SLT
SECURITIESLENDINGTIMES

A YEAR IN REVIEW

The path yet trodden

When the history of the twenty-first century is written, how much space will be dedicated to the economical upheaval that the world faced towards the end of its first decade? How much time will be spent on the regulatory overhaul that followed? How will such a history conclude?

These questions are difficult to answer, because financial markets are still reacting to what was the worst financial crisis since the Great Depression. Some say that regulation has done nothing to improve stability, and never will. Others claim that the last time banks were 'over' regulated, giant strides were made in fields as diverse as warfare, healthcare and space travel. Indeed, during the twentieth century, a man was put on the moon, and the internet was born.

Whatever your stance, regulations continued to come out in force during 2014. The Basel Committee on Banking Supervision featured heavily, with some claiming that Basel III and the US implementation of it are making financing a much harder business to conduct. The sheer number of new rules is also having an effect, as participants ponder ways and means of conducting reports and calculating ratios without distracting from making a profit.

Securities finance is often described as a non-core function, but its importance is increasing as more and more assets are put to work. Reports say that lendable asset levels are back to their best, although demand is lagging significantly behind. The message from agent lenders and prime brokers is one of optimism and compromise, an agreement that there is a 'new normal' in which opportunities exist, for all parties.

In this review of 2014, the industry's three biggest data providers look at how business went, with SunGard's David Lewis suggesting that it has consolidated its position rather than broken any new ground. With this in mind, experts consider what the biggest challenge will be in 2015, as the industry reaches the halfway point of the decade and decides how history will remember it in the years to come.

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A YEAR IN REVIEW 2014

A year in headlines

The front pages of Securities Lending Times have seen regulators move ahead with their reform agendas, market participants team up to improve collateral management practices, and agent lenders enter new markets

Issue 92
Silvercorp fraud battle rages on

Jon Carnes was accused of committing fraud by the British Columbia Securities Commission (BCSC), after he denounced Silvercorp on his blog and then made $2.8 million selling it short.

In a 20 December 2013 blog post, Carnes called the BCSC's allegations "false and without merit".

Issue 93
Anticipated €50 billion cash-flow drag from Financial Transaction Tax

There will be an estimated annual cash-flow drag of €30 to €50 billion resulting from the Financial Transaction Tax (FTT), a report suggested.

The annual cash-flow drag would be realised in different ways, said the report, including securities issued by EU-11 entities falling in value.

Issue 94
OCC and eSecLending innovate for central counterparties in times of stress

The operating arm of securities lending agent eSecLending and Options Clearing Corporation (OCC) teamed up to create an automated default management platform.

Using eSecLending operating arm Securities Finance Trust Company's (SFTC) hosted software Auction Platform Services, which is a secure web-based portal that offers the ability for listing auction assets, centralised bid submissions, and management/audit reporting, OCC will achieve administrative efficiency and cost savings.

Issue 95
Citi builds on emerging market reps

Citi entered the Russian market by launching lending services in Russian securities through its OpenLend platform.

The decision followed launches in India and Malaysia, and reinforced Citi's aim to build focus in the emerging markets.

Issue 96
ISLA okay with ESMA's easing of collateral diversification rules

The European and Securities Market Authority's (ESMA) proposal to ease certain collateral diversification rules contained in its guidelines for exchange-traded funds and other UCITS was met with open arms by the International Securities Lending Association (ISLA).

ESMA's current guidelines required no more than 20 percent of the NAV of a UCITS to be held in collateral from any one issuer.

In the consultation, ESMA considered allowing a derogation from this provision for government issued collateral in certain circumstances. This derogation would be limited to money market fund UCITS, only to allow them to use higher volumes of reverse repo against a single government issuer.

ISLA said that while it supports the proposal, the derogation should be available to all UCITS, and not just money market funds.

Issue 97
Lombard Risk and Broadridge on same side of the collateral coin

Lombard Risk Management and Broadridge Financial Solutions formed a global alliance to address changing industry needs in the collateral management sector.

"In recent years, several factors such as global regulatory changes, tighter liquidity, a move towards greater transparency and the increasing cost of collateral have prompted firms to rethink their approach to collateral management," said a joint statement.

"In response to these changing market dynamics, this partnership will lead to the creation of powerful Broadridge

integrated collateral management offerings, combining Lombard Risk's best-in-breed technology with Broadridge's industry-leading applications and infrastructure."

Issue 98
BNY Mellon hauls in two big catches

BNY Mellon caught some big mandates, in the form of US and Swedish pension funds.

The bank was chosen by the City of Phoenix Employees' Retirement System to provide custody, accounting, and securities lending solutions to plan assets valued at $2 billion.

The bank also scored a reappointment by Swedish state pension fund Sjunde APfonden, to provide global custody and collateral services for assets valued at $28.8 billion.

Issue 99
Broadridge serves up collateral solution

Broadridge Financial Solutions launched CollateralPro, following its link-up with Lombard Risk Management.

A comprehensive enterprise-wide solution, CollateralPro is designed to help investment banks, asset management firms and service providers transform their regional or global collateral management functions.

Issue 100
Banks to become as safe as houses

The Basel Committee on Banking Supervision finalised exposure standards that will help to protect banks from significant losses after counterparty failure.

The final standard set out a supervisory framework for measuring and controlling large exposures. It will take effect from 1 January 2019.

Issue 101
Pirum boosts SunGard's Astec Analytics intra-day trade data

SunGard's Astec Analytics and Pirum joined forces to allow mutual clients to deliver their data straight to Astec Analytics via Pirum technology.

The interface, which became available immediately, was developed in response to constrained information technology budgets dampening securities finance participants' ability to receive useful data quickly. It is available to all Astec Analytics and Pirum clients.

Issue 102
FSOC: more triparty protection needed

Additional steps may need to be taken to further increase triparty repo borrowers' protection against funding runs in the broader context of liquidity regulation, according to the US Treasury's Financial Stability Oversight Council (FSOC).

The FSOC, which is mandated to identify risks and respond to emerging threats to financial stability, said in its 2014 report that significant progress has been made over the past year in reducing market participants' reliance on intra-day credit from clearing banks.

But the risk of collateral fire sales persists, argued the FSOC in its report.

"The risk of fire sales of collateral by creditors of a defaulted broker-dealer, many of whom may themselves be vulnerable to runs in a stress event, remains an important financial stability concern given the destabilising effect such sales may have on markets and their potential to transmit risk across a wide range of participants."

While regulatory reforms implemented since the financial crisis, such as increases in the amount of capital, liquidity, and margin changes for US broker-dealers, "may help to mitigate the risk of default", the FSOC believes more can be done.

Issue 104
Wells Fargo product to hit US market

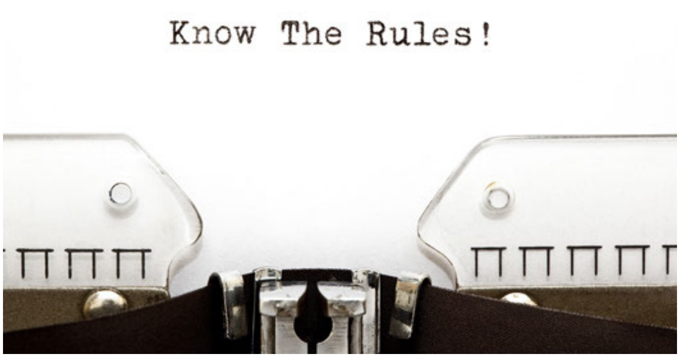
Wells Fargo Securities announced plans to launch a self-clearing prime brokerage product for its hedge fund clients by the end of June.

The new product, which had been in the pipeline since Wells Fargo bought San Francisco and New York-based prime brokerage services and technology provider Merlin Securities in April 2012, was awaiting regulatory sign-off ahead of its anticipated June launch.

Issue 105
EquiLend enters South Africa

Absa Bank, the South African banking entity of Barclays Group Africa, became the first ever domestic South African entity to execute a securities finance trade via the EquiLend trading platform.

With Absa Bank trading on EquiLend, the bank and its clients have the ability to automate securities finance trading with EquiLend counterparties around the globe.



Issue 106
Canadian funds get new lending rules

All investment funds engaging in securities lending in Canada were to be subject to enhanced disclosure requirements from September, while restrictions and operating requirements for non-redeemable investment funds would also come into force.

The final amendments to National Instrument 81-102 Mutual Funds were published in late June, as a part of the Canadian Securities Administrators's Modernization of Investment Fund Product Regulation Project.

Issue 107
Business booming in China, finds KPMG

The combined margin financing and securities lending activity among 115 Chinese securities brokers increased a staggering 341.71 percent between the end of 2012 and the end of March 2014, according to KPMG.

Its survey of the 2013 financial statements of 115 Chinese securities brokers found that their combined margin financing and securities lending balance increased from RMB 89.52 billion ($14.5 billion) to RMB 395.4 billion ($64.06 billion).

Issue 108
Irish central bank has UCITS worries

The Central Bank of Ireland claimed that there are strong grounds for limiting the collateral diversification relaxation set out in the revised version of the European Securities and Markets Authority (ESMA) guidelines on exchange-traded funds and other UCITS issues.

The relaxation, initially intended to apply to UCITS money market funds (MMFs), was extended to all UCITS funds in ESMA's final report in March, following market support for the move.

But the Central Bank of Ireland said that the extension could result in funds holding on to sovereign collateral of deteriorating credit quality in stressed market conditions.

ESMA's guidelines require all collateral to be high quality and no UCITS fund can have exposure of more than 20 percent of its collateral basket to any single issuer.

UCITS MFFs are exempt, as long as they receive securities from at least six different issuers, and no single issuer accounts for more than 30 percent of the collateral received.

The Central Bank of Ireland, in its 28 July consultation paper, said 'high quality' is not adequately defined to warrant the relaxation being extended to all UCITS funds.

It instead proposed a rule requiring a UCITS fund to only be able to accept high quality collateral. A determination of whether the collateral is sufficiently 'high quality' would be made before accepting it.

