securities lending times

ASIA2019

# Unlocking Asia

As Asia's securities lending market continues to grow, so do the region's lending revenues. IHS Markit data shows that Asian equities lending revenue saw an increase from USD $1,704,910,057 in 2017 to USD $2,169,822,325 in 2018.

Australia, this year's host of the PASLA/RMA conference, has also seen some positive activity with asset owners reengaging in the country's securities lending industry. According to J.P. Morgan's Andrew Bates and Tony Georgievski, beneficial owners in Australia typically now have a greater understanding of the product and the potential returns, with minimal risk, that can be generated from an agency lending programme.

As a result of the continued growth, there are now nine securities lending markets and a further two potentially opening up. Although Japan and Hong Kong remain at the core of volumes and activity in Asia, South Korea is third, and despite lower on-loan volumes, spreads of more than 300 basis points make up for that, BNY Mellon's Paul Solway reveals.

One of the big market drivers for the year ahead is technology. Currently, Asia is behind with others in terms of technological advances, however, Simone Broadfield of BNP Paribas explains there has been an increase around efficiencies and transparency through the use of automation and analytics across the Asia Pacific region.

Thank you to all of our partners, whose sponsorship and help has been instrumental in putting this handbook together. If you have any comments or suggestions for future issues, please don't hesitate to drop us a line.

**Becky Butcher**
Editor

securities lending times

**Publisher: Justin Lawson**
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6028

**Editor: Becky Butcher**
beckybutcher@blackknightmedialtd.com
+44 (0)203 750 6019

**Reporter: Maddie Saghir**
maddiesaghir@blackknightmedialtd.com
+44 (0)203 750 6019

**Reporter: Jenna Lomax**
jennalomax@blackknightmedialtd.com
+44 (0)203 750 6018

**Creative Director: Steven Lafferty**
design@securitieslendingtimes.com
+44 (0)7843 811240

www.securitieslendingtimes.com
Twitter: @SLTimes_

Office fax: +44 (0)20 8711 5985
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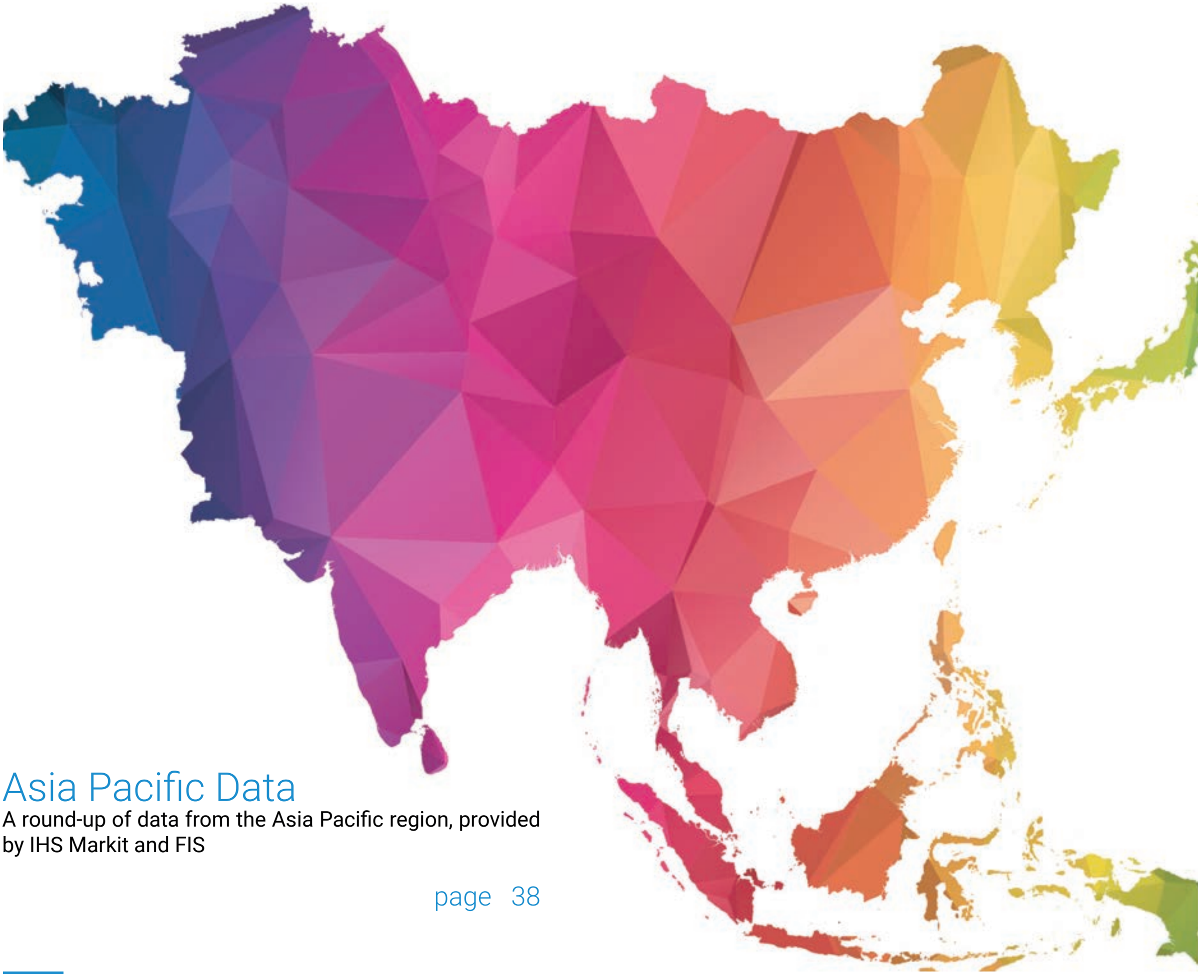


## MAS and SGX partner with Anquan, Deloitte and Nasdaq on blockchain

The Monetary Authority of Singapore (MAS) and Singapore Exchange (SGX) are working together to develop delivery versus payment (DvP) capabilities for the settlement of tokenised assets across blockchain platforms.

According to MAS and SGX, this will allow financial institutions and corporate investors to carry out the simultaneous exchange and final settlement of tokenised digital currencies and securities assets, improving operational efficiency and reducing settlement risks.

MAS said that three companies—Anquan, Deloitte and Nasdaq—have been appointed as technology partners for the project, which will produce a report on the potential of automating DvP settlement processes with smart contracts and identify key design considerations to ensure resilient operations and enhanced protection for investors.

Sopnendu Mohanty, MAS chief financial technology officer, noted that blockchain technology is radically transforming how financial transactions are performed today. He said that the ability to transact seamlessly across blockchains will open up a world of new business opportunities.

Tinku Gupta, head of technology at SGX and project chair, said the initiative will bring together multiple players to pursue real-world opportunities that will benefit the ecosystem.

## FIS selected by UnionBank of the Philippines

FIS has been selected by UnionBank of the Philippines (UnionBank) to help the bank digitise and enhance its commercial lending processes.

UnionBank will use the firm's solutions to re-engineer its commercial lending processes, including origination and credit assessment, liquidity and capital charge of loans and portfolios, data management and reporting.

The risk management solutions will also help the bank comply with regulatory requirements, such as Philippine financial reporting standards, as well as proactively manage its enterprise risk through an integrated platform across asset liability management, liquidity risk and capital management.

The company's technology will enable the bank to take advantage of advanced third-party data analytical tools through the use of open application programming interfaces.

According to FIS, this will result in improved credit risk monitoring and a greater ability to capitalise on growth opportunities in business lending.

