SIFMA Insights

The 2022 Asset Management Derivatives Forum Debrief

Perspectives & Key Themes from Market Participants

February 2022

Recently, the Futures Industry Association (FIA) and the SIFMA Asset Management Group (AMG) hosted their annual Asset Management Derivatives Forum. With three days of presentations and events and over 300 participants from both the buy side and the sell side, we gained insights into top-of-mind topics for market participants. Inside this note, we recap just some of what was seen and heard, including:

- The Industry Outlook – top 10 industry themes; a look at the new normal for the office
- The Regulatory View – Crypto; enforcement vs. guidance; proposed security-based swaps rule
- The ESG Perspective – strategic planning/framework for ESG; market touch point on carbon futures
- More on Market Themes – LIBOR transition; clearing house topics; market touch point on crypto futures

To see details from topics SIFMA has covered throughout the year, please see SIFMA Insights at (list of Insights reports in the Appendix of this note): www.sifma.org/insights

Thank you to FIA's Will Acworth, Senior Vice President of Publications, Data & Research, for his insights and contributions to this report. For more information on the FIA and Coalition Greenwich survey results, please contact: wacworth@fia.org.

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SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

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The Industry Outlook

Top Ten Industry Themes

To set the scene of the conference, Acting Head of SIFMA Asset Management Group (AMG) Lindsey Keljo and FIA President CEO Walt Lukken discussed member-identified industry priorities for attendees ranging from large to small firms trading equities, fixed income, derivatives, etc. As various perspectives arose during the week, it was a reminder of the importance of market participants coming together to discuss best practices as well as pain points that the industry must work together to overcome. A number of the identified priorities addressed operational aspects of the business, including:

- Operational issues raised by regulatory proposals, adding another layer to the typical legal concerns;
- Opportunities for technological efficiencies to improve general operational processes (ex: increasing automation and digitization in post trade processes to add scale and eliminate errors); and
- Managing the volumes of data that exist today; collection, maintaining data integrity, standardization, etc.

Surveying SIFMA AMG members ahead of the conference, the following top ten priorities for 2022 (and beyond) were identified:

Source: Survey of SIFMA AMG members, 46 Responses

We highlight some of the SIFMA AMG survey write-in responses:

- Integrating new technologies with old and bespoke infrastructure
- Building automation scale and efficiency
- Expanding bespoke instruments without impeding existing institutional flows
- Getting the right data at the right time
- Managing multiple sources of data
- Need for industry adoption of gold copy data standards and workflow

Next, we looked at how top issues for derivatives markets varied across the buy side versus sell side, noting the following from the FIA and Coalition Greenwich survey:

- LIBOR transition and the impact of capital requirements were in the top three for both
- Both listed technological change and political uncertainty in the top five
- Climate change was at the bottom of the list for both
- Implementing uncleared margin rules was #2 for the buy side but only #7 for the sell side

	Rank (#)	
Priority	**Buy Side**	**Sell Side**
LIBOR Transition	1	3
Implementing uncleared margin rules	2	7
Impact of capital requirements	3	1
Technological change	4	2
Political uncertainty	5	5
Cost of market data	6	4
Potential disruption related to post Brexit	7	6
Climate change	8	8

Source: FIA and Coalition Greenwich survey, ~200 responses (preliminary results)
Note: For more information on the FIA and Coalition Greenwich survey results, please contact: wacworth@fia.org.

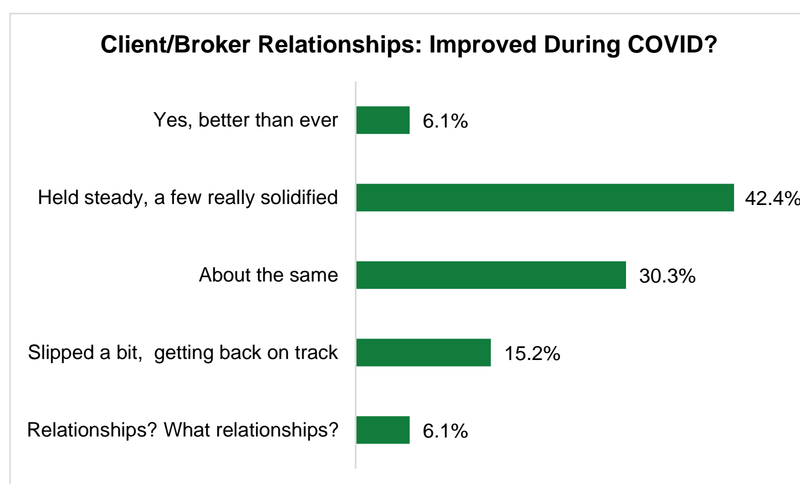
A few highlighted (non-fee related) pain points from the FIA and Coalition Greenwich survey included:

