Asset Management Derivatives Forum Debrief

A Joint Publication from FIA Research and SIFMA Insights

March 2024

The Futures Industry Association (FIA) and the SIFMA Asset Management Group (AMG) hosted their annual Asset Management Derivatives Forum on February 7-9. Six themes stood out at this year's conference:

- **Innovation and Growth**: Areas of rapid growth in the derivatives markets included the basis trade between Treasury futures and securities, futurization of equity swaps, and zero-day-to-expiry options on equity indices.
- **Artificial Intelligence**: Google Cloud shared current AI use cases and expectations for new cases in operations, marketing, and investments. Top governance challenges noted were data, hallucinations, and explainability.
- **Treasury Clearing**: The SEC's mandated central clearing for a large proportion of US Treasury and repo markets was a hot topic, as it will impact Treasury futures markets and the use of Treasuries as collateral.
- **Insights on Regulation**: Officials from the Fed, SEC, and CFTC discussed current rulemakings, and several speakers from the private sector shared their concerns about the potential impacts on liquidity and innovation.
- **Clearing Capacity**: A top concern is the limited number of banks willing to offer derivatives clearing services, and proposed increases to bank capital requirements will make an already difficult situation worse.
- **Operational Efficiency**: Several panels discussed ways the industry can tackle the need for greater standardization and increased automation in the post-trade process for exchange-traded derivatives.

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Executive Summary

The Asset Management Derivatives Forum brings together market participants from all sides of the industry to examine the latest developments in derivatives trading, clearing, operations, and regulation. The Forum presents a unique opportunity for institutional investors to connect with their market counterparts – brokers, exchanges, and technology providers – and share their perspectives on current trends, identify issues of common concern, and discuss best practices.

Six themes stood out at this year's conference:

Innovation and Growth – Speakers discussed several areas of rapid growth in the derivatives markets, including the basis trade between Treasury futures and Treasury securities, the futurization of equity swaps, and zero-day-to-expiry options on equity indices. Speakers also discussed potential uses for artificial intelligence (AI) in the trading and clearing workflow as well as the practical challenges to the adoption of AI.

Artificial Intelligence – To gain insights on the potential for AI, representatives from Google Cloud shared their thoughts on current use cases and expectations for new use cases in operations, marketing, and investments. Governance remains a main concern for market participants, with top challenges noted as data, hallucinations, and explainability.

Insights from Regulators – Officials from the Federal Reserve, the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) discussed current rulemakings, and several speakers from the private sector shared their concerns about the potential impacts on liquidity and innovation.

Clearing Capacity – A top industry concern is the limited number of banks willing to offer derivatives clearing services to asset managers and other institutional clients. Several speakers warned that proposed increases to bank capital requirements will make an already difficult situation worse. They also discussed ways for clients and clearing firms to work together to use the industry's clearing capacity more efficiently.

Treasury and Repo Clearing – The SEC's recently finalized regulations that will mandate central clearing for a large proportion of the US Treasury and repurchase agreement (repo) markets were a hot topic of conversation. Although this clearing mandate falls outside of the derivatives markets, it will have important implications for the Treasury futures markets and the use of Treasuries as collateral. Speakers discussed the challenges of implementing this mandate and noted that it will put further pressure on the banking industry's clearing capacity. Speakers also discussed the overall state of the Treasury market, and noted the challenges created by massive issuance by the US government, uncertainty about the outlook for interest rates, and constraints on dealer balance sheets.