Edwin Bautista, president and CEO of UnionBank of the Philippines, said: "UnionBank is in a major effort to digitally transform its businesses and processes, and we are looking at this relationship with FIS as a significant step in achieving our long-term objectives."

Marianne Brown, COO at FIS, commented: "We are delighted to support UnionBank as it reinvents its lending process and takes advantage of digital innovations to meet its business objectives."

"By using our integrated risk and compliance solutions, UnionBank will benefit from a centralised view of risk, liquidity, capital and profitability across its enterprise."

## Hong Kong to revise settlement and servicing model

The Securities and Futures Commission (SFC), Hong Kong Exchanges and Clearing (HKEX) and the Federation of Share Registrars (FSR) have issued a consultation paper proposing a revised operational model for implementing an uncertificated securities market in Hong Kong.

According to HKEX, in an uncertificated, or paperless, securities market, investors could hold and transfer securities in their own name without share certificates or other paper documents.

The digitisation of securities holdings and elimination of manual processes would enhance post-trade settlement and servicing, said the exchange, making Hong Kong markets more efficient and globally competitive.

The costs of new systems to support the revised model will largely be covered by HKEX and share registrars.

HKEX said: "The proposed model strikes a balance between preserving existing efficiencies in the clearing and settlement process and providing options for investors to hold securities in uncertificated form. Implementation would be conducted in phases."

## New Zealand Superannuation Fund starts securities lending

The New Zealand Superannuation Fund has started lending its holdings of stocks and bonds, a report has revealed.

As of October 2018, the fund held NZ$35.36 billion ($24.5 billion) in assets.

In May 2017, the fund was able to gain State Street Bank and Trust Company's support, appointing them as agents to lend a portion of the fund's securities for its new securities lending programme.

New Zealand Superannuation Fund said the new programme: "will help us to earn additional returns from our large passive holdings of equities and bonds".

## China to combine QFII and RQFII

China is set to consolidate the Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) schemes into one.

They are doing this in order to promote the steady and sound developments of capital markets.

When consolidated into one scheme, the QFII rules will act as the basis while incorporating RQFII rules and they will integrate the two special provisions of the QFII scheme, forming the unified Measures and Provisions.

This will mean that foreign investors will only need to make a one-time license application.

For the institutions from countries and regions that have not yet obtained the RQFII quota, funds for investment can be raised in foreign countries.

The China Securities Regulatory Commission (CSRC) has drafted two consultation papers on the Measures and Provisions.

In the consultation paper, it was noted that in order to facilitate RMB internationalisation, qualified investors are encouraged to invest with offshore RMB funds.

Under article 3, the paper also cited: "A qualified investor shall designate an eligible domestic commercial bank as the custodian for its assets, and designate a domestic securities or futures company, in accordance with law, to carry out its investments in China's securities and futures markets."

The QFII scheme and the RQFII scheme were respectively launched in 2002 and 2011, and have been operating in a steady manner, CSRC noted. According to CSRC, the schemes have been playing a positive role in channelling long-term foreign capital into China, optimising investors' structure of the capital market.

Additionally, they have been carrying out the value investing, enhancing corporate governance of listed companies, and promoting the sound and steady development of China's capital market.

The public comment period ended on 2 March 2019.

## ASX sees continued growth

The Australian Securities Exchange (ASX) revealed that total capital raised was $23.2 billion in November 2018, up 215 percent from November 2017. The statistic was released as part of the ASX Group's Monthly Activity Report.

In November, average daily futures and options on futures volumes were up 15 percent on 2017.

Average daily futures volume was up 15 percent and average daily options volumes were up 5 percent from 2017.

In November 2018, the average daily number of trades was 17 percent higher than last year. The average daily value traded on-market of 4.7 billion was up 11 percent from 2017.

Volatility, which is measured by the average daily movement in the All Ordinaries Index, was 0.6 percent in November down on the previous month by 0.7 percent.

Expected future volatility in November was an average of 16.2 compared to 16.4 in October.

Single stock options average daily contracts traded were down 6 percent and index options average daily contracts traded were down 9 percent on 2017.

The value of securities held in Clearing House Electronic Sub-register System was 2 percent lower than 2017.

## SEBI adds to physical settlement schedule

The Securities and Exchange Board of India (SEBI) has notified that stocks of heightened volatility will move to physical settlement in addition to the existing schedule of stock derivatives moving to physical settlement.

It was noted in SEBI's circular that if a stock satisfies their listed criteria, then derivatives on such stock shall be moved to a physical settlement from the new expiry cycle.

The criteria includes stocks which witness 10 percent or more intraday movement on 10 or more occasions in the last six months, or stocks which witness 10 percent or more intraday movement on three or more occasions in the last one month.

Additionally listed in the criteria was stocks, which witness 25 percent or more intraday movement on one or more occasions in the last month, or, if the maximum daily volatility of the stock (as estimated for margining purpose) is more than 10 percent either in equity or equity derivatives segment in the last one month.

SEBI outlined that exchanges shall review the conditions listed in their circular on a monthly basis although existing contracts on the stock shall continue to follow settlement mode as applicable at the time of contract introduction.

This follows their circular in January that announced that stock derivatives, which are currently being cash settled, will move to physical settlement as part of an initiative to help promote securities borrowing and lending.

Exchanges have been directed to put in place proper systems and procedures to ensure a smooth implementation of physical settlement.

## Affin Hwang launches retail SBL for investors

Affin Hwang Investment Bank and Bursa Malaysia have launched retail securities borrowing and lending (SBL) for investors.

The retail SBL enables investors to lend assets which they already own but do not intend to sell immediately, to Affin Hwang Investment Bank, as the borrower.

It will also enable retail investors to earn interest incomes for lending their assets, and potentially gain more returns over and above the dividends they would normally receive.

Datuk Maimoonah Hussain, group managing director of Affin Hwang Capital, said: "Affin Hwang Investment Bank is committed to being a leader in the securities industry in Malaysia and our provision of excellence to clients through innovative products has always been our aim."

"Retail investors continue to play a significant role in the domestic capital market."

"Therefore, Affin Hwang Investment Bank, in collaboration with Bursa Malaysia, are excited to offer this new product to the retail investors to potentially enhance their idle assets' performance."

Datuk Seri Tajuddin Atan, CEO of Bursa Malaysia, commented: "As at December 2018, there were 1.87 million retail accounts in our marketplace holding a portfolio worth RM 137.3 billion."

"Premised on this, investors can generate additional income through lending out their idle securities holdings in SBL transactions, and potentially increase the overall return from their investments."

## HKEX adds additional securities eligible for short selling

The Stock Exchange of Hong Kong Limited, a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEX), has added additional securities, eligible for short selling. The change came into effect on 9 November 2018.

Some 23 additional securities are eligible for short selling and 40 existing designated securities have been removed from the list.

The total number of designated securities for short selling after the revision stands at 929. The securities to be added to the list includes Jacobson Pharma, Differ Group and Tian Lun Gas. **SLT**

**Simone Broadfield**
**Asia Pacific head of agency securities lending**
**BNP Paribas**

# A plethora of growth

Simone Broadfield of BNP Paribas explains the increase in efficiencies and transparency through the use of automation and analytics in the Asia Pacific region

***Maddie Saghir reports***

**What opportunities are you seeing within the Asia Pacific space for securities lending in 2019?**

Markets across the Asia Pacific region are continuously developing, providing a plethora of growth and revenue optimisation opportunities. At BNP Paribas, we anticipate a continuation of borrower demand for high-quality liquid assets (HQLA) in particular for those assets held by lenders who are able to offer flexible collateral schedules and commit to longer-term trade structures.