- **Buy side**: Confirmation processes; trade identifiers/transactional data; and allocations/give-ups
- **Sell side**: Clearing/trade reporting (back office); allocations/give-ups (middle office); and risk management

The New Normal for the Office

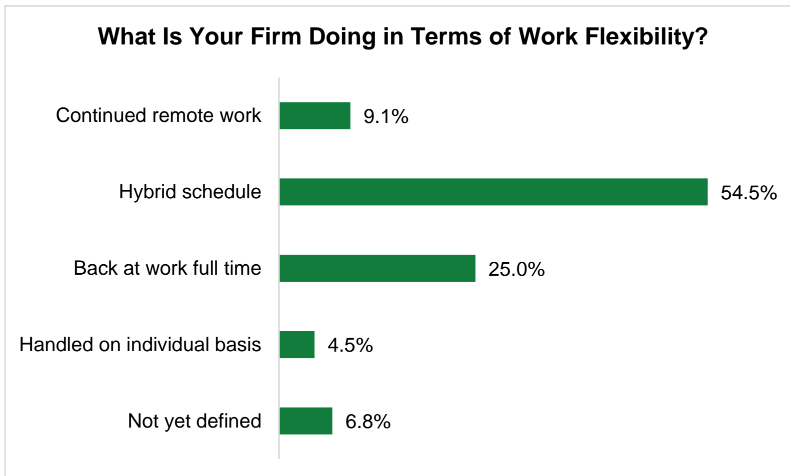
An important piece of the industry outlook is finding the new normal for work going forward. Markets remained open and business continued during the COVID peak in 2020 and throughout last year, despite many employees still working from home. However, it was not without challenges, as market participants had to find new ways to maintain connections with clients and get business done.

Polling the audience on how their client or broker relationships evolved during COVID, 42.4% said they remained steady for the most part while a few have improved. 30.3% indicated their relationships remained about the same. Regardless of the poll response, panelists all indicated the way brokers and clients interact has changed, perhaps permanently. And the change goes way beyond interactions taking place on Zoom instead of over a coffee. Panelists indicated the content of conversations has changed as well. Meetings have become more personal and getting to know more about your client's family and starting meetings with a personal conversation has replaced jumping straight into business.



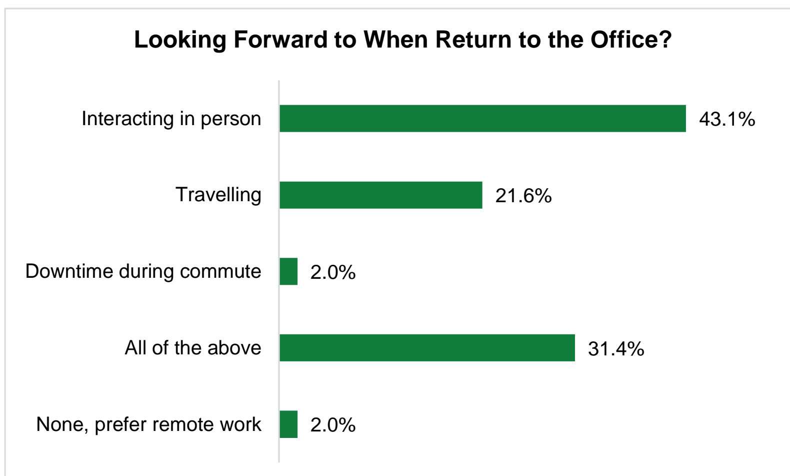
Source: Audience Polling

The term “intentionality” also was raised by panelists. While we may be starting a return to whatever the new normal may be, brokers and clients are now more intentional about how they use their time. This looks to continue, as most of the audience responded that they expect to have a hybrid work schedule going forward, 54.5% of responses. This compares to only 25.0% expecting to be back at work in the office full time.



Source: Audience Polling

With the return to office on a more regular basis, 43.1% of audience responses noted they are most looking forward to interacting with colleagues and clients in person again. 31.4% of respondents indicated they are looking forward to every part of work life pre COVID (interacting in person, travelling, commute downtime). It is interesting to look at the top responses – most expect a hybrid work schedule, yet the majority also miss the in person interactions with their teams. As such, technology as an equalizing tool will continue to be at the forefront of team togetherness. A panelist mentioned her team keeps the Zoom open all day, with everyone on screen but on mute. This way when a team member has a question, they can open their microphone and ask it, replicating the old days of walking over to someone’s desk. (Looks like financial services was ahead of Meta/Facebook in starting the Metaverse!)



