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How JP Morgan has fortified its securities finance business in a transformed space

JP Morgan has implemented a strategy under new leadership amid a convergence of securities finance and collateral management to cement its position in the market, proving that innovation in the space isn't confined to FinTechs.

In November 2021, Global Custodian published a feature on innovation in securities finance, with upstart FinTechs pouring into the space and making moves to modernise the market. The piece focused on how new entrants like Sharegain and HQLAx were capitalising on a perfect storm of regulatory and market infrastructure changes and applying new technologies to securities lending, subsequently turning heads and gaining traction.

The journey of a start-up is always an exciting one to map; however, we sometimes forget that innovation is not restricted to FinTechs. At the absolute opposite end of the spectrum to start-ups is JP Morgan and a securities finance team which isn't just relying on the name on the door to win and retain clients. Some of its top executives across the agency financing and collateral business spoke with Global Custodian about their approach to product, innovation and how they believe they are lightyears ahead of the competition, lifting the hood on a business which has made a swathe of meaningful moves lately.

"A little over three years ago I joined JP Morgan to run the securities finance business in the Americas and what we saw – as a management team – was a real transformation around the importance of collateral management, the importance of securities financing, and the two products converging, which is why we aligned them under our trading services umbrella," explained George Rennick, managing director, head of agency financing -Americas and global head of client relationship management in agency financing.

"We wanted to take a fresh look at what was really a 40-year-old business at JP Morgan, and identify opportunities for a differentiated product. So, we've spent the last three years altering strategy, both short- and long-term goals, and then building tools and structuring the team in a way that really meets sophisticated investor needs."

Rennick joined from Nomura in 2018, teaming up once again with former colleague Ben Challice, global head of trading services. At the same time, JP Morgan added Simon Heath from State Street as head of agency securities financing for Europe, Middle East and Africa (EMEA), and Ed Bond, who previously led SE Asia sales for JP Morgan, as head of agency securities financing and collateral management for APAC. Jon Atkins joined from Nomura to lead the global Alternative Financing product and extended the management team to include internal product partners Harpreet Bains and Tanya Gitman. The new-look team faced the challenge of strategising for a commoditised product, ultimately born out of operations that many firms had, in the past, treated as an ancillary business for the most part.

"I would say post-financial crisis, increased competition, challenged returns, cost sensitivities and different macro factors and interest rates around the globe, the importance of securities finance has elevated. Over the last decade securities finance has transformed from an operational function in many organisations to an alignment with either a portfolio manager sleeve or a Treasury sleeve based on what is important for a particular institution. Ei-

ther it's going to generate alpha in your portfolio and a return on basis points for your fund or your asset owners, or it's going to be an efficient way for you to fund your organisation. That transformation is where the opportunity really lies and where the future is."

Ahead of the competition

While the moves JP Morgan has made in this area seldom announced by a press release, clients have enjoyed the developments which have been greater accumulatively than the sum of their parts. Already one of the largest custodians, a tri-party agent and collateral management specialist, the team has focused on its distribution strategy, proprietary technology, client transparency, risk controls, and providing data to clients to make decisions.

In keeping with industry trends, Rennick and his team have had to contend with resource utilisation challenges as well as environmental, social and governance (ESG) issues relating to securities lending and the rise of FinTechs in the space.

When it comes to talent addition and tech spend, Rennick describes the unit's technology platform as being "light years ahead" of its competitors, following significant investment, while his team

We have sophisticated clients that are ultra-transparent on everything they do, that have a high value on securities financing, and so we know that can coexist.

"But to the question of do I think all the players in the space all realise it? Certainly not, and there's a role for us as an agent lender and as a large custodial bank, to utilise our trading services umbrella to continually educate."

