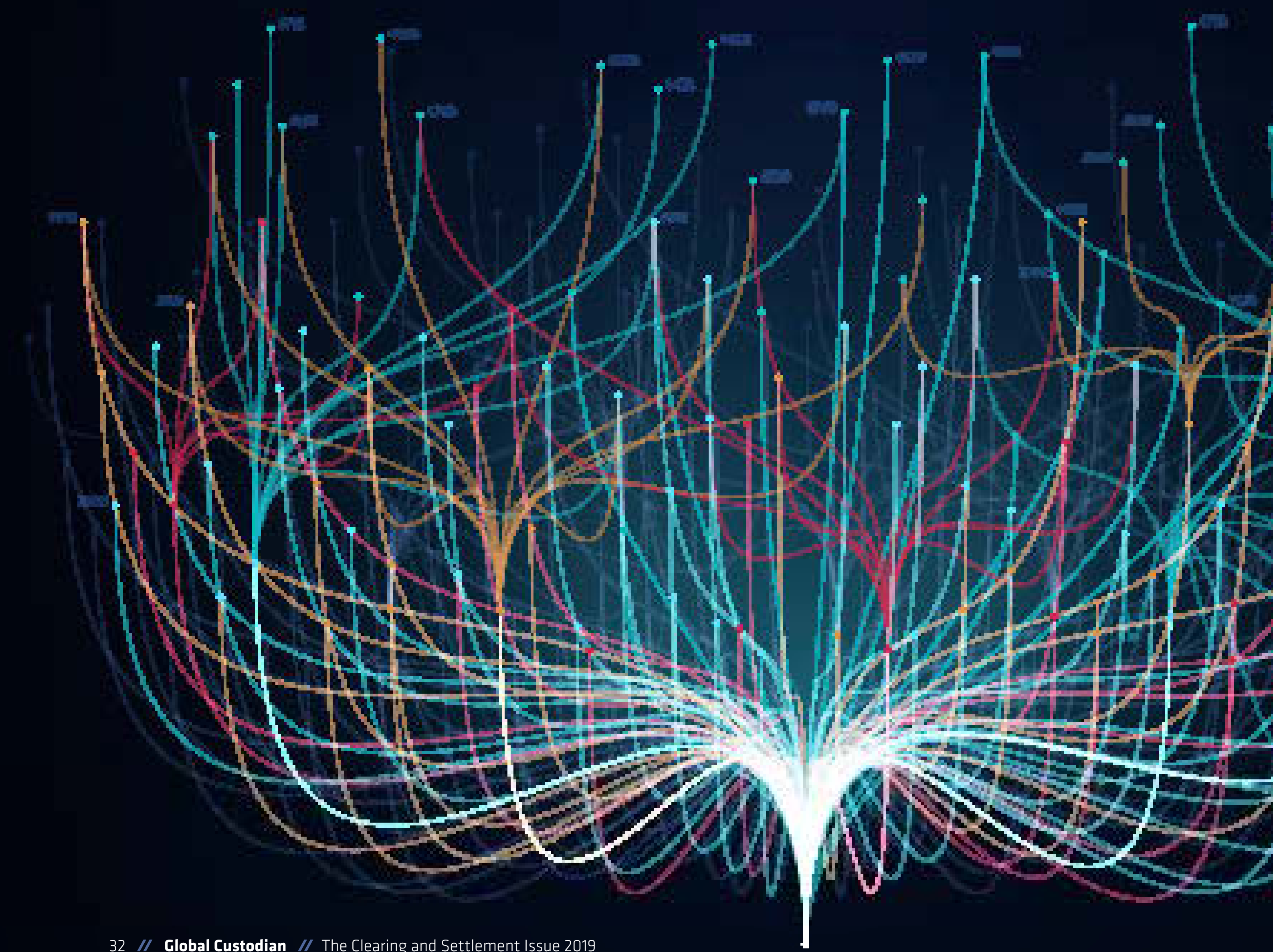
A NEW LANDSCAPE

This year's survey has been substantially revised to take account of regulatory developments and the engagement of the buy-side.