Source: Audience Polling

The Regulatory View

Crypto – Mind the Gap

Former CFTC Chairman Timothy Massad shared an interesting viewpoint on the regulatory gap in crypto. In the U.S., multiple regulatory agencies will contribute to the regulatory framework for digital assets, including:

- CFTC: Regulates futures and swaps markets and other categories of commodity transactions
- SEC: Regulates U.S. capital markets and enforces federal securities laws
- FinCEN (Financial Crimes Enforcement Network): Oversees money service businesses and enforces anti-money laundering laws
- OCC (Office of the Comptroller of the Currency): Regulates national and foreign banks operating in the U.S.
- Federal Reserve System: Regulates the payments industry (and more)
- State regulators

Looking specifically at the SEC and CFTC, the SEC would regulate crypto assets determined to be a security and the CFTC those deemed a derivative. Currently, neither SEC nor CFTC has authority to regulate the cash market for crypto, which is where much of the trading occurs.

Cattle Securities/Futures Do Not Equal Cows

Massad likened the regulatory gap in crypto assets to cows – cattle securities or futures contracts are not equal to the cows themselves:

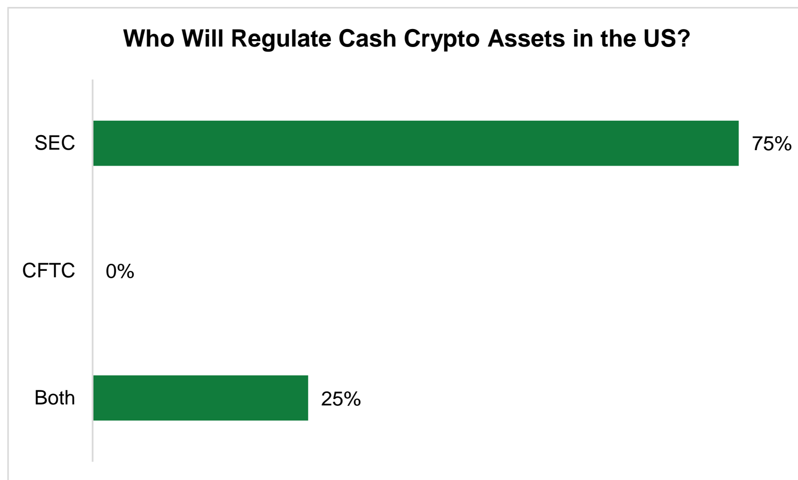
- The CFTC regulates cattle futures
- The SEC regulates securities of beef companies like National Beef
- Neither have the authority to regulate the cows themselves

Massad pointed out that the lack of regulations in the cash market weakens investor protections, given lack of standards for: governance/conflicts of interest; trade execution; reporting/record keeping; and operational resilience. While crypto/digital assets offer many positive opportunities, the regulatory gap can also lead to societal risks. Aside from well-publicized illicit activities, cyberattacks on crypto intermediaries could cause damage elsewhere in the financial system. Additionally, poor data quality in the crypto space could potentially lead to financial stability risks.

While Massad focused on the regulatory gap, he was clear to point out that enforcement was not the right way to set standards. A CFTC case last year, where it imposed a small fine on a crypto exchange related to wash trading, illustrates this regulatory gap and the limits of enforcement. The CFTC has the power to bring a manipulation case in the cash market even though it does not regulate the exchange. However, Massad explained, this case was not about the exchange failing to detect wash trading by a customer, rather this was wash trading by the exchange itself. There is no prohibition against wash trading by customers on crypto exchanges, nor is there a prohibition on proprietary trading by a crypto exchange itself. This is not allowed in securities or derivatives markets, as it creates the risk of bad practices such as front running customer trades. Since the CFTC cannot set standards for the crypto exchanges, even one CFTC commissioner expressed concern that the public would be misled by the case, noted Massad. This demonstrates that enforcement is an after the fact tool, rather than a forward looking way to guide markets.

How to close the gap? As digital assets are not all created equal, panelists in another session indicated a one-size-fits-all approach will not work. Regulations must balance sound and robust standards with flexibility for innovation. Massad recommended utilizing a principles-based approach, but he did not make a recommendation as to whether the SEC or CFTC should take the lead, noting there are pros and cons to both options.

In a separate session, panelists were asked who will regulate cash crypto assets in the U.S.? 74% said the SEC, while 25% replied both the SEC and CFTC.



Source: Panelist Polling

Enforcement vs. Guidance

While commenting on several issues, we found an overarching theme from SEC Commissioner Hester Peirce to be quite interesting. Similar to Massad, she indicated a preference to not take an enforcement approach when setting rules and standards. Specifically for the crypto markets, she would like to take a guidance approach, allowing for innovation while establishing guidelines for standards and practices. She also indicated her opinion that the interpretation of what is a security is currently overbroad. What are the regulatory objectives? “This is a transformative space, one where we need to get our arms around it in a productive manner and not let the enforcement division set policy.” She expects 2022 to be a pivotal year for crypto regulation.

