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To: **Operational Arrangements Working Group**
US Tri-Party Repo Infrastructure Reform Task Force

From: **The Asset Managers Forum and SIFMA Government Operations Committee**

Re: **Responses to the Questions on the 3 Way Trade Confirmation & Settlement Window Implementation Proposal**

Date: **January 14, 2011**

The Asset Managers Forum ("AMF") and the SIFMA Government Operations Committee would like to thank the Tri-party Repo Infrastructure Reform Task Force ("the Task Force") for its contributions in developing industry solutions that address the weaknesses in the tri-party repo market.

We also would like to specifically applaud the Task Force's Operational Arrangements Working Group for the tremendous effort in crafting the proposals for the three-way trade confirmation process and standardized settlement times. We recognize that these proposals are intended to work for all constituents of the tri-party repo market, and take into account the many nuances of the various participants while building a standardized process for the industry as a whole.

The Asset Managers Forum is the operations oriented affiliate of the Asset Management Group of SIFMA. Dedicated to facilitating collaboration among the buy-side operations community, AMF brings together subject matter experts to discuss and develop practical solutions to highly topical operational challenges. The AMF's mission is to provide thought leadership and guidance on pertinent industry issues and to create a premier venue for operations professionals to develop and share best practices in order to drive industry change.

We would like to thank the Task Force and its Operational Arrangements Working Group for the opportunity to comment on the 3 Way Trade Confirmation and Settlement Window Implementation Proposals. The responses below (in blue) were formulated by the AMF Tri-party Repo Working Group and represent the consensus views of the working group members.

This comment document also incorporates thoughts of the SIFMA Government Operations Committee (in red). While the SIFMA Government Operations Committee consists mainly of sell side constituents, many of the operational issues are common across the industry and it behooves the overall tri-party repo market to bring these voices together to look at operations issues in a more holistic manner.

- **3 Way Trade Confirmation Process Proposal**

1. **What additional considerations are important as we execute the 3-way confirm process? Of specific interest, how various lender segments will confirm trades.**

Firms will need to monitor mismatches either (1) online with the two agent banks, (2) through their vendor or (3) via an internal dashboard.

We expect cash investors to employ all three methods of confirmation: (1) through the agent bank portal, (2) direct electronic transmission and (3) through the utilization of a vendor as an intermediary.

The working group should consider enhancing planned messaging functionality to better support lenders managing trades through vendors.

2. **Specifically which additional fields, if any, are worth considering in order to for a repo trade to be considered successfully matched?**

The defined fields and details, as outlined in the proposal, are expected to be sufficient to confirm a matched trade.

3. **The document currently envisions a window from 7am - 3:30pm to perform three-way trade confirmations. Task Force discussions have highlighted the potential benefits of earlier confirmations (e.g., by 10am), especially during stressful market conditions. Is it feasible to expect that the bulk of confirmations, including allocations, can be performed by 10 am, or if not, by some other time prior to 3:30? Would it be more feasible to set a target for confirmations without allocation detail by 10 am? Please indicate views on the relative benefits and costs of these alternatives.**

The AMF committee members believe that 50% of the allocations can be confirmed by 10 am. Although not a requirement, most members believe a block match is best practice and will continue to utilize this current practice.

The Government Operations Committee members agree that a block match is a best practice, and believe that earlier confirmations (e.g., by 10 a.m.) are beneficial.

- **3:30pm – 4:30pm Settlement Window Proposal**

1. **The document mentions the segment of lenders that close their funds at 5 pm, thereby making early allocations difficult. Which other characteristics of the settlement proposal will prove challenging to other lender segments?**

It should be noted that in addition to 5:00 pm funds, there are funds that close at 3:00 and 4:00 pm which will also find early allocation submissions challenging. Similarly, investment managers managing money in separate accounts for clients frequently have late cash flow activity which may make it difficult to meet the proposed settlement window. Any investor that requires access to maturing repo proceeds for margin calls or to settle investment activity will need to obtain intraday credit (see #4 below) through a custodian or clearing bank. This should be readily available for mutual funds, but may be challenging for parts of the broad spectrum of separate accounts.