The 2019 Tri-Party Securities Financing Survey sees the continuation of the collaboration between Global Custodian magazine (GC) and AON McLagan Investment Services (McLagan). Under the terms of the arrangement, McLagan created and distributed this year's questionnaire, collected and analysed the data, and provided the text and tables printed here.

Unlike 2018, when McLagan made use of the questionnaire created by GC for its Tri-Party Securities Financing survey, this year saw the introduction of a substantially revised questionnaire. The changes were prompted chiefly by the need to adapt the questionnaire to the collateral management services tri-party providers are now offering to buy-side firms. The implications of these changes for individual service providers are presented in the pages that follow.

The Uncleared Margin Rules (UMR), which affect buy-side firms in phases from September 2019 and September 2020, mark the culmination of a regulatory process that began with clearable OTC derivative business shifting from a bi-lateral process into clearing through central counterparty clearing houses (CCPs).

As a result, the number of questions was increased from 36 to 53, and a number of established questions were revised. The Operations, Technology and Reporting section was divided into two separate sections labelled Technology and Operations. The Client Service and Relationship Management section was re-labelled as Client Service only, though it continues to cover similar issues.

The scoring system was modified before distribution to match the McLagan methodology. Instead of being asked to rate a tri-party agent from 1 to 7, where 1 is "very weak" and 7 is "excellent," respondents were asked to agree or disagree with a series of statements about the services they receive on a 20 point scale ranging from Strongly Disagree (-5) to Strongly Agree (+5).

Since the survey closed at the end of May, McLagan has analysed the completed questionnaires received, excising any that cannot be verified, weighted the authenticated responses, and prepared the average weighted scores, global average performance benchmarks and texts which are published here.

We are most grateful to the respondents which took the time and trouble to complete a questionnaire, and to the tri-party agents which assured clients the survey was important to them, and which completed a provider questionnaire of their own.

Methodology

The 2019 Tri-Party Securities Financing Survey asked respondents to address 53 questions divided between five service areas: Client service, Operations, Technology, Collateral Management and Product Capabilities.

20 completed questionnaires were received on behalf of five tri-party agents, of which two received enough responses to publish their average scores, both in absolute terms and relative to the average scores in each service area earned by all providers in the survey. Two others received enough responses to warrant a write-up without scores.

Respondents were asked to agree or disagree with a series of statements about their tri-party agent on a 20-point scale of -5 to +5. Though responses could vary from "strongly agree" or "strongly disagree," whether a response is negative or positive is contextual to the statement. Respondents could also select "Do not know" or "Not applicable," or skip a question altogether.

However, to facilitate comparison with the scores of previous years, the analysis published in this issue of the magazine is based on a reconfiguration of the answers given by respondents to match the 1 ("Unacceptable") to 7 ("Excellent") scoring range familiar in GC surveys for many years.

The scores are also weighted for the sophistication of the respondent, measured by the number of reasons for which tri-party is used, the number of asset classes and currencies in which the respondent transacts, and whether the respondent is active as both a collateral taker and a collateral receiver. In addition, the importance of a respondent to a particular provider is measured by the percentage of business the respondent places with that provider.

BNY Mellon

Profile of BNY Mellon	
Average daily value of assets outstanding in tri-party	US$2.9 trillion

Tri-party role	
Category	2018
Agent only	n/a
Principal only	Yes
Both agent and principal	n/a

User profile	
Category	2018
Repo	Yes
Securities lending	Yes
Collateralisation of futures (i.e. margin management)	n/a
Collateralisation of cleared OTC derivatives (i.e. margin management)	Yes
Collateralisation of non-cleared OTC derivatives	Yes
Re-use/re-hypothecation of assets	Yes
Investment (i.e. investing in transactions as an asset class)	n/a

The giant global custodian was one of the pioneers of tri-party. It devised the role of the third-party custodian of collateral to solve the shortcomings of the hold-in-custody repo financing model that were exposed by the dealer defaults of the 1980s.

More than 30 years on, BNY Mellon still services repo transactions. In fact, since JP Morgan exited the market five years ago, BNY Mellon has effectively owned the tri-party repo market in the United States (it accounts for $2 trillion of its outstanding tri-party balances). That business has changed, notably by the elimination of the day-long credit exposure assumed by the bank, but it has not disappeared.