This year will be a pivotal year as we capitalise on the enhancements and changes made across the global BNP Paribas' agency platform throughout 2018 and expand our trading capabilities later this year with the addition of a trading desk in Hong Kong.

## Which markets are the most interesting for BNP Paribas right now?

Our agency lending business is currently in the midst of a growth period across the Asia Pacific region. While the major liquid markets such as Hong Kong, Australia and Japan remain a key focus for us, we are also looking to extend our offering to markets such as South Korea where the intrinsic value of lendable assets is often higher.

## How would you compare supply with demand at present in the major markets?

The supply of lendable assets within the large-cap space is able to fulfil demand in the major markets. However, there is always consistent demand for higher value, less liquid small-mid cap assets across all markets and a tightening of regulatory capital requirements have also led to an increase in borrower demand towards particular types of assets such as HQLA. Non-callable assets in markets such as Japan and Australia are also in high demand.

## Asia is a wide area. Which markets are developing and which are falling by the wayside?

Significant progress has been made with respect to the implementation of a securities lending programme in the Philippines market, with the Philippines Bourse engaged with the Asia Pacific securities lending industry body as they work on the proposed framework.

## Asian equity owners have enjoyed revenue growth over the past few years. What has contributed to this growth and do you see this trend continuing?

There is a higher prevalence of assets trading on a specials basis within the region with market volatility providing frequent event-driven and directional short opportunities. A smaller supply of lendable assets in the emerging markets is also a contributing factor with markets such as South Korea and Taiwan consistently returning high average lendable fees. Trading automation and greater transparency across the region in recent years has also allowed traders to better optimise performance.

## Do you think harmonisation across the Asia Pacific can be achieved? What benefits would this bring?

The potential upside from harmonising governance, market regulations, market trading rules and securities lending framework—to name but a few—across the Asia Pacific region would be significant to say the least however the likelihood of this being achieved is low in the foreseeable future, given the number of markets, regulators and exchanges who would need to align—it would be a herculean task.

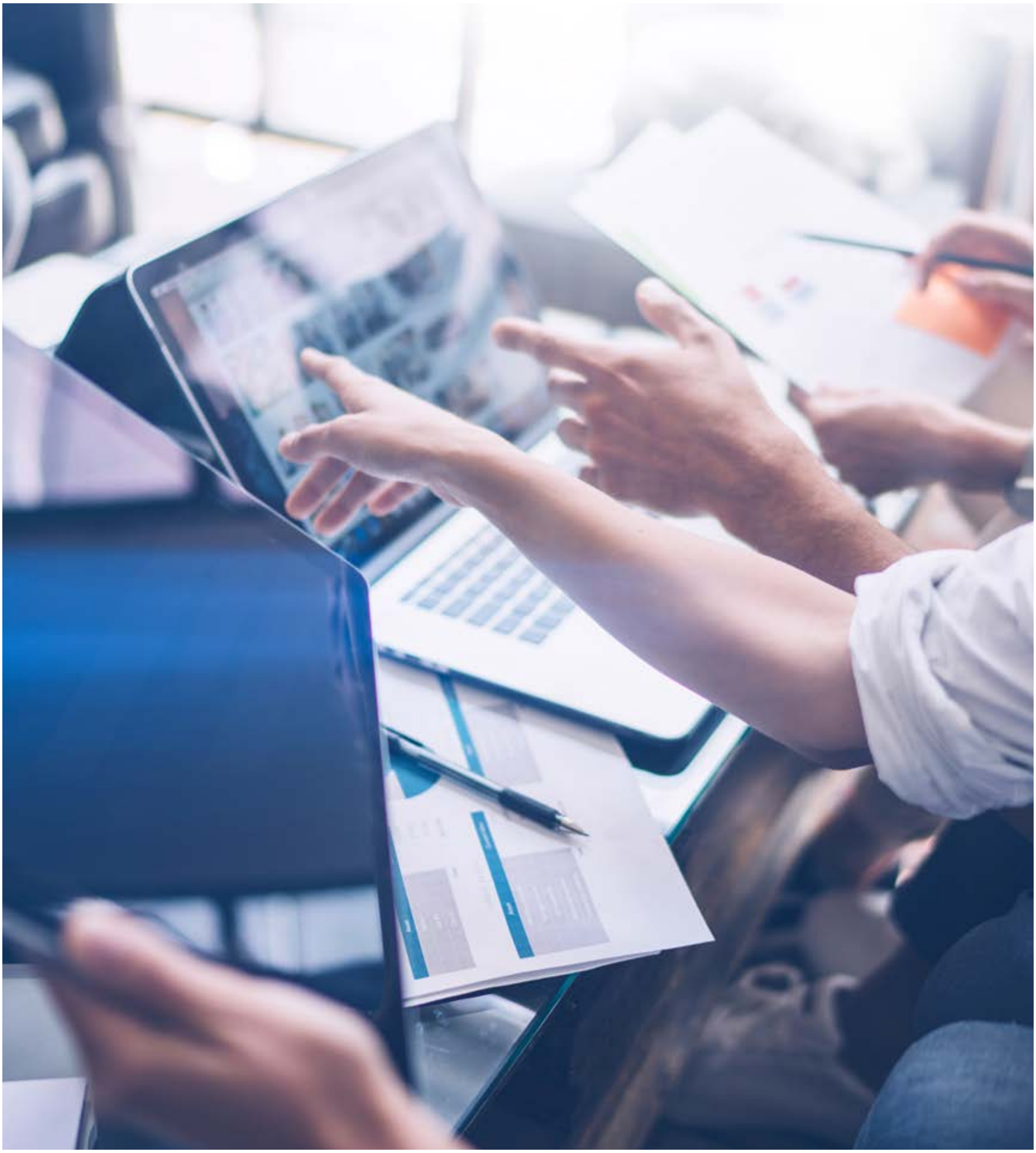
## What challenges do you see on the horizon for the securities finance industry in Asia this year?

The reluctance of some markets within the Asia Pacific region to open up securities lending to offshore lenders will continue to provide challenges to the securities finance industry, although recent developments within markets such as China bode well for the longer term.

## What market drivers should industry players be aware of in Asia this year?

We have seen increased efficiencies and transparency through the use of automation and analytics across the Asia Pacific region. As per the global execution space, the use of automated trading technology to handle increased volumes of quant driven flow is increasing, as is a more recent trend towards using analytics and algorithms to automate allocation methodologies in order to significantly reduce manual touch points from the very beginning, through to the end of the lifecycle of a trade.

It, therefore, stands to reason, that the continued developments around these topics, seen in other trading spaces, will also cross-over into the securities lending industry. **SLT**



# Keeping it current

Simon Lee of eSecLending discusses potential considerations for beneficial owners and their securities lending programmes

## Revenue optimisation

One of the main themes in 2018 for beneficial owners to optimise their programme revenue was for more emphasis to be placed on improvement in meeting borrower demand. Those lenders whose programmes were closer to a broad 'ideal' would inevitably outperform those lenders at the other end of the spectrum. It is the undeniable understanding that portfolio composition (quality and quantity) is the primary driver in determining the revenue opportunity available to an individual lender. However, increasingly, decisions concerning route to market, acceptable collateral, and ability to enter term trades are affecting programme performance to an ever-greater degree.