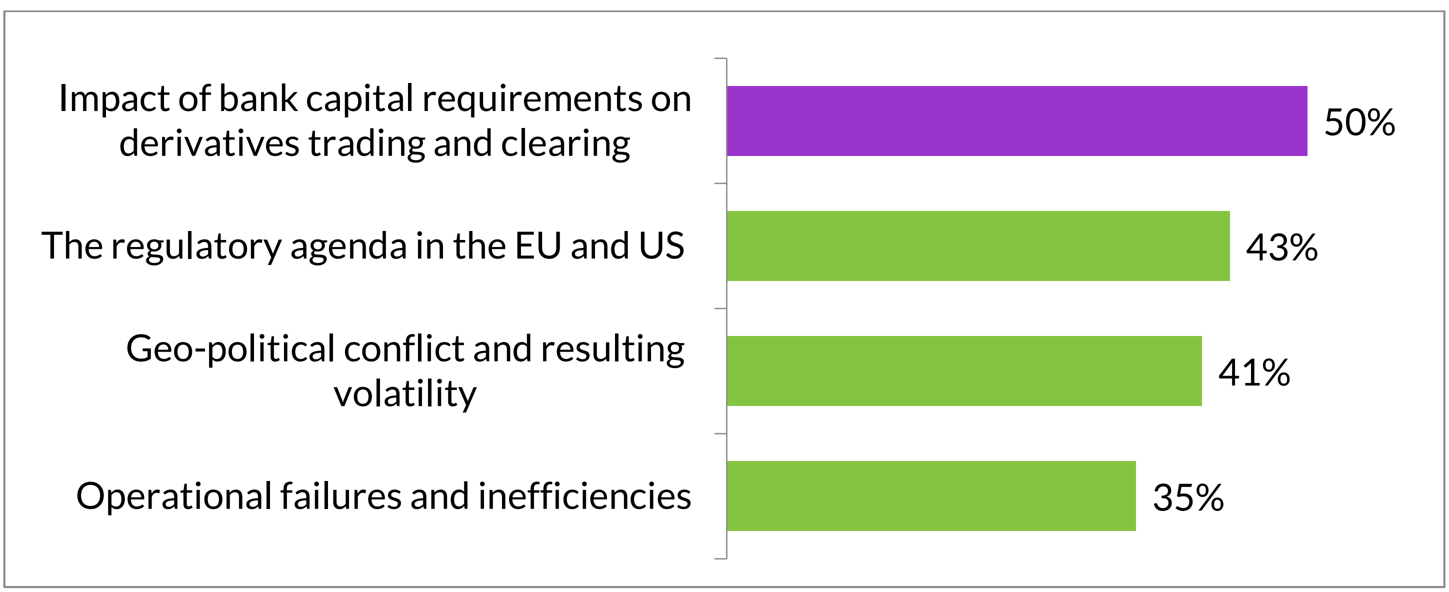
Operational Efficiency – Another hot topic, particularly for operations managers in the asset management community, was the need for greater standardization and increased automation in the post-trade process for exchange-traded derivatives. Several panels and roundtable meetings highlighted the complexity of ETD trade processing and discussed ways that the industry can tackle this problem in a collective manner.

Setting the Scene

To give some context to the program, Lindsey Keljo, the Head of SIFMA Asset Management Group, and Walt Lukken, the President and CEO of FIA, laid out the state of the derivatives industry. They discussed buyside and sellside views on trading volumes, technology transformation, regulatory change, and the outlook for growth and innovation. In general, they described the industry as benefiting from healthy growth in trading volumes but facing substantial capacity constraints given regulations and capital requirements.

Derivatives such as interest rate swaps, equity index futures, and foreign exchange forwards have long been used by asset managers and other institutional clients to manage risk exposures and enhance investment returns. With macroeconomic uncertainty and geopolitical tensions weighing on markets, volatility remains elevated in many asset classes, reinforcing the demand for derivatives as risk management tools. At the same time, exchanges and clearinghouses are rolling out new products and services designed to meet client needs, while technology vendors are exploring ways to make trading and clearing processes more efficient.

On the other side of the story, there are substantial constraints on the ability of intermediaries to support their clients. An FIA survey taken last December showed that 50% of respondents listed the impact of bank capital requirements on derivatives trading and clearing as the top concern for the industry. Banks play a key role in the derivatives markets as liquidity providers and clearing intermediaries, and recent proposals to increase the amount of capital required for client clearing have many banks and their clients worried about the potential impact on the cost of these services. The survey also showed that market participants are worried about the impact of new regulatory initiatives in Europe and the US as well as potential disruptions arising from geopolitical conflict.



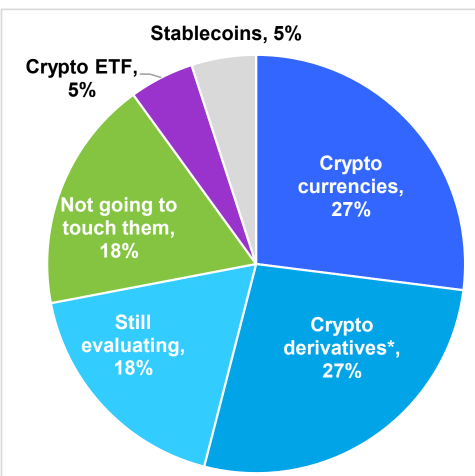
Source: FIA-Coalition Greenwich Derivatives Market Structure Report

Innovation and Growth

One of the themes woven through the conversations throughout the conference was the interest held by all sides of the industry in growth and innovation. That interest was expressed not only in the discussions around new products such as digital assets and zero day options but also in discussions on new technologies such as AI and tokenization.