Issue 109
Wells Fargo litigation finally over

The US district court for Minnesota granted final approval of a $62.5 million settlement in a class action against Wells Fargo on behalf of participants in the bank's securities lending programme.

The total settlement amount was among the largest recoveries achieved in a securities lending class action stemming from the 2008 financial crisis.

Issue 110
Pirum and Markit do data deal

Post-trade securities finance specialist Pirum teamed up with Markit to enhance the timeliness and transparency of information contained in the data provider's securities finance data set.

Mutual customers can use Pirum's data hub to deliver intra-day and end-of-day trade data to Markit's securities finance global data set,

with the company's new API delivery mechanism enabling customers to immediately benefit from enhanced coverage and timeliness.

Issue 112
Polish CCP enables securities lending

KDPW_CCP launched a negotiated securities lending and borrowing system in Poland.

The Polish central counterparty and the country's central securities depository, KDPW, said that securities lending within the negotiated lending system is designed to prevent or eliminate the suspension transaction settlement in organised trading.

It will also ensure the return of securities loaned in the automatic lending system, they added.

Issue 113
FICC stakes claim for central clearing of triparty repo

The Fixed Income Clearing Corporation (FICC), a subsidiary of the Depository Trust and Clearing Corporation (DTCC), announced plans to provide central clearing for the more than $1.6 trillion institutional triparty repo market.

It submitted a rule filing to the Securities and Exchange Commission, and an advance notice filing to both the SEC and the Federal Reserve, to outline its plans.

The rule filing outlined FICC's proposal to use its existing risk management and trade guarantee services for the institutional triparty repo market in the US.

Issue 114
Final NSFR: trick or treat?

Securities finance professionals were given a Halloween treat in the form of the finalised net stable funding ratio (NSFR).

The Basel Committee on Banking Supervision (BCBS) issued the final standard on 31 October, marking the end of its regulatory reform agenda.

The NSFR, a significant component of the Basel III reforms, requires banks to maintain a stable funding profile in relation to their on- and off-balance sheet activities. The BCBS wants it to become the minimum standard by 1 January 2018.

The final NSFR, originally put forward in 2009, largely retains the structure of the January 2014 consultative proposal.

Key changes introduced in the final standard on 31 October cover the required stable funding for short-term exposures to banks and other financial institutions, derivatives exposures, and assets posted as initial margin for derivative contracts.

Issue 115
FSB calls for SFT transparency

The Financial Stability Board (FSB) recommended that national and regional authorities collect appropriate data on securities financing markets to help them detect financial stability risks and develop policy responses.

The proposed standards and processes for doing so were outlined in a new report and were based on the policy recommendations in a previous paper, the Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, which was published in August 2013.

The FSB will complete its work on developing standards and processes by the end of 2015, based on the public consultation findings and further discussion with market participants.

By then, the FSB also plans to develop an implementation timeline for global data collection and aggregation.

Issue 116
ESMA: central counterparties are next

European Securities and Markets Authority (ESMA) chief Steven Maijoor waded into the debate over the chances of a central counterparty (CCP) failing, calling an appropriate recovery and resolution frame-work the next regulatory challenge.

Maijoor acknowledged that while a CCP failure has a "very low probability", the possibility "cannot be fully excluded" because "it would have quite severe consequences for the market".

The ESMA chief also reaffirmed his support of the EU's proposal to require securities finance transactions to be reported to trade repositories, saying that further progress on passing information to regulators is needed.

"These transactions, like repos and securities lending, very much increase the interconnectedness within asset management and with other parts of the financial system. I therefore very much support the European Commission proposal regarding the reporting of these transactions to trade repositories."

Read all about it

A selection of stories that were also in the news in 2014

The Florida State Board of Administration (SBA) chose **eSecLending** to provide it with securities lending and collateral management services.

The securities lending agent was selected in 2013 to auction and manage approximately $30 billion in global equity assets for Florida SBA's multi-agent lending programme.

eSecLending held an auction in November 2013 for Florida SBA's global equity assets and implemented the programme consisting of both exclusive borrower arrangements and discretionary lending in January.

Citi was awarded a mandate from Norges Bank Investment Management to provide global custody and securities lending services to support its $850 billion investment portfolio globally.

The mandate is believed to be one of the largest of its kind in the industry.

"It's a great privilege to have been selected by Norges Bank Investment Management to provide these services," commented Okan Pekin, global head of investor services for Citi.

"By having a global presence combined with in-depth, local expertise, our offering is well positioned to support Norges Bank Investment Management's mission and growth objectives."

4sight launched an equity derivatives software solution for synthetic prime brokerage.

It supports the full synthetic finance lifecycle and offers a front-to-back office solution for swap transactions, including contracts for difference, total return swaps and portfolio swaps, over a range of underlying assets, such as equities, futures and bonds, on a single or cross-currency basis.

BNP Paribas Securities Services extended its interactive reporting solution, Data Navigation Analysis (DNA), to its agency clients.

DNA is a data visualisation solution designed to enhance access to information for financial organisations across the investment cycle and will help expose insights and trends in large volumes of data.

The platform gives BNP Paribas's agency lending clients, including central banks, asset managers and asset owners, complete and flexible oversight and control over their lending activity.

State Street's securities finance revenue hit $147 million in Q2 2014, an impressive 72.9 percent increase over the first quarter of the year.

Revenue, which was up "primarily due to seasonality", was also up 12.2 percent over Q2 2013 because of new business in enhanced custody.

Triparty agent **Clearstream** began providing eurosystem triparty collateral pledge services to participants following the European Central Bank (ECB) creating cross-party triparty services on 29 September.

The changes will improve access to eurosystem liquidity by enabling the allocation of ECB-eligible collateral held in third countries to national banks of a cross-border basis.

EquiLend received regulatory clearance from the Australian Securities and Investments Commission to operate its securities finance trading platform domestically in the market.

The platform went live for trading among domestic firms on 8 October and trades between Australian entities were executed on the platform from the first day of trading.

Australian securities have historically been traded on the EquiLend and BondLend platform via offshore entities.

Post-trade services provided by EquiLend and BondLend were already being used by domestic Australian market participants.

National Australia Bank announced plans to introduce an agency securities lending programme as part of its ongoing investment in asset servicing and technology.

The new platform will provide greater flexibility on both counterparty exposure and investment returns. It came alongside plans to improve performance reporting, and to introduce a new registry platform and client portal.

Morgan Stanley became a clearing member of Eurex Clearing's Lending Central Counterparty (CCP).

"Morgan Stanley is supportive of CCP solutions for securities lending such as the Eurex Clearing model as it allows us to preserve our client relationships and deliver best execution with risk, re-source and operational efficiencies," said Susan O'Flynn, managing director and global head of CCP strategy and optimisation for Morgan Stanley.

"Tiered membership plays a critical part in facilitating buy-side participation through different forms such as the specific lender licence."

Eurex Clearing's Lending CCP was launched in November 2012. The current product scope includes equities from Belgium, France, Germany, the Netherlands and Switzerland, as well as a range of international fixed-income instruments and exchange-traded funds.

The clearing service reduces counterparty risk and provides significant cost benefits to market participants with increasing capital requirements for bilateral exposures.

Four clearing members have already been admitted to the service and have cleared their first transactions. Further market participants are expected to join soon.

Securities lending transactions from Eurex Repo's SecLend Market or via Pirum's CCP Gateway can be cleared by Eurex Clearing.

The service is integrated with two triparty collateral agents, Clearstream Banking Luxembourg and Euroclear Bank.

Getting to grips with a CCP

OCC's Joseph Pellegrini reflects on 2014, and reveals what the central counterparty is looking to bring to market in the future

How successful was OCC's 2014 for securities lending?

Our programmes have been very successful. Securities lending business done via OCC has been terrific, with volumes increasing and notional values skyrocketing. We have more members doing more transactions than ever—they're all looking to a central counterparty (CCP) as a possible solution for regulations that are in the pipeline.

We're also getting a lot of feedback from our broker-dealer members, so we're looking forward to 2015 and ways we can enhance our securities lending service.

Why is OCC bringing agent lenders into the fold?

Agent lenders are the prime source of liquidity. We have a big portion of broker-dealer business but it's probably a small part of an industry in which the agent lender is king. We need more liquidity in the programme to make it grow, so that's why we want to get them in.

We're looking at a two-phase solution for agent lenders. The first is to bring banks in as full clearing members. In that capacity they would pay margin and contribute to the clearing fund, just like our broker-dealer members. While this is a quick and easy enhancement to our programme, we understand that it does not solve the majority of issues for agent lenders.

The second phase will be much more like the traditional agent lender model, so that they can come in and do business the way they do it today. This is a longer-term project, as it's a little more difficult for us in terms of legal and structural work. This phase will hopefully be what agent lenders need to play ball with us.

Is this something that will appeal to regulators?

We think so. We are talking to regulators, particularly the Securities and Exchange Commission, and they like the idea of seeing a CCP used for some part of the securities lending business. Of course, this isn't mandated, but some regulations favour using a CCP, while others might offer exemptions down the road. We think that some of the regulations in the pipeline are pushing agent lenders towards the CCP solution, and we're here to help with that.

What about beneficial owners?

Beneficial owners are still unclear as to how they can face a CCP without diverging from the traditional agent lender model. Current practice sees them facing an agent lender or broker-dealer, and the CCP model is still evolving in the US.

Education is the key to addressing this. Beneficial owners need to be made comfortable with CCPs to the point that they understand that facing a CPP can be beneficial.

How are they reacting to CCPs? Do they want to become more comfortable with them?

Beneficial owners are learning more about CCPs as regulations change the way that securities lending is done. The pressure that they are putting on indemnification is one reason for this. Beneficial owners are asking more questions and it's clear that they want to increase their knowledge and understanding. Agent lenders need to take the lead on this, but OCC is here to help.

What can we expect from OCC next year in terms of new products?