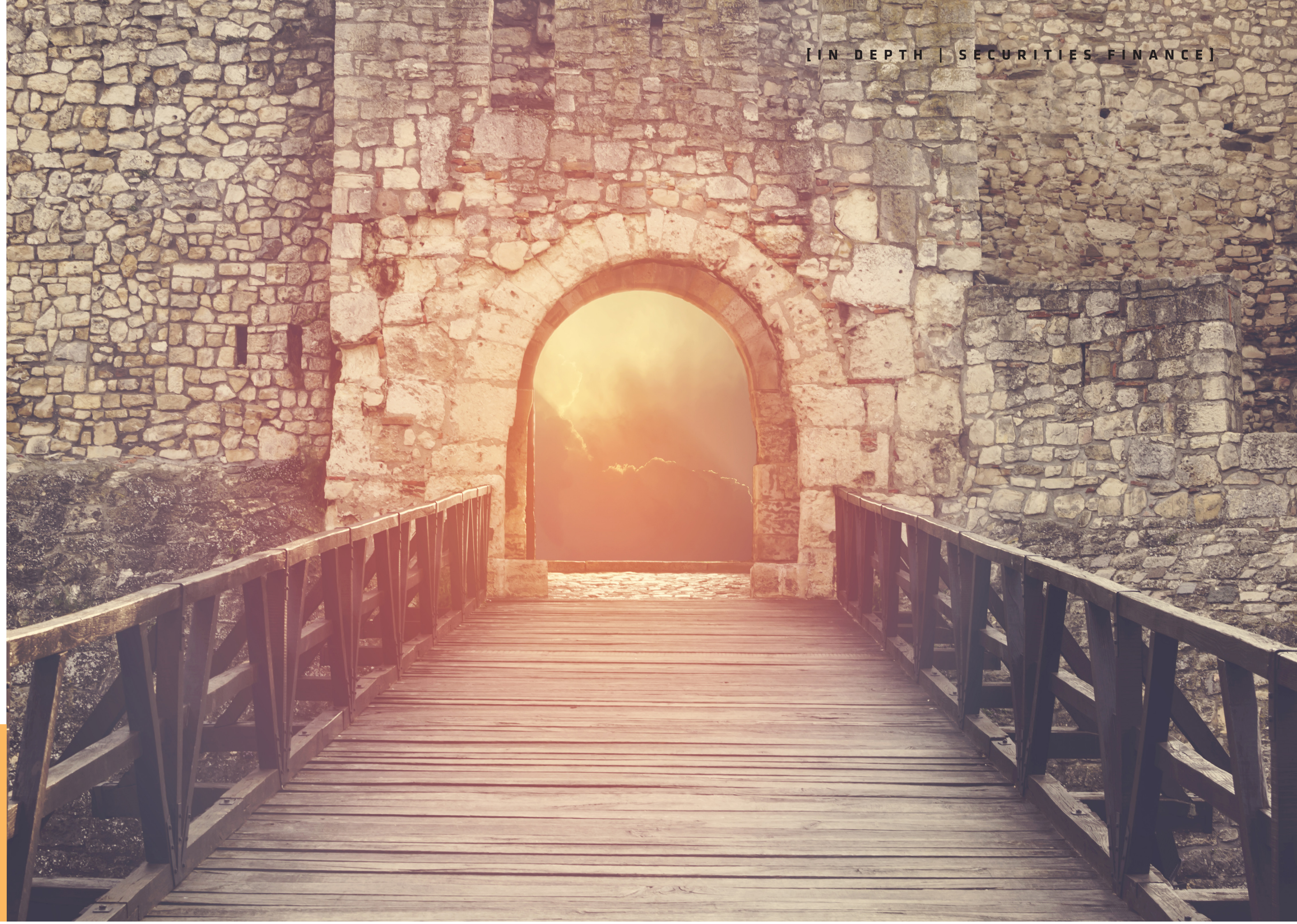
Winning with proprietary technology

JP Morgan hasn't shied away from FinTech partnerships within its securities services business either –with examples being Pirum, AccessFintech, HQLAx and StatPro, among others.

"We do look at FinTechs regularly, and the challenge as a general statement with FinTechs is that they've solved one part of the product, but oftentimes they don't bridge to a number of parts.

"There has to be something that a FinTech solves that either we haven't solved, or there has to be a gain in efficiency or a focus where we have a keen interest. And so, with our investment in our internal proprietary technology, we haven't had to rely heavily on FinTechs. But there are some interesting things out there and we are undertaking certain evaluations."

"How do you get securities to move more seamlessly, more efficiently around the world? Don't move them at all...We call it mobilisation through immobilisation."



continues to grow each year.

On ESG, JP Morgan has taken on an educator role with some clients, while leading the conversations where possible at an industry level.

Rennick believes the two concepts can co-exist. "ESG policies and securities lending are not mutually exclusive," he said. "You can bind things like your proxy policy with your ESG and your securities lending objectives and still accomplish what you're setting out to.

Innovation hasn't been solely dependent on partnerships and FinTechs. Around 18 months ago JP Morgan launched a new asset mobilisation tool for buy-side clients to keep track of what assets are being used for collateral and where they can be optimised for securities lending. The new Collateral Transport tool was launched ahead of phase five of the uncleared margin rules (UMR) which will impact a wide range of buy-side firms.

At the core of JP Morgan's collateral innovation has been Ed Corral, managing director, global head of collateral strategy. Corral returned to the bank after a 10-year spell at Morgan Stanley, which had followed an initial 20 years with JP Morgan – all within the collateral space.

