# DTCC FORUM 2020

## 2021: CHALLENGES AND PRIORITIES IN GLOBAL POST-TRADE

CONTENTS



# CCP CHALLENGES, FROM LIQUIDITY TO LIBOR

**In a wide-ranging "fireside chat" touching on topics that dominated the financial services industry during 2020—ranging from the impact of the COVID-19 pandemic to operational resilience and Brexit—DTCC President and CEO Mike Bodson and Daniel Maguire, Group Director, Post-Trade Division, LSEG, and LCH CEO, shared insights and experiences on how market infrastructures successfully addressed those challenges and were planning for the future.**

**The conversation, held during the virtual DTCC Forum on Dec. 1, was streamed live to more than 500 participants and is summarized here.**

## INFRASTRUCTURE PERFORMANCE

**Bodson:** It's hard to start any conversation about 2020 without talking about COVID and the massive impact it had. The first two weeks of the crisis were chaotic and stressful for clients and infrastructure, but there was pretty amazing performance by CCPs and firms' back offices across the globe. What was LCH's experience?

**Maguire:** COVID has been the first real test of the post-2008 financial ecosystem and the headline is, that global market infrastructure has proved pretty resilient. We maintained financial stability -- but that's our job, to absorb and manage risk, not amplify it. Clearinghouses and other infrastructure were a source of calm in the markets.

During March 2020, we saw unprecedented volatility, which was reflected in unprecedented trading and clearing volumes. At LCH, in some asset classes we saw daily activity many times greater than average -- but there was no need to adjust our opening times or change our processes or margin models. Beyond us, the wider ecosystem of clearing brokers, dealers, settlement agents all performed well and behaved predictably.

## REMOTE WORKING AND RETURN-TO-OFFICE PLANS

**Bodson:** At DTCC, 95% of us are working remotely and we've seen amazing performance. We have a team looking at continuing remote work after COVID and what the workplace will look like. Our view is, until vaccines are much more readily available, we'll stay remote, probably until mid-year. What are your plans for going back?

**Maguire:** We are continuing to focus on the welfare of our colleagues, as well as ensuring orderly functioning markets. As a global organization, LSEG is following local guidance in the jurisdictions we operate in.

The majority of our colleagues are continuing to work remotely, and we expect a gradual return in some locations where public guidelines and the status of the pandemic allows. We have demonstrated being able to run our collective infrastructure with high operational resilience. There's a cultural element of returning to the office, in terms of collaboration and customer interaction. That said, some of the new ways of working will persist.

## MANAGING VOLATILITY

**Bodson:** We saw volumes triple, especially in the equity markets, back in March. We had five days of 350 million trade sides, a new peak, which sparked a lot of discussion of margining and post-cyclicality -- although it always shocks me if anyone who's in the market doesn't know what VaR models will do under stress. What did you face?

> **"COVID has been the first real test of the post-2008 financial ecosystem and the headline is, that global market infrastructure has proved pretty resilient."**

**Maguire:** Our margin models behaved exactly as expected.

Under EMIR, we're required to have anti-procyclical measures embedded in our margin models. We've invested quite a bit of intellectual and financial horsepower in our models over the last decade, to make sure we have anti-procyclical measures in place, for example, incorporating longer look-back periods in our models. That means, in a more 'peacetime' environment margins don't go too low, and in times of volatility – there aren't huge spikes in margin.

For some of the bigger asset classes, like interest rate derivatives, our initial margins increased incrementally. That was primarily driven by new risk positions being introduced to the clearing house. Variation margin (VM) also continued to be called to mark to market on the portfolio.

The FSB said recently that, in terms of collateral posted to the CCPs, at this year's peak it was 2% to 3% of banks' available cash. While funding is expensive, VM is highly predictable and our IM is based on a simple algebraic calculation. Our models did what they said they'd do, and remained predictable, with no change to any processes.

## OPERATIONAL RESILIENCE

**Bodson:** Our colleagues around the world over the last month have seen a rash of system issues, glitches causing trading to come to a halt or having other impacts. The Digital Operational Resiliency Act (DORA) is coming out in Europe but regulating operational resilience is very difficult across different platforms and market structures. How do you think about operational resilience?

**Mike Bodson**
DTCC President and CEO

**Daniel Maguire**
Group Director, Post-Trade Division, LSEG, and LCH CEO
Read more about Daniel Maguire >

### RELATED CONTENT

The U.S. Treasuries Clearing Challenge: Finding the Right Incentives

COVID-19 Impact on SIFMUs and Global Financial Markets

> **Global regulations on resilience should focus on outcomes and all having the same high standards. My fear is, in the world of cyber, it's changing so fast that rules could become prescriptive and backwards looking.**

**Maguire:** As a clearing house, we've got to be predictable and metronomic: a port in the storm. We are heavily focused on our operational resilience and capability. Our operational performance in March and April is a clear demonstration of this focus.

