securities lending times

Nordics 2018/19

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Troubled digestion

Securities lending markets have reached their busiest point globally since the financial crisis, however, the Nordics are still having some trouble digesting an oversupply of lendable stock and bonds.

Although the Nordic region is still grappling with declining equity lending revenue and fees, lenders are becoming more flexible on terms and trade types. In this year's Nordics Annual, BNY Mellon explores how securities finance participants are adjusting to the competitive landscape.

Elsewhere, Northern Trust's Fiona Mitchell explains how the return of volatility to global markets and regulations governing the use of securities data is playing out in the Nordic region.

Data from IHS Markit highlights the key securities finance statistics of Denmark, Finland, Norway and Sweden, while Lago Kapital and SEB provide an update on the securities lending market in Sweden, Finland, and Norway.

As ever, if you have any feedback, don't hesitate to get in touch with us.

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Published by Black Knight Media Ltd

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The Nordics:

focused, flexible and distinctive

This year has seen the return of volatility to global markets and regulations governing the use of securities data. Fiona Mitchell of Northern Trust explains how these are playing out in the Nordic region

Becky Butcher reports

What distinctive activity has 2018 seen in the Nordic equity securities lending markets?

Firstly, we have observed a distinctive shift in activity around equity 'specials'. The oil sector and related supply chain companies have seen a reduction in short demand as global oil prices recovered and hedge funds therefore looked to other opportunities to deploy capital. Directional demand has moved to the retail sector, particularly for those companies burdened by large rental costs and less established online capabilities.

There continues to be a noticeable shift to move investment away from the high street and into e-commerce, to meet consumer demand for more convenient internet-based retailing. In the financial sector, increased short interest has developed across debt collecting companies, given concerns regarding overly complex balance sheets and cash flow accounting, coupled with a very crowded market place.

In terms of Nordic lending volumes, an increase in equity market volatility in 2018 has made it more challenging for traditional equity long/short hedge funds to find the investment conviction to deploy more capital to the short side. In contrast, an increase in trading activity from quantitative strategy funds, which thrive in more volatile conditions, has helped support a growth in lending volumes across the region relative to 2017.

The focus on corporate governance is a well-known characteristic of the Nordic markets, and our clients often choose to structure their programmes in ways that ensure they retain the exercise of voting rights in their domestic market to some extent.

What trends are you seeing in terms of fixed income demand?

Financing trades remain a dominant global theme as borrower demand for high-quality liquid assets (HQLA) remains strong. Borrowers continue to request greater collateral flexibility and term trade structures given the focus on operational efficiencies and satisfying regulatory requirements, so those clients who are comfortable with these parameters will enjoy stronger utilisation and returns.

We see Nordic fixed-income inventory as typically being best suited to an exclusive or sole-borrower type arrangement. Otherwise, pockets of demand are evident for general collateral bonds, but 'special' activity is muted.

In terms of collateral, whilst the acceptance of highly-rated Nordic sovereign bonds continues to increase, the market is more open to the concept of accepting high quality non-sovereign bonds, for example agency debt and covered bonds. This was highlighted in the release of the latest International Capital Market Association (ICMA) European Repo Market Survey, published in March 2018, with the share of Danish and Swedish-denominated assets used as collateral jumping to 6.3 percent at the end of 2017, from 2.5 percent during the previous year.

> ***"In terms of Nordic lending volumes, an increase in equity market volatility in 2018 has made it more challenging for traditional equity long/short hedge funds to find the investment conviction to deploy more capital to the short side"***

Going forward, the recently announced tapering and eventual termination of the European Central Bank's asset purchase programme is expected to have little impact on Nordic fixed income lending markets. Any subsequent rise in interest rates across the broader region may fuel some interest, though at this stage it is hard to determine if the motives of demand for Nordic assets will alter.

The regulatory environment continues to evolve. What are the key impacts for securities lending and the Nordics?

The Securities Finance Transaction Regulation (SFTR) is a key focus for the securities lending industry, given the extent and complexity of the data obligations and tight reporting deadlines, with reporting now expected to be live in 2020, staggered by different entity types.

Beneficial owners should be aware of the requirements of the regulation as the reporting obligation rests with them, although Northern Trust will be providing reporting services on behalf of our clients as we recognise we are best placed to perform the SFTR reporting for our clients. We are working closely with the International Securities Lending Association and International Capital Market Association to define new industry best practice.

Regulatory capital continues to be a primary concern for borrowers. Access to assets held by capital efficient beneficial owners or those with less challenging netting opinions, so-called ‘smart bucketing’ or segregated lending, continues to gain momentum with our borrowing counterparts. Nordic clients typically enjoy a more efficient structure in terms of capital usage and so may benefit from this emerging trade type.

The Agency Lending Disclosure process, an industry standard which enables agent lenders to provide banks and broker-dealers with underlying principle level detail for each loan executed, can be operationally challenging for some banks within the Nordic region. The exclusive arrangement route can, therefore, be particularly suited to facilitating trades with the Nordic borrower community.

EU Money Market Reform, which comes fully into force in January 2019, will impact those beneficial owners who reinvest cash collateral in money market funds. For many money market funds, this will result in conversion to low volatility net asset value (NAV) from constant NAV and lenders captured by this regulatory change should be aware of its possible effects.

Finally, can you outline an overarching Nordic trend you’re seeing?

Increased interest and engagement in securities lending from portfolio management teams is to the fore. There is now an even greater focus on special term and bespoke trades, as clients look to generate low-risk alpha given ‘every basis point counts’ in the prevailing investment environment.

Our experience is that this is resulting in institutions now considering the benefits of securities lending, and collaborating with clients who have long-standing experience in lending.

Risk management remains a key consideration, particularly in relation to counterparty exposure and acceptable collateral. **SLT**

> ***Nordic clients typically enjoy a more efficient structure in terms of capital usage and so may benefit from this emerging trade type***

Fiona Mitchell
Senior relationship manager for the Nordics
Northern Trust

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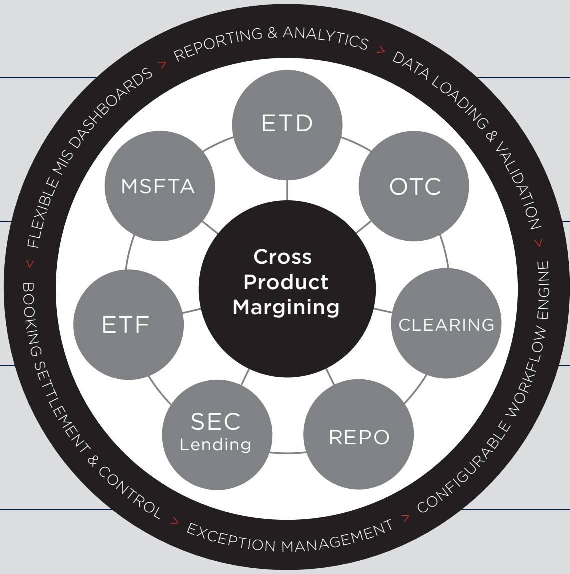

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A new frontier emerges

The Nordic region is still grappling with declining equity lending revenue and fees, but lenders are becoming more flexible on terms and trade types. BNY Mellon explores how securities finance participants are adjusting to the competitive landscape

New challenges

Securities lending markets have reached their busiest point globally since the financial crisis, reflecting more beneficial owners looking to lend to enhance their revenues. The Nordics, meanwhile, are still having some trouble digesting an oversupply of lendable stock and bonds.