With regulatory expenditure growing across the industry, cost-management becomes an even more important feature of the business in 2019, thus driving this focus on optimising the supply/demand dynamic for beneficial owners. The differential in borrower demand for lendable supply deemed of higher quality will increase. This will provide an opportunity to enhance performance for those lenders that can develop their programmes accordingly, yet hindering those lenders whose programmes are deemed less attractive due to portfolio composition, collateral requirements, or otherwise.

For beneficial owners, the name of the game remains constant—structuring their securities lending programmes within a robust governance framework, ensuring their service providers are delivering on their goals and objectives, and that the risk/reward equation is appropriately managed.

## New entrants/new supply

Last year saw several new beneficial owners coming to market, either lending for the first time or re-entering after a hiatus. Many absences even stretched back to the financial crisis in 2008. The reasons behind this are relatively consistent; an increasingly competitive fund management sector that recognises the boost to funding performance that securities lending revenue can provide, and for other asset owners, a greater appreciation of the revenue opportunity that may be left on the table by sitting on the sidelines.

This scenario is expected to continue through 2019, supported by a combination of factors. These include the continued downward pressure on fund management fees and consequential impact on profitability. Additionally, further growth in the passive and exchange-traded funds sector—funds for whom securities lending is often an integral strategic component—and more subjectively, the level of comfort investors have around securities lending—seemingly rising every year—we are removed from 2008; helped by the increase in regulation, education, and transparency in the industry.

With new lenders, there is new lendable supply, which could have a potentially dilutive effect on the performance of individual lenders in the more liquid asset classes and markets. While it is true that the market evolves and identifies new opportunities from lending in new markets to enhanced operational efficiencies through automation, beneficial owners should be cognisant of any potential impact on their individual programme. This may be more the case for those lenders that participate in a pooled programme structure, for whom programme performance is oftentimes relative to other lenders in the pool, and therefore more obviously influenced by the dilutive effect of increased lendable supply within the pool. Going back to previous comments on revenue optimisation, we see further benefits for beneficial owners in considering how programmes may be enhanced to push to the front of the pack. For new entrants, this is another factor to take into the decision-making process when deciding how to best access the market.

## Regulation

No article that looks at how the coming year is shaping up is complete without the mention of regulation. Though for our purposes in this article, we will limit our discussion to observations of how beneficial owners are dealing with regulatory change, the potential impact to lending programmes that beneficial owners should be mindful of, and the questions to be asked of service providers in 2019.

Securities Financing Transactions Regulation (SFTR) is the four-letter acronym that will be getting the most airtime from market participants in 2019, with the current expectation that the requirement to report will be live during 2020. While beneficial owners domiciled outside of the EU may not have a reporting requirement per se, their borrowing counterparties and agent lenders will likely be impacted to varying degrees, which for many organisations will require significant human and financial resources. Those beneficial owners not directly impacted by SFTR requirements should still be aware of how their service providers and counterparties may be impacted to avoid any consequential negative impact on their individual programme provision and performance.

Another piece of European regulation, the Central Securities Depositories Regulation (CSDR) will be receiving attention from securities lending market participants this year and next, for the impact that delayed settlement of securities lending transactions in the EU may have on the costs associated with this piece of regulation. The focus for lenders will be on settlement efficiency for new loans, recalled loans, and most importantly for beneficial owners, ensuring timely settlement of sales trades of securities that were on loan at the point of trade and necessitate a market recall.

While market participants lending in emerging and Asian markets are well versed in the risks associated with failed settlement in these markets and associated costs, operational efficiency will come under increasing scrutiny through this coming year, thanks to CSDR.

Although no longer a topic that is considered new, the cost of regulatory capital on the business remains as relevant today as it ever was, even as the impact on securities lending programmes continues to develop. As we noted at the outset, beneficial owners that best meet the evolving borrower demand dynamic will stand to profit most from enhanced programme performance. These shifts in demand are in part a product of the regulatory costs faced by borrowers. So, to comprehensively examine this topic, we need to look at the key regulatory costs facing agent lenders and most importantly indemnification costs, which is potentially the biggest impact on beneficial owners.

Again, while the topic is one that has been a talking point among agent lenders and beneficial owners for some time, the discussion does not stand still. As other regulatory costs come to the forefront, existing costs like indemnification provisions must get reviewed in a new context, and programmes may be adapted accordingly. Revised fee splits, limitations on the scope of indemnities, and restrictions on lending activity are all potential adaptations open to agent lenders to manage these costs.

Given the relevance, these considerations have to individual programme performance, staying current to the circumstances of their indemnification policy should be on every beneficial owner's agenda this year. **SLT**

***"As other regulatory costs come to the forefront, existing costs like indemnification provisions must get reviewed in a new context"***

**Simon Lee**
Managing director, head of business development
eSecLending Europe

# The boomerang effect

J.P. Morgan's Andrew Bates and Tony Georgievski discuss attitudes towards securities lending in Australia, market trends and what to expect for the rest of this year and beyond

**What is the attitude to securities lending in Australia?**

We have seen somewhat of a resurgence from Australian asset owners to engage or re-engage, in securities lending in Australia. In light of recent macroeconomic and microeconomic influences, both asset owners and managers are now seeking increasing alpha for their funds via a securities lending programme. The realisation of the potential revenue achievable from a securities lending programme has seen more focus on the product, away from the yesteryear of a set-and-forget programme. Beneficial owners in Australia typically now have a greater understanding of the product and the potential returns, with minimal risk, that can be generated from an agency lending programme.

## What do you see in terms of client requirements in Australia?

Similar to clients in other locations, Australian clients want to understand the drivers of the programme and the impact that their risk profile has on returns. They want to see what securities are in demand, where the returns are coming from and also how they rank among their peers. Transparency of both the market and their programme is paramount, and the ability to have access to in-depth reporting is fast becoming a necessity. They are also keen to understand the effect the various lending parameter decisions have on their returns.

Despite the domestic alignment of the Australian market, asset allocation growth has been peripheral to Australia. This has placed more importance on a provider's ability to service the client on both a domestic and international scale. Our global presence and footprint have helped us forge strong partnerships, which are key requirements for many beneficial owners.

## What market trends are you seeing in Australia?

Clients that have previously shut down a lending programme have been looking to reengage, and the peer benchmarking done across both the asset owners and asset managers showcases the need to 'keep up with the pack'. There is more information flow amongst the entire client base, which helps to promote best practice and continual improvement in the Australian marketplace.

We have seen greater allocation to emerging markets in the international assets of the portfolios, which has created interest in lending those assets in newer markets such as Brazil and South Korea.

The concepts of environmental, social and governance (ESG) and being responsible asset owners have broadening appeal to many beneficial owners. One result is that super funds are keen to demonstrate their participation in proxy voting. Compulsory proxy voting by a lender leads to borrowers often being forced to close out long-term trades to satisfy a recall. As a consequence, borrowers are targeting balance towards non-proxy voting clients or contentious vote recalls only. Understanding the impact for both sides, J.P. Morgan can have an appropriate dialogue, explaining that clients can still be responsible to shareholders while continuing to generate securities lending revenue for their portfolio. Rather than recalling a whole on-loan book, we can discuss alternatives to consider and work with our clients as their needs evolve.

On the topic of sustainable investing, we have also worked with a number of funds to meet their ESG requirements by only taking single names or industries out of their portfolios. They would prefer participating in a lending programme that concurrently optimises portfolio returns and satisfies commitments to their respective social and sustainability goals.