We constantly test our technology and processes, checking everything from capacity to resilience. It's a key priority for our Board and risk committees and we recognize the importance of embedding a culture of operational resiliency throughout the organization.

As for DORA, it's complex in scope and covers every part of the financial industry. It's raising the bar to make sure all participants are conscious of their role as part of an ecosystem. We're supportive of this work and would encourage global standardization in this area.

**Bodson:** This is not an area of competition but of mutual dependence. Global regulations on resilience should focus on outcomes and all having the same high standards. My fear is, in the world of cyber, it's changing so fast that rules could become prescriptive and backwards looking. Convergence of regulations is great as long as we get to the same outcomes.

## BREXIT

**Bodson:** How have you prepared for Brexit? How will it impact your business?

**Maguire:** We've spent a lot of time and effort behind the scenes with authorities on the Continent, in the US and the UK preparing. As a Group, we are well positioned for Brexit. From LCH's perspective, LCH SA has the appropriate recognition in place and can continue to offer services in the UK and the rest of the world.

LCH Limited, the UK CCP, will become a third-country clearinghouse to the EU. The constant message we've gotten from all clients, in the EU and elsewhere, is they want continued access to LCH Limited and our global liquidity pool. LCH Ltd has gotten the okay to continue operating under a temporary equivalence until June 2022, which gives us some degree of comfort and allows our customers to continue to access LCH's clearing services. March and April really showed that people gravitate to liquidity and that all markets need unfettered access to global liquidity. We're hoping to achieve permanent recognition in the months and years to come.

## LIBOR

**Bodson:** Last topic: Libor. The Fed has said recently it wishes to speed the transition and cut off the use of Libor. But it's such an important part of what you do.

**Maguire:** The shift to alternative reference rates is huge and existential. It's good to see the public and private sectors, including regulators across the globe, work together to achieve this transition.

What have we been doing? LCH sits in the middle of a lot of interest rate-linked derivatives; 80% of the notional outstanding at SwapClear are linked to LIBOR. Over the course of the year, in a huge choreography with other clearinghouses, we've taken a significant step, which is transitioning from a discounting perspective all the Euro notionals, about €80 trillion, to €STR and re-referencing from a discounting perspective about US$120 trillion, some 1 million trades, from Fed Funds to SOFR. There's a lot more to be done but as an industry, I think we're on the right path.

# CONSIDERING THE FUTURE OF GLOBAL REGULATION

**Is global regulation of financial services headed toward convergence or divergence?** On this topic -- the theme of the first of two sessions at the 2020 DTCC Forum on December 1st—the consensus was clear: the future lies in convergence.

Despite recent political trends favoring more parochial regulations, panelists along with Forum attendees who were polled in advance saw a converging of regulations as desirable and inevitable.

This year's Forum, held for the first time via global webcast, had more than 500 attendees across multiple time zones and was focused around the theme of 2021's challenges and priorities in global post-trade.

Panel moderator **Andrew Douglas, DTCC Managing Director for Government Relations, EMEA & Asia,** opened the conversation by asking the three panelists to define what regulatory convergence should look like.

**Tara Rice, Head of Secretariat, Committee on Payments and Market Infrastructures (CPMI) at the Bank for International Settlements (BIS),** called for distinguishing regulations from standards. "International standards provide guidance and consistency. They are principle-based. They don't describe a particular, granular way rules are addressed. The CPMI supports overarching international standards for FMIs." By contrast, she said, "Yet, the manner in which individual jurisdictions choose to implement standards is up to those jurisdictions. Variation in practice is okay, but not divergence in outcome."

"My definition of convergence is moving toward one another to achieve a common result – like increased central clearing or useful reporting structures for OTC," said **U.S. Commodity Futures Trading Commission (CFTC) Commissioner Dawn DeBerry Stump.**

Divergences occur in the different paths jurisdictions take to get to the result, she said. "Sometimes divergences flow from differences of opinion among regulators. Since the Group of 20 (G20) issued its mandates [in 2009], going in different directions has created compliance conflicts and obstacles injected by regulators themselves. We've learned from what we've done well, which helps now to address compliance conflicts."

**Fabrizio Planta, Head of Markets and Data Reporting at the European Securities & Markets Authority (ESMA),** emphasized supervisory convergence – developing detailed rules that multiple jurisdictions are willing to implement and applying the rules in a consistent manner. "It's one of our main objectives at ESMA," he said. He cited bilateral margin standards as an area where regulators have successfully demonstrated this approach.