In January 2024, a few weeks before the conference, the SEC approved applications by several asset managers to introduce exchange-traded funds (ETF) based on bitcoin.[1] Although investors already have several other ways to invest in bitcoin, the SEC approvals marked a turning point in the availability of this asset class, with several large asset managers such as Blackrock, Fidelity, Wisdom Tree and Van Eck throwing their weight into marketing and distributing these funds.

To set the scene for this discussion, audience members were asked if they have used or intend to use digital assets, including not only cryptocurrencies but also cryptocurrency futures and options, ETFs, and stablecoins. The responses showed that almost two-thirds of the audience had used or were intending to use some type of digital asset.



Source: Audience polling (*Derivatives includes futures or options)

One futures exchange representative commented that the ETF approvals would accelerate the growth of digital assets as an asset class, but he cautioned that the lack of clarity on how these assets are regulated in the US will remain an issue for institutional investors. The CFTC asserts that most digital assets should be considered commodities, while the SEC asserts that they are securities, and lawmakers have been unable to clarify this issue through legislation.

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[1] We note that while market participants, including many of the asset providers, commonly refer to these as ETFs, the SEC approved the listing and trading of a number of spot bitcoin exchange-traded product (ETP) shares.

Digital assets are not just an innovative asset class, however. One asset management executive shared some insights on how banks and asset managers are exploring the potential of the underlying technology to change the way traditional assets are traded. As an example, she pointed to Project Guardian, an initiative hosted by the Monetary Authority of Singapore that is testing blockchain-based solutions for trading foreign exchange. She also commented that several large asset managers are working together to test this technology, and she emphasized the huge potential for gains in efficiency

Another area of innovation discussed at the conference was the "futurization" of equity swaps. A clearing firm executive highlighted the introduction of total return futures as a more capital efficient version of the total return swaps used in the over-the-counter derivatives markets, and noted that open interest in these contracts has been rising steadily on exchanges such as Eurex and CME. One asset manager commented that these contracts have been "huge topic of conversation on trading desks." In a similar vein, there were several mentions of foreign exchange futures as a more capital-efficient alternative to non-deliverable forwards, given the implementation of margin requirements on uncleared derivatives.

Several speakers talked about the rising use of options with shorter time to expiration, and in particular the explosive growth of zero-day options. These options are exactly the same as traditional equity index options, except that instead of expiring once per month or once per quarter, they expire on the same day, allowing investors a more precise way to speculate on intra-day market moves. An audience poll showed that zero day options are catching on with institutional investors; more than half of the respondents to the poll said their firms frequently use these options.

Some areas of growth noted by market participants include:

Energy

- Growth driven by increased volatility given events - geopolitical tensions, supply chain constraints, ESG, U.S. election. Growth in freight, iron ore, emissions/ESG/voluntary carbon markets.

Rates

- The inflation and interest rate battle led to renewed interest in short-term rates, reigniting an entire group of investors. Expected to be a major growth area in 2024 as markets anxiously await the Fed pivot.

Digital

- Regulatory challenges exist, particularly in the U.S. With banks locked out of things like stablecoin - a new, good way to move collateral - the industry is missing out.
- Project Guardian is looking at scalable ways to use blockchain; ex: SGD traded on blockchain.

Regions

- Asia and specifically China remain growth areas. As China's regulatory framework opens up, it creates access to very deep and liquid commodity markets.

Treasury Markets

Mike Salm, Director, Fixed Income, Franklin Templeton, discussing current trends in interest rate markets

Last but far from least, there was an extended discussion on current trends in the interest rate futures markets. The uncertain outlook for inflation and interest rates led to a surge in trading activity in interest rate futures in 2023 and it is expected to be a major growth area in 2024. An official from CME, the largest US futures exchange, noted that initial margin held for interest rate futures and options has surpassed the initial margin held for equity index futures and options, and trading of both short term interest rate futures and Treasury futures hit record levels in 2023.

A panel of portfolio managers and interest rate strategists highlighted several trends that are driving trading activity across both cash and futures markets. They noted that massive issuance to fund the federal government has flooded the cash market with supply at the same time that demand from central banks has fallen. Treasury supply take is now resting in the hands of asset managers and hedge funds, who are more sensitive to price than other buyers.