Commissioner Peirce also discussed the money markets, noting that while prescriptive rules “seem to work” in calm markets, they can cause unintended problems under times of stress. For example, the post-2008 rules did not really work in the COVID turmoil of 2020. Her preference for this area is to put the onus on the asset managers running money market funds to address issues as they arise rather than apply strict, set industry-wide rules when the rest of the market can anticipate the choices to be made and trade based on such choices.

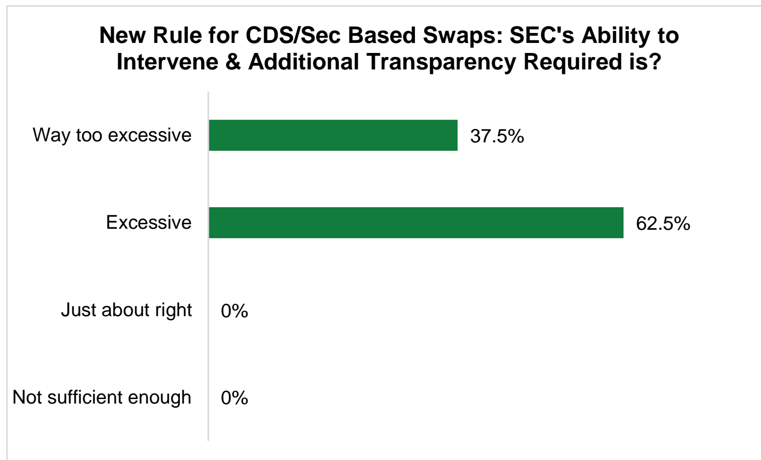
Finally, she spoke to the GameStop event in early 2020. Her take is that you cannot draw broad policy from the report that was produced to analyze the event. Specific to payment for order flow (PFOF), her hope is that there is not a kneejerk reaction in regulating this aspect of equity market structure. She noted – and SIFMA agrees – that the retail investor has never had it better on trade costs ($0 commissions) and the ability to execute trades in a quick and cost effective manner. We have written that any significant alteration to market structure could change this dynamic for retail (and institutional) investors. She went on to note that retail trades bring a different perspective to markets than institutional trades, and it is good to get the views of retail investors into the markets.

Commissioner Peirce also noted that the move to T+1 in securities settlement would be a positive for markets if done “reasonably and in the right time frame”.

Security-Based Swaps

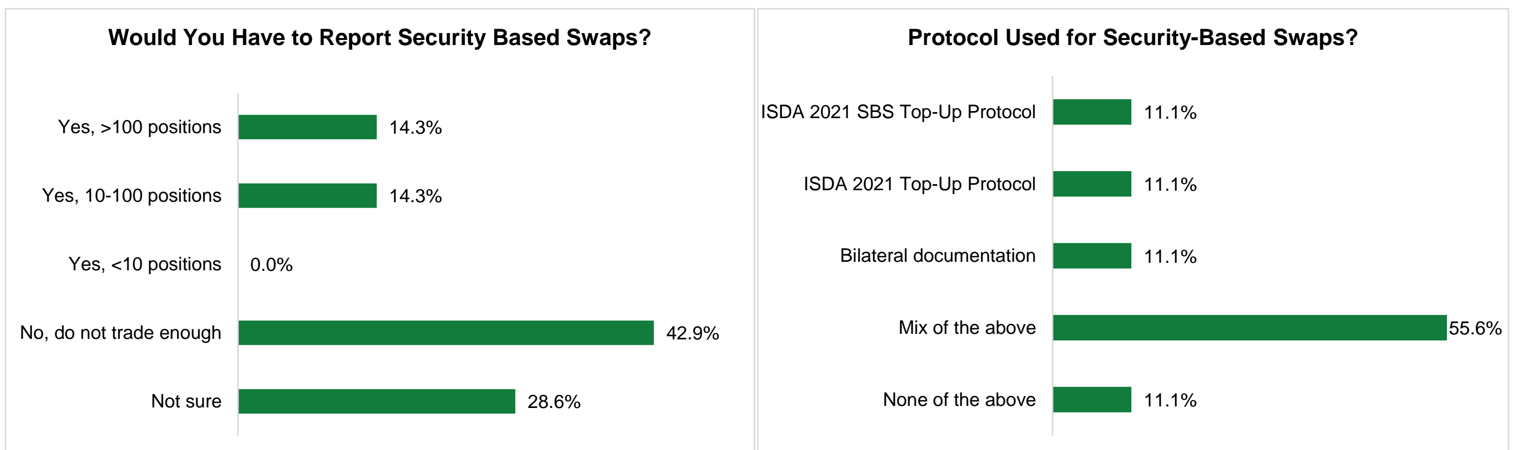
In December 2021, the SEC voted to propose rules "to prevent fraud, manipulation and deception in connection with security-based swaps, to prevent undue influence over the chief compliance officer of security-based swap dealers and major security-based swap participants, and to require any person with a large security-based swap position to publicly report certain information related to the position." Panelists consider the rules to be very broad with limited safe harbors. The rules are expected to impact swap dealers, their counterparties, and borrowers, in other words everyone across the transaction chain. As such, some market participants are concerned that it could have negative ramifications on markets, including market participants no longer participating in these markets.