In the first half, the average value of stocks and government bonds on loan in the region were at their highest levels since 2008 and 2014, respectively,

according to IHS Markit data, amid an increasing appetite to lend when yields on assets in many portfolios are at all-time lows.

Equity borrowing averaged $39.3 billion a day in the first six months of the year, up 28 percent from a year earlier. The lion share of new activity was attributable to Sweden, where $19.3 billion of securities were on loan, up 30 percent year-over-year.

Government-bond borrowing in the region averaged $8 billion a day in the first half, double the first half of 2017. Revenue from government-bond lending grew an impressive 83 percent year-over-year and more than tripled in Sweden and Denmark, driven largely by a requirement for many financial institutions to hold high-quality liquid assets.

But a familiar problem lingers over the Nordics: a glut of securities is pressuring the fees investors can earn—and that's before any potentially interested clients join the fray.

Revenues from equity securities lending were $310.7 million in the first half, slightly up from last year's levels thanks to the post-crisis global economic recovery and policy changes to name a few, but down from a peak of $580 million in the first half of 2013 and 2014.

Adding to the uncertain business climate, European regulators want to bring transparency to the global securities lending market, covering $21 trillion in lendable value, which will introduce new compliance burdens. Between today's low-yield environment, the pending regulatory overhaul and the decline in fees mean that lenders are in for some stark challenges.

Revenues remain on a downward trend. Fees to borrow Swedish equities averaged 154 basis points on an annualised basis in the first half and fees for Danish equities averaged 36 basis points—both post-crisis lows, IHS Markit data found. Fees to borrow Swedish government bonds in the first half of the year fell 38 percent from the year-ago period, averaging 18 basis points.

The squeeze is on because while asset prices are rising, the pool of securities available to lend is growing faster than borrower demand. In other words, asset owners are lending out a lower percentage of what they have than before, and getting a lower rate when they do.

The inventory of equities available to lend in the Nordics was $272.8 billion as of the end of June, the most for that period in IHS Markit data going back to 2007. This is because more beneficial owners have loaned out securities while asset prices are going up.

Meanwhile, the percentage of equity inventory on loan in Norway and Finland—a metric known as the "utilisation" rate—is at its lowest point in the record books. In the first half, there were an average of just 10.4 shares on loan for every 100 shares available in Norway, and 9.6 Finland shares for every 100 available.

Fee fluctuations

To be sure, there are a few bright spots. Revenues from government-bond lending were $7 million in the first half, virtually double their $3.8 million year-ago level. As of the second quarter, income from Finland equity lending totaled $51.8 million, up 52.8 percent from the year-ago quarter.

Fees in Finland were up in the first and the second quarter from a year ago by 1 percent and 8 percent, respectively. This performance was largely attributable to interest in specials such as Finnish telecommunications giant Nokia Corp, which saw bids up 30 to 50 percent because of some supply being taken out of the market.

Second-quarter income from Norway equity lending rose 11 percent from a year ago to $44.5 million, a turnaround from the first quarter when income had fallen 25 percent because of reduced demand for two specials: Norwegian Air Shuttle ASA and deep water drilling company Seadrill.

Overall in Europe, revenues from European equity lending were just over $1.3 billion in the first half of 2018, a 19 percent improvement year-over-year, but only because last year was an especially challenging one.

By and large, lenders are being forced to become more creative, in particular those asset managers whose portfolios track a benchmark. A number of firms are also looking to enter securities lending to overcome natural drags in performance, for example, if they have to hold cash-like assets for liquidity reasons.

Stephen Kiely, head of sales and relationship management for securities finance across Europe, the Middle East and Africa at BNY Mellon Markets, says he has received a steady pipeline of new clients, including some engagement from hedge funds looking to lend directly that haven't previously tested the waters.

"The sort of engagement in securities finance from a broader client base, which we've seen elsewhere, is coming through," says Kiely.

"Since the financial crisis, the whole product has become part of the front-office investment decision-making process and the Nordics are catching up."

Lenders are increasingly flexible on terms, embracing new trade types or assets to lend, and entering term transactions in addition to overnight ones. Kiely says lenders also have broadened their collateral parameters and their programmes are becoming more modular as they look to add new trades.

Transparency eyed

New regulations are coming and the market will need to embrace transparency at arguably its most interesting inflection point in years. The value of securities on loan globally is now just shy of $2.5 trillion, the most since September 2008, according to IHS Markit.

Front and centre are the non-cleared margin rules for over-the-counter derivatives, which we will discuss later, and a new framework for securities lending markets, Securities Financing Transactions Regulation (SFTR).

SFTR is designed to give supervisors a deeper view into the securities finance market's interconnectedness following a buildup of leverage that emerged during the financial crisis.

The aim is to cover those entities governed by the European Market Infrastructure Regulation and as the July 2018 newsletter of the International Securities Lending Association stated, the final technical standards of the SFTR will be adopted imminently by the European Commission.

Once enshrined into law, SFTR will require both parties to each transaction, whether financial or non-financial, to report details to a trade repository beginning as soon as the second half of 2019.

There will be as many as 165 record fields to fill out, including the composition of any collateral that is pledged or received against a trade, and any haircuts applied. It also includes an obligation to send over daily changes, such as re-pricings.