We're putting the finishing touches on the work that we need to do for an AQS Equity Repo product. The proof of concept is done and we're in the process of finalising the rules around the transaction. We expect that to come to market in 2015. **SLT**

> "Beneficial owners are learning more about CCPs as regulations change the way that securities lending is done. The pressure that they are putting on indemnification is one reason for this"

Joseph Pellegrini, vice president of the business operations group
Options Clearing Corporation

Automation: past, present and future

What does securities finance need to automate, and why? Experts discuss the issues

The move towards automation is often mooted but never completed, and securities finance is no different. Jonathan Lombardo of Pirum raises the issues with Stuart Skeel of BNY Mellon, Kit Newman of Barclays and Andy Krangel of Citi, and asks how far securities finance has progressed in the automation game, and which level it must tackle next.

Jonathan Lombardo: Before the financial crisis in 2008, what were the drivers that led you to identifying automation as a route forward?

Andy Krangel: The driver for automation has been predominantly process improvement/efficiency-based. Until 2008, securities finance was growing exponentially to the extent that participants were looking at doing more with the personnel and systems they had. We had many middle- and back-office people servicing large accounts. But, as the financial crisis showed, that was unsustainable in the long term.

Lots of thinking about automation has come post-2008, when revenues decreased dramatically, very quickly. Before the financial crisis, we were all mainly focused on growing the business. Now, we can't afford to have numerous people working on manual operational tasks—it's no longer feasible and we have to be more efficient. We were looking at it before the crisis, but it wasn't on agendas as much as revenue growth.

Stuart Skeel: The need for automation had been created by the trading desk with a view to increasing volume and revenue. Operations required a level of automation in order to keep up, but it is now becoming fundamental to what the settlement and exposure teams do today.

Much of what we do around international equities and non-cash triparty is run and managed in London, with billing and supporting functions handled by other locations. We have close-knit teams, with only a relatively small number of people managing a large volume of trades and collateral. Our operations have historically been located close to the trading desk, as we feel that to be an efficient way to operate. For instance, it used to be that same-day pre-pay was only really supported by operations as a favour to the desk and for that traders wanted operations located close by.

Automation helped them to keep up with what traders were doing, so operations were looking for the best way to reconcile. Everything flows from reconciliation. Once that is perfected, exposure and billing follow on—it was for that reason that we looked towards automation.

Everything is a risk

Lombardo: With volumes and activity on the rise pre-crisis, scalability was becoming more of an increased burden on day-to-day processing. What steps were taken to identify processes that were lacking efficiency and required automation?

Kit Newman: There would be a squeeze on the function to perform better and then it would be analysed. Costs and benefits would be considered, as would the possible effects on the business of doing it externally or internally.

Krangel: The initial drive was from a process improvement perspective and not doing more with less. I have run operations in the past and there have been processes, such as billing, that have generated a lot of operational challenges. Billing is a tricky area, because delays in reconciling and agreeing bills can result in being months behind collection, which can cause serious problems. I'd say that is still a challenge in securities finance.

Newman: That's right. Billing wasn't seen as a risk in the past. Most were focused on the borrower the going bust. That's changed to the point where all exposures to borrowers are considered risks, including bills outstanding and corporate actions. The longer they are left, the greater the chance that the loan will be returned, leaving the lender uncollateralised.

Lombardo: Realising in-house capacity was still stretched and your client base was continuing to expand. Was an in-house solution considered or was the reach of external vendors the only viable solution?

Skeel: That decision was reached by looking at the best way to access borrowers. Looking at it from that perspective meant that we were far less likely to tackle it in-house. Also, offerings were already out there that could connect to a majority of our counterparties, which made a lot more sense when connecting with so many.

Krangel: I totally agree. Technically, we have multiple borrowers that we can lend to, so there is no way we could ever build a reconciliation structure with all of them that is practical. There is not a single, industry-wide lending system out there.

There are certain things that an agent lender can do for its entire borrower network, such as send out its available inventory in a consistent format. But to actually create a reconciliation process with multiple counterparties, I don't think we would've have cracked that internally given the market system variation.

Connectivity is king

Newman: I think counterparty connectivity is the most important area for the buy side, particularly how the most important information is accessed without having someone to ask for it over the telephone or via email.

Whichever vendor offered the most cost-effective solution and the biggest community of agent lenders was the one to go for. But broker-dealers also considered the fact that multiple vendors were out there, each with different networks using their offerings, and so many would often sign up to lots of services as

they came online. Eventually, they would decide which one was most appropriate.

I also think it was about understanding what a vendor can provide, because there wasn't a general awareness about what was out there. The decision was probably based on existing relationships with certain vendors.

Skeel: There are needs that require links to other participants in the market, so it makes sense to use a vendor because it removes the need to cultivate each link individually.

Newman: Of course, there is also internal infrastructure to consider when looking at vendors. The broker-dealer might have solutions in common with lenders in terms of how currency positions are financed, for example. These components had to be factored in when choosing a vendor.

Lender-led

Krangel: The decision to build in-house or use a vendor system tends to be driven at a firm level. With our lending system, we have an in-house build and have done it that way for some time. We have considered vendors but the lending system is quite

specific to the operating model. It also has to link to internal systems, such as custody.

One of the challenges of using a vendor is that generally the system is being built for many organisations, not just for the particular agent lender. If a specific need exists, the agent lender has to justify why it needs what it needs over the requirements of other users, or alternatively pay for that development. In-house lending systems allow greater flexibility and customisation.

I think that a lending system is very different to an interface into the market.

Lombardo: When looking across vendor solutions, how did functionality come into the decision making process?

Skeel: We originally looked at connectivity, then considered functionality. Those were the two key priorities, in that order. Yes, one system may provide access to more counterparties, but as a lender we also thought that we could choose a system that worked better for us and then push for the borrowers to accept it. If they wanted to reconcile with us, and we know they did, then we could say that this system is the one that we want to use. Whether or not they were open to that is difficult to say because they hedged their bets on what they were going to use anyway, but connectivity and functionality certainly made that choice for us.

Lombardo: Is there scope for a global solution?

Krangel: I think that it is beneficial to have more than one provider, both from a pricing and risk perspective. Without competition, there is less incentive to improve or price competitively.

My problem with a global solution is that it is putting all of your eggs into one basket. I would certainly want to consider how long it would take to transition everything onto to the single system before making that decision.

But, ultimately, I think that today market participants are focused on cost control and will look at alternative solutions that are as efficient as long as potential transitions don't trigger capital costs. It has to be done effectively and wisely.

It's real, this time

Lombardo: Moving on from vendors and solutions, has the introduction of real-time become a critical component of intra-day risk management? Why or how does real-time become critical to your business?

Krangel: Consider central counterparties (CCPs): real-time is critical for them. It's also important for pre-trade, so that it can be viewed and differences identified before it becomes a real trade. Finally, the ability to calculate required value processing (RQV) in real-time is essential, because trading throughout the day needs to be collateralised on a real-time basis.

Skeel: The information throughout the trading day that enables us to look at how efficient we are makes real-time critical. Collateral optimisation is going to be more and more important going forward and real-time tools are needed to move towards that optimisation. I also think regulations coming out next year will demand more real-time pre-matching information.

Newman: The potential for a trade to fail at 4pm means that counterparties are going to want to be able to borrow replacement securities at the same time, and they will want to plan that in advance. The only way that is going to happen is if a counterparty can match up and collateralise in real-time. The market is moving in this direction.

Lombardo: Firmly believing that knowing where you stand at any point in time during the trading day is crucial. The ability to re-evaluate exposures in multiple intervals, giving firms the ability to reassess risk and reposition, is critical for moving the industry forward.

What next?

Lombardo: Finally, what is the main driver for you in 2015 to increase automation?

Skeel: We need to concentrate on better marks and returns functionality next. That's a main focus for us.

Krangel: Among other things, we are going to make better use of the mark-to-market process. We are not using that enough and we should be.

Newman: We want to make pre-trade matching more efficient with counterparties across the business. **SLT**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A brave new world

If 2014 has taught us anything, it's that we are now in a world where regulation seems to breed more regulation, says Jeremy Taylor of Rule Financial

In 2014, we witnessed the continued march of regulation, which has had a significant impact on banks and many other financial institutions, and 2015 promises to see regulation and compliance remain firmly on the agenda for many firms. The challenge now is how do we take the lessons learned in 2014 into the New Year and beyond?

In our 'Focus on Regulation' series, we started the year by highlighting how many businesses are revising their business models as the balance between business profitability and the cost of compliance becomes ever more complex.

All financial institutions have needed to monitor the change and increase their investment, just to keep up with the pace and complexity of these regulatory changes.

In May, David Field spoke about the industry upheaval caused by over-the-counter (OTC) derivatives reform. Compliance comes at a cost for investment firms. Many have found it difficult to justify the required investment for new systems and processes and have struggled to find ways to keep business lines profitable in this brave new world.

The future will mean more and more firms making the difficult decision to withdraw from those markets that have become unprofitable for them, or where they cannot justify the level of investment required to achieve compliance and stay in the 'new' market.

The European Market Infrastructure Regulation (EMIR) has provided firms with a series of ongoing challenges. We've seen firms slowly getting to grips with EMIR's reporting requirements, but the challenges will continue. In the coming months, firms will be required to produce a series of reports, including collateral reporting, delegated reporting, clearing and product standardisation.

We couldn't talk about regulation this year without mentioning the 'behemoth' that is BCBS239. After getting to grips with the detailed requirements of EMIR, many firms are now dealing with the extensive demands of BCBS239, with programmes set to continue throughout 2015.

The directive's 14 principles relating to institutional risk management are clearly well intentioned. However, there are pros and cons to the fact that BCBS239 does not offer a prescriptive formula of specific requirements.

Firms may wish to view it as yet another 'box ticking' exercise, but this reform actually provides a great opportunity to make significant and long-lasting improvements to the governance and structure of many financial institutions. The question is: will those who are affected embrace this opportunity?

If we look ahead towards 2015, we know the shadow of BCBS239 will continue to loom large over firms as they prepare to comply with the principles of the directive for January 2016. Then, BCBS261 follows hard on its heels and will see many firms having to divert investment and resources to build new front-to-back processes and settlement mechanisms for initial margin on uncleared derivatives.