## What do clients in Australia value about your programme?

Clients in Australia understand the benefits of a strong bank backing as indemnity for the programme and place a premium on the stability and standing of J.P. Morgan as they evaluate programme entry and expansion. Our clients value the risk culture of J.P. Morgan and the process diligence embedded within our lending programme.

The local Australian presence of our extensive lending team (across trading, relationship management and operations) enables our clients to have real-time discussions, solutions and market commentary delivered to them.

## How has J.P. Morgan's agent lending team expanded in the Asia Pacific?

As our client base in the Asia Pacific grows, we are committed to providing relevant expertise to our local client base and their counterparts. The organisational alignment of agency securities lending is designed with an intentional regional focus, but with global coordination: the Asia Pacific regional head has direct

***We see continued growth in non-cash collateral being preferred over cash, and increased use of the domestic tri-party providers***

**Andrew Bates**
Senior trader, agency securities lending, APAC
J.P. Morgan

responsibility for trading, cash reinvestment, client management, product and operations. This model helps support the timely resolution of client requests for Australian lenders, in-region strategic decision making and the ability to customise products for the local market. By building out our lending product and services across Australia and other Asia Pacific markets, and investing in our technology and operations footprint, we are able to constantly adapt to support our clients' needs.

## What is the outlook for the rest of this year and beyond?

With the rising cost of cash collateral and Bank Bill Swap rates trading consistently at 50 basis points (and higher) over the official RBA rate, the cost for borrowers to pledge cash collateral, has risen substantially. We see continued growth in non-cash collateral being preferred over cash, and increased use of the domestic tri-party providers. In addition, borrowers are increasingly using synthetic structures (such as total return swaps) to minimise balance sheet usage.

The sophistication of the clients' lending programmes and their requests has increased over the past year(s). The changing regulatory landscape (both internationally and domestically) has changed the demand drivers and lender classification and clients are looking to best manage this within their lending programme. We are able to support this evolution by facilitating directed trades, non-indemnified structures and continual revision of all collateral offerings. Term trades will continue to be an enhanced revenue opportunity as beneficial owners are accepting the premium achievable for longer duration loans. The extension of the client's own investment horizons aligns with the borrower's capital and liquidity requirements as they seek more refined and directed financing. **SLT**

***The changing regulatory landscape has changed the demand drivers and lender classification and clients are looking to best manage this within their lending programme***

**Tony Georgievski**
Head of agency securities lending relationship management
Australia and New Zealand, J.P. Morgan

# Good times forecast

Although levels of borrower demand are lower than before the crisis, Mark Snowdon of Northern Trust explains that Australia is now seeing a new growth impetus in line with its Asian counterparts

Australia is big business for the securities lending industry, and securities lending has become big business for Australia. According to the major data providers, Australian assets account for around one-fifth of the total lendable supply in the Asia Pacific region. Along with global markets, supply declined dramatically in the wake of the global financial crisis but has now rebounded to surpass pre-2008 levels. Although levels of borrower demand are lower than before the crisis, Australia remains a well-established and mature securities lending market that is now seeing a new growth impetus in line with its Asian counterparts.

The Australian market's domestic orientation and close-knit investment community set it apart from other markets. Word of mouth is important in helping the industry grow, and reputations are hard-won and keenly protected. This makes a local presence essential for relationships and information flows.

With a presence in Sydney and Melbourne, organisations like Northern Trust can provide local expertise to domestic lending clients. As the asset owner and asset manager sectors continue to consolidate and grow, the bar has been raised across the industry and has driven innovation in Australia and beyond.

Against this backdrop of progress, and with a need to seek additional alpha wherever possible, the perception of securities lending has shifted. For participants who opted out of securities lending following the crisis, appetite to re-engage their programmes has generally been weaker for onshore local lenders than it has for those of other jurisdictions. However, the industry has been able to demonstrate how securities lending has evolved into a more robust, transparent and flexible offering, with new tools available for customising parameters and managing risk.

Organisations that used to lend have now returned; those that never left are expanding their programmes. There is also a growing segment of the market that has never previously engaged in securities lending but is now launching programmes to meet their bespoke needs and specific requirements. As funds have struggled to fight the headwinds and impacts of a low interest-rate and low growth environment, the need to reduce costs and enhance performance has come to the fore, particularly for products that deliver revenue streams with relatively low levels of risk.

## Growth over time

Australian lending has been viewed as heavily general collateral in nature, due in part to the dominance of companies with large and liquid market capitalisations. While this dynamic occurs across the Asia Pacific and even globally, it does appear more pronounced in Australia. The decline in index arbitrage strategies is a global phenomenon but accounted for significant loan volumes in Australia before the negative impact of increased regulation and balance sheet management. However, in a cyclical market where change is a constant and volatility is always around the corner, the landscape is changing for lenders and borrowers alike. This is creating alternative opportunities for market players and reshaping participant behaviour. For instance, the capital raising mandated by the Australian Prudential Regulation Authority saw strong securities lending revenues on the back of dividend reinvestment plan trades in 2017. While these opportunities fell away, collateral-flexible lenders and those who engaged in term trades continued to benefit from elevated spreads even for general collateral stocks in 2018.

In the fixed income space, there remains a robust trend to borrow high-quality liquid assets (HQLA) on a termed basis. Basel III required borrowers to meet liquidity ratios and funding thresholds—liquid coverage ratio and net stable funding ratio—and the migration of over-the-counter derivatives to a centrally cleared model has created further demand for HQLA as collateral. Historically, borrowers would have accessed HQLA supply instead of cash collateral, but the repo rate dynamic has made this trade economically difficult and made non-cash collateral the optimal choice.

Borrowers need to reduce capital drag on their balance sheets, and we have seen continued and growing demand to borrow HQLAs in the form of Australian government bonds instead of lower-rated or less liquid collateral. With the additional benefit to borrowers of accessing these HQLAs on a term basis, lenders have received premiums for the term element of the trade as well as the collateral transformation aspect.

A large proportion of assets are held by Australia's superannuation funds. As the fourth-largest segment in the world, the superfunds continue expanding through increased mandatory contributions from members throughout the next decade. While asset allocation, particularly in equities, remains largely domestically focused, there is evidence that the benefits of greater diversification and liquidity in global markets are driving a more globally balanced approach.

With domestic lending revenues being more focused and therefore generally more volatile in nature, a trend towards globalisation will help to diversify and enhance securities lending revenue streams for local beneficial owners. Recent industry data showed an increase to almost USD $20 trillion of lendable assets globally in 2018, with over USD $2.1 trillion on loan. Over time, increased allocations to offshore exposure are expected to give access to attractive and more consistent returns.

The benefits of a growing securities lending industry are felt not just by lenders and borrowers. As a well-regulated practice that aids the smooth functioning of capital markets through enhanced liquidity and price discovery, securities lending delivers benefits to a range of domestic and global stakeholders.

## Technology leading the way

Advances in technological capabilities continue to transform the securities lending industry. Robotics is a key enabler for operational improvement, artificial intelligence (AI) is allowing improvements to the sourcing and enrichment of trading data and detailed reporting is a key benefit to lenders and to trading optimisation.

Technology provides opportunities for improvements across the value chain, from trading strategies and operational efficiencies to enhanced revenue generation and deeper counterparty relationships. At Northern Trust, we are working with a number of new technologies including machine learning, AI, robotics and data analysis. In addition to increased transparency, we are likely to see the use of automated pricing mechanisms, which enable lenders to more accurately predict and determine appropriate pricing levels for specials. A focus on investing in areas we believe will unlock value for our clients, such as automation of the trading function, frees resources to seek maximum trading value for our clients. Our expectation is that the practical application of new technology will help drive competitive advantage through greater efficiency, optimised performance and enhanced client experience.