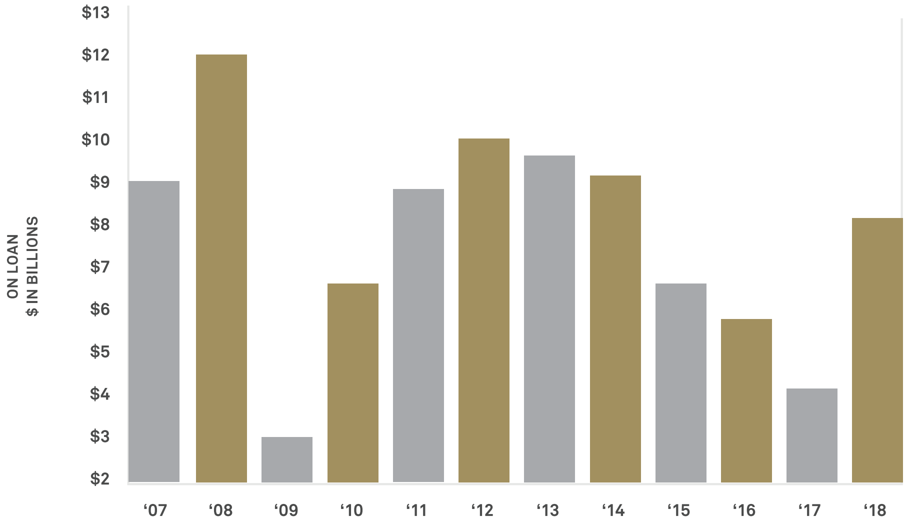
The requirement initially focused on banks and financial institutions. Next up are funds, including insurers, pension funds and sovereign wealth funds, in 2019. After that comes the corporate sector and, later, small financial companies and individuals. Eyeing the workload, some are already outsourcing their compliance to agent lenders.

James Day, head of securities finance for Europe, the Middle East and Africa at BNY Mellon Markets, said: "People are now starting to wake up to SFTR, but we have been preparing for the last two years. We're on top of it and we can make this easy."

Non-cleared margin: Another regulatory consideration is the broadening of firms subject to new daily margin exchanges for non-cleared swaps, following a framework set by the Basel Committee of Banking Supervision and the International Organization of Securities Commissions. Sell-side market participants have already been subject to the rule and now buysiders will feel the impact of these regulations, which require firms to pledge or receive initial margin daily to all counterparties in a swap.

This represents a unique opportunity as hundreds of new borrowers are poised to flood the securities finance markets looking for assets to comply with the new margin rules. **SLT**

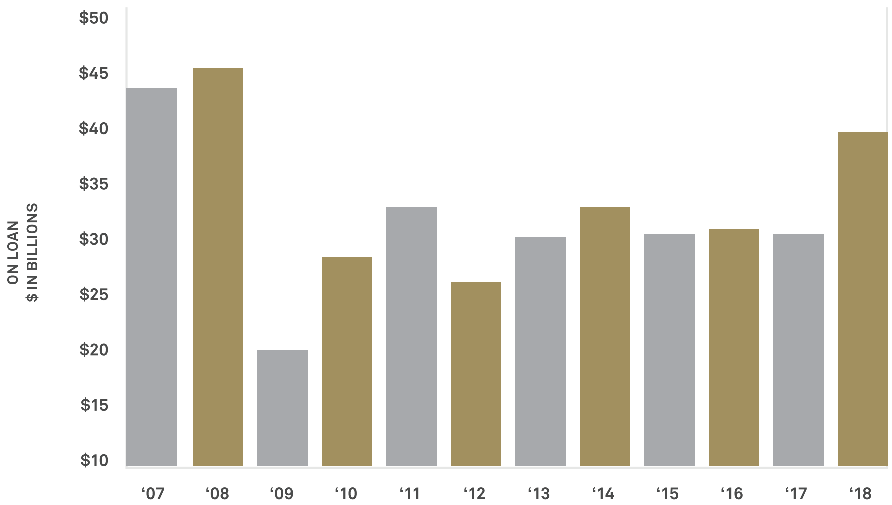
Nordic Fixed-Income Lending Activity



*Daily average of fixed-income securities on loan across first half of each calendar year (for Denmark, Finland, Norway, Sweden)

Data Source: IHS Markit

Nordic Equities Lending Activiy



*Daily average of equity securities on loan across first half of each calendar year (for Denmark, Finland, Norway, Sweden)

Data Source: IHS Markit

Equity Securities Financing in Nordic Countries

Q1 2018

	Quarterly Revenue (USD M)	YoY Change	Average Value (USD Bn)	YoY Change	Weighted Fees (Bps)	YoY Change	Average Lendable (USD Bn)	YoY Change	Average Utilisation	YoY Change
Denmark	5.31	-6.8%	6.82	48.6%	36	-37%	71.57	41%	6.43	6.8%
Finland	17.59	9.9%	5.82	8.9%	139	1%	44.90	38.6%	8.77	-21.2%
Norway	19.42	-25.1%	4.87	12.3%	184	-33%	36.09	50.3%	7.91	-21.2%
Sweden	77.30	23.8%	17.99	40.2%	198	-12%	124.47	30.9%	9.22	10.8%

Q2 2018

	Quarterly Revenue (USD M)	YoY Change	Average Value (USD Bn)	YoY Change	Weighted Fees (Bps)	YoY Change	Average Lendable (USD Bn)	YoY Change	Average Utilisation	YoY Change
Denmark	7.25	22.2%	7.21	27.0%	45	-3%	66.89	14.0%	6.87	8.4%
Finland	51.81	52.8%	7.68	44.6%	304	8%	45.84	42.5%	10.25	0.5%
Norway	44.49	11.1%	7.57	21.6%	267	-8%	38.36	59.3%	12.83	-20.7%
Sweden	85.19	-7.7%	20.65	22.9%	184	-23%	117.51	12.1%	11.09	9.1%

Data Source: IHS Markit

SFTR:

the practical implications

Ed Oliver of eSecLending explains what the Securities Financing Transaction Regulation is and what is expected from firms

I was asked to moderate a panel earlier this year, which aimed to address the practical implications of Article 4 of SFTR. Aside from the thought that a 45-minute panel discussion would only scratch the surface of the subject, our panel was struggling to get some positive thoughts to share with the audience. Why is this?

The reporting burden

Firstly, for reporting of securities finance transactions, the burden falls on the principals to the transaction, which in many cases, includes the buy-side participant despite the fact that they have appointed an agent to manage the activity for them.

Who is required to report?

EU-based entities and non-EU based branches of an EU entity. For example:

- A Luxembourg UCITS lending a security to a German borrower—both parties will need to report the transaction
- A UK pension fund lending a security to a New York branch of a French entity—both parties will need to report the transaction
- A US pension fund lending to a UK borrower—only the UK borrower will be required to report
- A US 40 Act fund lending to an EU branch of a US entity—only the EU branch of the US entity will be required to report
- A Japanese pension fund lending to an Australian borrower—neither party will be required to report

EU pension funds, UCITS, insurance companies and others will likely delegate their reporting requirements to their appointed agent, usually a custodian or third party lending agent. Importantly, the buy-side participant will need to be satisfied that the reporting is being done accurately as it is their responsibility. Therefore, there is an additional element of oversight that will be required for those firms.

Given that most beneficial owners will delegate reporting responsibilities to their agent, the 'burden' of reporting the transactions will be with the agent. For securities lending transactions, agents have become accustomed to providing significant data sets to the data vendors that service the industry—for example, IHS Markit, DataLend and FIS Astec Analytics take daily data from the agents detailing available inventory for lending and actual loan information. They anonymise and aggregate the data and provide it back to market participants in the form of web and Excel tools that assist in trading and performance benchmarking.