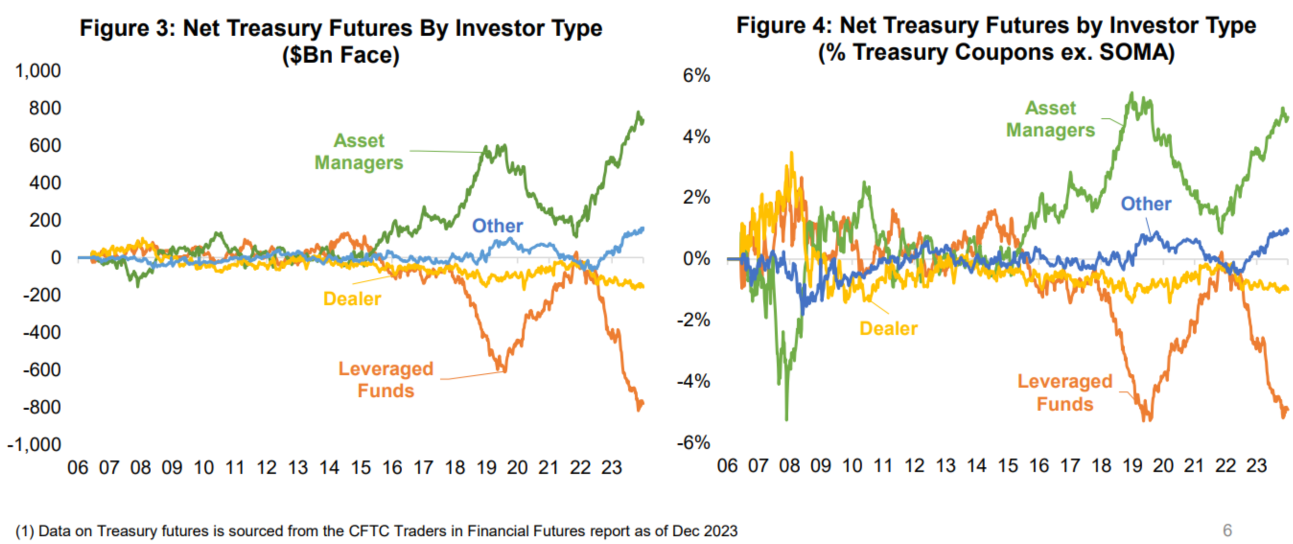
The panel also discussed a recent report by the Treasury Borrowing Advisory Committee (TBAC) – comprised of senior representatives from a variety of buy and sell side institutions which present their observations to the Treasury Department on the overall strength of the U.S. economy and provide recommendations on a variety of technical debt management issues – on the growth of the so-called "basis trade" by hedge funds. This trade involves short positions in Treasury futures and long positions in cash Treasuries via the repo market. The trade is motivated by a persistent premium for futures over cash, and the panel discussion dove into the reasons for this premium.

Since Treasuries are highly correlated, investors do not have to hold every individual Treasury security across the curve. They can hold a few points on the curve and still get the return of the whole curve. The portfolio managers explained that this allows investors to deploy cash into other strategies. For example, front end corporate bonds provide better returns than front end Treasuries.

Regulatory restrictions also play a role. For example, pension funds cannot repo Treasuries, meaning they cannot buy Treasuries if they do not match duration (or do a barbell). As an alternative, they use futures. This enables them to save some cash and also make a higher profit – fund futures with cash +15 bps, invest at +45-50 bps and take profits.

The panelists pointed out that Treasury futures hold other benefits, including: they do not show in firms' expense ratios, where repos do (cost of leverage); they provide anonymity; and they are extremely liquid.

As a result, holdings of Treasury futures by asset managers have been growing rapidly in recent years, and that increase has been matched on the other side of the market by an increase in short positions held by hedge funds.



Source: Treasury Borrowing Advisory Committee presentation, "Discussion of Treasury Futures Positions Across Different Investor Types", January 30, 2024

Artificial Intelligence

To set the stage for the discussion on AI, audience members were asked, “How is your firm using AI today”? 46% of audience members responding indicated that they are testing AI but have not yet deployed it, and 34% said they are using AI in a limited manner.