The impact of the proposed Markets in Financial Instruments Directive (MiFID) II within securities markets will also be significant. Industry analysts have already predicted that implementing the directive will be very problematic: firstly, due to the scale and scope of the legislation, and secondly, the desire of national governments to curtail the influence of the EU over financial markets.

In the UK, it is now more than four years since the Independent Commission on Banking (ICB) report, led by Sir John Vickers, was completed in September 2011. The report recommended that banks 'ringfence' their retail and investment banking activities, creating a clear divide and ensuring that retail banks are unaffected by the potential risks investment banking.

UK banks still have until 2019 to implement reforms, although more detail is still required. The scale and costs involved in such a separation means that banks must start to plan now for the worst-case scenario, while creating a flexible model that can adapt to the final format of the reform.

If 2014 has taught us anything, it's that we are now in a world where regulation seems to breed more regulation, and currently it is difficult to see the end of a post-regulatory world. We can confidently predict that in 2015 regulation isn't going away—and sprinkle into the mix the manifesto promises of the UK general election, it is likely to be a very hot topic.

So, best wishes to everyone for a relaxing holiday season and a well-deserved rest. We'll see you all in 2015 for a continued focus on regulation. **SLT**

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Securities finance market: by the numbers

DataLend provides a snapshot of the global securities finance industry from the second half of 2014

Global on-loan balances are off their July highs, having dropped by about $100 billion through the course of the second half of the year. It is not unusual for balances to drop off toward the end of the calendar year as short positions are closed out.

Inventory values have climbed to among their highest levels ever since DataLend's launch. The growth is most pronounced in North America, which has added around $600 billion in inventory in this time period to about $8.122 billion by December 2014. In

Figure 1: Global on-loan balances, H2 2014 (USD billions)

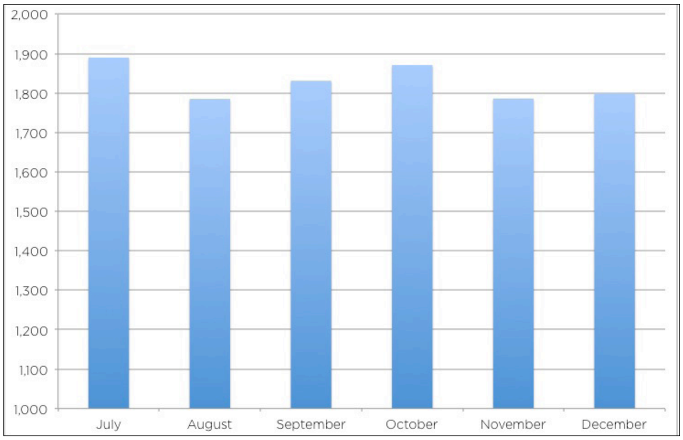


Figure 2: Global inventory balances, H2 2014 (USD billions)

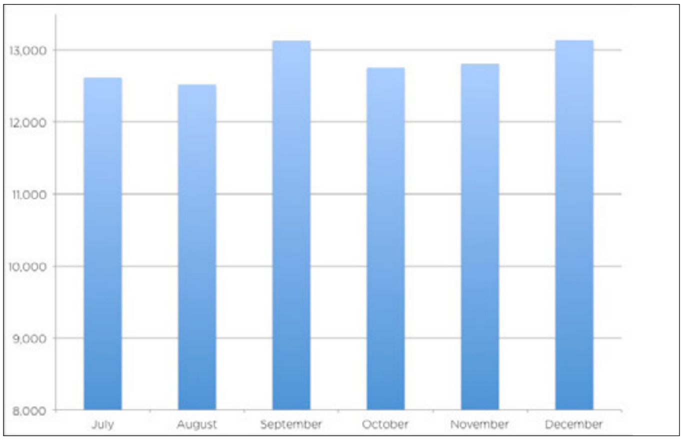
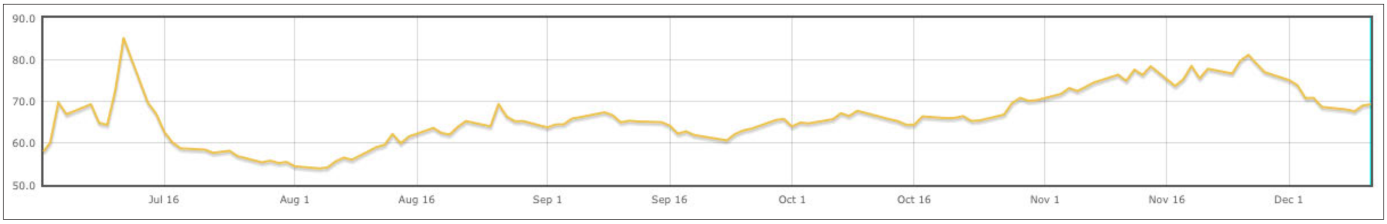


Figure 3: DataLend Target 50, H2 2014



the Europe, Middle East and Africa (EMEA) region, total inventory has fluctuated between $3.4 billion and $3.7 billion in this time period, while Asia's inventory has hovered around $1.3 billion.

Figure 3 shows the DataLend Target 50 (DL50), a proprietary index tracking the 50 hottest stocks in the securities finance markets on a daily basis. The DL50 is composed of the 50 most expensive equities to borrow for the user-selected region determined by volume-weighted average fee/rebate rate and utilisation. The DL50 is meant to be a benchmark utility to determine how the hottest securities in the securities lending market are trending over time.

Figure 4: DL50 Components, December 2014

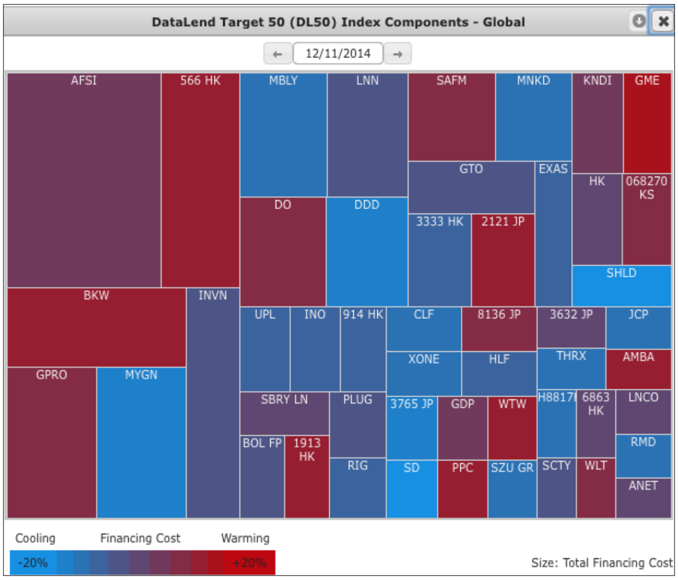


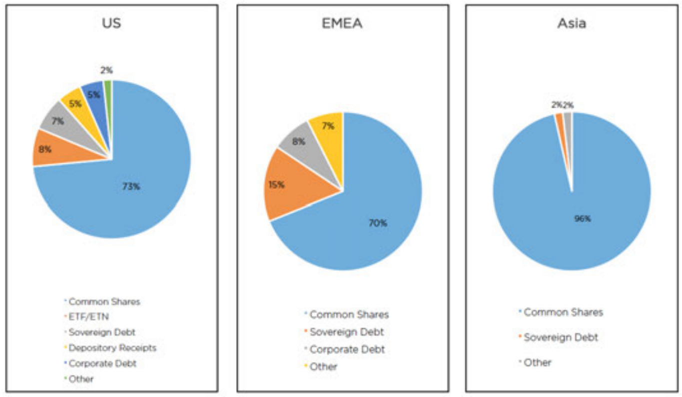
Figure 4 depicts the DL50 heat map, comprising the 50 hottest stocks in the global securities finance market on a recent trading day. AmTrust Financial Services (AFSI), Hanergy (566 HK) Burger King (BKW) and GoPro (GPRO) were among the hottest stocks of the day, while Myriad Genetics (MYGN) and InvenSense (INVN) were shown cooling, although they were still among the hottest stocks in the world.

2014's hottest equities

US	Europe	Asia
3D SYSTEMS	ALLIANZ	GUNGHO ONLINE
GOPRO	GEMALTO (FR)	ANHUI CONCH
MYRIAD GENETICS	SIEMENS	EVERGRANDE
MANNKIND	TOTAL	CELLTRION
SEARS HOLDINGS	GEMALTO (NL)	HANERGY SOLAR

The DL50 in 2014 saw frequent appearances by these names, which were the hottest equities of the year.

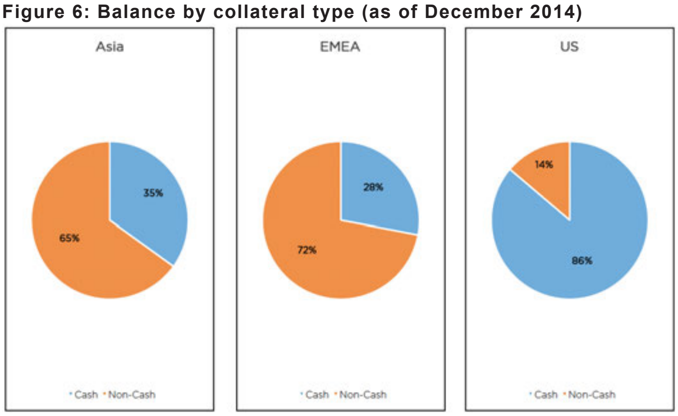
Figure 5: Asset class breakdown by region by percent of total revenue (as of December 2014)



Equities, primarily common shares, continue to drive most of the revenue earned in the securities lending markets globally.

The trend is most pronounced in Asia, where 96 percent of the revenue earned in securities finance came from lending of common shares, primarily due to few fixed income securities out on loan there, and low fees to borrow for those that are.