However, the wider tri-party business of the bank has evolved in ways that make it very different from what it was a decade ago. The investment banks which used tri-party in the pre-crisis years to tap cash-rich banks for funding now face a variety of capital, liquidity and other constraints on their ability to play the yield curve in that way. The buy-side firms which used tri-party – if they used it all – as a convenient way to look after the collateral they received in return for lending cash or securities to investment banks are now collateral providers themselves. Much of the time, BNY Mellon is not holding collateral for cash lenders to investment banks at all but non-cash collateral for asset managers (or, to be more exact, their agent lenders) lending their securities to investment banks.

Spooked by the losses they incurred on cash collateral reinvestment in the crisis, securities lenders now prefer securities as collateral. Tri-party techniques honed for what was once a sell-side financing business, such as marking-to-market, collateral optimisation algorithms, matching collateral schedules, counterparty concentration risk management and collateral substitutions, have proved just as useful for supporting intermediated buy-side securities lending against non-cash collateral. However, the drive under the Dodd Frank Act and the European Market Infrastructure Regulation (EMIR) to push OTC derivative transactions into clearing, and the introduction of margin rules even for non-cleared OTC derivatives, is slowly drawing asset managers into tri-party as direct rather than indirect users. They need to use repo to raise cash to meet variation margin calls. They also see tri-party as a viable way to segregate the initial margin they pledge to central counterparty clearing houses (CCPs).

BNY Mellon has also responded to buy-side overtures to engage in financing, now the investment banks have shrunk their balance sheets. Impressed by the success of the "enhanced custody" business at rivals State Street, BNY Mellon has launched a "prime custody" business of its own, in which it is assuming a role once monopolised by the prime brokerage arms of the investment banks: advancing credit to asset managers as principal. This evolving and more complex market is one in which investment banks, clearing brokers, global custodians, asset managers, CCPs, central securities depositories (CSDs) and end-investors interact directly and indirectly in a variety of ways. It is intrinsically more difficult to distinguish between the lenders and the borrowers - and their agents - than it was in the heroic age of tri-party repo.

BNY Mellon in particular needs to attract a much broader range of respondents if this survey is to do justice to its collateral management business.

Weighted average scores achieved by BNY Mellon					
Category	+/- 2018-2019	2019	2018	2017	2016
Client service*	n/a	n/a	5.12	5.69	5.23
Operations*	n/a	n/a	5.27	5.69	5.37
Techology*	n/a	n/a	5.27	5.69	5.37
Collateral management	n/a	n/a	5.54	5.72	5.42
Product capability	n/a	n/a	5.08	5.76	5.38
Total	n/a	n/a	5.24	5.72	5.35

Weighted average scores achieved by BNY Mellon versus the global averages				
Category	2019	2018	2017	2016
Client service*	n/a	-10.40%	-0.40%	-9.20%
Operations*	n/a	-7.20%	-0.50%	-6.60%
Techology*	n/a	-7.20%	-0.50%	-6.60%
Collateral management	n/a	-5.20%	3.10%	-3.40%
Product capability	n/a	-6.40%	4.90%	-3.70%
Total	n/a	-7.3%	2.10%	-5.80%

**Client service was until this year combined with relationship management.* ***The operations and technology sections were combined until this year*

Client type	
Category	**2018**
Collateral takers	Yes
Collateral providers	Yes
Both collateral takers and collateral providers	Yes

Collateral currencies	
Category	**2018**
US dollars	Yes
Euros	Yes
Sterling	Yes
Japanese yen	Yes
Swiss franc	Yes
Danish krone	Yes
Swedish krona	n/a
Australian dollars	Yes
New Zealand dollars	n/a
Other APAC countries	n/a
Other currencies	n/a

Asset classes used as collateral	
Category	**2018**
Government securities	Yes
Public agencies/sub-national governments	Yes
Supranational agencies	Yes
Corporate bonds	Yes
Covered bonds	Yes
Residential mortgage-backed securities (RMBS)	n/a
Commercial mortgage-backed securities (CMBS)	n/a
Other asset backed securities (ABS)	Yes
CDOs, CLNs, CLOs, etc.	n/a
Convertible bonds	Yes
Equity	Yes
Money market instruments (e.g. bills, CDs, LoCs)	Yes
Cash	Yes
Funds	n/a
Other	n/a

