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35th Annual Conference On Securities Lending
Day 3
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11 October 2018

Important innovation

OCC's Matt Wolfe discusses the firm's progress towards delivering innovation and value to the industry, and why central clearing benefits all Americans

Day three agenda inside

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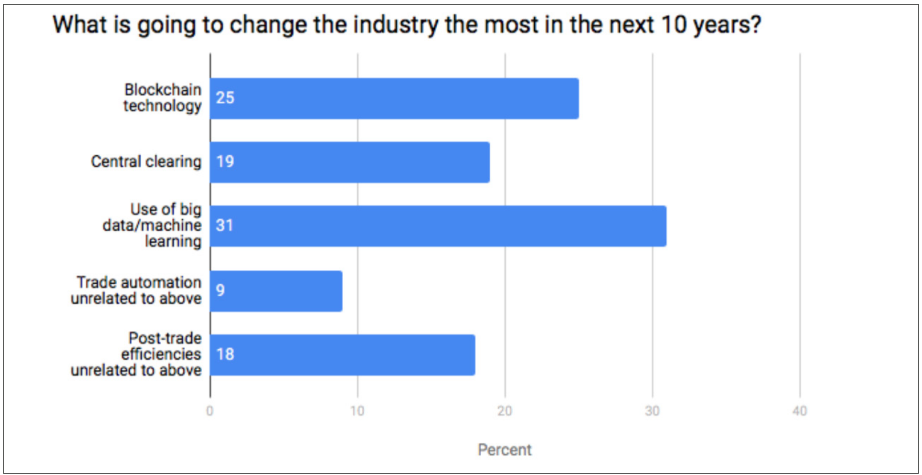
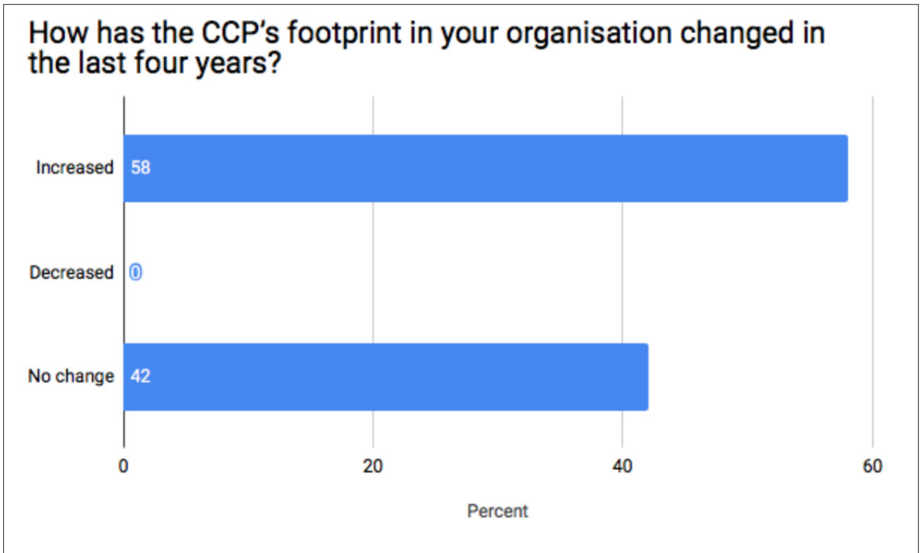
Interesting answers to interesting questions

Questions posed to attendees throughout the RMA conference have provided illuminating answers on the state of the industry



Poll one: Opinion was split at this year's RMA conference when attendees were asked what would cause the biggest disruption in the industry over the next 10 years.