Figure 6: Balance by collateral type (as of December 2014)



Cash (collateral) is king in the US, where such collateral is often reinvested into money market funds, short-term repo or other vehicles. Non-cash instruments (particularly government bonds, though increasingly other asset classes such as high-quality equities) collateralise the lion's share of Asian and EMEA securities lending transactions. **SLT**

2014 sees securities lending make a comeback

This year has proved buoyant for the industry, with demand and fees rebounding from the lows seen in 2013, says Simon Colvin of Markit

The year saw inventory levels continue their ascent to a new all-time high, topping $16 trillion over the summer. Inventories have since off somewhat over recent months and now lie at $15.3 trillion. Equities make up nearly two thirds of all assets currently sitting in lending programmes, representing a record high share, as the portion of fixed income assets held in lending programmes has shrunk by more than a third from the post-crisis split.

This strong resurgence in the value of equities sitting in lending programmes was led by North American assets, which have tripled in value since 2008. This year has been no exception as the value of North American assets in lending programmes has jumped by 9 percent in the last 12 months, roughly in line with the market's return, so inventory in the region has not grown in real terms.

Outside of North America, things haven't been as buoyant, as the value of both European and Asian equities in lending programmes have fallen in the last 12 months, by 1 and 9 percent respectively. Note that the inventory numbers are skewed somewhat by foreign exchange movements, as the drop in the value of European inventory is mirrored by a fall in the value of the euro against the dollar. Eliminating foreign exchange fluctuations, we see that European assets have held steady while Asian equities have registered a slight increase.

Equities borrowing volumes also saw a significant lift over the last 12 months and now sit 9 percent higher than at the start of the year. The bulk of the increase was seen in North American equities (they make up two thirds of the equity balance), which saw a 10 percent increase in aggregate balance. European and Asian balances fared even better, jumping by 16 and 5 percent in dollar terms, which underrepresents the increased demand to borrow in local currency.

The fact that demand to borrow increased at a higher rate than inventory in Europe and Asia sees utilisation rates in these regions on track to end the year with a much better outlook than 12 months ago, when utilisation rates stood at all-time lows.

The current utilisation rate in Asian equities sits at 5.4 percent, a tenth higher than a year ago. European equities utilisation has fared even better with an 18 percent jump to 5.8 percent. North American assets have seen flat utilisation rates, as the bump in value on loan was matched by a similar move in inventories.

Fees have also held up well over the last year, which is unsurprising given the improving demand picture. Current weighted average fees have risen from the lows seen at the closing stages of last year in all three major regions. While the weighted average fees of North American and Asian assets have increased by around a tenth from this time last year, those in Europe have proven most resilient and now sit 40 percent higher than at the same point a year ago.

Note that this is skewed somewhat by the recent capital distribution from LVMH, which has lifted the region's averages fee in the closing weeks of the year.

The improving fee and utilisation situation has been translated into increased equity lending programme profitability from where it stood a year ago. The Americas and Asia now have much healthier return-to-lendable figures than what was seen in 2013. While European equities have not performed as well over the last 12 months in return-to-lendable figures, this has been offset by an increase in inventory values, which in turn have translated into better revenues for the industry.

The rise in revenues has been helped somewhat by corporate actions, as recent IPOs and M&A activity, which have been buoyant in the last 12 months, have grown to represent a fifth of all equity revenues since January—twice the proportion seen a year ago.

The year has also been successful for short sellers, with the most expensive-to-borrow shorts in all three major regions have underperformed the rest of their market peers over the last 12 months. Portfolios made up of the 10 percent most expensive-to-borrow shares in North America, Europe and Asia have underperformed the rest of the market by 15, 9 and 10 percent respectively, making 2014 one of the best performing years for high-conviction short sellers.

The strong performance was helped in the closing months of the year with the heavily shorted portfolios in all three regions underperforming the market during the fourth quarter. This was helped somewhat by the recent slump in oil prices, which saw

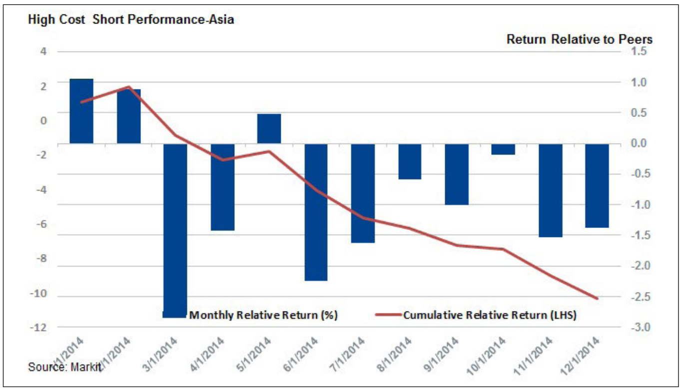
> "The improving fee and utilisation situation has been translated into increased equity lending programme profitability from where it stood a year ago"

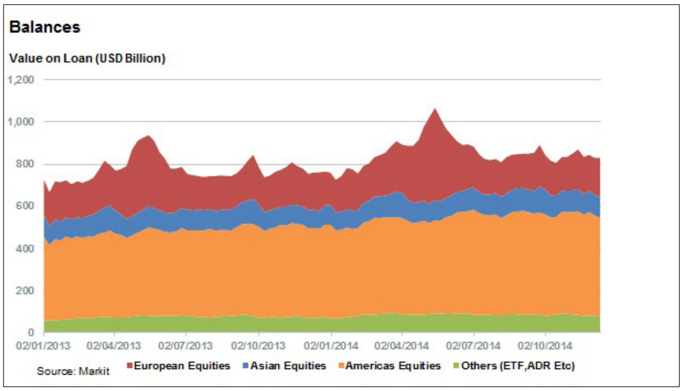
Simon Colvin, analyst, Markit Securities Finance

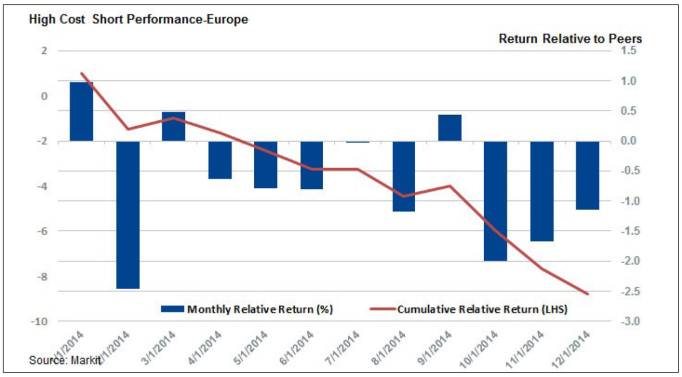
energy services firms, many of which were heavily targeted by short sellers, experience sharp share price declines.

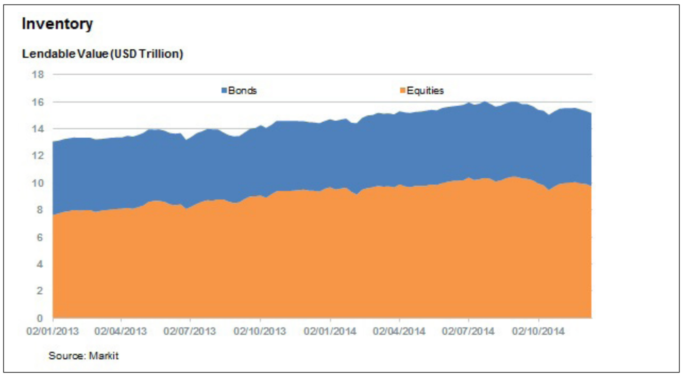
Interestingly, short sellers haven't been particularly keen to spread out their energy plays in the wake of the price decline, as the proportion of energy shares in the heavily shorted portfolio has remained relatively steady in the closing month of the year. The stocks in the energy sector that have been targeted coming into the closing weeks of the year, mainly services and speculative marginal producers, have seen an increased shorting activity as demonstrated by a rise in demand to borrow their shares.

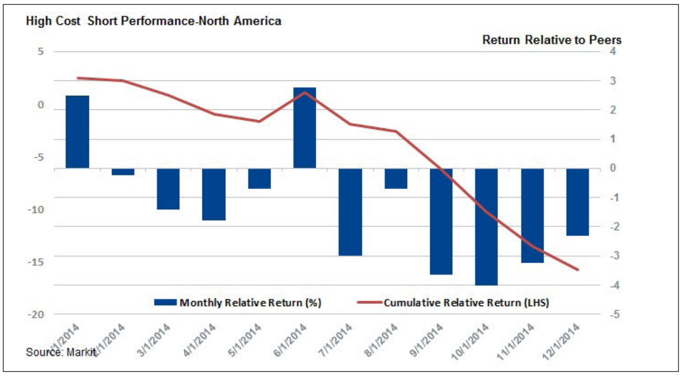
This year has proved buoyant for the industry from a demand and fee point of view, with both rebounding from the lows seen in 2013. This has in turn translated to better profitability for lending programmes and (with inventory at an all-time high), ultimately, revenue. The year has also been a fruitful one for short sellers, as the most in-demand shares have significantly underperformed in all three regions. **SLT**

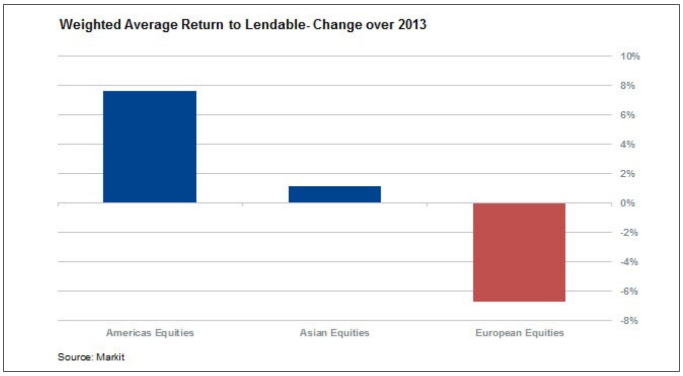












Did 2014 bring everything we expected?

