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Regulatory evolution prompts change in trading behaviour

Mike Norwood of EquiLend looks at how regulation has been driving fixed income securities lending

Day one agenda inside

Regulatory evolution prompts a shift in electronic trading behaviour in securities lending

With fixed income in securities lending exploding recently, Mike Norwood, head of trading at EquiLend, looks at how regulation has been a key driver behind the volume trend

Electronic trading in securities lending has experienced significant growth over the past few years. While equity desks were relatively quick to pursue automation, and to leverage straight-through processing (STP) via EquiLend's NGT platform, more recently fixed income volumes have exploded, with a 62 per cent growth so far in 2024, compared to the same period in 2023. This is a marked change of behaviour for the industry, and we do not expect this trend to slow.

There are a number of drivers behind this electronification of our market, but the primary factor is regulation. Starting with the Securities Financing Transactions Regulation (SFTR), progressing through to the Central Securities Depositories Regulation (CSDR) and on to accelerated settlement in multiple markets, regulatory regimes have made it clear that participants must focus on accurate and efficient processes to maintain compliance.

Market players have responded to this by shifting technological investment from discretionary items to regulatory initiatives meant to reduce operational risk and ensure compliance. Given the potential for significant penalties related to settlement under CSDR, European market participants have been quicker to reduce operational risk by implementing automated processing to ensure accuracy.

Many EquiLend clients report automated trade execution levels of 90 per cent or higher. The multinational profile of industry participants has also resulted in improved digital footprints and infrastructure which can be leveraged globally. The improved architecture resulting from SFTR and CSDR compliance paved the way for a relatively short runway for the US and Canada to embrace accelerated settlement and move to T+1 in May of this year.

The elimination of manual processing, in the aim of reduced operational risk and regulatory compliance, has had other unintended, albeit positive, consequences. It has resulted in the creation of scale, allowing for more efficient processing of transactions worldwide. This trend is not only specific to trade execution. Usage of our post-trade lifecycle management tools have also increased meaningfully in the last year.

Electronic recalls are up by 30 per cent compared to May 2023, with more than 2,000 a day being processed in May 2024. Automated returns have likewise seen a 34 per cent growth over the period from 2020 to 2023, and we have observed greater reconciliation match rates for automated versus manual transactions.

The technology improvements related to regulatory compliance, combined with the pressures on firms to do more with less, have pushed us toward a more efficient marketplace, and firms are keen to leverage this scale to grow without costly additions to staff.

Since 2019, fixed income volumes on NGT have grown by 157 per cent, with equities up 15 per cent over the same period. Market volatility has remained relatively suppressed in this same period, and, as a result, we are not necessarily witnessing a lot of net new trading activity in equities. With the increased diligence required by increased regulation, NGT volumes continue to grow due to client preference to automate wherever possible. Within the fixed income space, corporate debt has long embraced STP in trading, as typically these desks are more like equity in technology resource availability.

Both high-yield and investment-grade have seen volumes increase as issuance looks to capitalise on demand related to high rates and interest rate speculation. Japan has exited its Zero Interest Rate Policy (ZIRP), and we have observed significant growth in Japan on NGT, with a 95 per cent increase in all fixed income volumes since the start of 2024. Across all three regions where trading is conducted, fixed income trading has grown by double-digit percentages.

Aligned with the direction of the industry, vendor tools have evolved to enable the greater electronification of the market. With more real-time data available, client algorithms can have greater confidence in pricing volatile US specials, and traders can observe market-level execution on names that drive outperformance.

NGT enhancements have introduced greater transparency into hit rates and errors, while allowing clients to create more bespoke trading logic, such as implementing trading limits and restriction lists. Enhancements such as these result in fewer manual touchpoints, allowing firms to trust NGT to trade while they sleep, safe in the knowledge that any trades executed will be in line with firm strategies.

NGT is also integrated with EquiLend's ECS Loan Market, which automatically transmits transactions to the OCC for clearing to ensure that bilateral and cleared trades fit within a standard operating model. Post-trade has also kept pace with market movements and the increased volumes we have seen on NGT which naturally flow through our post-trade solutions. The EquiLend Risk Resolution Suite — a centralised hub for identifying, mitigating and prioritising potential breaks in recalls, returns and settlement — has created a better user experience for the 24/6 processing of returns and recalls necessary to facilitate a T+1 environment.

Given the advantages of improved technological infrastructure, there is unlikely to be a pullback from the advancement of technology in any sector globally — ours is no different. At EquiLend, we look forward to this progress and are ready to deliver further value to clients. Our sights are set on meeting current client needs while preparing for the future state of the markets: as a case in point, using distributed ledger technology (DLT) to further automate lifecycle management and eradicate reconciliation with EquiLend 1Source.

We expect STP levels to continue to follow the growth trends we have seen so far and to increase exponentially in line with sector forces. Each firm's greater digital adoption enables us to deliver value to our clients in the form of reduced processing costs, less risk and more time spent on driving innovation into new products, trade types, counterparty relationships and markets. The EquiLend ecosystem is ready to support the industry with a tech stack that, while centred around trading, starts with inventory management and can take clients all of the way through to contract termination and regulatory reporting.