The Government Operations Committee members believe that for the market to work under the new guidelines, the majority of allocations (ideally targeting 90% or greater) and new cash would need to be received by the proposed 3:30 p.m. – 4:30 p.m. settlement window, preferably as close to the front end of the window as possible.

2. **What changes will dealers and lenders need to make as a result of the removal of the daily unwind?**

Refer to #4 below. All participants understand that the removal of the daily unwind will result in forced netting of daily settlements.

The Government Operations Committee members believe that a standardized netting process at the clearing banks, with a finite set of netting practices, would help the market work by reducing the number of wires.

Some dealers are very focused on the ability to re-optimize allocations in some fashion. Originally a dynamic collateral optimization (DCO) for the collateral substitution process was meant to be available. Due to competing demands this may no longer be the case – some have explicitly asked for a full collateral unwind each afternoon for a full re-optimization of the allocation nightly. Clearing banks have apparently engaged the Fed on this and are awaiting a response. This could represent a risk to those dealers who have been focusing on having the DCO ability.

Dealers' operations would need to compress their 8:00 a.m. – 6:00 p.m. processes down to a 3:30 p.m. – 6:00 p.m. timeframe with potential implications for systems, personnel resources, and collateral optimization/adjustment processes and capabilities.

3. **What changes will need to be made in order to enable cash lenders to wire cash into clearing banks by 3:30?**

Investment Managers rely on global custodians to act on settlement instructions. The new timing will require investment managers to communicate trade instructions to their custodians in a timely manner and custodians, in turn, will need to act upon those instructions within the required timeframe. Using the proceeds of a maturing repo trade to make a new repo investment with a different dealer will require that the custodian or clearing bank provide intraday credit to the lender, as the proceeds will not be available prior to 3:30. The investment managers will follow up with their custodians regarding these changes.

4. **How will lenders who may have become accustomed to early morning return of tri-party cash be able to source sufficient alternative intraday liquidity once the settlement window is changed to 3:30?**

To some extent, lenders who have relied on intra-day liquidity from tri-party repos may move a portion of their investment into other products, including less regulated products, which can provide liquidity prior to 3:30 pm. There will be no large-scale secured overnight investment in the USD market that provides access to funds prior to the close of securities in settlement systems; this move will tend to increase either counterparty or liquidity risk in lender portfolios. In addition, Custodians or third parties may provide lenders with credit facilities to meet intra-day liquidity needs. According to NY Federal Reserve Staff Report 477, there are over 4000 lenders active in the tri-party repo market (although the top 10 investors represent 60% of the cash invested). The largest investors should have little difficulty obtaining these facilities, but the credit departments of the custodial community may be challenged by the sheer number of smaller accounts requiring intraday credit. Note that custodians could be stressed to meet intra-day liquidity needs if market wide conditions resulted in significant redemptions across multiple custody clients. Investment managers are in current discussions with their custodians to ensure sufficient liquidity provisions are made. Otherwise, investment managers are looking into alternative means. More work needs to be done in this area to avoid damage to the efficiency of the securities settlement and payment systems.

- **Implementation Timeline**

1. **What key risks to a phased implementation should the task force keep in mind?**

We agree a phased implementation is important in mitigating risks and in performing necessary interim checks. For distant deadlines, progress should be monitored closely and deadlines readdressed as necessary. IM's, Custodian's and vendors are dependent on the Clearing Bank's ability to develop defined models. Investment managers and custodians will also need to revamp their relationship. It is critical to allow this broad community sufficient lead time to safely implement these changes.

While the Government Operations Committee supports the shift to 3:30 p.m., the task force should monitor the effects on Tri-party participants as they arise during implementation and be open to considering proposals to address them. Dealers agree that progress for distant deadlines should be monitored closely and deadlines readdressed as necessary. For example, the task force has proposed moving the unwind time to 10 a.m. in July and then jumping it to 3:30 p.m. in August. Dealers believe that this jump may create operational and liquidity risks, and a more stepped approach, i.e. moving to 3:30 in smaller increments, may mitigate the risks.