David Lewis of SunGard's Astec Analytics assesses whether lenders and borrowers got the 2014 they asked for

Returning to work in January will bring the inevitable questions enquiring as to whether you had a good Christmas or not, and whether, of course, you received the presents you were hoping for. Every year, for some inexplicable reason, Santa fails to get my new motorbike down the chimney, and once more I have to make do with socks and a scarf. Does this make me cynical, or lacking in hope for better things to come? Of course not, for I work in securities finance and that requires resilience and an unswerving belief that things will indeed get better next year.

Looking back to this time a year ago, the industry crystal ball suggested that the great collateral transformation trade would be riding in to rescue the industry's revenues. Risk would be a thing of the past as we would all be trading bilaterally or anonymously through central counterparties (CCPs), saving healthy quantities of regulatory capital for much more exciting financial products and services along the way.

Is that what happened though, or have we reached the end of the year once again a little deflated when we compare our hopes and expectations for 2014 with what has actually occured?

Risks and returns do not seem to have changed that much, especially when you look at the HQLA (high quality liquid asset) fixed income segment. Incoming legislation such as the European Market Infrastructure Regulations (EMIR) and Basel III was expected to push demand for HQLAs skyward, with fees rising along with the demand. Taken against decreasing demand and income elsewhere in the financing markets, this source of new income was expected to reinvigorate flagging profit and loss accounts.

Figure 1, sadly, tells a different story. While fixed income loan volumes are rising, overall fee returns appear to be falling. The plots shown indicate returns to assets actually lent, not the returns to the fund. A falling rate here suggests borrowing fees actually charged are falling. Securities lending is not immune to the vagaries of supply and demand economics, and as Figure 1 shows, rising demand is not yet sufficient to push borrowing fees northwards as the supply side remains plentiful

Concerns raised by many observers, myself included, suggested that certain beneficial owners would never entertain what is, from their point of view, a collateral downgrade trade, ie, be tempted to give up their HQLAs against collateral of (perceived) lesser quality such as equities or cash.

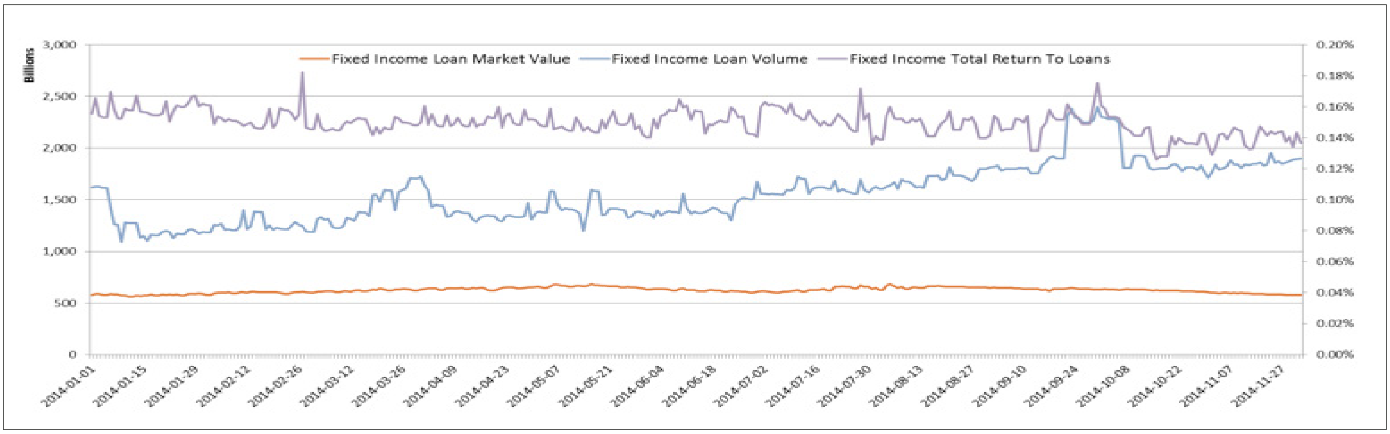
It seems we were wrong, as the need for revenue generation and the reluctance to reject too many money-making ideas from their agents have indeed attracted many new players over 2014. Too many, some might argue, for plentiful supply has kept fee levels, and therefore revenues, low.

But what has caused this sudden rush of blood to the head? The need for revenue was given as the accepted answer. Beneficial owners, many of which had dialled down their risk appetite aggressively immediately after the financial crisis, have been relaxing their collateral requirements, potentially both along the duration curve as well as down the credit rankings. Some have also extended their approved borrower lists in a quest to gather a bigger share of the limited demand that is out there. In an ongoing low interest rate environment, such funds have been starved of revenues elsewhere and have looked to solid and stable products such as securities lending to fill in some of the gaps. But has it worked?

Figure 2 shows the total return-to-lent assets (ie, the value that loans made are earning, rather than a return to availability) for 2014 (indexed to 1 January 2014) and shows a decline in overall returns for fixed income loans from a weighted average of around 16 basis points, down to 14 bps. Equities fared better than bonds, showing a 5 bps increase in returns-to-lent assets over the year, suggesting that while actual volumes outstanding might be falling, the average rates paid have risen slightly during 2014.

As returns diminished in bonds and edged up slowly in equities, we understand that funds have been pushing harder for more absolute revenues from lending, and indeed their cash reinvestment strategies. Reinvestment guidelines are also being loosened in the

Figure 1: Fixed income volumes, values and return-to-lent values over 2014



hunt for yield, and certain types of asset-backed securities are starting to reappear on lists of acceptable investments.

It has long been said that you cannot create demand in the borrowing environment, and demand has certainly been woefully absent in recent times, but you can make yourself a more attractive lender by being ever more flexible and accommodating, particularly when it comes to term or term-like trades.

While I would never want to curtail the industry in its search for returns or in its efforts to protect income levels as best it can, 2014 has indicated that some corners of the market seem to have relatively short memories when it comes to potentially being caught on the wrong side of collateral, and so saddled with illiquid assets to sell when things go bad.

CCPs were also being hailed as the cure for risk in our marketplace as we went into 2014, but little has actually happened in that regard—certainly not the splash that many expected and some hoped for.

At the end of 2014, the rhetoric seems to have been adjusted somewhat, and talk is now of around 15 percent of the market heading for trading on CCPs rather than an en masse transition. The reluctance to jump aboard this particular bandwagon has been described variously as being due to the costs, the need to trade through a clearing member, and—one of the very aspects that is supposed to make the CCP an attractive solution—anonymous trading.

Far from being the key to additional trading opportunities, the extra protection said to be provided by CCPs allowed you, even encouraged you, to lend assets to borrowers that you may not normally have approved or traded with. Far from being an advantage as many hoped it would, this seems to have actually put many off.

At the IMN conference in September, one panel finished with a question for all. It was along the lines of: "What is the biggest thing you expect to happen in the next five years?" One answer surprised many: "A CCP will fail." This seemed to go against everything we were to expect from such facilities, yet it struck a chord.

The European Securities and Markets Authority (ESMA) recently addressed the same concern as its chief executive, Steven Maijoor, stated that the possibility "cannot be fully excluded" and described such a failure as potentially exceeding "the systemic impact of the failure of a large international bank". Perhaps putting all the eggs in one basket is not the way forward, after all.

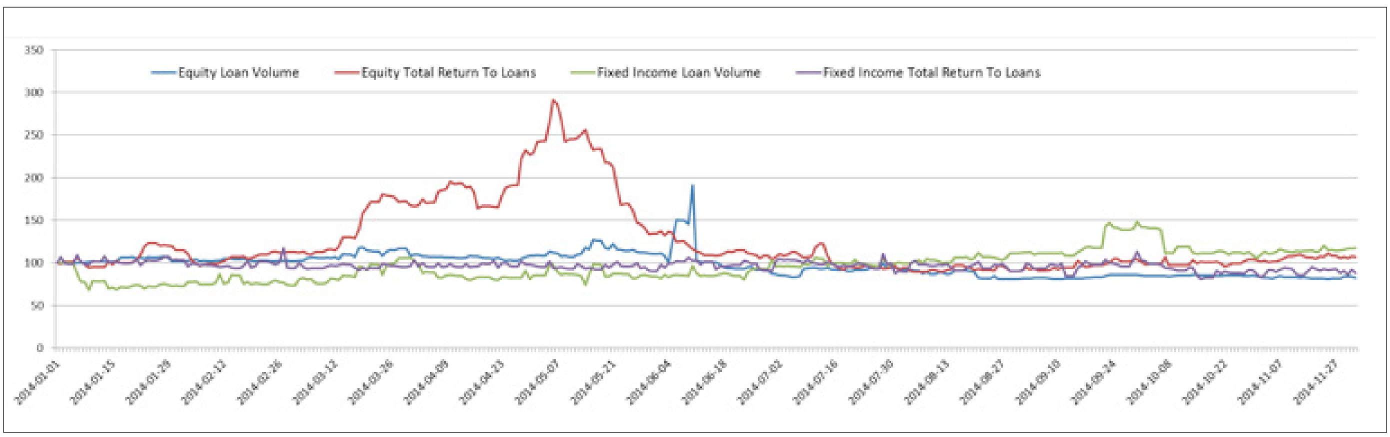
So, at the end of 2014, what has changed? Absolute returns are down, despite rising fee levels in some areas, but that is perhaps not unexpected as the trend has been downward for a little while, and demand has not returned strongly to the market. Volumes are up and increasing, which again may not be a surprise, especially in the fixed income arena, where some demand for HQLAs has come into play—just not enough to start driving the fees up.

Has 2014 been a bust, then? A professional observer might kindly describe the industry as having "consolidated its position" rather than broken any new ground. New regulations are edging into the mechanisms of our markets, but they are nothing that one could describe as having a revolutionary impact (more like an evolutionary one).

But here we are again, at the end of the year, looking forward to the next one and talking of many things that will make our industry better, leaner, more profitable and ever more indispensable to the wider financial marketplace. I always look forward optimistically about these things, and every year I think about a new helmet to go with the new bike that Santa is going to bring me. We shall see. **SLT**

David Lewis
Senior vice president
SunGard's Astec Analytics

Figure 2: Equity and fixed income volumes and return-to-lent values over 2014, indexed to 1 January 2014



Is your glass half-full or half-empty?