The use of blockchain technology will be more widespread in five years' time, with its potential to drive both small-scale benefits for lenders and borrowers, and major industry-wide improvements and opportunities. Through our experience and expertise in deploying blockchain technology for private equity markets, Northern Trust believes distributed ledger technology will improve the transparency and efficiency of the market and provide potential opportunities to achieve industry cost efficiencies across the value chain. As confidence continues to grow in the technology, future opportunities could develop around account structures, regulatory reporting and digital issuance.

## Strategic opportunities

At a time when some asset owners and asset managers are working closely with their boards to approve first-time engagement in securities lending, some lenders in Australia are leading the way in using securities lending as a vehicle to meet the needs of other functions with their businesses.

Many Australian asset owners remained committed to their securities lending programmes during and beyond the crisis, and have continuously evolved ways to derive additional value from the service and infrastructure. One interesting theme being explored is the extent to which securities lending can help the needs of the treasury function, with respect to cash management and liquidity, through concepts such as cash collateral self-investment, agency repo, collateral optimisation and peer-to-peer lending. With regulation never far away, the advent of a widely used securities lending central counterparty clearing platform is also a possibility.

While differences exist across beneficial owners with respect to the evolution of their programmes, many of these concepts are ultimately helping pave the future direction of the industry. Lending agents must continue to provide the ongoing partnership support, flexibility and customisation that afford their clients the means of fulfilling their long-term investment and risk management objectives.

## Looking ahead

Australia, like its Asian counterparts, remains an important securities lending market. It has strong growth prospects and provides industry participants with a wide range of compelling opportunities. As Australian asset owners and managers continue to fight the headwinds of a low-return and low interest-rate environment, the need to cover costs and enhance performance has never been more important. This has encouraged the resurgence in securities lending that is now in full swing.

We expect continued efforts from the industry to develop lending programmes against a backdrop of robust, global demand. The forecast is bright and the outlook is positive. **SLT**

# Emerging Asia

While the Asian markets are still seen as emerging marketplaces, Paul Solway of BNY Mellon explains the market in Asia will continue to grow with nine securities lending markets and a further two with potential

## Asian equity owners have enjoyed revenue growth over the past few years. What has contributed to this growth and do you see this trend continuing?

Asian markets are still seen as emerging marketplaces that continue to bring new stories both in terms of corporate and economic activity. This helps to provide traders with a plethora of long-short opportunities.

Japan and Hong Kong are still at the core of volumes and activity, given the former's size and breadth domestically and the latter's liquidity and access to corporate activity related to China.

Five out of the 10 top-earning stocks in Asia last year were from Japan. The country is also the number one revenue earner with huge volumes. South Korea is third and, despite lower on-loan volumes, spreads of more than 300 basis points make up for that.

Going forward, the market in Asia will continue to grow. There are now nine securities lending markets with a further two markets potentially opening up as well, with the Philippines recently adding new short-sell rules and Indonesia looking at potential models.

However, there are risks. While Asian markets are often seen as engines of global demand, impacts can be felt even if one company's performance is down. For example, Taiwan felt Apple's lower Q4 results which no doubt impacted supply chains.

## How is technology influencing Asia?

Unlike other geographies, Asia still remains behind the curve in terms of technological advancement. Despite that, it is only logical that this gap will narrow in time as more institutions connect to new systems and improvements that have been made in other markets, like the US.

The make-up of the market also makes it harder for technology to develop in Asia given its disconnectedness, with traders in different markets having a diverse set of customs. This takes additional time and money for standardised systems to develop.

However, I expect there to be huge technological gains in Asia this year given that investment is now starting to flow into the market in this region.

Technological improvements won't just help traders focus on higher value items like specials or more complex trades, but they also enable back and middle office advancements that are critical in order for the rest of the trade lifecycle to function efficiently. Without this, post-trade issues become inevitable.

**As markets in the region evolve, various corporate events affected demand in the Hong Kong market. To what extent has this impacted the Asian market as a whole?**

Hong Kong will always be hugely relevant to Asia given it is viewed as the easiest route to China, with topical sectors including property, heavy industry, transport and financials.

Last year was also a banner year for Hong Kong in an initial public offering (IPO). Companies such as Xiaomi, Meituan Dianping and China Tower listed and were responsible for 20 percent of the top 10 earners in Hong Kong.

**What challenges do you see on the horizon for the securities finance industry in Asia 2019?**

In Singapore, the Singapore Exchange (SGX) moved its settlement cycle from T+3 to T+2, creating some operational difficulties for the local market as a result of early settlement regulations which make it hard for institutions to move securities to the right place on time. This has meant some providers of lending liquidity have reduced or stopped their lending activity.

**Can you name a market driver in Asia that industry players must be aware of for 2019 and any other key trend we should pick up on?**

Like other markets, technology is going to be a big driver for Asia given its lack of standardisation—this will be relevant for both the trading floor and the operational side of the business, which both need to develop symbiotically in order to get the most out of those developments.

Additionally, traders have a plethora of short-selling rules to consider across each market, so using technology as an enabler to navigate quotas and other exchange limiters will certainly be of benefit to the high-frequency or quant traders.

In 2019, from a market perspective, Japan will continue to be the main focus of participants as it pulls out of low growth rates. We have already seen a good uptick in activity this year in corporate activity—such as Takeda Pharm/Shire deal and the SoftBank IPO at the end of last year. Technology will, of course, continue to be a key trend as it drives further efficiency in securities lending. It will help solve the issue of how to run this business better, faster, cheaper and safer. **SLT**

*“In 2019, from a market perspective, Japan will continue to be the main focus of participants as it pulls out of low growth rates”*

# A bump in the road

What does the future hold for South Korea's securities lending market?

Asia offers a diverse range of securities lending markets, which all vary in their stages of development. But in recent months, South Korea has been feeling the struggle.

At last year's PASLA/RMA Conference on Asian Securities Lending, Seoul-based market representatives voiced concerns that the hardening of short selling rules in South Korea through 2016 to 2017 would negatively affect their business—and now it appears their worries were not without merit.

South Korea was one of the most lucrative Asian markets for securities lending from 2015 to 2017. Local investors only accounted for 20 percent back in 2011, but in early 2017, that percentage hovered around 35 percent on average, with local investors increasingly taking on a larger command of the market.

However, recently the walls have come crashing down, as stock loans in South Korea tumbled about 24 percent over last October.

In a Trend Analysis release, published by the Korea Financial Investment Association (KOFIA) in October 2018, KOFIA indicated that the Korea Composite Stock Price Index (KOSPI) had closed at 2,029.69pt before falling to a yearly low of 1,985.95pt as a result of mass selling by foreign investors.

KOFIA said: "This was triggered by concerns of economic recession due to decreasing global trade volume from the prolonged US-China trade war and volatile global stock prices on top of continuing US interest rate hikes."

It added: "Meanwhile, tumbling US stocks weighed down on the stock markets of other major economies, which also negatively impacted Korea's stock prices."

As a result, the net asset value of domestic equity funds dropped by Won (KRW) 6.4 trillion, despite a slight inflow of capital.

KOFIA also found outstanding margin loans came in at 9.04 trillion won (US $8.06 billion) as of the start of November, down 23.8 percent from 2 October.

Margin loans taken to buy stocks traded on the main KOSPI market plunged 21.1 percent to 4.71 trillion won, while those for shares registered with the tech-heavy, secondary KOSDAQ market tumbled 26.4 percent to 4.33 trillion won.

