The growing pains of securities financing within Asia

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Singapore-based Vice President of Global Securities Finance at ING Bank

Much of the appeal of Asia's financial markets lies in the range of opportunities provided by its diverse nature, versus the more developed frameworks of the US and European markets.

But as Asia's securities finance markets mature, frustrations can arise for market participants due the constraints resulting from a fragmented landscape.

A lack of diversity

According to Sean Bunyan, Head of Financing Sales for Asia at Standard Chartered Bank, the region's securities financing activity mainly falls into three broad categories: international prime brokers and securities lenders looking to support typically equity-focused borrowing and lending transactions; large fixed income-based markets dominated by major domestic banks, such as Japan and Australia; and smaller, emerging markets, in which local banks use repo trades to meet short-term financing needs.

"But overall, the number of participants in each market silo is not necessarily that big, which can make the mobility of assets more difficult to achieve," he said, speaking at a panel session – 'The changing dynamics of security financing' – at Euroclear's Asia Collateral Conference 2016, held in Hong Kong in late November.

Bunyan cited Australia as an example of a large and mostly liquid securities financing market, which nevertheless struggled to function as efficiently in times of market stress, due in part to a narrow base of market participants.

"This is the result of a lack of diversity, not only in terms of banks but also non-banks: Aussie government bonds are not necessarily on their schedule for repo collateral even though, from a credit perspective, many market participants are willing to hold them," he said, contrasting the travails of the Australian government bond market with the ability of the vast US Treasuries market to absorb marked swings in demand because of its range and quantity of market participants.

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Sean Bunyan, Head of Financing Sales for Asia at Standard Chartered Bank

The trend remains positive

Despite such structural and regulatory constraints in individual markets, prevailing global trends have encouraged the growth of Asian securities financing activity.

Aditya Bhargava, Singapore-based Vice President of Global Securities Finance at ING Bank, said Asia had experienced an increase in volumes and participants in recent years, driven in part by a significant growth in debt capital markets issuance.

"Most of the repo dealers that we speak to across the street have seen a big increase in activity," he observed. "Balance sheet restrictions globally have had an impact, but returns in Asia are still quite attractive."

The pursuit of new yield opportunities and the diverse implications of post-crisis capital adequacy regulations are contributing factors to rising activity in Asia's repo and securities finance markets, panellists asserted.

More is needed

But they also suggested further initiatives were still needed to increase participation, thus utilising a greater share of available collateral, and boosting liquidity and market development in the longer term.

While the roll-out of the Basel III capital adequacy framework has had a profound impact on the securities finance market in Asia, its influence has not always been uniform.

Cash collateral from corporates might be more attractive to most financial institutions in the repo markets under its Net Stable Funding Ratio (NSFR), but the widely different impacts of Basel III – determined by factors including size, structure, jurisdiction and the approach of individual institutions to compliance – has led to a diverse range of needs that the repo and securities finance markets have adjusted to fulfil in recent years.

Diversifying risk

Although largely content with bank deposits, Asia's corporate treasurers are highly sensitive to the risks of relying too heavily on one instrument to fill their cash investment needs.

Yields can rise and fall, regulations can change incentives and appetites overnight, unexpected market events can impact systemic stability, panellists acknowledged.

"Ten years ago, extreme market stresses prevented corporates from placing deposits and they may face similar challenges in the future," warned Jack Cheung, CEO of Hong Kong's Treasury Markets Association, and a former banker.

Whether attracted by the prospect of higher returns or the need to diversify, treasurers must offset potential gains against the costs of entering and maintaining participation in an unfamiliar market.

Differing interpretations of common rule

Noting the increased prevalence of longer tenors and evergreen trades in Asia's repo markets, as banks look to secure high-quality liquid assets to meet regulatory requirements, panellists agreed that Basel III's impact varies not only between firms, but also departments and desks.

The suggestion is that different banks may well take different approaches to similar, if not identical, trades.

One bank's treasury might tell its repo desk that it needs to be fully NSFR-compliant, while another might believe

50% NSFR-compliance is good enough due to a strong overall position.

Two banks with a similar capital structure or credit rating may view the same trade differently due to differing internal rules.

Such diversity has generated a healthy variation of demand, panellists said. Although this made it easier to match counterparties than a more one-dimensional market, they perceived a growing trend toward sharp differences in valuation.

"I foresee banks pricing the same bond completely differently – and by a significant margin. For smaller non-deposit-taking banks, buying short-term paper may no longer be attractive. There is a risk that CD (certificates of deposit) programmes could suddenly grind to a halt," warned Bhargava.

How standardisation can help

Prompted by moderator Olivier de Schaetzen, Head of Product Solutions for Collateral Management at Euroclear, panellists identified developments that could further prompt a sea-change, raising Asia's securities finance volumes beyond the isolated pools of liquidity that have characterised the market to date.

Acknowledging the deep, domestic fixed-income liquidity in large, sophisticated markets such as China, India and Korea, Vijay Chander, Executive Director for Fixed Income at Asian Financial Markets Trade Association ASIFMA, suggested Asia could leverage regional standardisation initiatives to mobilising assets more effectively beyond national borders.

In particular, European efforts to create a 'simple, transparent and standardised' securitisation market could be used by Asian jurisdictions to generate high-quality assets within a widely-accepted framework, this guaranteeing their portability.

"There's a lot of thinking going into making securitisations work again and it would be good if Asia could align itself with these efforts," he said.

Opening the doors to foreign investors

Closer to home, Chander noted that developments in China – such as the opening up of interbank bond markets to foreign investors and the growing sophistication of its derivatives markets – could have implications for the region's securities financing markets, in terms of demand, supply and mobility of collateral assets.

ING's Bhargava suggested that the ability of the Philippines and Indian markets to fulfil their growth potential depended largely on approach of regulators to opening up onshore markets.

"There have been a lot of discussions recently and I am hopeful that these will help to unlock collateral in the region," he said. "Regulators are open to foreign participation but in a very controlled manner."

While Asia offers greater diversity than Europe and the US in terms of the range of market structures and potential opportunities, it trails them in terms of breadth of participation.

The combination of 'low-to-no-to-negative' interest rates on cash deposits and the after-shocks of the financial crisis has increased the openness of western corporates and Non-Bank Financial Institutions (NBFIs) to opportunities of the repo market.

This greater diversity of participation has helped US and European repo markets offset the negative impacts of Basel III, but has not yet found an echo in Asia.

"Asian NBFIs have not had a crisis situation. For them, bank deposits are still a very safe and simple product," said Bhargava. "It will take time to overcome the disconnect between corporates and repo dealers."

Standard Chartered's Bunyan acknowledged that there were difficulties in reconciling the needs of international banks and Asia's NBFIs and corporates, notably on the question of tenor.

But, with securities finance markets in Asia and beyond looking to stimulate liquidity, he asserted that there was increasing evidence that the ecosystem would be more diverse and complex in future.

"Over the past three years we've seen non-bank market participants willing to put their government bond portfolios to work, thus facilitating the term financing requirements of the big global banks. There is more to do, but it has begun," he said.