Clearstream Banking

Profile of Clearstream Banking	
Average daily value of assets outstanding in tri-party	US$497 billion

Tri-party role	
Category	**2018**
Agent only	5.00%
Principal only	70.00%
Both agent and principal	10.00%

User profile	
Category	**2018**
Repo	90.00%
Securities lending	60.00%
Collateralisation of futures (i.e. margin management)	n/a
Collateralisation of cleared OTC derivatives (i.e. margin management)	30.00%
Collateralisation of non-cleared OTC derivatives	25.00%
Re-use/re-hypothecation of assets	25.00%
Investment (i.e. investing in transactions as an asset class)	15.00%

"Excellent relationship with Clearstream!" enthuses a client. "Excellent client and customer service – it is the major differentiation with their competitor." The scoring of client service was up last year, and the trend has accelerated in 2019. This represents a return to historic form at this provider. As a client puts it, Clearstream is ultimately "carried by outstanding personnel and relationships built over many years rather than technology or operational capabilities." But it is also an accolade for the regional client servicing teams, as Clearstream recently shifted to them the client-facing responsibility previously assumed by the dedicated product team. "Good service and responsive to our issues," writes a client, though a second is postponing judgment on the change. "As GSF disappeared, we have some doubts about the future," he writes. "Wait and see."

There is always more to be done. A respondent who acknowledges the "hard work and the level of service" nevertheless adds that "they should be coming more often to educate our collateral management team [to] give them clear guidelines on the new procedures and applications they are using ... [We] need to receive more information on the evolution of their products."

As it happens, product development, which was a conspicuous strength in 2018, remains one this year. Clearstream has enhanced its concentration risk management services to encompass the sovereign limits set by the European Market Infrastructure Regulation (EMIR) and extended its eligible asset coverage to money market funds, in a move designed to help buy-side firms drawn into tri-party by EMIR. At least one client is paying attention, since he writes that "it could be interesting for us to develop concentration criteria on funds."

The detailed scoring of collateral management picks up hints of other areas clients would like Clearstream to explore further, including rehypothecation and upgrade trades. But calls for the ICSD to do more to facilitate the mobilisation of collateral across borders are being addressed by continuing investment in distributed ledger technology (DLT).

The collateral tokenisation experiment of a year ago has matured into support of the HQLAx joint venture led by parent company Deutsche Börse, which also uses tokens - dubbed Digital Collateral Receipts (DCRs) - to improve liquidity in collateral markets by achieving title transfer without necessitating movement of the underlying securities. It has yet to influence the score for collateral management, which has effectively stood still. Only one area does worse than that. This is operations, where the detailed scoring indicates room for improvement in the servicing of collateral ("Service could be improved a bit regarding the efficiency of the tax department"), exception handling and the processing of margin calls.

This last is worrisome, since the fourth phase of the Uncleared Margin Rules (UMR) is turning asset managers into consumers of tri-party services, many for the first time. The on-boarding and legal documentation challenges are correspondingly significant. To secure buy-side business, Clearstream is simultaneously refurbishing its account structures and its exposure monitoring and collateral transformation services to accommodate fund managers – and marketing the customised buy-side financing services offered by Eurex Repo and Eurex Clearing. Unsurprisingly, fund managers are not yet delivering a collective verdict on these various efforts, because the final, buy-side phases of UMR are not scheduled to bite until September 2019 and 2020. For now, Clearstream can bask in scores that are up for a second year in row, well ahead of the global benchmarks, and accompanied by flattering comments.