However, the current data sets provided to these data vendors is much smaller in scale—approximately 25 data fields. SFTR requires 153 data fields and the collation of these additional data sets is a challenge for the industry. The International Securities Lending Association (ISLA) pulled together a small data interpretation working group to help provide clarification on some of the data requirements, which are open to interpretation. The output from this group was published in May this year.

At the time of writing (August 2018), the final Regulatory Technical Standards (RTS) are still yet to be published, but most observers do not expect a reduction in the number of data fields. This is despite the Financial Stability Board (FSB), in effect the catalyst to guiding regulators to obtain more transparency on SFTs, suggesting on 5 March this year that they felt 30 data points were sufficient. Separately, an independent survey of market professionals conducted by consultant firm Finadium in February this year, determined that 75 percent of respondents thought that between 15 and 50 data points is the ideal number to gain sufficient insight into SFT activity.

Currently, there is not a broad exchange of data that exists in securities lending for other transactions caught by SFTR, including repo, margin lending and buy-sell backs. The reporting of these transactions may be even more challenging.

Reconciliations

Reconciliation is another area where securities lending has an advantage over other SFTs. Under SFTR, there is a requirement for matched entries to be submitted to the regulators by both sides of the transaction (assuming both are in-scope EU entities) so reconciliation is absolutely key. Currently, securities lending participants utilise reconciliation tools provided by Pirum or EquiLend to ensure post-trade efficiencies.

There will still need to be an additional focus on the timeliness of reconciliation and clearing breaks to ensure that all items are matched ideally before reporting is delivered by midnight on trade date plus one. This will ensure that corrections aren't required subsequent to the first reporting of a transaction. It is to be expected that significant resources will need to be applied to focus on reporting breaks in the initial stages of live reporting but, over time, the breaks for securities lending should be manageable.

It should be expected that there will be better matching rates than seen in the early stages of the European Market Infrastructure Regulation (EMIR) reporting of over-the-counter (OTC) derivatives.

Again, industry standard reconciliation tools do not generally exist for the other SFTs, so this is an area that will require significant focus. There are already vendor solutions such as Trax Match Repo emerging to fill this gap.

What is new?

We have discussed the reporting requirement and data elements. We have also mentioned that data vendor solutions are now in place. The most relevant of these solutions in the securities lending and repo markets are provided by an IHS Markit/Pirum offering and by EquiLend/Trax. Both service partnerships will offer services that include reconciliation, provision of unique trade identifiers (UTIs), time stamps and onward reporting to trade repositories (TR). The latter three elements are all new requirements to satisfy SFTR. For UTIs and time stamps, ISLA and the industry have already worked on developing a 'waterfall' that addresses how a UTI and/or timestamp is developed depending on the circumstances of the trade and the relationship between the principals to the transaction.

The provision of legal entity identifiers (LEIs) is new for SFTs, but most buy-side participants have likely obtained these to support EMIR reporting and, increasingly, LEIs are becoming common in other reporting areas too. Although it will be a task to gather and store LEIs, it should be one of the easier components of the new requirements.

TRs are also new for SFTs as they are authorised by the European regulator, European Securities and Markets Authority (ESMA), to collect and report the SFT data. Some buy-side participants will already be reporting their derivatives activity to a TR as required by EMIR, and may choose to use the same one for SFTR (although not all TR may apply to do both). Some participants may choose to use the TR that is linked to a data vendor solution. Others could potentially provide internally generated transactions, such as in-house repo activity, to one TR and have their securities lending activity distributed to another TR via an agent.

Another significant change for the securities lending community is the requirement to provide loan lifecycle updates. At present, the standard data reported to data vendors is end of day positions—what is available for lending and what is on loan. SFTR requires reporting of corporate actions and margin updates for example.

ESMA is also keen to understand the level of re-use of collateral that occurs. For most buy-side participants, collateral re-use is likely to be minimal, if it happens at all.

Although, ironically, the move of OTC derivatives activity to central clearing has increased the likelihood of the buy-side utilising securities lending and repo to obtain appropriate collateral to pledge as initial and variation margin. Thus, any re-use growth in recent years has been driven by ESMA's own regulation.

The majority of lending agents that operate a traditional lending programme have a further complication as well. In the current market, in order to allocate lenders fairly into loans where a number of lenders hold the same security, the lending agent operates an algorithm (sometimes referred to as the queue) to determine which lender should be allocated the loan. As a result, it is not possible for the borrower to know the identity of the lender at the point of trade negotiation. The details of the allocated lenders on each loan are shared at the end of the business day (during overnight processes) with the compliance team at each borrower using a process known as Agency Lender Disclosure (ALD). The lenders on each loan can change intraday as lenders sell securities and other lenders get 'reallocated' into the loan. Thus the actual lenders on an individual loan are dynamic. ISLA has developed an ALD Working Group that is aiming to improve the ALD process so that lender details can be provided in a timelier manner and this will be a significant exercise for all participants.

It can be concluded, accurately, that this regulatory reporting initiative requires a very considerable production to provide a huge, reconciled data set to the regulator within tight deadlines. This 'production' inherently will cost money and resources. The TR and data vendors will not be providing their services free of charge.

There is not going to be additional revenue to help compensate the buy-side for these costs, or indeed the agents where they are required to produce the data on their client's behalf. The typical portfolio in a securities lending programme earns approximately four basis points per year. That is not a massive revenue number, but it helps to offset costs in some cases or improve portfolio performance in others. A small percentage of the revenue is shared with the lending agent (perhaps 10 to 20 percent) and, ultimately, in most cases, it will be the agent expected to pay for the additional costs as the buy-side participant will argue that an increase in their costs may lead them to examine if the activity is worth it.

Is the reported data helpful for regulators?

The question for the industry is will all of this additional data be helpful to regulators? We have already mentioned that the data being provided will be more detailed than ever before.

The data is also further complicated by the one-sided nature of much of it. Many of the biggest lenders in securities lending are based outside of the EU, such as US Pension and US Mutual Funds or Sovereign Wealth Funds. There is currently no requirement for these entities to report, but if they are transacting with an EU bank, then the bank will be required to report. It is anticipated that in excess of 60 percent of loans involve a non-EU lender, so there will be a significant amount of one-sided reporting.

The EU has gone first with their regulation to satisfy the FSB directive to obtain more transparency in SFTs. However, it could be the case that other regulators will seek a smaller subset of data that is similar to the data set already provided and perhaps closer to the 30 to 40 data points the FSB has suggested will be sufficient. Will ESMA's regulatory leading approach ultimately be scaled back? Some industry participants are already talking optimistically about SFTR 2.0.