But it's not all doom and gloom, DataLend indicates that South Korea is still the fourth largest market in the Asia region by on-loan and inventory value.

As of 12 November, there were still approximately 2,200 securities on loan on any given day, the vast majority of which (over 90 percent of the total) were equity securities, according to DataLend, the securities finance market data provider.

DataLend also found the average daily on-loan balance so far this year (as of 12 November) stood at $14.80 billion on loan/day, while equities were at $14.36 billion and fixed income stood at $439.85 million.

As Paul Solway, regional head of securities finance, Asia Pacific of BNY Mellon, comments: "Receivers are keen to accept Korean equities as another way to secure loans/repo trades, and Korean Treasury Bonds are emerging in financing desirability among borrowers."

Broadly speaking, Solway adds: "Institutions are increasingly looking into how to automate their trading functions to simplify workflows and reduce operational risk. There are ample opportunities to drive pre- and post-settlement efficiencies in Korea and across the rest of Asia."

## Seoul relative

Despite the slight scare in October last year, custody clients and the international community are still favouring South Korea, and collateral has its opportunities there too.

As Darren Boulos, head of foreign exchange (FX), Asia Pacific, at BNY Mellon, says: "South Korea is a strategically important country for [BNY Mellon] custody clients and the international investment community. It captures some of the largest investment flows among the restricted markets BNY Mellon serves."

As Solway indicates, in the Korean market "pharmaceutical companies, [as well as] marine transportation, technology and heavy industrial/manufacturing sectors continue to dominate specials activity".

This is mirrored by Sam Pierson, senior director, at IHS Markit who states: "Celltrion and Celltrion Healthcare have been most popular, [at the end of 2018] there was some more demand for Samsung and affiliates into earnings, with Samsung electro-mechanics seeing a surge in borrow demand."

However, Solway warns: "South Korean economy is growing only gradually, with GDP slightly below expectations. Fiscal and economic policy developments in the coming months could cause investors on the long and short side of the market to change their market positioning."

And as for collateral, Natalie Wallder, markets head of collateral management at BNY Mellon, explains: "Challenges will undoubtedly present themselves in relation to the industry mobilising eligible collateral to manage regulatory changes, such as the need to segregate margin for over-the-counter derivatives."

But she states: "Such challenges, however, can turn into opportunities where the market expands its range of eligible collateral to include other high-quality liquid assets (HQLA) and creates more seamless solutions to use onshore securities."

## A question of regulation

Regulations governing securities lending are more global in nature, according to Solway, but he states they are driving opportunities across the marketplace.

He adds: "Markets like Korea and Taiwan continue to be very rules-driven and transparent on the short side. Some participants believe this could set the standard for other markets in future, whereby local intermediaries form part of the ecosystem that allows for reporting to exist at a granular level via the central exchange or depositary."

"As we have seen, this transparency requirement is the driver of more recent regulations such as the Securities Financing Transactions Regulation in Europe."

"This, in turn, should bring new trading counterparties to the market who are looking to transform cash assets into HQLA. It also creates more of a need for institutions who hold Korean assets to further finance them."

Solway predicts that the financing market will continue to evolve in the near term. This, he says, "is where triparty agents can assist to mitigate operational and settlement risk for borrowers and lenders".

## Neighbours

Where China is concerned, trade tensions with the US could have a knock-on effect when predicting future successes in the Asia Pacific region.

However, David Braga, head of Australia at BNP Paribas Securities Services, notes: "China [is] generating the most interest and demand. We have built a robust product offering to support clients' investment ambitions in China."

Elsewhere, Singapore has evolved and is now seen as an active financial hub for Southeast Asia and globally.Singapore's advanced technological infrastructure has been a strength and the city-state remains in a prime position to help increase Asia's securities lending market.

As Solway indicates: "Securities lending across Asia continues to develop and grow."

"The Philippine and Indonesian local bourses are both revisiting their domestic short-selling mechanisms that in turn will require facilitation from viable securities lending platforms that can support both local and offshore participation. As always, China remains a market that the whole industry is keen to see open up beyond the existing restrictions that disqualify many firms from securities lending." **SLT**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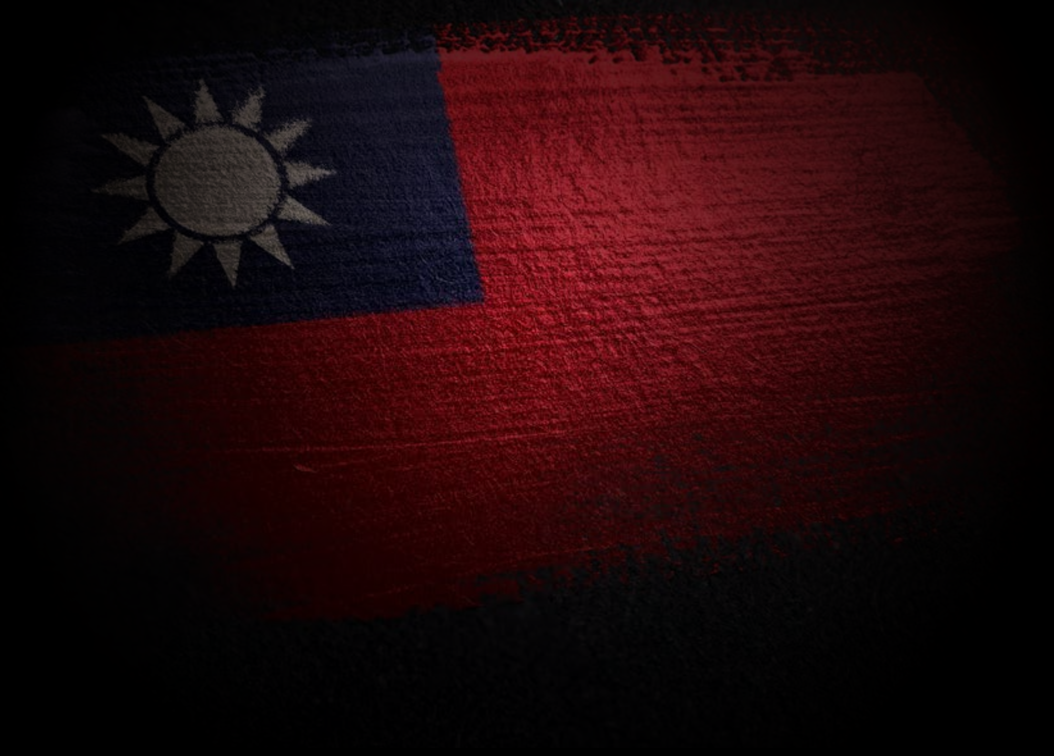
# ASIA DATA SNAPSHOT