A panel of industry experts then discussed the current state of adoption and the opportunities and challenges ahead. One panelist began the panel by noting that ChatGPT enabled mass democratization of generative AI (Gen AI). Even as little as a year or so ago, there were only a few firms who could afford to use it. Now there are “tons” of models being used across multiple firms. While seeing a commoditization of the basic model, there are now many applications and use cases in process. But they also cautioned that Gen AI is at the peak of the "hype cycle" and said companies need to consider the value proposition to the business and weigh it against the risks.

To get some insights on how technology firms see the potential for AI, FIA and SIFMA AMG invited Google Cloud to discuss the evolving landscape for Gen AI. The Google Cloud speakers noted that there are already many well defined ML/AI use cases in financial markets today. As people shift from general to more specific models – models trained on general data but fine-tuned with proprietary data – they expect Gen AI to open up new use cases in operations, marketing, and investments.

Examples of use cases identified by Google:

General

- Sales and relationship management involves repetitive tasks like planning meetings, developing marketing materials, and preparing meeting recaps. Meeting reports can be uploaded to train models, which can produce future reports, freeing up sales staff’s time to focus on clients.

Marketing

- Models can be trained on what the firm does, including specific strategies and funds. Models learn from this data and then create marketing materials that are highly personalized for clients.

Research

- Models can be trained to summarize financial research. For example, the model can study a company’s earnings call transcripts. If someone is interested in the build out of new data centers, the model can generate questions on data centers and then create follow up questions using an element of reasoning.

Markets

- Some of ML is predictive, ex: predict volatility patterns. Models can access more data – real time prices, historical prices, earnings reports – and help build the variables to be used in the model to predict a future event like an options strike price.

Governance remains a main concern for market participants. Panelists laid out a road map for tackling governance challenges, including:

- **Data**: As the methodology of Gen AI commoditizes, data becomes the differentiator. Firms need to put in place controls to monitor and prevent as necessary the transmittal of personally identifiable information (PII) or sensitive data outside of the firm's fire wall. Firms should have good hygiene on information coming into the model and what results are going out.
- **Hallucinations**: AI experts use the term "hallucinations" to describe the incorrect, misleading, or fictitious results that can be produced by Gen AI models. Firms need to put in place controls to minimize hallucinations. There should be a human in the loop to evaluate answers before making decisions based on the model's results. There should be guardrails for work flows and an approval process for use cases.
- **Explainability**: Firms need to be able to explain how and why decisions were made based on the model's results. For example, is the model being trained on anecdotes or a couple of articles? Firms need a data driven evaluation process of the models.

In general, panelists indicated that firms should explore use cases and implement ones after they evaluate them thoroughly, but they need good policies and controls in place before proceeding. Panelists also recommended keeping good records on the development and usage of models.

Another challenge for wide adoption of Gen AI, particularly in higher risk areas such as investments, is the regulatory environment. Regulators are focused on safety and security of end users and, in this light, how Gen AI should and should not be used (based on the risk of the task presumably). As such, panelists noted that firms should have general controls in place to protect PII (personally identifiable information) and project-specific controls to address bespoke risks, as well as the ability to provide transparency into its models.

Education is key in working with regulators – regulators learning along with industry – to work through any fear or skepticism of the technology. The balance is in promoting technological advances versus creating no harm to investors. One panelist summed up the balance nicely:

- AI as a tool for good: Encourage investors to save more, diversify portfolios, or assist in tax loss harvesting.
- AI as an area to monitor for potential damage: Making trading "fun" could lead investors to take on more risk than may be deemed appropriate.

As AI comes in many different forms, panelists – in an almost wish list for regulators – suggested that regulators could think through different levels of explainability required for different use cases. For example, in operations, firms using AI to identify fails is a low stake use case. Conversely, using an AI model to make loan decisions represents higher risks. These use cases should have different regulatory requirements.

Finally, panelists discussed the SEC's Predictive Data Analytics (PDA) proposal. The SEC has indicated that AI can have conflicts that get programmed in and then scaled, and that firms using the technology will need to identify and neutralize conflicts. Under the façade of targeting AI, PDA as it stands includes a broad array of covered technologies – essentially any technology, as read today – used to engage in investing. For example, this includes benign technologies such as Excel spreadsheets. Around this proposal, panelists again suggested education as a tool for market participants, using meetings, teach-ins, and the comment process to engage regulators.

Insights from Regulators

Representatives from the Federal Reserve (Fed), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) discuss current rulemakings during a panel discussion.