The question is around what problem regulators are trying to solve. Looking at the proposed rule for security-based swaps, including single-name CDS, and the SEC's ability to require additional transparency, 100% of respondents thought it was either excessive or way too excessive. The call was not for no regulation, but rather smart regulation.



Source: Audience Polling

Additional feedback from audience polling on the scope of inclusion under the proposed large position reporting rule and protocols used for security-based swaps rule go live October 2021 include:



Source: Audience Polling

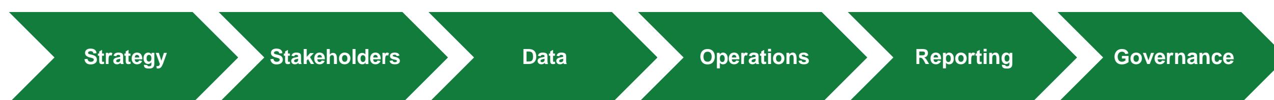
The ESG Perspective

Strategic Planning for ESG

Given what a hot topic Environmental, Social, & Governance (ESG) investing is in the financial services industry, SIFMA Insights will be highlighting conference commentary on this topic throughout the year. As mentioned above, firms have different focal points based on their size, trading mandates, etc. This was seen in the ESG space as well.

Firms are in varying stages of their ESG journey. A poll of the audience showed that the majority of respondents are in the later stage of strategic planning for their ESG agenda: 42.3% executing on their strategy, 15.4% have the strategy developed but have not yet executed it. 38.5% of respondents are in the middle stage of the planning process, noting they are in the process of developing their strategy. Only 3.8% replied they have not yet started.

Source: Audience Polling

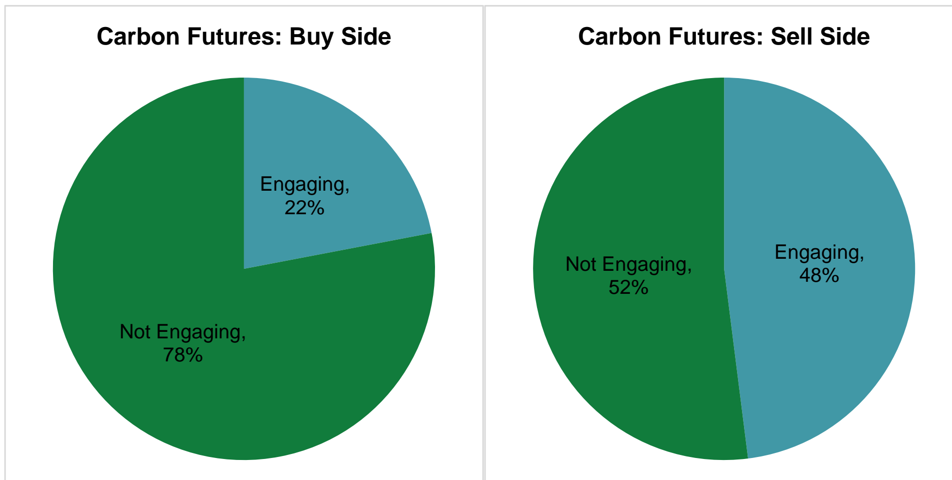


Whether just starting your firm's ESG plan or already executing your strategy, panelists bucketed the ESG strategic planning journey into:

- **Strategy & Planning**: Identify the hurdles in getting formal buy-in (Board, C-suite, portfolio managers, etc.). Determine which parts of the framework are based on Sustainability Accounting Standards Board (SASB) or SEC/CFTC recommendations. Look back to past large operational changes, such as the Sarbanes–Oxley Act of 2002 (SOX), for best practices, lessons learned, what fell through the cracks, etc. Formalize the full strategy before any pieces are operationalized and translate your ESG strategy into your organization's ecosystem.
- **Stakeholder Engagement**: Stakeholders to consider range from the front to middle to back office all the way to the C-suite, as well as investors and clients. Preemptively look back to past examples to identify methods which have worked before and best practices for managing reluctant stakeholders. Determine how the organization as a whole will define what "good" looks like and how much input stakeholders will have in this determination. Identify expected challenges in transition strategies not just from the investor but also corporate lenders perspectives.
- **Data Management & Tools**: Data is a detailed question that brings up many challenges within an organization, such as the lack of transparency and access (which can be said across financial services, not just for ESG investing). Firms will need a plan to manage the data collection process for ESG reporting, as much of the data is new, unstandardized, and varies by providers (ex: ESG ratings/scores) and corporations (as reported in financial statements).
- **Sustainable Operations**: Firms should identify and describe what sustainable operations approach is used at their organization. Aspects can include sustainable supply chains, energy transition, diversity and inclusion policies, etc. This operational impact assessment should include a cost/benefit analysis.
- **Performance & Reporting**: Identify key performance indicators to be monitored. Build reporting frameworks and standards to monitor the indicators. Allow for flexibility for your organization to make changes in your strategy if reporting reveals unexpected data points. As with all transactions in financial services, robust reporting goals must be balanced with the ethical principles of monitoring clients and products, as well as care taken around transparency and who will have access to confidential data.
- **Governance, Risk, & Compliance**: The U.S. started behind other regions from a regulatory perspective, with the push in the U.S. for ESG metrics and products originally driven by markets (investors, corporates) themselves. However, the regulatory environment is changing. For example, the SEC is moving ahead on climate disclosure and is placing a greater focus on monitoring climate-related risks. As such, firms will need a strong corporate governance framework with an internal control system and compliance standards and processes in place.

Market Touch Point: ESG

Looking again at differences across buy side and sell side, we looked at responses from the FIA and Coalition Greenwich survey for engagement in trading carbon futures. While only 22% of buy side respondents indicated they are engaging in this market, 48% of the sell side responded yes to engaging (either actively or planning to).



Source: FIA and Coalition Greenwich survey, ~200 responses (preliminary results)
Note: Engaging = already active or plans to enter; not engaging = watching with interest or not relevant
For more information on the FIA and Coalition Greenwich survey results, please contact: wacworth@fia.org.

More on Market Themes

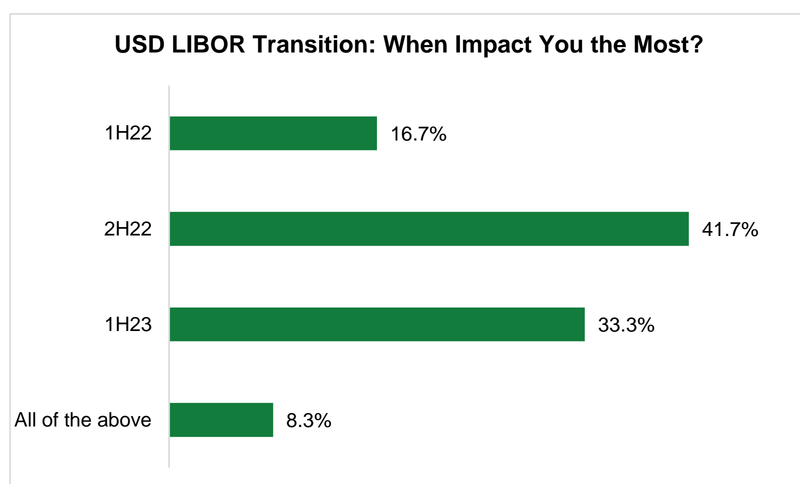
USD LIBOR Transition

In the fixed income space, the focus of most market participants has been on the Fed raising interest rates – one panelist called it a "dramatic" rise in rates, noting 5+ hikes are currently priced in – and Quantitative Tightening (policies to reduce the size of the Fed's balance sheet). Market participants worry about distortions in mispricing credit risk, the functioning of money market funds, or pension fund deficits. One panelist indicated that bond holders will lose money slowly, or they will lose money quickly.

Not surprisingly, conference panelists continued to discuss the ongoing LIBOR transition. With the close of 2021 came the end of new issuance of USD LIBOR products and limitations on trading activity by US banks, with limited exceptions[1]. The exception is for risk management of existing contracts, and panelists indicated the sell side has robust exception policies in place to meet requirements. Panelists did note concerns about the existing liquidity in these products in order to undertake risk management effectively.

What is interesting is that this transition has been in motion for years. Firms started their research on what operational changes would be needed in 2017, and then began making updates to systems (ex: accounting systems). Market participants had to decide the right time for their firm and clients to get out of LIBOR products and into new ones, ex: SOFR products in the U.S., ahead of the deadline. One large asset manager on a panel indicated they chose to move early, despite the fact that most other firms did not.

