

Bank of England

Bank of England Securities Lending Committee: Working Group on Settlement Efficiency

Foreword

Andrea Rosen, Director, Markets, Bank of England

The Securities Lending Committee serves as a forum for UK market participants to meet and discuss issues concerning the UK securities lending market. The Bank attends the forum as an Ex-Officio member and provides Secretariat support. Through its work, members noted reports of elevated levels of settlement fails in 2023, particularly on the return leg of transactions.

In the summer of 2023, the Committee initiated a Working Group (“the Working Group”) for investigating and highlighting the issues around settlement efficiency in the UK, building on the work conducted by the International Securities Lending Association. The Group drew on expertise from across the industry to monitor the market, conduct investigations and gather data. The Group also considered the wider interaction across related markets and jurisdictions. In conducting these investigations, the Group was able to identify the drivers and impact of fails in the securities lending market.

The following report serves as a valuable tool for participants, highlighting solutions from best practice to investment, which are of particular importance as the UK approaches an accelerated settlement regime by 2027.

The Bank is pleased to provide its support to the Working Group and appreciates the work of those who have contributed to the report. The recommendations which the Working Group have made will ensure best practice across the market.

To maintain the role of the UK securities lending market in delivering settlement certainty to those that seek to lend or borrow securities, market participants are strongly encouraged to consider the following report, as it relates to achieving a robust settlement rate and a more transparent, real-time framework to address failing or failed securities transactions.

Executive Summary

The Working Group's investigations since H2 2023 confirmed that the persistent level of settlement failure within the UK securities lending market would be significantly reduced with the adoption of the following principles:

- Enhanced static data management
- Real-time communication of position-impacting data between parties
- Consistent trade and lifecycle event instruction discipline
- Increased investment in pre and post trade automation
- A market-wide adoption of industry best practices

Introduction

The Securities Lending Committee Working Group on Settlement Efficiency (“Working Group”) was convened to examine the drivers and impact of settlement failure in the UK securities lending market, drawing comparisons from global markets where relevant. The impact of failed securities lending trades can be felt far beyond the lending market, leading to potential elevated fail costs across capital markets and reducing confidence in lending as a key liquidity provider to repo, cash and collateral markets.

Investigations included a review of potential solutions available to market participants with a focus on automation, operational resilience and best practice, as we consider the progression towards accelerated settlement across global markets.

This bulletin will be the first in a series, the second of which will be presented in the autumn and will review the impact of accelerated settlement in the US and Canada (both large securities lending markets) and will take a deeper dive into the data highlighting the settlement challenges in the UK securities lending market.

Recommendations

We start with our recommendations to all market participants. To alleviate the current level of settlement fails in the UK securities lending market, participants are strongly encouraged to implement the following set of recommendations set out by the Working Group and recognised by the Bank of England's UK Money Market Code.

- Invest in appropriate automation to remove manual intervention in the trade management process and associated lifecycle events.
- Focus on pre-trade position certainty through timely resolution of contract exceptions.
- Manage transaction exceptions on a real-time basis and prioritise settlement of transactions which facilitate an onward market delivery.
- Instruct based on known holdings on value date, refraining from releasing instructions which are reliant upon future dated inventory availability to ensure settlement. Improve recall discipline through more timely communication of recall requirements at the earliest opportunity, on trade date.
- Ensure that both parties exchange a complete suite of standard settlement instructions across lender accounts prior to initiating trades.
- Establish a standardised protocol for the timely communication of lender-actioned fund reallocations, to ensure future settlement of returns.
- Deliver an industry standard partial settlement model for UK lending return transactions.
- Ensure securities lending data integrity by instructing trades with recognised industry standard classification, thus permitting simplified monitoring and development of the securities lending market.
- Implement a robust operational continuity plan with regular reviews, to ensure global teams and supporting technology infrastructures continue operate during any challenging event.

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Settlement Trends



Despite relatively high settlement efficiency rates for fixed income securities within lending programmes, the UK securities lending market has recognised ongoing challenges in further optimising settlement processes and settlement rates.

Market participants recognise the resource and settlement risk impacts of current manual processes and that these challenges may become more acute considering potential regulatory changes and the move to T+1 settlement cycles.

Addressing these issues will not only improve settlement efficiency but also unlock the full potential of the UK securities lending market by:

- Reducing operational costs: Streamlined processes minimise manual intervention and rework, leading to cost savings.
- Enhancing market liquidity: Improved efficiency allows for faster and more reliable transactions, ultimately increasing liquidity in the market.
- Mitigating counterparty risk: Timely settlements minimise the time window for potential counterparty defaults.

By working collaboratively, regulators, industry bodies, and market participants can develop and implement solutions to optimise settlement efficiency in the UK securities lending market. This will ensure the market remains competitive and adaptable in the face of evolving global trends.

The Importance of Transaction Management Discipline – a CREST case study

For Securities Lending and Repo, the CREST platform plays a crucial role in facilitating the transfer of loaned and repo'd securities between the two parties of a transaction. An enhanced data set is provided to CREST to capture the specifics of a lending or repo contract in a central registry. The CREST registry tracks all open loans, borrows and Repos including updates to each contract - matching status, settlement notification, daily mark to market, interim returns and the final close out of the contract between both parties. Each new deal is marked as either SLO (Stock Loan Open) or RPO (Repurchase Obligation), which defines the required data points needed in CREST and which are supplied by each party to the contract e.g., trade date, value date, term date, fee rate and collateral type.

These data elements are a core requirement for settlement and for future event related activity to be processed accurately and in a timely manner.