## COLLABORATION VS COMPETITION

Asked by Douglas about lessons learned from the negotiations between the CFTC and European authorities, Stump said the regulators made tremendous progress in swap data reporting as well as clearinghouse rules. She noted that Dodd-Frank established a framework that encourages better communication among regulators.

**Andrew Douglas**
DTCC Managing Director, Government Relations, EMEA & Asia

**Tara Rice**
Head of Secretariat, CPMI at BIS
Read more about Tara Rice >

**Dawn DeBerry Stump**
U.S. CFTC Commissioner
Read more about Dawn DeBerry Stump >

**Fabrizio Planta**
Head of Markets and Data Reporting at ESMA
Read more about Fabrizio Planta >

> **The industry is much-better positioned today regarding margin, risk and transparency from implementing trade reporting following the 2008 crisis.**

Both the CFTC and ESMA have "implemented common data elements [for swap data reporting]," Planta added. "One principle we agreed on was, if we use the same element, we need to report it consistently. Local variations are allowed and not all the elements should be used by all jurisdictions." The agencies also worked together on the implementation timetable, to make life easier for the industry, he said.

Is divergence bad, Douglas asked, if it manifests itself as competition? Competition among service providers is beneficial; what about between regulators?

"Such competition is not good," Planta said. "It doesn't make our markets safer or more efficient."

"As regulators in international bodies and bilateral conversations we've challenged each other -- not adversarial but in attempts to get aligned around a common goal," said Stump.

She acknowledged that, "because the US was first to implement [trade reporting rules], we suffered from some first-mover disadvantage." Over time, a focus on results "prompted us to reset to work towards convergence and it's been to our benefit."

## TRADE REPORTING GAINS

In the panel's closing minutes, Douglas posed two questions submitted by audience members. First, will we see global convergence on future Securities Finance Transactions Regulation (SFTR) mandates? Panelists demurred from commenting, preferring instead to reiterate that jurisdictions should seek where possible to apply standards in a consistent manner. Rice added that, with jurisdiction-level regulations, one size does not necessarily fit all.

As for insights regulators have gained from trade reporting implemented following the 2008 crisis, Planta and Stump concurred the industry is much-better positioned today regarding margin, risk and transparency.

"These improvements showed value during the COVID-19 crisis too," Planta said.

"We're certainly better off than 10 years ago when we had no data on the OTC market, and in fact we were told specifically not to regulate OTC," said Stump.

In Europe, Planta noted, trade repository data is widely available to many regulators, who use it in a number of ways, including statistical reports on the derivatives market, activity reports on non-financial counterparties, and market monitoring in the context of Brexit and COVID-19.

The data collected is also improving over time, according to Stump. "We initially sought to take in data sets that weren't necessarily useful," she said. "Now we're on the verge of implementing 'Swap Data Reporting 2.0' – a refinement of the data we need based on what we've learned."


### RELATED CONTENT

DTCC Launches Consulting Services

Regulators Narrow the Distance to Reach Data Standardization for Global Derivatives Reporting

DTCC Acquires Sapient's Pre- and Post-Reporting Platform

# CCPS AND TECHNOLOGY

DTCC's Annual Forum, convened this year in a webcast format, elicited a number of thoughtful questions from attendees around the broad topic of CCPs and technology. Because time ran short, DTCC President & CEO Mike Bodson was unable to address the questions during the Forum. Instead, we presented several of them to the company's top thought leaders in the fintech space, **Managing Director for Business Innovation Jennifer Peve and Managing Director and Global Head of Technology Research and Innovation Rob Palatnick.**

### JENNIFER PEVE

**Are fintech firms in the financial market infrastructure (FMI) space threats or complements to your business model?**

Both FMIs and emerging fintech players are innovators and each brings something valuable to the table. Incumbents such as FMIs have been innovating for decades to make the industry more efficient, and are known for their ability to deliver robust, resilient technology at scale on behalf of the industry. Whereas Fintech firms are known for focusing on delivering key capabilities in new and clever ways that can complement existing processes and workflows.

Ultimately, this comes down to innovating responsibly, employing the right technology and approach to achieve the best result for clients, and therefore, combining the strengths of FMIs with key partnerships with Fintech players has the potential to result in high value solutions for clients.

Do you foresee a trend of FMIs providing industry-authoritative data stores for broker/dealers, particularly to improve post-trade processing?

FMIs seek to implement data standardization, which results in the creation of data stores for the industry. If you think about it, every single FMI has a data store for its community – NASDAQ's records of traded activities, for example, or DTCC's data on equities cleared with us. These data stores absolutely enhance post-trade processing: by improving data standards up front at the point of data flows, FMIs improve downstream uses of that data. The opportunity lies in how to leverage these data stores in a way that enhances the post-trade space.