The conversation started with what many consider to be the most important issue facing the industry – a pair of proposed increases in capital requirements for banking organizations operating in the US. The proposals include several provisions that will change the treatment of cleared derivatives, making it much more expensive for banks to offer clearing services for their clients.

Specific to impacts on the cleared derivatives markets, under the proposed rule, capital charges would be calculated similarly for cleared and uncleared derivatives. Federal Reserve Deputy Associate Director David Lynch explained that this is because they believe operational risk – which plays a large role in calculating the charges – is similar between cleared and uncleared derivatives. (Market practitioners would disagree.)

Market participants are highly concerned with the minimum haircut floor requirement. The U.S. would be the first jurisdiction to implement this minimum haircut on secured financing transactions , including repos and margin loans. Lynch acknowledged the comments on this aspect of the proposal and admitted that the minimum haircut may need to be adjusted. In fact, it was further acknowledged that numbers from the proposal were based on assumptions and many effects of the proposed rule are actually unknown. All comments are currently being reviewed. Additionally, the Fed is conducting a quantitative impact study to collect data to better assess the effects of the proposed rule and is meeting with commenters on the impact on FCMs.

Another area of concern for market participants is the SEC's mandate on Treasury/repo clearing (please see the next section of this note). SEC Commissioner Hester Peirce indicated that she would have preferred more time to consider potential impacts from the rule and then a staggered approach to rule changes and implementation. After all, the rule depends on the Fixed Income Clearing Corporation's ability to meet tight deadlines set by the

SEC. Peirce noted that this is yet another example of the SEC rushing to put out rules in an unfinished state, thereby leaving various details and major policy determinations to self-regulatory organizations such as FICC.

Other Areas of Interest

- **Block trade reporting**: CFTC Commissioner Caroline Pham indicated that block trade reporting thresholds should be appropriately calibrated, based on analysis of relevant data. The agency is aware that one unintended consequence of increased transparency is that other parties can front-run positions, negatively impacting end users like asset managers.

- **Custody** (safeguarding proposal): Similar to comments in other areas, Peirce commented that the SEC should slow down, reassess, and consider a more workable custody rule that addresses clearly identified problems. She indicated that the SEC is discussing futures commission merchant (FCM) issues with the CFTC, concerned about the impact on derivatives markets given the inability to custody swaps, for example, limitations on rehypothecation and conflicting FCM requirements.

  Market participant view: On other panels, market participants commented that there are conflicts between existing rules. Under CFTC rules, FCMs cannot guarantee against losses. However, this would be required under the SEC's custody rule. This is viewed as another in a pattern of SEC rulemaking – as one panelist said, the rulemakings are like "bullets already in flight before aimed at the target."

- **Dealer definition**: Peirce indicated that while the final rule moved significantly from the initial proposal – elimination of the two quantitative tests – it still contained many "flaws". The final rule utilizes a "significantly different" rationale for determining dealer status, stated Peirce, replacing the current dealer-trader distinction. The rule will also require private funds to register as dealers under select circumstances.

  Market participant view: On other panels, market participants noted that the final rule had improvements. It removed the qualitative prong around trading similar securities on the same day, both long and short positions. This could have "killed" healthy arbitrage. It removed the quantitative test. Market participants do not believe size is an indicator of whether a firm is a dealer (ex: large pension plans trade big positions given the nature of their business). It removed the aggregation requirement, applauded by market participants as buying/selling on the same day on similar securities could actually be on behalf of different clients. However, the SEC did not give a timing and kept discretion. This could put asset managers in a "bad space", because once they register – or are forced to register – as a broker-dealer they are no longer a customer. Additionally, market participants further noted that the SEC gave no guidance on what constitutes evading aggregation.

Clearing Capacity

An ongoing concern for the industry is the decline in the number of FCMs that provide clearing services for clients. In the US, the top five FCMs hold around 65% of customer funds held in futures accounts and an even higher percentage of funds held for cleared swaps, and all five are part of large banking organizations that are subject to capital requirements set by banking regulators. Many in the industry are concerned that the latest US proposals to increase capital requirements will further reduce the capacity for offering client clearing services. According to FIA, the top five US banks will see the capital requirement for their client clearing business increase by 80% if the proposals are implemented in their present forms. That includes 22% from the impact of the Basel III endgame proposal and 58% from the proposed surcharge on the US banks that are deemed to be global systemically important banks (GSIBs).[2]

This topic came up on several panels during the conference. Most large asset managers use bank owned FCMs to clear their trades, so the increased capital requirements will directly impact their clearing relationships. As one panelist pointed out, when Credit Suisse was forced to exit the business after the Archegos debacle in 2021, the bank's clients were able to move their cleared derivatives to other FCMs. The panelist warned that the proposed capital increase will make that far more difficult going forward because of the additional capital required to onboard new clients. As one clearinghouse executive put it, while in the short term there is in-depth capacity at each clearing member, the market is concerned about “closed doors” in the medium to long term. Without the ability to port positions and collateral to another clearing member, market stability will be impacted, particularly in times of market stress.