The transition did not come early. One panelist indicated even six to seven months ago the industry was in "terrible shape" for the transition. Now we are seeing good momentum, albeit with swaps moving faster than futures. When asked when they expect to see the most impact from the USD LIBOR transition, 41.7% of the audience responded 2H22.

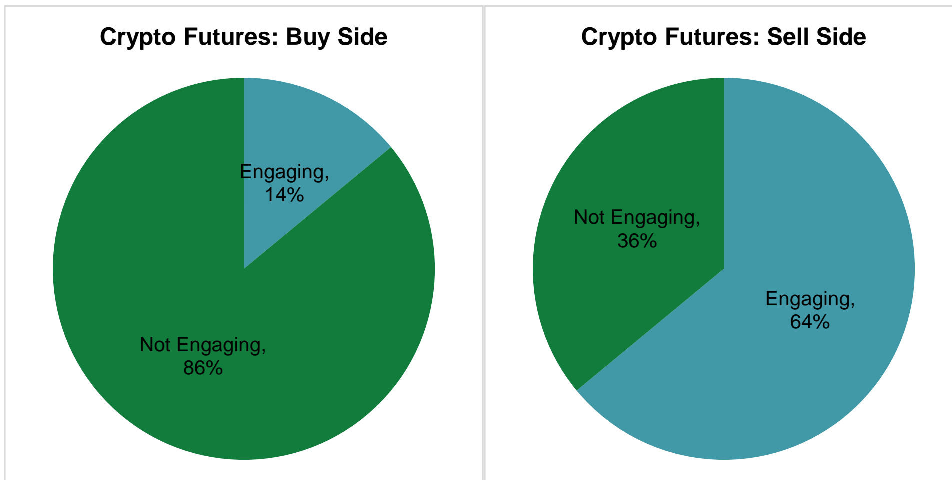


Source: Audience Polling

[1] One-week and two-month USD LIBOR ceased publication on December 31, 2021. Three-month, six-month, and one-year USD LIBOR will cease publication after June 30, 2023.

Market Touch Point: Crypto Futures

Looking again at differences across buy side and sell side, we looked at responses from the FIA and Coalition Greenwich survey for engagement in trading crypto futures. While only 14% of buy side respondents indicated they are engaging in this market, 64% of the sell side responded yes to engaging (either actively or planning to).



Source: FIA and Coalition Greenwich survey, ~200 responses (preliminary results)
Note: Engaging = already active or plans to enter; not engaging = watching with interest or not relevant
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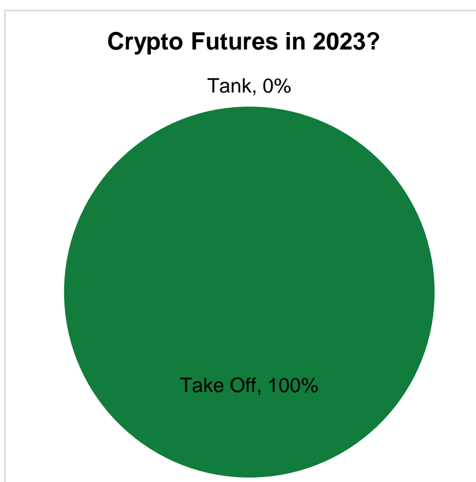
Additionally, a poll of panelists were asked if crypto futures would take off a year from now, and 100% replied yes.



Source: Panel Polling

Clearing House Topics

Lessons from the Dash for Cash

Sir Jon Cunliffe, Bank of England Deputy Governor, Financial Stability, discussed international efforts to review margin practices. Findings from a review focused on the surge in margin requirements during the COVID peak in early 2020 and outlined three areas where international standard setters plan further work: (a) the procyclicality of initial margin requirements and variation margin collections; (b) transparency into margin methodology; and (c) preparedness in terms of liquidity management.

Cunliffe calls the March 2020 market moves a "dash for cash which turned into a stampede". He is concerned that some market participants have characterized the market volatility in this period into one of two views:

- **Nothing really to see here**: The disruptions were brief and then markets returned to normal. This view implicitly states that markets would have returned to order and stability on their own, discounting the intervention by central banks. Cunliffe believes this characterization is unsupported by the facts.
- **Central banks' role is to maintain market liquidity**: Since this was an exogenous shock, central banks intervened promptly as they should have, as the private sector alone is unable to protect markets against liquidity shocks. Cunliffe has significant concerns with this view, given: (a) a moral hazard can result if market participants believe it is central banks' job to ensure liquidity; and (b) it is presumptuous to assume central banks will always be able to step in to preserve liquidity.

