



Operations Industry Initiative Survey: High Level Summary

November 2, 2017 - In order to target, build and achieve greater operational efficiency for the loan market, and to have a better understanding of our members' views on position reconciliation, FpML messaging, blockchain/distributed ledger technology, the LSTA, together with a small group of members representing dealers and buy-side institutions, put together an Operations Industry Initiatives Survey. 92 LSTA members completed the survey. 88% of all respondents perform an operations role within their institutions. Some answered responded with respect to multiple roles as, for example, a member may function as both an agent bank and broker dealer. Based upon this, 14 broker dealers, 71 buy-side institutions, 22 agent banks, 5 custodians and 10 middle office service providers responded.

Position Reconciliation:

96% of respondents think it is very important to their firm to reconcile positions; however, only 69% actually reconcile to the Agents books and records. Of those who don't, 2/3 say the custodian reconciles on their behalf. Of all respondents, 46% cite their primary method of reconciling positions is manually to agent bank notices, whereas 22% typically utilize Market Loan Reconciliation ("MLR") and 19% use their own internal systems with 13% primarily relying on other methods. When asked just of the buy-side, the results were almost identical.

When asked how often do you reconcile positions on MLR, regardless of whether or not it is their primary method, 13% responded that they reconcile daily, 21% weekly, 38% monthly and 28% on an ad-hoc basis. When asked how often they reconciled using other methods, 33% responded that they reconcile daily, 8% weekly, 31% monthly and 28% on an ad-hoc basis. Note that parties may actually reconcile using multiple methods. 37% of respondents follow up with the Agent daily while 14% follow-up weekly, 17% monthly, 30% on an ad-hoc basis while 2% never reconcile. 50% of the lenders and 71% of the Agents who upload positions to MLR do so daily. A third of respondents discussed with their auditors their ability to use a position reconciliation platform for the purpose of completing the confirmation process of the audit; a handful of firms said that their auditors plan to use MLR to confirm positions during 2018.

Bottom line: Market participants should reconcile positions on a more regular basis - ultimately daily -- in order to improve data accuracy. In order to do so, agents, lenders and especially auditors, should evaluate the benefits of online tools, e.g. MLR.

FpML Messaging

64% of respondents said they are aware of FpML messaging. Of those 37% either send and/or receive messages today, 22% say they will use it in 2018-2019 and 40% do not expect to utilize FpML. Of those who use it, 14% send messages only, 9% send and view messages and 9% send and their internal systems consume the messages, 59% receive and view messages, 9% receive and their internal systems consume the messages. Of those who plan to use it in the future, 38% plan to consume messages, while 62% plan to send and consume.

Institutions see the biggest benefits of FpML as increased efficiency and straight thru processing (70%), better communication between Agents and lenders (65%), a consistent standard message format across agents (59%), clearer more legible notices (51%) and reduced risk (48%).

The responses as to why FpML is not fully utilized today (meaning messages sent and received

electronically) ranged from it is not an internal priority (49%), to there is a perceived lack of commitment from institutions across the market (41%), internal technology constraints (39%), vendor technology dependencies (33%), cost (22%) and minimal benefit (20%).

There was an overriding response that marketplace adoption and changing market behavior is the biggest challenge to implementing FpML (78%), followed by the lack of a direct network between the Agents and lenders (44%), the need for middleware or an FTP site to consume the messages directly (44%) and cost (41%). 13% saw minimal to no benefit.

With respect to the last three queries, respondents were asked to select all that apply and in all cases did choose multiple responses.

Bottom line: Those who understand FpML are aware of the enormous benefits it holds for data accuracy and transparency. Vendor participation and education are key as there is an underlying need for institutions to understand how transmitting the standard electronically can automate processing functions. With a better understanding and the ability to work to solve technology constraints and dependencies through middleware or otherwise, commitment among institutions across the market will expand.

Blockchain

When asked if they understand blockchain/distributed ledger technology (DLT) and how it would impact loans 42% said yes, 35% said no, 21% said while they had seen DLT use cases they were unsure how it could impact loans, and 2% said they didn't think that DLT would impact loans. A disproportionately higher percentage of buy-side institutions were unfamiliar with DLT than were dealers and agents. When those who said "yes" were asked what they thought would be the biggest benefits of blockchain/DLT to their institutions (and again they could select all that applied) the responses ranged from reducing settlement time (67%), increased transparency with no need for reconciliation (64%), increased auditability/traceability (56%), reduced operational costs (56%), improved efficiency of cash settlement through the introduction of a "DVP model", and increased security through an authenticated permissioned network (44%). 15% saw minimal to no benefit. Of those who said they understood blockchain/DLT (i) 5 broker dealers, 15 buy-side institutions, 8 agents, 3 custodians and 3 middle office service providers said they plan to use it in 2019 and beyond and (ii) 17 institutions who responded to the survey, spread among the various constituencies, have been involved in recent blockchain/DLT initiatives.

Bottom line: There is a massive need in this space to educate the market and provide an awareness of the steps being taken to implement DLT.

LSTA's Operational Initiatives in 2018

Because respondents could select multiple options, there was a fairly high response rate to all the suggestions; however, improving automation of the trade settlement process in existing settlement platforms and through new technology was ranked high by all. This was followed by decreasing settlement delays relating to assignment agreements, i.e. borrower's consent, deemed consent, affiliate letters and DQ lists. Tied for 3rd place were two options: (i) reducing the number of days that agent banks freeze settlements, especially as they relate to interest and principal payments and (ii) standardizing the amendment process. A strong 4th option was implementing delayed compensation in the primary market. (Unsurprisingly, this was driven by the buy-side.) Driving MEIs and CUSIPs and promoting FpML rounded off the initiatives.

A number of other operational and/or technology initiatives were suggested by respondents:

Assess financial penalties on agents that settle trades after T+7 (assuming the buyer and seller are ready to settle by T+7). There is a need for agent accountability. Continue to fine tune the secondary delayed compensation guidelines, i.e. penalize a buyer who checks ready to close but hasn't posted an affiliate letter or requested Borrower Consent by T+6. Have the LSTA take more authority to steer the market and push vendors to improve their systems/platforms on a more reliable, faster timeline. Encourage open market vendor agnostic initiatives to create a channel for open competition and easier implementation across all market participants. FpML distribution should be available to an institution, not through a specific pay per use channel. Open source solutions more easily adoptable. Simplify and standardize the

KYC process to be built on all platforms with cross utilizations. Implement a DTC or clearing house for all par loan trades to allow for T+3 settlement. Automate amendment voting. Drive consistency globally for identifiers (CUSIPs), KYC, amendments and push for STP with regards to notices and settlements.

Bottom line: 2018 will be an exciting year if we can strive to increase data accuracy, achieve greater operational processing efficiency and move forward on existing and future technology innovation. Don't Stop Us Now; Changes are ahead!