Let's not get ahead of ourselves though—we have yet to see the final regulatory technical standards. Once this is available, we will be waiting for it to be published by the European Commission before the one-year clock begins ticking to the first reporting requirement. Although the reporting requirement is being phased in with only the banks having to be ready for day one, the lenders (and their agents) will need to be ready so that the banks have sufficient information to be able to report on day one. At the time of writing, the best guess for day one is during the first half of 2020.

Did we find any positives?

We concluded that post SFTR implementation, the SFT marketplace could be in a much better place primarily because of the increased rigour around reconciliation processes that will lead to increased efficiencies. The question has to be whether this increased efficiency will compensate for the increased costs that will result from SFTR reporting and, indeed, start to repay the resources used in the project.

A viable long term solution to ALD will also be a big win if it can be achieved. This should help borrowers too as the enhanced capability to share details of the lenders allocated to a loan may allow borrowers to gain additional capital relief if managed well.

Whatever happens though, it is up to the industry to do the heavy lifting. In discussions with the buy-side participants, it is clear that they are going to rely on their agents to provide the data and get this right. Any suggestion that the reporting won't work or will be inaccurate could lead to EU lenders pulling back from participation in securities lending. They have a requirement to report accurately and could be subject to regulatory fines if they fail to do so.

The good news is that the industry is actively working on the SFTR project—led by industry associations, and supported by the commercially opportunistic technology companies—participants in the marketplace are getting their solutions lined up so that they can demonstrate and reassure their clients that they will be ready for day one. Many agents, including eSecLending, are starting to produce test files to see if the additional data points can be easily produced. Others are still wrestling with the build versus buy question and vendors are being inundated with requests for information. The industry will be ready and will be interested to see what regulators do with the data. Perhaps another potential positive will be that the transparency provided to regulators will reinforce the message that SFTs are low risk transactions that help to provide liquidity to the capital markets. Will this ultimately be beneficial to the industry as regulators become more comfortable with SFTs and actually start to roll back existing regulation or will it reduce the impact of future regulation? Only time will tell. **SLT**

When will reporting be required?

The first reporting obligation will occur one year after the EU ratification of the final regulatory technical standards (RTS) and publication in the Official Journal. The reporting is then phased in:

- 12 months after ratification: investment firms (including borrowers) and credit institutions
- 15 months after ratification: central securities depositories and central counterparties
- 18 months after ratification: all other financial counterparties, including UCITS, AIFs, pension funds, insurance companies
- 21 months after ratification: all non-financial counterparties

This article is an updated, abbreviated version of an article published in the Journal of Securities Operations and Custody in August 2018.

**Note: the issuance/settlement market of the security in the transaction is irrelevant for this reporting*

"The transparency provided to regulators will reinforce the message that SFTs are low risk transactions that help to provide liquidity to the capital markets"

Ed Oliver
Managing director, product development
eSecLending (Europe)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At SEB, we pride ourselves on building long-term relationships with our clients. It's a major reason we are now one of the largest equity prime brokers in Europe. With more than 25 years' experience in prime brokerage, equity finance and tailor-made structuring and financing solutions, we offer a comprehensive portfolio of securities financing services.
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Data snapshots

IHS Markit highlights the key securities finance statistics of Denmark, Finland, Norway and Sweden

IHS Markit

Exclusive data sponsor

Denmark

All currencies USD

H1 Revenues: $12,638,880
H1 Average Fee: 0.4 percent
H1 Average Loan Balance: $7,019,700,463
Average Lendable Value: $69,218,887,384
H1 Utilisation: 6.7

Sweden

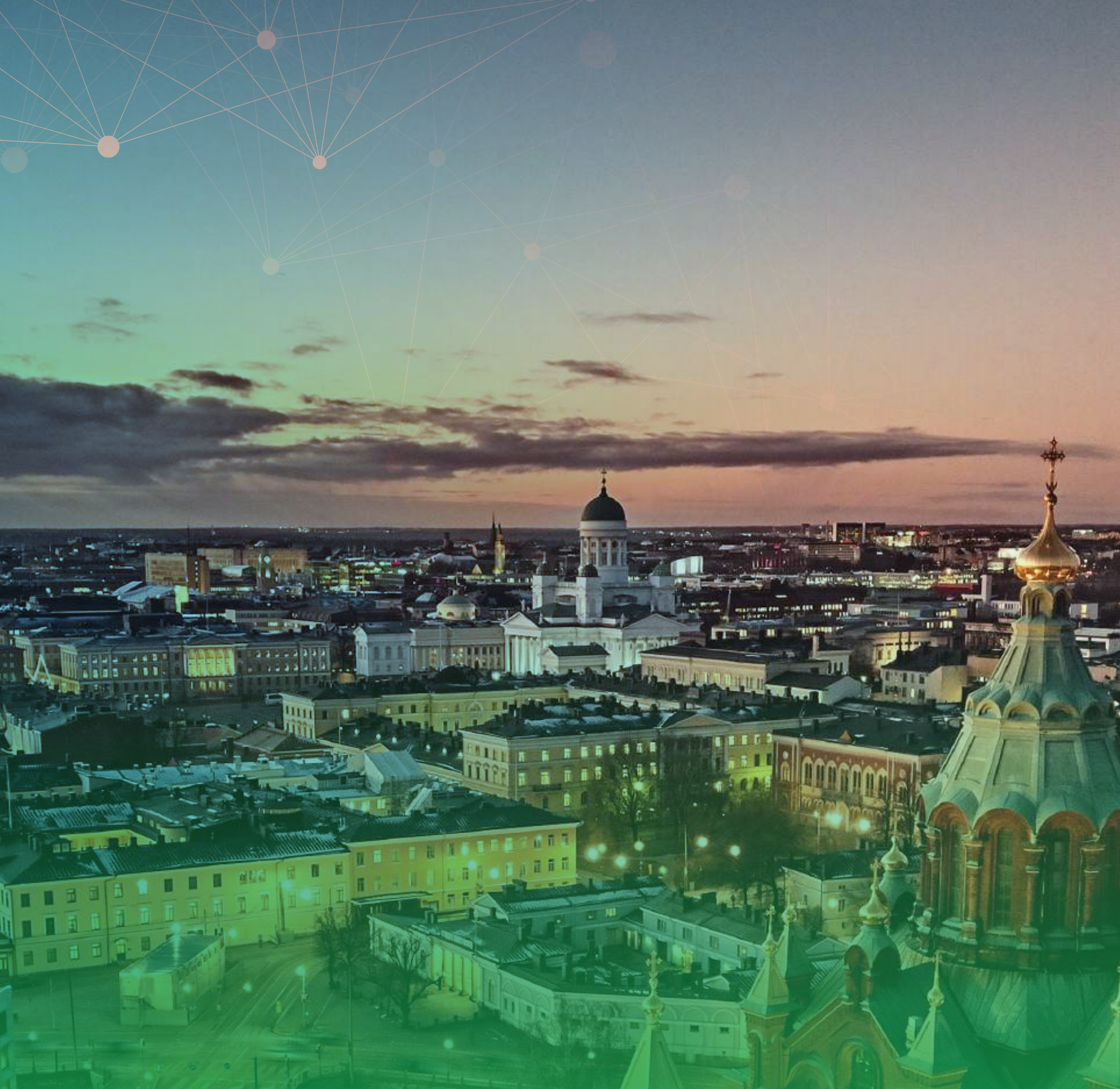
All currencies USD

H1 Revenues: $164,056,587
H1 Average Fee: 1.5 percent
H1 Average Loan Balance: $19,346,571,531
Average Lendable Value: $120,945,576,073
H1 Utilisation: 10.2