*All figures provided in USD*



# Taiwan

**Value on loan**
$8,759,420,037

**Lendable assets**
$57,389,651,300

**Lending revenue**
$213,841,544

**Fee**
2.43%

**Utilisation**
7.29

*Figures provided by IHS Markit*

# Singapore

**Value on loan**
$2,130,334,353

**Lendable assets**
$53,121,988,086

**Lending revenue**
$25,557,672

**Fee**
1.19%

**Utilisation**
3.12

*Figures provided by IHS Markit*

# South Korea

**Value on loan**
$13,788,859336

**Lendable assets**
$127,479,586,547

**Lending revenue**
$482,995,070

**Fee**
3.50%

**Utilisation**
5.92

*Figures provided by IHS Markit*

# Phillippines

**Value on loan**
$34,781,196

**Lendable assets**
$1,299,495,409

**Lending revenue**
$486,613

**Fee**
1.43%

**Utilisation**
2.68

*Figures provided by IHS Markit*

# Thailand

**Value on loan**
$907,938,509

**Lendable assets**
$16,513,751,595

**Lending revenue**
$16,251,469

**Fee**
1.80%

**Utilisation**
3.96

*Figures provided by IHS Markit*

# Malaysia

**Value on loan**
$ 731,975,102

**Lendable assets**
$14,591,430,446

**Lending revenue**
$ 25,362,122

**Fee**
3.45%

**Utilisation**
4.56

*Figures provided by IHS Markit*

# Australia

**Value on loan**
$19,802,629,987

**Lendable assets**
$285,484,485,478

**Lending revenue**
$133,219,912

**Fee**
0.67%

**Utilisation**
5.30

*Figures provided by IHS Markit*

# Japan

**Value on loan**
$98,919,681,992

**Lendable assets**
$850,571,879,590

**Lending revenue**
$878,916,860

**Fee**
0.90%

**Utilisation**
6.18

*Figures provided by IHS Markit*

# New Zealand

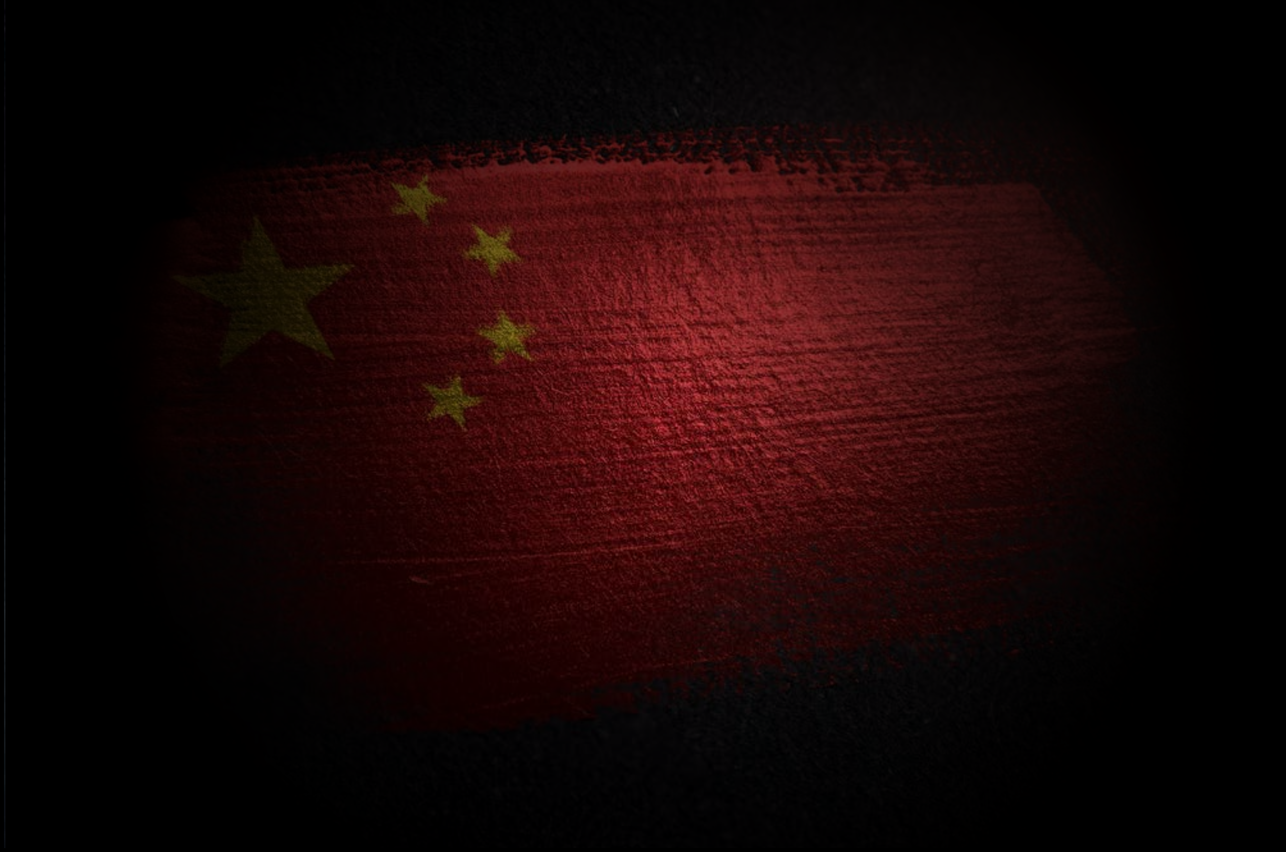
**Value on loan**
$1,255,247,844

**Lendable assets**
$9,249,488,281

**Lending revenue**
$6,271,978

**Utilisation**
13.672

*Figures provided by FIS*



# China

**Value on loan**
$261,110,222

**Lendable assets**
$20,077,662,382

**Lending revenue**
$21,220,669

**Utilisation**
1.714

*Figures provided by FIS*

# Hong Kong

**Value on loan**
$27,047,469,977

**Lendable assets**
$502,254,859,516

**Lending revenue**
$365,370,489

**Utilisation**
5.391

*Figures provided by FIS*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BNP PARIBAS

**Adnan Hussain**
Global head of agency lending and head of MFS UK
Tel: +44 207 595 1435
Email: adnan.hussain@uk.bnpparibas.com

**securities.bnpparibas.com**

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BNY MELLON

**Paul Solway**
Regional head of securities finance
Tel: +852 2840 6690
Email: paul.solway@bnymellon.com

**www.bnymellon.com**

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**Simon Lee**
Managing director, head of business development
eSecLending Europe
Email: slee@eseclending.com

**www.eseclending.com**

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**Regional heads for agency securities lending – Asia Pacific**

**Japan**
James Manning
Executive director
Tokyo, Japan
Tel: +81 3 6736 6646
Email: james.manning@jpmorgan.com

**Australia/New Zealand**
Tony Georgievski
Vice president
Sydney, Australia
Tel: +61 2 9003 6527
Email: tony.x.georgievski@jpmorgan.com

**Asia**
Chunhua Ou Hall
Executive director
Singapore
Tel: +65 6882 7251
Email: chunhua.ou@jpmorgan.com

**www.natixis.com**

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**Francois Maury**
Head of global securities financing, Asia
Tel.: +813 4519 2167
Email: francois.maury@natixis.com

**Christophe Bensoussan**
Global head of global securities financing
Tel: +33 1 58 55 80 23
Email: christophe.bensoussan@natixis.com

NORTHERN TRUST

**Mark Snowdon**
Head of capital markets, Asia Pacific
Tel: +65 6437 6777
Email: Mark.Snowdon@ntrs.com

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**Phil Morgan**
Chief operating officer and head of sales
Email:Philip.morgan@pirum.com
Tel: +44 207 220 0965

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1. RBC quarterly results released 28 November, 2018
2. Global Custody Survey, Global Investor ISF, 2011 to 2018, unweighted
3. Standard & Poor's (AA-) and Moody's (Aa2) legacy senior long-term debt ratings of Royal Bank of Canada as of 27 November 2018

STATE STREET

**Francesco Squillacioti**
State Street securities finance global head of client management
Tel: +1 617 664 4756
Email: fsquillacioti@statestreet.com

**www.statestreet.com**

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