New regulations are coming thick and fast, but there is room to manoeuvre. Jeremy Taylor of Rule Financial reports

Firms could be forgiven for admitting a sense of 'regulatory fatigue' as they approach the end of 2014. This would be understandable, as regulatory demands continue to increase rapidly as a consequence of the now 'distant' financial crisis of 2008.

The reality is that we are now living in a new era of enhanced scrutiny and regulation. Some may view it as a temporary state, while others will see it simply as a cyclical phenomenon, and one that the global financial sector has experienced before, with cycles of regulation and liberalisation taking place ever since the Great Depression of the 1930s.

Firms might complain about the burden of compliance, but there is a general recognition that there was, and there remains, a need for change. Rebuilding trust and confidence in the financial industry is a fundamental principle going forward.

The US Dodd-Frank Act, European Market Infrastructure Regulation (EMIR), Markets in Financial Instruments Directive (MiFID) II and BCBS239 are just some of the most significant regulations that were designed and enacted to help restore this confidence. The challenge for many firms has been in dealing with the pace and relentless nature of regulatory change.

More resources and budgets are being allocated to support compliance. The implementation of more complex restructuring programmes to help comply with the new legislation continues to increase, adding to the growing pressure of the simpler forms of previous regulatory compliance. This will only continue in 2015 and beyond.

Firms may feel that their resources are being pulled in many different directions as they attempt to withstand this regulatory avalanche, however, some have come to realise that some regulation does present them with opportunities. The challenge in 2015 is whether firms have the vision, expertise and capability to take advantage of the opportunities on offer.

This year saw the EMIR trade reporting mandate come into effect, on 12 February.

The drive to reduce risk and improve transparency within the over-the-counter (OTC) derivatives market has continued to prove a challenge for market participants and the regulator. Achieving EMIR's reporting requirements for collateral reporting, delegated reporting, clearing and product standardisation has produced mixed results.

It suggests that further clarification on reporting standards is needed, while some firms may appear to be experiencing a lack of confidence in their reporting.

Both buy-side and sell-side firms have experienced varying degrees of difficulties in terms of compliance. Most large sell-side firms invested a lot of time and resources, as well as millions of dollars, to ensure that they had in place robust reporting mechanisms before the deadline passed. Unfortunately, the same could not be said of the buy side, which has struggled to catch up.

Buy-side firms have suffered from a lack of reporting experience in comparison to their sell-side counterparts. This lack of experience has proved particularly challenging as EMIR has increased the level of reporting obligations for buy-side firms in covering OTC derivatives and exchange-traded derivatives.

Criticism was levelled at the regulator, the European Securities and Markets Authority (ESMA), which was accused of not providing enough guidance to firms before the mandate was implemented. The view remains that a number of important questions were left unanswered before the deadline passed.

ESMA denied many of these claims, and argued that it has provided sufficient guidance, especially on how to implement standards for reporting to trade repositories. ESMA's stance has been one whereby firms should look to apply the existing guidance that is already in place.

However, the view persists that there has been a lack of guidance and no clear consensus on reporting requirements around trade representation, on how unique trade identifiers should work, the standards required for legal entity identifiers, or clarity on collateral reporting.

This will need to be urgently addressed if firms are to have confidence in the system and in their efforts to comply with trade reporting requirements. ESMA is currently conducting a further consultation, focusing on reporting standards. This should be completed in February 2015 and will hopefully lead to better clarification and standardisation around reporting. If this does not happen, it may be left to individual firms to take up the regulatory initiative themselves and make best efforts to solve individual issues.

A further consequence of EMIR is that the regulation has come with a high financial cost. The price of doing business in OTC derivative trading has increased and this raises some difficult questions firms. Cleared and non-cleared OTC derivative transactions have become more expensive. In this changed environment, how do businesses continue to make a profit?

We are likely to see readjustments within the OTC market over the next few years. The cost for non-centrally cleared transactions is substantially higher than centrally cleared OTC derivatives. As such, there will be winners and losers between those firms that can afford to invest in new systems and processes, thereby remaining profitable in this market, and those that cannot. Others may decide to look for cheaper and more standardised alternatives to non-cleared products, or withdraw completely from those markets in which they can no longer make a sensible profit.

The increased cost of doing business will mean that firms will be forced to undertake major reviews of their product lines and restructure their offerings as required.

Continuing the theme of derivative trading reform, MiFId II and the Markets in Financial Instruments Directive (MiFIR) have also continued to generate sizeable discussion and consultation in 2014.

Although the objective of greater transparency and fairer competition in capital markets is a welcome move, MiFID II faces a number of challenges from EU member states protecting their own interests.

The European Parliament's adoption of MiFID II and MiFIR in April 2014 was a significant landmark. On 22 May 2014, ESMA published its discussion and consultation papers on proposals for regulatory technical standards and implementing technical standards that should be adopted.

MiFiD II contains more than 100 requirements for ESMA to draft these standards. ESMA also has to provide technical advice to the European Commission that will allow it to adopt these delegated acts.

The consultation and final report was a significant undertaking for ESMA. With this in mind, we are still playing a waiting game in terms of reaching the finalised standards. The consultation period ended on 1 August and its findings will be provided in the form of technical advice to the European Commission by the end of 2014.

The first quarter of 2015 should see ESMA's publication of the technical standards report. It is anticipated that the final technical standards will be delivered to the European Commission by July 2015. The objective for firms in 2015 should be to remain up-to-date and engage with the policy-making process. Secondly, firms should not hold back in continuing to develop their strategies and implementation plans for MiFID II ahead of the 2017 deadline.

A review of regulation in 2014 would not be complete without discussing the impact of BCBS239. The fallout from the 2008 financial crisis uncovered shocking levels of institutional risk management. This included the widespread absence of consolidated views of risk across organisations and the inability of firms to produce the required aggregation and reports quickly enough.

The 14 principles mandated by BCBS239 broadly cover governance and structure, risk data aggregation capabilities, risk reporting practices, and supervision. Firms seeking to comply with BCBS239 need to enforce common risk data standards and policies supported by strong governance structures.

The ongoing criticism of BCBS239 is that it is not prescriptive in its requirements. The onus has been left with the firms to decide whether to implement the minimum requirements for compliance, or to go further by undertaking significant and long-lasting changes in the operational management of risk data aggregation.

Many firms are at different stages on the road to compliance. Next year will prove to be an intense and pressurised year for those who know they will struggle to meet the January 2016 deadline.

Following hard on the heels of BCBS239, we also have BCBS261. This relates to non-centrally cleared derivatives and will see many firms having to divert investment and resources to build new front-to-back processes and settlement mechanisms for initial margin on uncleared derivatives. Firms that embrace the principles fully will be able to enjoy a considerable advantage over competitors that aspire to simply comply.

This era of financial regulation may feel like an endless onslaught for some, but the difference between success and failure in this new environment will depend largely on the attitudes and strategies adopted by individual firms. Some may view the onslaught of regulation as a bad thing, while others see it as redefining the market and presenting new opportunities for growth.

It is understandable that many firms may feel like guinea pigs in a series of ongoing tests. However, rather than view regulation as a form of punishment for the sins committed in the past, regulation should be embraced and accepted as the 'new normal'. In doing so, new opportunities will ultimately begin to present themselves.

In 2015, those firms that embrace the new reality will be those that are open minded, flexible and agile about the future. Firms should seek to collaborate more with colleagues, both internally and externally, to find workable solutions. A new way of thinking and operating may be required for some, but it is important to remember that not every firm will do this effectively. For those that do, the coming year presents a number of opportunities. **SLT**

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Jeremy Taylor, specialist, operational processing and derivatives, Rule Financial

What next?

Industry experts say what the biggest challenges will be for securities finance in 2015

Elaine Macallan
Head of Colline functional development
Lombard Risk Management

The biggest challenge facing the industry in 2015 and beyond will be dealing with the impact and consequences of regulatory reform. Clarity is still required over the multiple emerging proposed global regulations and there is still some way to go to ensure that there is consistency for global market participants.

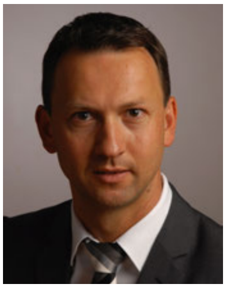
For individual institutions, the focus will be to understand how regulations affect their businesses, both directly and indirectly, and to ensure that they can meet their regulatory obligations within the stated deadlines. For all participants, this will involve significant adjustment of existing technology, infrastructure and processes, and planning for the change programmes needed to support this should be a priority for all institutions in 2015.

It is important to understand that there is lead time for technical development and process change. There is an urgent need for clarity on regulations and deadlines in order for firms and their technology vendors to implement business solutions to meet them.

Ben Cole
Director
Lombard Capital Markets

The increased capital charges that regulators are imposing as a result of Basel III mean that prime brokers are having to carry more capital to support a business that's not as profitable as it has been in the past. As a result, many prime brokers are, and will have to continue to, review their customers, with a view to identifying where the cost of capital is high, but the revenue outweighs the risk. Prime brokers will have to continue to increase fees on some, while exiting the less profitable ones. This will, in turn, present opportunities for the smaller, more niche brokers.

The Alternative Investment Fund Managers Directive is a real concern, and all eyes are on the European Securities and Markets Authority's (ESMA) next move. If ESMA forces prime brokers to segregate alternative investment fund and non-alternative investment fund client assets in pooled or omnibus accounts, they will not be able to rehypothecate, which in turn affects prime brokers' operating models.



Markus Büttner
CEO
Comyno

Streamlining inventory optimisation efforts continues to be an immense challenge. Many have successfully implemented adequate transfer pricing policies, broken down silos and put in place central inventory optimisation units. While this makes perfect sense and progress has been made, I believe that making these newly created structures work without friction will require more time, as well as continuous adjustments.