Weighted average scores achieved by Clearstream Banking					
Category	**+/- 2018-2019**	**2019**	**2018**	**2017**	**2016**
Client service*	12.33%	6.56	5.84	5.31	5.95
Operations*	0.00%	5.69	5.69	5.25	5.94
Techology*	-5.27%	5.39	5.69	5.25	5.94
Collateral management	2.22%	5.98	5.85	5.15	5.76
Product capability	14.29%	6.32	5.53	5.22	5.76
Total	5.94%	6.06	5.72	5.23	5.85

Weighted average scores achieved by Clearstream Banking versus the global averages				
Category	**2019**	**2018**	**2017**	**2016**
Client service*	7.36%	2.10%	-7.00%	3.30%
Operations*	5.37%	0.20%	-7.20%	3.30%
Techology*	2.47%	0.20%	-7.20%	3.30%
Collateral management	3.10%	0.20%	-7.20%	2.70%
Product capability	1.94%	1.90%	-4.90%	3.10%
Total	3.41%	1.10%	-6.70%	3.10%

**Client service was until this year combined with relationship management.* ***The operations and technology sections were combined until this year*

Client type	
Category	**2018**
Collateral takers	15.00%
Collateral providers	15.00%
Both collateral takers and collateral providers	65.00%

Collateral currencies	
Category	**2018**
US dollars	80.00%
Euros	75.00%
Sterling	60.00%
Japanese yen	45.00%
Swiss franc	40.00%
Danish krone	30.00%
Swedish krona	25.00%
Australian dollars	35.00%
New Zealand dollars	25.00%
Other APAC countries	n/a
Other currencies	n/a

Asset classes used as collateral	
Category	**2018**
Government securities	85.00%
Public agencies/sub-national governments	70.00%
Supranational agencies	75.00%
Corporate bonds	70.00%
Covered bonds	62.50%
Residential mortgage-backed securities (RMBS)	25.00%
Commercial mortgage-backed securities (CMBS)	25.00%
Other asset backed securities (ABS)	30.00%
CDOs, CLNs, CLOs, etc.	10.00%
Convertible bonds	25.00%
Equity	45.00%
Money market instruments (e.g. bills, CDs, LoCs)	30.00%
Cash	35.00%
Funds	15.00%
Other	n/a

Euroclear

Profile of Euroclear	
Average daily value of assets outstanding in tri-party	US$892 billion

Tri-party role	
Category	2018
Agent only	12.50%
Principal only	75.00%
Both agent and principal	12.50%

User profile	
Category	2018
Repo	100.00%
Securities lending	50.00%
Collateralisation of futures (i.e. margin management)	12.50%
Collateralisation of cleared OTC derivatives (i.e. margin management)	25.00%
Collateralisation of non-cleared OTC derivatives	25.00%
Re-use/re-hypothecation of assets	25.00%
Investment (i.e. investing in transactions as an asset class)	n/a

This year brings an end to the steady upward momentum of the period since 2016. Allowances must be made for the difficulty of making comparisons in the wake of the alterations to the questionnaire. The turn-out by clients is much reduced too. But there is an artlessness to the scoring which makes it ring true. After recording scores in half the questions that place Euroclear only in "satisfactory" territory, the average respondent declares that Euroclear is excellent value for money, will win more business and can be safely recommended to peers.

It might be argued that respondents are merely being realistic. After all, the duopolistic nature of tri-party in Europe (though the choice is narrower still in the United States) means that none of the shortcomings identified by a survey will cost the incumbents either present or future business. Network effects are at work too. Every user of tri-party needs as many potential counterparts on the same network as possible – a self-reinforcing factor which also makes it hard for new entrants to dislodge the incumbents.

It is no surprise to find that respondents believe Euroclear gives them access to a wide range of counterparties. But the apparent contradictions in the scoring do mean that survey respondents, however few in number, mean what they say. And the scoring of collateral management has undeniably slumped, albeit not to a worrying low level, or in terms of the basic responsibilities of a collateral manager.

In the quotidian work of valuing and substituting collateral, Euroclear is doing fine. The disappointment really stems from the more challenging tasks, such as mobilising collateral across borders, re-using assets, upgrade trades and managing collateral risk dynamically in real-time. This last point is echoed in the scoring of Euroclear for technology. Levels of automation are clearly lower than the respondents expect, and the need for human intervention higher than they would like.

The knock-on effects are visible in the assessment of operations, where respondents register dissatisfaction on the everyday tasks (exception handling and margin calls), the occasional needs (asset servicing) and the nice-to-have (data management and insights). The sum of these various gripes is want of innovation. But neither the technological not the operational misgivings prevent respondents acknowledging that Euroclear helps them make good use of their inventories, meet cleared and non-cleared margin calls efficiently, and keep on the right side of laws and regulations. They also think the ICSD will keep their assets safe, not least by segregating them effectively.