The Financial Stability Board (FSB) studied the events in early 2020 to identify what drove the demand for liquidity. While this was a holistic review of the market turmoil, Cunliffe focused on the impact of margining practices. Margin calls are naturally pro-cyclical – markets move and losers have to pay variation margin (VM) to winners; initial margin (IM) increases as risk does to protect clearing members from a default. Yet, the March 2020 events were dramatic:

- Total IM increased ~$300 billion, +>70%
- Daily VM calls moved from $25 billion at the start to $140 billion by the end, +>500%
- Exchange-traded derivatives represented 2/3 of total IM increases across all asset classes
- IM at clearing houses for cash equities increased >300%

Looking at this data raised several questions, bringing it back to Cunliffe's three buckets:

- Procyclicality – For VM, Cunliffe stressed the need for greater predictability of calls and more efficient collection methods. For IM, Cunliffe noted the need for a review of clearing house margin models and how they respond to volatility under market stress.
- Transparency – Cunliffe spoke about this in terms of the need for data and tools to plan ahead, in order to anticipate margin calls. An example would be a more robust margin simulator to prepare for upcoming calls.

- Preparedness – Cunliffe raised the issue of better liquidity management by clearing members and clients as a means to help the whole system be better prepared to handle margin calls under stress situations.

Conference attendees broke down the events during the dash for cash into two separate buckets, separating the issues for VM versus IM:

- IM grew too far too fast – Was it too low to start? Are we seeing a race to the bottom on margin requirements?
- VM calls can cause operational issues – it is hard to transfer the money if calls come in late in the day. Clearing members may be tasked to post the money that day (typically within an hour), but they will not receive the money back from clients until a day later.

Transparency & Disclosure

Continuing on the transparency theme, it appears to be consensus among conference attendees that clearing houses need to do better job on transparency of their margin models. As discussed above, there is a big gap between the immediacy of a clearing member posting collateral and when they collect margin from clients. Banks may have the capital and cash somewhere on the firm’s balance sheet, but it may not all be available when needed. Firms would prefer margin moves to be more predictable so that they are better able to plan for increases.

Market participants discussed tools provided on clearing house websites to estimate future margin needs. For example, take the recent Russia/Ukraine situation. A clearing firm gets notified by a client that they want to reposition their portfolio to trade WTI futures against the event. Firms would be able to use the margin tool to anticipate additional margin requirements. This transparency would give them the ability to plan ahead.

While some of these margin calculator tools exist (ex: CME CORE margin calculator), firms note that not every clearing house has one. Additionally, some of these tools use the prior day’s data, which does not provide up to date data to calculate current calls. Another issue stated by market participants is that some of the tools only allow firms to run the analysis for one position at a time.

Additionally, panelists indicated they need to find technological efficiencies to move collateral in a more automated way. For example, the industry should increase usage of APIs versus spreadsheets.

Appendix: SIFMA Insights Research Reports

Monthly Market Metrics and Trends: www.sifma.org/insights-market-metrics-and-trends

- Statistics on volatility and equity and listed options volumes
- Also highlights an interesting market trend

SIFMA Insights Market Structure Primers: www.sifma.org/primers

- Capital Markets Primer Part I: Global Markets & Financial Institutions
- Capital Markets Primer Part II: Primary, Secondary & Post-Trade Markets
- Electronic Trading
- US Capital Formation & Listings Exchanges
- US Equity
- US Multi-Listed Options
- US ETF
- US Fixed Income
- SOFR: The Transition from LIBOR
- The Evolution of the Fintech Narrative

SIFMA Insights Equity Market Structure Analysis Series:

- Analyzing the Meaning Behind the Level of Off-Exchange Trading, Part II
- Analyzing the Meaning Behind the Level of Off-Exchange Trading
- Why Market Structure and Liquidity Matter

SIFMA Insights: www.sifma.org/insights

- Market Structure Survey: Volatility, Volumes, Market Levels & Retail Investor Participation
- SPACs versus IPOs
- A Look Back at 2020 Market Structure Themes
- US Capital Formation’s 2020 Journey
- Market Structure Download: Post-Election Update
- Market Performance Around US Presidential Elections
- Market Volatility Around US Presidential Elections
- Market Structure Download
- A Deeper Look at US Listed Options Volumes
- The Cboe Trading Floor Reopened – Revisiting Volume Data
- NYSE Goes All Electronic – What Does It Mean?
- The NYSE Trading Floor Reopened – Revisiting Market Share Data
- COVID-19 Related Market Turmoil Recap: Part I (Equities, ETFs, Listed Options & Capital Formation)
- 2020, the Year of the SPAC
- The 2020 Market Madness
- The VIX's Wild Ride
- The 10th Anniversary of the Flash Crash

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