Even without the looming threat of the proposed increase, the industry is looking for ways to reduce the cost of clearing by using the existing clearing capacity more efficiently. Several panelists mentioned efforts at their firms to reduce margin requirements by incorporating a margin analysis into the trading process. As one asset manager said, clients are using "what if" calculators to determine how much margin would be required if they added a position to their portfolios. In a similar vein, several clearinghouse representatives said they are adjusting their margin methodologies to offer more margin offsets between related positions, including offsets between futures and swaps.

[2] We note that this conference and therefore the commentary on Basel III endgame occurred before Fed Chairman Powell testified to Congress that officials have begun reconsidering the proposal and are aware of industry complaints about cost and potential economic impact.

Treasury and Repo Clearing

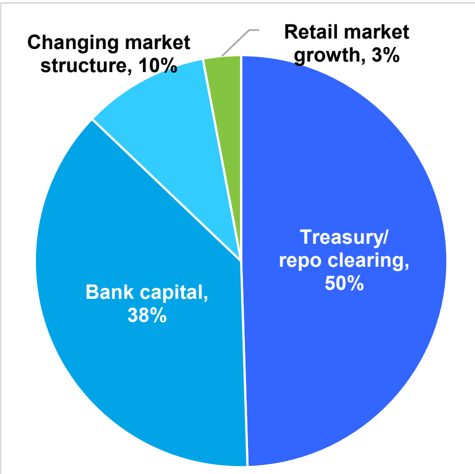
One of the hottest topics at this year's conference was the SEC's recently finalized regulations that will mandate central clearing for a large proportion of the U.S. Treasury and repo markets. Although this clearing mandate falls outside of the derivatives markets, many speakers and attendees commented that it will have very substantial implications for related markets such as Treasury futures as well as trading operations across the industry.

The SEC rule applies to "covered clearing agencies" in the U.S. Treasury market. At present, the only clearinghouse to which this rule applies is the FICC, a subsidiary of the Depository Trust and Clearing Corporation. FICC currently clears 32% of the Treasury market today, of which 19% is cleared in a "hybrid" form, with one leg cleared bilaterally and one leg through FICC. How much of the market will need to transition to central clearing is not certain, but the mandate is expected to apply to a majority of Treasury and repo trades executed by dealers and inter-dealer brokers with their clients. DTCC estimates that $2.5-$4.0 trillion in incremental volume of cash Treasury and repo trades could be subject to the clearing mandate, on top of the around $7.0 trillion per day cleared today.

Several speakers expressed concerns about the challenges of implementing this mandate. Although the clearing requirement will not take effect until 2025 – margin segregation by March, cash Treasuries clearing by the end of the year – much needs to be done between now and then to put the necessary clearing infrastructure into place. That includes changes to rule books (including comment periods), setting up operations at FICC, and significant operational changes at asset managers, broker-dealers, and clearing firms. According to one panelist, any clients who do not currently clear need to figure out how to access FICC and will need to set up “10-15” new clearing broker arrangements. This was likened to driving in fast track lane by that panelist. It was noted that SIFMA and SIFMA AMG are sponsoring the development of standard documentation for the clearing of U.S. Treasury repos.

A poll of the audience at the conference flagged another concern about this mandate – its impact on clearing capacity. Banks are already facing constraints in their ability to clear futures and swaps for their clients; adding cash Treasuries and repos will put further pressure on this capacity.

AMDF audience members were asked, “What do you think is the biggest issue in 2024 that will change clearing capacity”? Half of audience members identified Treasury/repo clearing as the biggest issue for clearing capacity in 2024 (50% of responses). This was followed by bank capital requirements (38% of responses).