Hot off the back of JP Morgan's official announcement that its securities services division will support the bank's asset management unit (JPMAM) in its multi-year initiative to implement a new operations model by providing middle-office capabilities, the discussion with Corral was a perfect opportunity to discuss the advancements within the platform. While the units belong to the same family, it's easy to overlook that the mandate came from one of the largest asset managers in the world, which had noted the automation, reporting capabilities, onboarding capabilities and additional product coverage the unit had put in place when selecting its partner.

The collateral story

Despite the assumption that JP Morgan's asset management arm would always pick its securities services unit for such a service, the deal was no slam dunk, and the team believed the agreement was a validation of its work in recent years.

Corral's team has also been advancing its use of APIs, the assets it covers – including equities as collateral – and supporting different derivatives types, a key requirement for JPMAM, but also developments which will benefit existing and prospective clients.

The first phase is planned for mid-2022, when JP Morgan's securities services division will provide operational processing support for a range of derivatives products. The asset manager believes the change will enable it to efficiently implement the use of new and different products, thereby expanding its derivatives capabilities.

The collateral team is also contending

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with a wave of global regulations, most notably the combination of uncleared margin rules and the affiliate rule. Given JP Morgan's position as the largest derivatives trading house, almost all those impacted by phase five of the uncleared margin rules had a trading relationship with the bank, therefore triggering the affiliate rule, where you can't use the custodian of the affiliate. This forced JP Morgan into action if it wanted to keep its clients from engaging another custodian for the affiliate activity and risk losing them.

"There were some extraordinarily large buy-side firms in phase four, at that size they somewhat operated like banks and broker dealers, so the true volume of buy-side participants (in the general sense of the term) is what came in to scope in phase five. This was the first experience for us and really the industry where the buy-side was selecting custodians or tri-party agents, while also considering the trading relationships they had with the broker dealer subsidiaries of some provider, including JP Morgan itself," explained Corral.

"We acted. We built a solution where we continue to manage 100% of our clients' collateral, including the affiliate-related collateral. We built a bilateral delivery capability on our tri-party platform to automatically deliver the collateral out to the independent third-party custodial location. So the clients didn't have to do that second set up and got the benefit of one provider managing 100% of their portfolio.

"It's included in their reporting. They don't have to do anything different. They have the same process, even though the affiliate related collateral has extra steps behind the scenes. This was a solution born out of necessity to support our clients and the JP Morgan derivatives franchise at large."

Turning challenges into opportunities

Partly out of necessity, and partly out of understanding the market and the need to innovate for its clients, JP Morgan set up three affiliate-rule solutions – internationally with Euroclear, and two in the US with DTC and State Street.

Tri-party collateral management solutions which were traditionally used for securities financing are now supporting the introduction of uncleared margin rules as firms use them to receive – or post – initial margin. In a space which has opened up for opportunity, the moves JP Morgan has made set it up well for phase six, with other potential applications also available in the future.

Another move has been in the central counterparty (CCP) space, where clearing houses have traditionally preferred to receive collateral bilaterally. Corral explained that, in the past, tri-party agents have tried to fit the CCPs into tri-party in a "square peg into a round hole kind of way" by asking them to accept collateral via tri-party, which they will do to a limited degree. But JP Morgan has moved to making its model fit the needs of the CCPs by making the delivery to and from the CCP bilateral.

The custodian's innovation hasn't stopped there. Just over a year ago, JP Morgan completed an intraday repo transaction using its custom-built blockchain-based platform. The repo trades, conducted between JP Morgan's broker-dealer and banking entity, used an in-house developed blockchain application, Onyx, supported by instantaneous settlement to swap digitised US Treasury bonds for JPM Coin, its internal dollar-backed stablecoin.

> "Transformation is where the opportunity really lies and where the future is."

JP Morgan developed the solution and tested its viability by conducting trades between two of its affiliates, alongside successful simulations of trades with Goldman Sachs and other entities, with BNY Mellon as the tri-party agent. Other providers are also said to be in the pipeline for this project, which Corral has high hopes for.

"How do you get securities to move more seamlessly, more efficiently around the world? Don't move them at all. Leave them exactly where they are and move the value they represent," Corral highlighted, enthusiastically. "We call it mobilisation through immobilisation.

"Basically, we've created a mobile liquidity pool for clients that they can deploy more seamlessly than the securities themselves," he said.

"When it comes to the future for that product, it's almost like a sunburst in the sense that it's going to expand to other asset classes. Evolving from US Treasuries to equities, international assets, etc. As we see the inclusion of additional tri-party agents, most notably Euroclear," Corral explains.

JP Morgan has spotted multiple opportunities in the convergence of bilateral and tri-party, tokenisation and the new regulatory landscape and grabbed them with both hands through an experienced team with a vision on how to make one of the biggest providers in this space even better.