Dealers' operations understand that the clearing banks will have the necessary technology to support straight through processing of substitutions prior to go-live. With the correct technology in place there should be no impact to the timing of settlements or the number of fails. However, if the auto-substitution technology is not implemented in time, it could represent a risk to the dealers. For example, with auto-substitution technology in place dealers believe that there is no incremental risk that market manipulation of Treasury prices could take place. However, there is concern that without auto-substitution, market manipulation could be possible as a market participant could hold deliveries while using lack of liquidity or inability to borrow as a cover (see Dealers' answer to #4 under Implementation Timeline). Daylight Overdraft charges should still provide incentive to make deliveries a.s.a.p.

Dealers' operations believe that GCF also needs to be considered in the auto-substitution model, and how it affects the inter-bank model.

2. **Which specific implementation challenges to the 3-way trade confirm process should the task force keep in mind?**

Investment managers who are planning to build direct feeds with the Agent Banks or to utilize a vendor may need an alternative plan in the event their primary confirmation process is unable to meet the stated deadlines. A close working relationship between Agent Banks, Vendors and Dealers is required to both maintain direction and meet the stated deadlines.

3. **Which specific implementation challenges to the 3:30pm settlement time should the task force keep in mind?**

In addition to late day funds, we will need a recommendation for new funds which arrive after the settlement window closes. Refer to # 4 above. It is important to recognize that the elimination of intraday credit extension comes from the decision to not unwind term trades and are forced netting of daily settlements. The payments must be made from maturing repo proceeds (estimated by some as between 5-15% of daily maturities) will require intraday credit extension to someone – the dealer in the former model, the lender in the new model. As the settlement time is pushed later in the day (10 am in July, etc.), regulators should monitor closely the amount of that credit extension to determine the appropriate balance between the risk of concentrated credit extension and the efficiency cost of distributed credit extension.

The Government Operations Committee would add that the timing of DTCC collateralizations should be considered.

Dealers' operations believe that GCF solutions are a challenge: Are GCF repos unwound or not, and what are the appropriate mechanics to accommodate based off the decision? The Government Operations Committee believes that the time frame compression of all-day processes that have occurred heretofore from 8:00 a.m. – 6:00 p.m. down to a 3:30 p.m. – 6:00 p.m. time frame may create operational risk (e.g. system glitches/failures, personnel resources) for dealers.

Dealers' operations believe the task force should also consider the collateral projection functionality and optimization capability available today. Dealers relying on the clearing banks to provide security projections and upon collateral being in the box may be severally impacted. The clearing banks will need to work with these dealers to adjust their reporting, e.g. to include the securities reflected in their Tri-party accounts.

The Government Operations Committee would note that the task force may want to consider the effects on the uncollateralized loan programs (e.g. BNY's UNCL program) and intraday liquidity that the shift to 3:30 p.m. may cause.

4. **Which specific implementation challenges to the committed credit facilities should the task force keep in mind?**

This is not believed to affect the buy side.

The Government Operations Committee would add that the uncollateralized loan programs (e.g. BNY's UNCL program) of the clearing banks are widely used. The task force may want to examine the metrics of usage of these programs among dealers and the potential impact of the clearing banks removing this service (e.g. increased fails) due to the settlement time change. For example, there may be decreased liquidity, slower settlements/increased fails, and impacts on programs that have promoted liquidity such as Daylight Overdraft and TMPG Treasury Fails Charge.

Dealers' operations are unsure if the uncollateralized loan programs would still work effectively under the auto-substitution program. Dealers see uncollateralized loan programs as still working with auto-sub, however, have noted that a condition would be that the lender accepts cash in the shell. Some dealers have noted that some of their lenders may not accept cash.

The Asset Managers Forum welcomes the opportunity to work with all industry constituents in the implementation phase of the Tri-Party Repo Infrastructure Reform. Our main goal is to assist asset managers in the operational implementation of the Task Force recommendations. For more information regarding the Asset Managers Forum, and its Tri-party Repo Working Group, please contact Tim Cameron, Managing Director, SIFMA Asset Management Group at tcameron@sifma.org, or Elisa Nuottajarvi, Manager, SIFMA Asset Management Group at enuottajarvi@sifma.org. The SIFMA staff contact the Government Operations Committee is Michael Drennen mdrennen@sifma.org