The area of most immediate concern is client service. Consistently impressive through each of the previous three years, it is now well below the survey benchmark and a full quarter behind the score achieved by the rival across the Ardennes. The problem is not the day-to-day contacts, or even the relationship managers, but a sense that Euroclear is not taking the trouble to understand the needs of its clients. This is of course an occupational hazard of any duopolist in any industry. But the senior management of the Brussels-based ICSD will not fail to hear the uncomfortable resonances of an historical culture they appeared in recent years to have overcome.

Weighted average scores achieved by Euroclear					
Category	+/- 2018-2019	2019	2018	2017	2016
Client service*	-18.11%	4.93	6.02	6	5.94
Operations*	-23.62%	4.56	5.97	5.92	5.81
Techology*	-20.94%	4.72	5.97	5.92	5.81
Collateral management	-14.84%	5.28	6.2	5.78	5.71
Product capability	8.06%	6.17	5.71	5.7	5.75
Total	-9.72%	5.39	5.97	5.85	5.8

Weighted average scores achieved by Euroclear versus the global averages				
Category	2019	2018	2017	2016
Client service*	-19.31%	5.20%	5.10%	3.20%
Operations*	-15.56%	5.30%	4.60%	1.00%
Techology*	-10.27%	5.30%	4.60%	1.00%
Collateral management	-8.97%	6.10%	4.10%	1.80%
Product capability	-0.48%	5.30%	3.80%	2.90%
Total	-8.02%	5.40%	5.10%	3.20%

**Client service was until this year combined with relationship management.* ***The operations and technology sections were combined until this year*

Client type	
Category	**2018**
Collateral takers	12.50%
Collateral providers	25.00%
Both collateral takers and collateral providers	62.50%

Collateral currencies	
Category	**2018**
US dollars	75.00%
Euros	87.50%
Sterling	37.50%
Japanese yen	25.00%
Swiss franc	12.50%
Danish krone	12.50%
Swedish krona	n/a
Australian dollars	12.50%
New Zealand dollars	n/a
Other APAC countries	n/a
Other currencies	n/a

Asset classes used as collateral	
Category	**2018**
Government securities	87.50%
Public agencies/sub-national governments	75.00%
Supranational agencies	75.00%
Corporate bonds	75.00%
Covered bonds	50.00%
Residential mortgage-backed securities (RMBS)	n/a
Commercial mortgage-backed securities (CMBS)	n/a
Other asset backed securities (ABS)	12.50%
CDOs, CLNs, CLOs, etc.	n/a
Convertible bonds	12.50%
Equity	37.50%
Money market instruments (e.g. bills, CDs, LoCs)	12.50%
Cash	12.50%
Funds	n/a
Other	n/a

SIX Exchange Services

Profile of SIX Exchange Services	
Average daily value of assets outstanding in tri-party	Not disclosed

Tri-party role	
Category	**2018**
Agent only	Yes
Principal only	No
Both agent and principal	n/a

User profile	
Category	**2018**
Repo	Yes
Securities lending	Yes
Collateralisation of futures (i.e. margin management)	Yes
Collateralisation of cleared OTC derivatives (i.e. margin management)	In discussion with clients
Collateralisation of non-cleared OTC derivatives	In discussion with clients
Re-use/re-hypothecation of assets	Yes
Investment (i.e. investing in transactions as an asset class)	No

SIX did not attract enough responses to be formally assessed this year. Those that it did receive confirm that the strength evident a year ago in client service remains in rude health. And the Zurich-based ICSD would argue that, with 160 accounts being migrated on to a new platform, giving clients a sabbatical from the survey is entirely consistent with maintaining their respect.

If the new Future Tri-Party Agent (FTPA) service works as intended, it will certainly win plaudits in this survey next year. It promises users a comprehensive real-time view of all collateral either in use or available for use across all of their financing activities. With the existing CO:RE collateral trading platform being integrated into FTPA, the new service effectively erases the distinction between the front office and the back. The benefits, in terms of optimising the deployment of collateral, are obvious.