Norway

All currencies USD

H1 Revenues: $64,031,545
H1 Average Fee: 1.9 percent
H1 Average Loan Balance: $6,213,170,940
Average Lendable Value: $37,227,463,885
H1 Utilisation: 10.4



Finland

All currencies USD

H1 Revenues: $69,956,783
H1 Average Fee: 1.7 percent
H1 Average Loan Balance: $6,766,549,521
Average Lendable Value: $45,363,541,697
H1 Utilisation: 9.6

Top Nordic Specials

Name	Country	H1 revenue ($ million)	Avgerage balance ($ million)	Avgerage fee
Nordea Bank Ab	SE Equity (OMX)	$32	$15.8 million	2.4 percent
Sampo Oyj	SE Equity (OMX)	$18	$13 million	2.1 percent
Dnb Asa	NO Equity (OBX)	$18	$9.8 million	1.5 percent
Nokia Oyj	FI Equity (HEX25)	$11	$9.6 million	1 percent
H & M Hennes & Mauritz Ab	SE Equity (OMX)	$11	$8 million	0.8 percent
Svenska Handelsbanken Ab	SE Equity (OMX)	$10	$6.9 million	1.2 percent
Equinor AsaHandelsbanken	NO Equity (OBX)	$10	$6 million	0.8 percent
Swedbank Ab	NO Equity (OBX)	$10	$5.9 million	1.4 percent
Skandinaviska Enskilda Banken Ab	NO Equity (OBX)	$9	$5.7 million	2 percent
Intrum Ab	SE Equity (Others)	$8	$5.1 million	3.3 percent

Room for maneuver

Jarkko Järvitalo, CEO of Lago Kapital, discusses Finland's securities lending market as well as the future growth of the company

Becky Butcher reports

Describe the securities lending market in Finland over the last 12 months?

The awareness for securities lending is growing among Finnish investors. Asset managers have adapted securities lending as a mechanism to cumulate profits, cover expenses, and uplift fund performance.

Outperforming stock loan fees are often caused by corporate events such as subscription rights and tender offers. Compared to previous years, the amount of corporate events has been limited in the Finnish securities market and there have not been many hot stocks uplifting the securities lending volumes and fees. As the acquisitions and mergers tend to come in waves, we are hopeful that the corporate event market will soon recover.

What trends are you currently seeing?

Recently equity financing has gained attention in private equity and family firms. These firms have become more aware of the ways they can utilise their long-term investments by using their existing stocks to create liquidity instead of selling. We see that the Finnish securities lending market will benefit from this trend as it allows borrowers to access more diversified portfolios and illiquid stocks.

There is also a rising curiosity toward Eastern Europe. Finland's geographical locations between the east and

the west provide Lago Kapital with a natural relation to the eastern European market and we are eager to step in.

How does Finland differ from the other Nordics? What does it offer that others don't?

The taxations of securities lending deals have remained strict in Finland. In the eyes of a tax authority, a security loan is treated as an equity sale. Due to Finland's rather high capital-income tax, private investors are restricted to participate in the lending market. Additionally, the second Markets in Financial Instruments Directive adds further restrictions to securities lending for private investors.

The lendable value of the Finnish market is around €40 billion. Compared to big brother Sweden, trading volumes in Finland show that there is a lot of room for potential growth.

How has market liquidity and average utilisation evolved over the past year? How does this compare to other Nordic states?

Lago Kapital recently started to offer liquidity providing service to Nordic small- and mid-cap stocks to increase liquidity. An in-house built algorithm in combination with our natural access to the stock loan market ensures a better order book for these companies. Over a short period, we have seen positive results and are expecting to acquire more clients for our liquidity providing services in the near future.

According to DataLend, the utilisation level is around 12 percent in Finland. The corresponding figure of the Swedish securities lending market is almost the same with 12.6 percent. However, it has to be noted that these two are not comparable in market size; the volume of the Swedish market is nearly triple compared to Finland.

What is the average fee range in Finland? And how does this compare to others in the Nordic region?

According to DataLend, the average fee level in Finland is around 40 basis points (bps). Special names carry higher fees and general collateral names are traded at around 15 to 20 bps. To our best knowledge, this is in line with the other Nordic markets. A growing number of lenders such as private investment companies with more diversified portfolios entering the securities lending market may cause an uplift in the overall average fees as access to illiquid names grows.

How has Lago's place in the Finnish market developed? Are you still the only local broker-dealer?

We are fortunate to remain as the only local broker-dealer in Finland specialised in securities lending. The familiarity of the firm has grown together with an awareness of the stock lending. As securities lending has become a more common procedure for the wider crowd, and we believe that the price sensitivity of securities lending has increased. Meaning that investors are more eager to look at options outside their daily bank instead of taking the first bid crossing their path.

Is the trend of local lenders making their international securities available still developing?

Lago has good access to international names even if the common Finnish investor still favours main index names. We hope that going forward, international securities investments will be made directly instead of through funds or exchange-traded funds.

How do you expect the next 12 months to pan out? What opportunities/challenges do you expect to see?

Like anywhere in Europe, 2018 is the year of the Securities Financing Transaction Regulation (SFTR). We have started preparations early and most of our data points are already in place. As it will require efforts to meet the new reporting standards, we also see SFTR as an opportunity for the securities lending market. While the market´s transparency increases this will possibly boost not only the familiarity of the market but also its reputation.

Lago Kapital aims for significant growth in the upcoming years. The company has made investments in human capital and these resources have been placed to automatisation allowing us to scale our services to a wider audience. **SLT**

> ***"We are fortunate to remain as the only local broker-dealer in Finland specialised in securities lending. The familiarity of the firm has grown together with an awareness of the stock lending"***

Jarkko Järvitalo
CEO
Lago Kapital

Leading the way

Christoffer Danielsson of SEB explores how Sweden is leading Scandinavia’s growth outlook for this year

The Swedish economy, which is the largest of the four in Nordic economies, is expected to grow 2.8 percent in 2018, according to Håkan Frisén, the head of economic forecasting at SEB. In 2017, the Swedish gross domestic product grew by approximately 3 percent compared to 2 percent in Denmark and Norway. The international upswing combined with loose domestic monetary policies benefited export-driven Sweden to take advantage and grow even more than its neighbours.