**Do you foresee that present infrastructure systems will be adapted to tap private markets with service offerings, or will there be a need to design a new, adjacent private market system infrastructure from the ground up? If so, why?**

Private markets have emerged as an area where the industry has an opportunity to create, rather than just adapt. So, yes, creating new, adjacent infrastructure in this space is possible.

Last year, we executed Project Whitney, a trial 100% focused on creating a digital platform for the private market space.

Because private markets lack the integrated infrastructures that exist for public markets or other asset classes, we saw an opportunity to create a new ecosystem for participants in this space. Furthermore, current technology solutions that could help private market stakeholders are fragmented and siloed – or primarily address the needs of late-stage pre-IPO companies. We saw a role for blockchain here, to create long-term value for these stakeholders – the ability to support data privacy, resiliency and ownership in ways that do not exist today.

**Jennifer Peve**
DTCC Managing Director for Business Innovation
Read more about Jennifer Peve >

**Rob Palatnick**
DTCC Managing Director and Global Head of Technology Research

**RELATED CONTENT**

Key Considerations For Successful Cloud Adoption In Financial Services

The Digital Upgrade To Paper-Based Trade: DLT In Private Markets

To maximize operational and cost efficiencies, we designed a digital securities management platform that would drive a network effect across multiple stakeholders – issuers, placement agents, fund administrators, transfer agents, alternate trading venues. The platform would run discrete services such as transaction consent and compliance around private market transactions, leveraging cloud computing and smart contracts.

DTCC's vision to bring private market stakeholders onto a common platform was brought to life through the Whitney prototype and demonstrated how a digital platform could provide common services and create a number of efficiencies for the industry – and potentially foster new business models.

### What impact will DLT have on DTCC's future business models? Please share your vision and roadmap of projects embracing DLT.

We expect to see new business opportunities evolve as DLT networks are adopted like the way the internet introduced new business models such as the introduction of electronic trading applications for retail customers. And while there are many unknowns when it comes to the exact future business models that may emerge, opportunities in governing and/or operating a DLT network on behalf of an industry consortium is one that is often discussed.

Over the last five years, DTCC has demonstrated its commitment to understanding the full potential of DLT through various initiatives. And recent experiments such as **Project Whitney** and **Project Ion** are examples of our recent efforts. In 2021, we will continue to explore digital assets across various asset classes and process to understand where best to maximize opportunities, and seek to quantify the client value of DLT in certain use cases such as Project Ion.

Although DLT is not necessarily an end-to-end answer for every business or process, there certainly will be opportunities for firms to embrace it as part of their solutions toolbox.

## ROB PALATNICK

### How will crypto-currency impact markets and the regulatory landscape?

We've seen markets and regulators taking a very cautious approach to crypto assets in general. They're trying to make sure appropriate investor protections are in place, as with any new asset class. These protections include all the usual elements for any modern financial asset, such as know-your-customer, resiliency and anti-money laundering and that trading marketplaces are operated and overseen in a manner consistent with other regulated markets that have investor confidence. We should expect this approach as the market continues to evolve. We're working with our clients in the industry and our regulators to find the right opportunities for DTCC to help in this evolution.

### With many different firms doing DLT proof of concepts and creating multiple blockchains in the ecosystem, are we truly solving our integration problems or are we creating a new layer of complexity that everyone will need to integrate?

The answer is yes. The evolution of financial services processes and technology has always proceeded through experiments and evaluations with leading edge technology often supporting innovations in financing, trading and investment opportunities in existing, or previously untapped assets classes. As the more successful experiments mature, the need to expand the scale of the innovation and open the idea to more investors, and often to converge different approaches to the same idea, drives the financial industry and tech industry come together on standards and create common protocols and common processing workflows.

Today, it's absolutely true that various different DLT models are being evaluated and different technology stacks are being leveraged. But early in the evolution of any new technology or processing model it's very hard to pick winners and often the final and best implementations are built on the lessons and mistakes and failures of the early movers.

It is highly unlikely that a single ledger technology will emerge as a global winner, and it is not even clear that would be a desired outcome, given the innovation, resiliency and security that come from more diverse ecosystems. So, interoperability between ledgers will become a requirement to support real-world financial transactions. Organizations like Hyperledger and other standards bodies are already emerging and driving the right level of thoughtfulness and experimentation. Interoperability protocols have been proposed and are like to result from those efforts.

A primary value of DLT is its ability to eliminate layers of reconciliation because there is a single version of the truth. But it's fair to ask, with so many different models and technology stacks being explored, are we creating more complexity or solving a problem? We should know that this early in the lifecycle of a innovative technology like this, no one can really know what the final state will look like. I do expect at some point the different approaches will come together.

DTCC
ADVANCING FINANCIAL MARKETS. TOGETHER.™