But collateral management was already strong at SIX. Where the new technology is likely to make a larger impact, especially as it matures, is on the issues evident in the scoring of product capabilities a year ago – namely, limited reach across geographies, counterparties and asset classes. For now, SIX remains a wholly European, and primarily Swiss, tri-party collateral manager. The investment in FTPA is a bet that technology can secure new business for SIX, not just by spawning services that free market participants to jettison legacy systems and services in favour of a single window into all their collateralised financings, but across borders too. If the ICSD can deliver on that promise, the capital savings alone will more than cover the costs of the migration for users, let alone any efficiency gains in the management of collateral.

SIX also sees FTPA not as a destination, but as the start of a technological journey into a largely digital future. It is already looking to incorporate findings from its experiments – undertaken in conjunction with Digital Asset – into the application of distributed ledger technology (DLT) to the repo market. SIX also expects artificial intelligence to prove useful in identifying further cost savings and enhanced returns in the collateral markets. But even the finest technology cannot earn its reward unless the collateral markets continue to grow. Over the last 12 months, SIX has found demand for its tri-party services undimmed, but it has also noticed a decisive shift towards the highest quality paper. This fits a wider pattern. The biennial International Capital Market Association (ICMA) survey of the European repo market has for some years tracked a shift towards the highest rated paper. Regulation of the OTC derivative markets under the European Market Infrastructure Regulation (EMIR) is changing the nature of the firms that can make use of tri-party services, and SIX is already talking to buy-side firms affected by the need to meet margin calls in both their cleared and uncleared OTC derivative business.

Despite its similarity to EMIR, the Securities Financing Transactions Regulation (SFTR), which affects disclosure and reuse as well as requiring counterparts to report collateralised trades to a trade repository, is at least as likely to shrink the size of the collateral market as expand it. In market conditions such as these, characterised by new client types, regulatory constraints on growth and rising demand for the highest rated paper, a single window into what collateral is available, and where and when, is certainly designed for success.

Weighted average scores achieved by SIX Exchange Services					
Category	**+/- 2018-2019**	**2019**	**2018**	**2017**	**2016**
Client service*	n/a	n/a	5.96	6.02	5.79
Operations*	n/a	n/a	5.85	5.76	5.83
Techology*	n/a	n/a	5.85	5.76	5.83
Collateral management	n/a	n/a	5.84	5.38	5.56
Product capability	n/a	n/a	4.96	5.14	5.4
Total	n/a	n/a	5.66	5.58	5.65

Weighted average scores achieved by SIX Exchange Services versus the global averages				
Category	**2019**	**2018**	**2017**	**2016**
Client service*	n/a	4.20%	5.40%	0.60%
Operations*	n/a	3.00%	1.80%	1.40%
Techology*	n/a	3.00%	1.80%	1.40%
Collateral management	n/a	-0.10%	-3.10%	-0.90%
Product capability	n/a	-8.40%	-6.40%	-3.40%
Total	n/a	-0.10%	-0.40%	-0.60%

**Client service was until this year combined with relationship management.* ***The operations and technology sections were combined until this year*

Client type	
Category	**2018**
Collateral takers	Yes
Collateral providers	Yes
Both collateral takers and collateral providers	Yes

Collateral currencies	
Category	**2018**
US dollars	Yes
Euros	Yes
Sterling	Yes
Japanese yen	Yes
Swiss franc	Yes
Danish krone	Yes
Swedish krona	Yes
Australian dollars	Yes
New Zealand dollars	Yes
Other APAC countries	n/a
Other currencies	Yes

Asset classes used as collateral	
Category	**2018**
Government securities	Yes
Public agencies/sub-national governments	Yes
Supranational agencies	Yes
Corporate bonds	Yes
Covered bonds	Yes
Residential mortgage-backed securities (RMBS)	No
Commercial mortgage-backed securities (CMBS)	No
Other asset backed securities (ABS)	No
CDOs, CLNs, CLOs, etc.	No
Convertible bonds	Yes
Equity	Yes
Money market instruments (e.g. bills, CDs, LoCs)	Yes
Cash	Yes
Funds	No
Other	n/a