Source: Audience polling

Several speakers also flagged an issue with the type of clearing model. Currently FICC offers a "sponsored" model which has generally been implemented in a way in which the trading counterparty and the clearing member are the same. In the futures and swaps markets, clearing can be "done away", where the clearing broker may be other than the trading counterparty. Panelists noted that some form of the done away model will be necessary, which will lead to important changes in trading relationships.

Panelists also noted that the transition to central clearing could lead to other changes in market structure. Currently the Treasury securities market is split between "dealer to customer" markets in which banks provide liquidity to clients, and "dealer to dealer" markets in which banks trade with each other and with principal trading firms. One panelist commented that the Treasury market has outgrown the ability of dealers to provide liquidity and called for an "all to all" model similar to the futures exchange model as a way to increase liquidity.

Panelists summarized the timeline for Treasury/repo clearing below:

Compliance Dates for the Treasury/Repo Clearing Rule

Within 60 days after publication in the Federal Register

- Must provide proposed rules changes regarding the separation of house and customer margin, SEC access and all changes to comply with conditions for 15c3-3a debit

Within 150 days after publication in the Federal Register

- Must provide proposed rule changes regarding the requirement to clear eligible secondary market transactions

March 31, 2025

- Compliance date of rule changes regarding the separation of house and customer margin, SEC access and all changes to comply with conditions for 15c3-3a debit

December 31, 2025

- Compliance date of rule changes regarding clearing **cash** transactions

June 30, 2026

- Compliance date of rule changes regarding clearing **repo** transactions

Source: Panelist estimates

Treasury Clearing: What is in Scope?

The rule applies to "covered clearing agencies" in the U.S. Treasury market. At present, the only clearinghouse to which this rule applies is the FICC, a subsidiary of DTCC.

The rule requires that covered clearing agencies adopt policies and procedures designed to require their members to submit for clearing certain secondary market transactions, including:

- **Repo**: All repo and reverse repo collateralized by Treasury securities entered into by a member of the covered clearing agency, unless the counterparty is a state or local government or another clearing organization or the repurchase agreement is an inter-affiliate transaction.

- **Cash Treasuries**:
    - All purchase and sale transactions entered into by a member of the clearing agency that is an interdealer broker.
    - All purchase and sale transactions entered into between a clearing agency member and a registered broker-dealer, government securities broker, or government securities dealer.

Operational Efficiency

One of the unique features of this conference is that it brings together operational experts from asset management firms with their counterparts at the derivatives clearing firms. This allows for in-depth discussions on practical issues that affect the trading and clearing work flow, with both sides sharing their frustrations and their suggestions for improvements.

All sides agree that greater standardization would go a long way to making the trading and clearing work flow more efficient, especially in the exchange-traded derivatives markets. As one panelist commented, there is "lots of scope for increased efficiency in the futures space," given the large number of exchanges that list futures and the wide range of systems used to process trades.

Several panelists spoke about the need to attach standardized codes to each trade so that certain characteristics of the trade would remain with the trade all the way through the post-trade process. Currently some of that information is lost along the way, resulting in time-consuming reconciliation processes.

One panelist made a comparison to the AirTag device that people use to track their phones, keys, cars and other objects, and said the industry needs to find a similar solution that can be attached to a position when it is executed and then used as a data source for all the other systems "downstream" from the point of execution. That data could include information about the type of execution, such as whether it was executed via an algorithm or a broker, which is needed for the calculation of brokerage fees. "Data is key to everything else," said one participant, adding that an industry-wide adoption of common data standards would pave the way for increased automation and more efficient trade processing.

On a related note, several panelists talked about a recent focus on "operational resilience" in conversations between clearing firms and their clients. This has become a higher priority as a result of recent ransomware attacks in the financial services sector that have highlighted the interdependence of trading and clearing firms and their technology vendors. One clearing firm executive noted that conversations with potential clients used to focus on the firm's technological capabilities. Now clients are asking about the firm's ability to withstand cyber attacks and maintain the continuity of their clearing operations.

Looking farther out on the horizon, there is a lot of interest in new technologies such as tokenization and predictive AI and their potential in post-trade processing. One operations expert at a large asset manager cautioned, however, that "integration and interoperability" are essential. "If I can't connect it to my system, I can't use it," he warned.

Authors

FIA Research
Will Acworth
Senior Vice President of Publications, Data & Research
wacworth@fia.org

SIFMA Insights
Katie Kolchin, CFA
Managing Director, Head of Research
kkolchin@sifma.org

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FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. FIA's mission is to: support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.