Falling housing prices and the absence of the 2 percent inflation goal has been a cause of concern for the central bank this year, posing a potential risk to growth, but only if they cause the private consumption to slow, which they have not done so far. The central bank will still not move the interest rate until April 2019 our head of research Olov Holmgren is predicting.

Swedish export has instead gained momentum during the past year and is expected to continue to strengthen next year. This will stimulate manufacturing investment and investments in the public sector. Together with further strong demand, high energy prices and a weak Krona, the inflation will stabilise around 2 percent in 2018, according to our macro and foreign exchange research analysts.

In comparison to our neighbours Denmark and Norway, who are expected to grow 2 percent in 2018, Sweden will remain the top performer. This development we can also see in the securities lending market where the attractiveness to borrow Swedish companies for other banks and hedge funds has risen during the year, according to IHS Markit.

How has the Swedish lending market developed during 2018?

Borrowing and lending of equities in Sweden has risen during the year according to IHS Markit data from a value on loan of $16 billion to $19 billion year-to-year. Despite not having one of the bigger lending markets, the percentage of shares on loan is relatively high in comparison with other European markets.

When it comes to the supply (which means the number of shares possible to lend) and the number of lenders of securities, the holdings are still relatively dominated by a few large Swedish pension funds and insurance companies. Lenders have become more sophisticated in the region and are more actively looking to maximise performance for their portfolios and using securities lending as a tool to do that.

The interest in mid- and small-caps are getting more attractive as often the share price on those companies tend to be more volatile based on speculations around the future growth prospects creating a bigger support for short selling some of these names. The availability of lending mid and small-caps names also increases when more funds and lenders are willing to lend out their long positions. The market would like to see long-only investors lend out their general collateral holdings, which generate lower margins and not only the special ones which are lent out at higher rates.

Financing trades have also become more and more attractive in Sweden due to the solid performances of Swedish companies and the stability of them on the securities lending market which means they are generally accepted as collateral. generally accepted as collateral.

Corporate events have been fewer in Sweden compared with last year. We have seen a few smaller right issues such as Karo Pharma and D.Carnegie. While last year we had bigger rights issues with Getinge, Eltel and Dios Fastigheter. It is hard to say the reason behind it, but some analysts point to the stable Swedish economy as being one of the factors in giving companies the confidence to raise capital.

Hottest stocks in Sweden

Past performances may not be an indicator of what's to come. Volvo and Hennes & Mauritz (HMB) are two of the biggest companies in Sweden whose performance could not be more different over the past months. While Volvo's share price has been rising 40 percent, HMBs share price has dropped 40 percent due to the lack of development in the clothing sector and an increase in competition from other companies.

This has led to a squeeze in the HMB lending pool, and many hedge funds have, during the year, taken up a big portion of the supply as the short interest increased in the name. As to the pricing of those two names and the availability in the lending market, Volvo is being traded at general collateral levels while HMB is getting more and more special due to the lack of availability.

Fingerprint has been a widely discussed name during the year as well. It was dropped out of the OMX 30 (Sweden's large-cap index) after a turnover in its stock plummeted. It has been the most shorted company during 2017 but as share price dropped, heavily, hedge funds finally decided to leave the name.

Swedish IT-company Mycronic is at the top of the list this year of most shorted stocks in the Nordics with as much as 11.3 percent of its capital shorted, according to IHS Markit data.

Intrum Justitia is another Swedish company that is heavily shorted this year. These are a few of the hottest and most traded names in Sweden this year.

The larger shareholders or funds that lend out shares and have a long-term holding period have definitely increased this year as well.

Earning that extra money in their long positions has attracted more lenders to take part in the securities lending market.

Future

There are still a lot of questions to be answered on how and if the Swedish economy will continue its growth during the rest of the year even if it is expected to do so, according to our analysts.

These past months we have seen a renewed focus by investors on warning signs that Sweden's decade-long property boom is coming to an end and the risk of a bubble is present. The household debt and weakened Swedish Krona will have an impact on export-driven Sweden.

We have already seen an increase in shorting Swedish-listed commercial property companies and how this will develop during the rest of the year, only time will tell. **SLT**

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Christoffer Danielsson
Equity Finance Trader
SEB

Picking up the pace

Vegard Ropstad of SEB explains how momentum in the Norwegian economy has increased and explores other trends in the market

Momentum in the Norwegian economy has risen markedly and full-year growth in mainland gross domestic product (GDP) picked up to a trend-like 1.9 percent in 2017 from 1 percent in 2016. Both sentiment indicators and solid fundamentals indicate that the economic expansion is robust. The upswing in the petroleum and business cycles will provide major contributions to GDP growth, countering the negative impact of a further contraction in housing investment and less expansionary monetary policy.

A clear stabilisation in the housing market has reduced downside risk to domestic demand, and strong monthly gains since the start of 2018 have pushed existing home prices back to peak levels. Private consumption will, nonetheless, be weak by Norwegian standards as higher interest rates eventually start to bite. The strong transmission mechanism calls for a gradual hiking cycle, which the subdued inflation outlook will encourage. Norges Bank is planning to hike its key interest rate to 0.75 percent in September. The pace of rate hikes thereafter will be slow. We expect an average of two hikes yearly, with a key rate of 1.75 percent by the end of 2020.

The Norwegian krone has recovered in 2018 on the back of solid fundamentals and a hawkish shift by Norges Bank, but the krone has proven vulnerable in the context of escalating global trade frictions. The krone's often poor liquidity has amplified its recent depreciation against the euro. Solid fundamentals nonetheless remain intact. A repricing of the market's cautious expectations for Norges Bank should result in a wider interest rate spread against the eurozone. The long-term value of the Norwegian krone remains favourable.

Norwegian equity indices had an impressive global outperformance over the last year as the favourable economic backdrop overshadowed most worries in a world of noise. The OSE Benchmark Index added a solid 26.50 percent over the last twelve months, currently sitting at all-time-high. This compares well towards all global benchmarks where: S&P 500 +20.73 percent, MSCI World +15 percent, Stoxx600 +8.27 percent, MSCI Nordic +7.21 percent, MSCI Asia Pacific +6.79 percent and MSCI Emerging Markets +1.7 percent.

Beneath the OSEBX surface we find pleasure and pain. The gains are stemming from a relatively narrow group of large caps where Equinor, DNB, TGS Nopec Asa, Aker BP, Yara International, Marine Harvest, Schibsted and Telenor contribute positively with 78.4 percent of index performance. Holding the index back are negative contributions from Norsk Hydro, XXL Asa, Thin Film Electronics, Europris, Wallenius Wilhelmsen Logistics, Borr Drilling Ltd and Orkla, in sum weighing -5 percent on performance.