Ueli von Burg
Head of cash and collateral trading and management
Zürcher Kantonalbank

There will be two major challenges. The first is to find enough and the right clients that can provide firms with the relevant term liquidity versus a flexible collateral schedule that is adding the value they need, especially when the net stable funding ratio comes into force.

The second is that the industry will have a greater need to focus on making business management more efficient overall by considering the new and mostly stricter guidelines in respect of balance sheet, capital costs and liquidity needs across business units.

In general, the market environment once again will be challenging. There is no inflation in sight, an ongoing and very low interest rate environment persists and there is an excess of liquidity, meaning that low general collateral lending fees and repo spreads will continue. However, I do expect to see some interesting specials.

Peter Economou
Chief risk officer
eSecLending

The industry's biggest challenge in 2015 will continue to be the manner in which firms respond to the numerous regulations that are affecting the market.

Agent lenders will need to adjust their programme structures to address the higher cost of capital for indemnification, counterparty concentration limits, and evolving changes demanded by the buy side as final rules become better defined and understood.

Agents will also be challenged by their willingness to absorb the additional costs by reducing margin, adjusting lending trade structures to take more of the balance sheet 'hit', and deciding the amount of credit exposure to allocate to lending rather than to other businesses in the firm.

Borrowers will be similarly challenged. They will need to evaluate the level of balance sheet and credit exposure that they will allocate to borrowing securities, particularly the higher volume/lower spread trades that have been popular for years.

The challenge for beneficial owners will be their willingness to: pay a higher price for indemnification, or to potentially lend without it; sacrifice returns from more capital-friendly trades for the agent lender; adjust trade structures to accept other forms of collateral at a potentially higher risk for themselves (if done with limited or no indemnification); or diversify and move away from their sole lending provider to protect their lending revenue in a risk-controlled manner.

Guillaume Boland
Senior market manager
SWIFT

In 2015, we will continue to see regulations put pressure on the cost of collateral. Manual processing will no longer be the norm, particularly because margin calls and account segregation models will increase operational burden.

In terms of operational readiness, players in collateral will have to ensure the robustness of their operation models. We look set to see decreasing operational risk through reduced manual effort, and decreased overall costs associated to such risks. Standardisation will also be a key challenge for the coming year in order to reach operational efficiency.

David Lewis
Senior vice president
SunGard's Astec Analytics

Next year will continue the theme of change in our industry, bringing both challenges and opportunities for all levels of the market's stakeholders. Adaptability to change has been one of the great strengths of the securities finance industry, but the cumulative effect of these changes (regulatory, structural, environmental and so on) is likely to make the generation of revenue ever harder.

It is very unlikely that the demand for securities finance will cease, but what is more likely is that those active in the market will seek to find more efficient ways of fulfilling those needs, with total return swaps and single stock futures for just two options creating equivalent economic effects to borrowing securities without some of the regulatory or capital overheads.

Beneficial owners will also adapt their behaviour as they seek to retain or build revenues, relaxing collateral and counterparty requirements or entering into collateral transformation-style trades that they would have refused previously. The challenges facing our industry are many, but their combined effect will bring the all-important joint challenge of meeting clients' changing needs and making valuable returns into sharp focus.

Edward Cockram
North American product consulting director
4Sight Finance Software

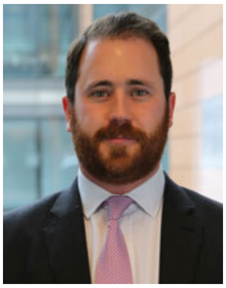
The main challenge is adapting to the increasing pace of change in a business that is not used to rapid change. This broad, complex, and regulatory driven step-change in the market is compounded by continued low spreads and volumes in repo and securities borrowing and lending, along with increasing balance sheet restrictions.

Greater reporting requirements and increased premiums on liquidity and liquid assets are also placing pressure on market participants. Businesses need to respond with higher fidelity analysis on performing areas, pushing down from entity and divisional to desk, book and even trade level.

This requires systems able to advise traders on the full cost and compliance consequences of trades, in the face of an increasingly complex regulatory environment.

It also involves greater efficiency in usage of assets, through enhanced monitoring of current and future asset usage, demand and availability, while reducing time spent on manual data manipulation.

The industry is undergoing an irreversible transformation, similar to those experienced in the auto manufacturing and telecommunications sectors. As with these industries, process improvement, supported by effective use of technology, will be key to maintaining profitability.



James Cherry
Global securities financing sales manager, UK and Ireland
Clearstream

The next challenge for Europe concerns the world of over-the-counter (OTC) derivatives. Mandatory clearing will be introduced for a number of forms under the European Market Infrastructure Regulation (EMIR) and in parallel, new margin requirements will be levied for uncleared products. While we have had the opportunity to watch our cousins in the US and can learn from the consequences of the Dodd-Frank Act, many firms are still unaware of the full extent to which their business will be affected under EMIR and the Basel Committee on Banking Supervision-International Organisation of Securities Commissions rules.

Optimisation will become a key concern for both the buy and the sell side as they are confronted with an increasing operational burden. For asset managers, inefficient or ineffective use of collateral will fundamentally erode positive fund performance. To be efficient, the amount of collateral that a firm has to allocate and how this collateral is chosen, sourced and deployed must be priced before execution.

As a result, collateral management, particularly in the OTC space, will begin to form an integral part of a firm's strategic decision making in 2015.

Rob Chiuch
Global head of agency securities finance, global collateral services
BNY Mellon

The world's business environment is evolving in ways few people could have imagined in recent years. Strategic dissonance is therefore likely to challenge some industry participants as the market continues to reorganise itself around regulatory change.

Furthermore, apparently divergent global economic activity and monetary policy could lead to increased volatility next year while unconventional sources of financing are entering a market with an uneven playing field. There's more moving parts than ever, though I'm personally optimistic, believing we'll see a busy 2015.

Sunil Daswani
Head of client relations, capital markets, Asia Pacific and EMEA
Northern Trust

It has to be regulation. Although the extent to which global regulation will affect the securities lending business remains uncertain, the industry is positioned in anticipation of imminent changes, the effects of which are already evident.

From a borrower perspective and specifically within the context of Basel III effective 2015, the most noticeable change has manifested within the collateral space, as equity finance desks have increasingly been leveraged as the vehicle to drive balance sheet optimisation in an effort to reduce funding costs and minimise capital charges.

In practical terms, not only has this demanded increased flexibility from lenders in the types of collateral accepted, it has also driven a change in the nature of trading, such as the growth of 'evergreen' or termed structures to facilitate financing requirements. Lenders have therefore been tasked with ensuring that their capabilities are positioned well to secure both existing and future growth, given that higher utilisation rates are generally afforded to those with greater flexibility.

Collateral flexibility also enhances borrower relationships by allowing them to swap collateral preferences as and when their funding requirements dictate.

Ed Marhefka
Managing director, securities finance
Markit

The industry's biggest challenge in 2015 will continue to be about implementing a diverse regulatory scheme that has already reduced balance sheets, increased expenses (people, technology, risk, legal and capital charges) and, importantly, caused participants to assess their core strategies and the impact on their business models.

Custodian lending agents are grappling with change affecting indemnification, aggressive splits and collateral utilisation. Prime brokers must address the potential shortage of risk capital to fuel alternative investment leverage requirements. At the other end, beneficial owners are questioning the risk-return dynamics and the impact on their programmes. Against these dynamics, the industry will naturally evolve.

The better prepared market participants are making the adjustments and soldiering on. There may be a challenge in implementing and communicating changes to a diverse client base. Those who adapt will inevitably reap the benefits of a favourable, rebounding financing market. Revenue opportunities will emerge as we move towards a re-shaped and, hopefully, more robust financing environment.

David Martocci
Global head of agency lending, investor services
Citi

We are looking forward to 2015 and see it as a year of opportunity for the industry and our lending clients. Our confidence is based around the resilience and stability of the market as well as our own growing client base and our clients' interests in broadening their lending activities.

The industry is focusing on the regulations regarding the amount of capital that needs to be set aside when conducting transactions, including securities lending trades. The changes have the potential to affect both lenders and borrowers. The various market participants and industry bodies continue to work with regulators while also exploring the implications and opportunities that are arising. Throughout its history, the industry has proved itself to be flexible and agile in dealing with the numerous changes and challenges that it has faced.

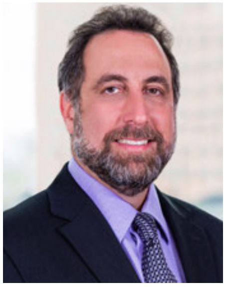
Another area of focus is emerging markets, as clients seek to enhance their returns from securities lending. By leveraging our on-the-ground presence we are able to provide clients with the expertise and infrastructure they require in order to tap into these lucrative revenue streams.

We are excited about the prospects for our clients and for the industry in the new year.

Todd Berlent
Chief executive
Helix Financial Systems

Regulatory requirements are constantly changing and imposing new rules. As a result, there are additional costs that all participants in the industry must consider. Companies must adopt or develop new tools, resources, and processes so they can become, and remain, compliant while at the same time attempting not to adversely affect their profit margins.

Trying to comprehend the full depth of these regulations and constantly keep pace with the latest requirements is a challenging endeavor, and this undertaking is further exacerbated given how overall profit margins have eroded in the industry in recent years.



Richard Enfield
Executive director product, collateral management
Omgeo

For the sell side, the biggest challenge for 2015 looks to be the impending requirements from the Basel Committee on Banking Supervision and the International Organization of Securities Commissions for margining on non-cleared derivatives. The implementation deadline is rapidly approaching, and there are a number of requirements that are not sufficiently defined currently to enable firms to take definitive action. For example, there is no guidance on allocating minimum transfer amounts on currency-basis exposure. In order to properly adhere to requirements, technical development and business implementation is going to be necessary.

While planning and high-level analysis can take place, until further detailed guidance exists, development of solutions cannot really start in any meaningful manner. The first deadline was December, when many firms have technology freezes in place, which pushes implementation calendars earlier in the year. That December date was the only thing fixed. Time periods for business definition, technical development, testing and implementation are only shrinking. **SLT**