Leveraging the standardised framework of the CREST registry and the deal matching/ settlement processing, both parties experience a high rate of settlement on new loans. Lenders will settle deliveries from available asset pools and both parties actively exchange information on the status of settlement, responding to any failing activity to maximise settlement on expected value date.

Borrowers optimise inventory positions and return loans as soon as necessary, to reduce funding costs and borrow fees. Borrowers project their inventory requirements on a daily basis and calculate loan returns based upon expected settlement activity across their accounts.

Borrowers are therefore reliant upon all projected transactions successfully settling to provide sufficient inventory to enable the return delivery of the loaned assets to the lender. If any of the expected settlement activity for that value date fails, the borrower may have insufficient assets to cover the return of the loan and the proposed delivery will fail, impacting onward settlement of other dependent transactions.

Borrowers may therefore experience higher end-of-day fail rates on return events, when retaining open market instructions in CREST. Multiple repairs are often required to process the failing instruction. Amendments made to trade specifics (typically a quantity or value date repairs) will enable settlement with the lender and will subsequently update the outstanding loan amount in the CREST registry.

Most lenders do not experience the same level of return settlement fail events as borrowers. CREST provides lenders and their designated custodians with reports detailing open contract quantities and values, including settled return activity. Subject to the lender's custodian arrangements, individual market instructions may not be required to instruct a security return settlement within CREST. If the custodian requires instructions, this can result in the lender experiencing loan return fail rates in line with the borrowers fail to deliver activity.

The processing routines and the manner in which open loan quantities are updated vary across market participants, this leads to a disparity between lender and borrower end-of-day fails

reporting, with variances in settlement rates seen in publicly available settlement performance data.

We therefore recommend that market participants consider the following focus areas to improve settlement rates in CREST:

- Industry best-practice working groups should partner with CREST to:
 - Consider extending the DVP settlement window, to increase the opportunity for loans to settle and enable onward delivery to cover dependant deliveries on value date.
 - Implement a systematic auto-partial process within CREST, improving the movement of available shares between borrower and lender throughout value date, reducing the value of failed trade activity and improving the overall settlement rate.
- Participants should increase the use of same day return processing to allow for borrowers to propose return quantities with a greater expectation of settlement for good value.
- Consider the adoption of a systematic auto-partial process within CREST for securities lending flows, improving the movement of available shares between borrower and lender throughout value date to target a reduction in the value of failed trade activity and improving the overall settlement rate.
- Ensure that all parties are using the correct designation of event type (SLO, REPO, DEL etc) ensuring that the contract type is truly reflective of the contract held in CREST, assisting in market monitoring and tracking of overall settlement performance by product type.
- Review the technical requirements relating to the tracking and maintenance of the CREST deal header, assess the market usage of this reference and the impact of any changes within CREST needed to support an accelerated settlement cycle.

Investing in Operational Resilience

Technology plays a vital role in improving settlement rates in the securities lending market. Traditionally, settlement rates have fallen when manual processes are preferred over automated solutions, as this necessitates large scale global support teams. With the expansion of available technology and integration with existing systemic infrastructure, it has enabled firms to operate at scale and improve settlement efficiency, thus removing significant operational friction.

The industry faces renewed focus on settlement rates considering expected changes to settlement regimes. Firms must pivot quickly in the face of any systemic outage and may struggle to manage the volume of daily transactions, which technology has effortlessly managed. As a result, settlement rates appeared to take a downward turn in the face of recent service outages, reflecting the impact of manual operations for large scale volumes. Investing in operational resiliency is a proactive and strategic approach which can enable organisations to quickly adapt when faced with challenges and disruptions within the settlement process and ensures minimal impact to firms. Whilst the lending market has responded well historically to disruption, the recent challenges highlighted the lack of planning within organisations and the agility of the operating model to move between automated solutions. We would therefore encourage all market participants to consider their operational resilience to any significant event, and to ensure the appropriate continuity plans are regularly maintained.

Accelerated Settlement & Looking Ahead

In light of the “Geffen Report” recommendation that the UK market move to T+1 settlement no later than end 2027, this presents an opportunity and a challenge for the securities lending market. Where the lending markets can operate on a T+0 basis, we would anticipate a potential increase in demand to help with settlement coverage in other markets; however, settlement certainty across lending transactions will become ever more important with less time to resolve exceptions. Greater investment into automation and zero-touch processing will be essential, with many post-trade processes still requiring manual intervention. The industry must, for example, adapt to the challenge of timely recall issuance to avoid most recalls being issued on a T+0 basis, which may in turn lead to an increase in cash market sell fails. We would strongly encourage market participants to review the application of recently published best practice recommendations for timely recall issuance to their operating model and consider how the exchange of key data points between lenders, lending agents and borrowers can be expedited. Other themes highlighted within this bulletin, in particular the call for increased investment in pre trade data exchange, heightening collateral management efficiency, and focusing on real-time fails management, will all be essential for securities lending market participants to thrive within a compressed settlement framework.

As referenced in the introduction to this bulletin, a further update will be published in the Autumn. This will look in greater detail, at the data underpinning issues and opportunities identified during the Working Group’s research phase. In addition, we will provide a look-back at the impact of the US and Canadian transition to T+1 and potential lessons learned for the UK market as it prepares for a move to T+1 settlement. This bulletin (and future updates from the Working Group) is intended for all securities lending market participants and the Working Group would therefore ask that each organisation reviews the issues raised here, takes action where applicable to their involvement in the market and advocates for the intended outcome – a collective focus on and investment in higher settlement rates in the securities lending market.