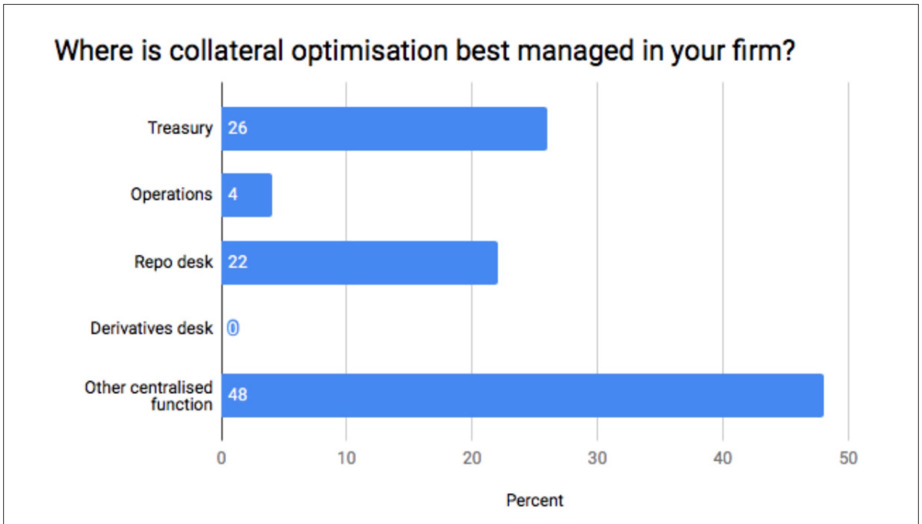
While the hype of blockchain persists, attendees at the conference chose big data and machine learning as the most disruptive, perhaps swayed by Tuesday's informative discussion on the benefits of financial technology, where panellists remarked on how firms are poised to reap great benefits from structuring and drawing insights from raw data.



Poll two: More than half of attendees answering this question saw an increase in the footprint of central counterparties (CCPs) over the last few years.

CCPs have seen a growing level of importance in recent years following the post-financial crisis reform that mandated central clearing of standardised over-the-counter derivatives.

A recent study from The Financial Stability Board, the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures, and International Organisation of Securities Commissions found that CCPs were becoming an increasingly important part of the financial system.



Poll three: Attendees believed that centralised functions are best when managing collateral optimisation. The poll, which came in a session on the evolution of the treasury function, revealed that respondents shared the views of the panellists on stage, who explained that centralised decisions ensure the entire business is working together in optimising collateral.

Live polls were accurate at the time of publication

RMA conference boasts growing female attendance

Almost 30 percent of speakers at this year's RMA Conference on Securities Lending are women, according to Tamela Merriweather, conference co-chair at the event.

In the RMA's welcome remarks, Merriweather revealed the statistic, which is a growth of nearly 20 percent over the past five years. Merriweather also revealed that 20 percent of the conference attendees are women, which is around a 5 percent rise from 2016. This year's conference has drawn in a total of 515 attendees, with nearly 50 speakers.

Women in securities finance have been in focus at the conference, with the inaugural session at the event celebrating women and their roles in the industry.

Firms shouldn't 'innovate for innovation's sake'

Firms shouldn't be innovating for innovation's sake but should look to provide solutions to problems in the industry.

A speaker, who was discussing new technology in the market, said that the industry needs to decide what technology it should be investing in. She said: "A ton of financial technology companies are popping up, but which are the right ones we need to be partnering with to take us forward?"

Another panellist discussed the rise of financial technology companies in the industry but warned that firms should be picky to ensure they get the right solution to their problem. The panellist also questioned whether firms should be developing in-house systems or working with service providers.

He said: "Do you build your own platform in-house? Do you get a platform to take you 80 percent there and then do the rest with your own intellectual property?"

With the added danger of upcoming regulations, technology is becoming more important than ever to ensure smooth transitioning, and panellists agreed that the use of big data can help to ease some of the burden brought by these regulations.

Intraday reporting could prove difficult under SFTR

Under the Securities Finance Transactions Regulation (SFTR), end of day reporting will be manageable, but intraday reporting could prove difficult.

One panellist on a session about SFTR said many things can happen throughout the lifecycle of a trade and all of these issues will have to be reported.

These concerns will “drive volume” under the reporting obligation.

