite a decision two years ago not to actively engage with the survey, J.P. Morgan continues to attract a sizeable number of responses. This year has actually seen an increase in client responses. Scores have also improved at all category levels by between 26 and 47 basis points, taking the bank above 5.00 (Good) in all areas, bar Product Capability.

In the area of Relationship Management and Client Service, the bank remains somewhat below the market average, though comments suggest a recognition that further improvement is in the offing. "Engaged and willing to help, but lacking internal coordination and support. Open for suggestions and willing to improve," says one client. The highest question score in the survey overall was garnered for the quality and experience of front-office relationship managers – an average 5.90. At 5.25, J.P. Morgan remains 65 basis points below this.

At a question level, the bank's highest score is for the quality of collateral servicing – a more than respectable 5.50 and approaching the market average of 5.73. At the other end of the scale, it is rated in the mid-fours (Satisfactory) for the range of counterparties to which it gives access, the ability to source lower cost finance and the value received for fees charged, where it nevertheless records considerable improvement over last year's weak rating. ●

Category scores

	2016	2015	Difference
Operations, technology and reporting	5.22	4.96	0.26
Relationship and client service	5.17	4.7	0.47
Product capability	4.69	4.46	0.23
Collateral management	5.12	4.7	0.42

Best question scores (provider)

	J.P. Morgan	Survey	Difference
Quality of collateral servicing	5.50	5.73	-0.23
Quality flexibility and timeliness of reporting	5.44	5.71	-0.27
Competitiveness of deadlines	5.31	5.74	-0.43
Accuracy of collateral valuations	5.30	5.69	-0.39
Understanding your business needs	5.29	5.79	-0.50

Best question scores (survey)

	J.P. Morgan	Survey	Difference
Quality and experience of front office relationship managers	5.25	5.90	-0.65
Levels of straight through processing	5.10	5.80	-0.70
Understanding your business needs	5.29	5.79	-0.50
Efficiency and timeliness of margin calls	5.14	5.78	-0.64
Breadth of range of securities asset classes and transaction types	4.93	5.78	-0.85

SIX Securities

SIX Securities services has recorded an increase of over 50% in client responses in this year's tri-party survey. Client comments are sparse. "Just a great service at SIX," says one, though there are grumbles at the benefits of recent platform changes. Its biggest fans are to be found among collateral takers and clients at the smaller end of the spectrum.

The increase in its responder base has serviced SIX well from a results perspective. Relationship Management and Client Service has held steady at an already impressive 5.79, while the other three categories have recorded rises of between 26 and 35 basis points.

At a question level, the highest score achieved by SIX was a spectacular 6.42 for levels of STP – 84 basis points higher than the market average. It also exceeds the market average for the range of securities asset classes and transaction types available by some way.

Across all providers, the highest score was for quality and experience of front office relationship managers. On this question, SIX Securities Services nudged slightly ahead of the market average.

Value received for fees charged is often at the lower scoring end of survey ratings as a whole and so it is with SIX, whose score of 5.00 on this measure remains a few points higher than the market taken as a whole. ●

Category scores

	2016	2015	Difference
Operations, technology and reporting	5.83	5.48	0.35
Relationship and client service	5.79	5.8	-0.01
Product capability	5.4	5.14	0.26
Collateral management	5.56	5.21	0.35

Best question scores (provider)

	SIX Securities	Survey	Difference
Levels of straight through processing	6.42	5.8	0.84
Efficiency and timeliness of margin calls	5.94	5.78	0.04
Quality & knowledge of client serv. personnel	5.89	5.76	-0.05
Quality and experience of front office relationship managers	5.81	5.9	0.02
Breadth of range of securities asset classes and transaction types	5.81	5.78	0.61

Best question scores (survey)

	SIX Securities	Survey	Difference
Quality and experience of front office relationship managers	5.81	5.9	0.02
Levels of straight through processing	6.42	5.8	0.84
Understanding your business needs	5.73	5.79	0.01
Efficiency and timeliness of margin calls	5.94	5.78	0.04
Breadth of range of securities asset classes and transaction types	5.81	5.78	0.61