Overall volumes were slightly dented during the February/March transition into the second Markets in Financial Instruments Directive and the double volume caps implementation. Otherwise and not surprisingly, volumes have remained stable and muted in sympathy with the low volatility environment experienced.

Looking at the overall equity lending market in Norway, the assets in lending programmes are made available not only by major international custody programmes but also directly by a good mix of local players, even though the latter segment contribute relatively in a lesser degree than in Sweden.

The overall asset base of Norwegian equities made available for lending is roughly $41 billion, with about 10 percent on loan.

Over the course of not only the last 12 months but over the last three to four years, among the biggest revenue providers in the specials space have been Seadrill and Norwegian Air Shuttle.

The multiyear successful short of one of the world's biggest drillers, Seadrill, culminated with the company emerging from the chapter 11 process this summer. The company was in many ways the marquee short within the oil service space over a down cycle that lasted the best part of four years up until last year. Out of the numerous names in the sector that were favourite targets for short sellers—seismic companies TGS Nopec and Petroleum Geo-Services being notables, along with Fred Olsen Energy, Prosafe and Subsea, Seadrill has been the longest lasting short much due to a very complex restructuring/refinancing.

Norwegian Air Shuttle has historically been used in peer trades as it screens as an obvious short candidate on key metrics. Long Ryanair and short Norwegian has been a popular sector play. Investors have found the company overleveraged, and with increasing capital expenditure commitments in the coming years there has been uncertainty whether Norwegian will be able to secure financing.

This fear increased this spring as a bond matured and the refinancing price in the bond market was very high (the bond market was essentially closed to the company). This further led to the equity issue.

Norwegian Air Shuttle has also struggled operationally, as the extreme growth has led to growing pains such as a lack of pilots as well as problems with aircraft engines. These problems have led to poor earnings and low cash generation. Combined with the financial leverage mentioned above, this has made the short even more popular.

The turning point for the short was the equity issue followed by the bid and interest from International Consolidated Airlines Group, which many argue confirms the company's potential and asset backing. Following this, the overall short was at a multiyear low of 1.75 million shares in early May, compared to the pre-equity issue highs of eight to nine million.

However, with the increasing fuel prices and continued strong growth on long haul, there is still a large discussion on whether the company will be able to become profitable in time to avoid too much reliance on the capital markets backing. That there is still a congregation of believers on the short side is proven by the overall short doubling into midsummer of 3.7 million shares where it's since stayed. On the flipside, the sale of assets that started late August might provide some headroom and increased liquidity making the short less attractive. On top of this, the company seemed to have increased focus on cost and reported improved cost control in Q2 2018, in addition to positive traffic figures with improving yields that has led to a positive share price reaction the last few weeks.

Another name that has its merit for a mention in a Norwegian equities lending update, is XXL Asa (market capitalisation Norwegian krone 6.6 billion). Even though falling under the small/midcap banner, this shouldn't disqualify it from becoming a good revenue provider, as one of the top revenue makers Norwegian Air Shuttle comparably only has a market cap of only Norwegian krone 11.9 billion.

XXL Asa — a physical retail versus online story? The overall short position in XXL Asa has had a steady increase over the course of the last 18 months with a recent all-time high. As the case is with most companies within the retail space, the company has been, and is, vulnerable to an increased degree of online shopping. This has not yet hit XXL Asa in a big way, but the 'Amazon story' seems to be a thematic approach and backdrop to shorting large segments of retail in general. Even though not ultimately resulting in the death of physical retail, it certainly seems to be an idea that it has successfully gained traction. At the same time, more sporting goods chains have recently established and are establishing in the Nordics, making the competition even tougher.

In addition, retail in general in the Nordics are vulnerable to the higher indebtedness amongst consumers, who are showing signs of more cautious spending, and if the negative trend of falling growth and squeezed margins are not showing signs of a reversal, the end game for this short is still far away.

As sectors like oil/oil service that are cyclical by nature, are dominant in Norwegian equity indices, one can be certain that even though they are through the trough of the last down cycle, there will come a time again when focus will increase on the short side, and revenue from the lending activity of these equities yet again will rise. **SLT**

> ***There will come a time again when focus will increase on the short side, and revenue from the lending activity of these equities yet again will rise***

Vegard Ropstad
Equity finance
SEB

Vendor Profiles

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eSecLending is an independently owned financial services company providing securities financing, collateral and liquidity services, and default management solutions to institutional investors, and clearing organisations worldwide.

eSecLending is headquartered in Boston, Massachusetts and has offices in London, England and Burlington, Vermont. The company was founded in 2000 and is owned by Parthenon Capital Partners, a private equity firm based in Boston and San Francisco.

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IHS Markit, in partnership with Pirum Systems, offers an end-to-end reporting solution for securities financing transactions (SFTs), which sets an industry-wide standard, providing the foundation needed to reconcile trading activity down to the unique trade identifier and legal entity identifiers level of granularity. The SFTR solution offers participants turnkey connectivity to trade repositories. This modular solution leverages our proven track record of delivering industry-wide reporting solutions and our 11 years of partnership with the securities lending community.

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• Built-in infrastructure and relationships: Tap into the existing relationships that IHS Markit has built across the securities finance industry. Our network of data contributors, built over the last 11 years, represents $15 trillion of inventory held by over 120,000 underlying funds. We process and match over 3 million transactions daily using a reporting spec that already covers the majority of fields required by the latest draft of the SFTR legislation.

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• Future-proof compliance: Get a solution that has the flexibility to deliver transaction reporting across future legislation, which might require transaction reporting, as well as any additional transparency/risk reporting framework that could be mandated across the securities finance industry.

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IHS Markit securities finance consulting provides fully independent research to institutions already active, or considering becoming active, in the securities finance market. This includes repo, securities lending and prime brokerage activities.

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- Programme evaluation
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- Collateral reviews
- Spotlight surveys

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Lago Kapital is an independent securities finance broker based in Finland and regulated by the Finnish Financial Supervisory Authority. We are the leading equity finance broker in Finland. Our client portfolio consists of mainly institutional lenders holding a wide selection of stable positions total worth of approximately €6 billion.

We are specialised in Scandinavian and Eastern European markets. We offer flexible ways of trading to meet our clients' needs, either by traditional securities lending, repo contracts or single stock futures. We are constantly looking for new opportunities and partnerships.

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- Client service: a clear focus on delivering results and maintaining lasting relationships with our clients
- Risk management: robust risk management practices from a stable, disciplined lending agent with a history of capital strength
- Superior returns: a track record of performance, exceeding industry benchmarks in the majority of asset classes and markets in which we lend

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