Another panellist remarked on the problems that may arise from reporting on a trade that never actually happened. To avoid this, panellists said it would be important to develop ground rules for the regulation.

Industry bodies will need to develop these ground rules soon to ensure firms are prepared for SFTR, and a speaker said that they would like to see the rules adopted because “nothing will clarify the industry’s response like a deadline”.

Panellists said this was a “tall order” for associations and industry bodies, such as the International Securities Lending Association, which is currently working on guidelines.

“I think at this point we all agree we aren’t going to get more clarifications from the regulations. It’s on the industry to band together and have a consistent approach”, another panellist remarked.

Another concern raised on the panel was the issue of fees for firm’s using trade repositories (TR).

One speaker who represented a TR said that, first and foremost, it is the “industry that needs to be taken care of”.

The speaker said: “There’s definitely a lot of concern in the industry on fees. We looked at the way we price under European Market Infrastructures Regulation, which is based on a trade-based unique transaction identifier.”

“We questioned if this was a fair model under SFTR, but we don’t believe it is.”

“We’re moving to a submission based pricing model, being an industry-owned organisation, we have to effectively provide for costs and a small margin.”

Panellists were also concerned about whether European regulators could amend the regulation if they were to decide that the requirement was “too much”.

While changes are possible, one panellist said it would be difficult to adjust after implementation, due to EU regulatory constraints within the regulation’s first two years.

Speakers also discussed whether, under the reporting requirements, now was a good time to begin using a central counterparty (CCP) structure.

One panellist said the CCP structure was a good idea but warned that if securities lending revenue becomes de minimis, it might result in a shift away from physical lending to synthetic lending.

Finally, panellists discussed SFTR in the context of the Automated Loan Deposit (ALD) requirements.

Speakers observed the similarities between the two reporting requirements and questioned how the SFTR would effect ALD.

One speaker said that the requirements could “co-exist in the short to medium term”, but promoted SFTR as providing a “higher degree of granularity”.

Why central clearing is an important innovation for all Americans

OCC's Matt Wolfe discusses the firm's progress in delivering innovation and value to the US securities lending market, and why central clearing benefits all Americans

Central clearing in the securities lending industry has been a regular topic for many years. Over the past several years, the discussion among market participants has evolved from skepticism, particularly from the buy-side who viewed the majority of the benefits accruing to the dealers, to more recent conversations focused on the "when" rather than the "why". I think in many ways this is due to the successes of Eurex and Fixed Income Clearing Corporation through the introduction of buy-side clearing models.

I would like to share the progress that OCC, the world's largest equity derivatives clearing organisation, has made towards delivering similar innovation and value to the US securities lending market, and more importantly, why we believe central clearing benefits all Americans.

As of 30 September 2018, OCC's stock loan programme clears about $83 billion worth of loans for 80 different clearing members (OCC stock loan data is now available on our website, www.theocc.com). Of those clearing members, 59 percent are bank-owned with a risk weighting of 20 percent, while the remainder are broker-dealers with a risk weighting of 100 percent. Through central clearing, those 80 participants are able to substitute their counterparty's credit and risk weight for OCC's two percent risk weight. That equates to about $1.4 billion in capital savings to OCC's stock loan clearing members, allowing them to bolster their balance sheets and support other trading activities.

Currently, OCC's membership is limited to dealers who lend and borrow from each other, which is a small subset of the securities lending market. However, the vast majority of securities-lending activity is between beneficial owners, supported by their agents, and dealers. Unfortunately, this critical set of participants has never had access to central clearing for stock loans, and OCC is making progress on making that possible for the first time.

OCC, in concert with a committed group of agent lenders and dealers, is making great progress on three fronts that are currently preventing loans by beneficial owners from being centrally cleared; risk, legal, and technology.

On the risk front, we have identified a non-cash model that addresses both the commercial concerns of participants as well as a central counterparty's (CCP) obligation to ensure they have sufficient financial resources to cover likely and unlikely market conditions and losses.

To support this risk framework, OCC has worked closely with the BNY Mellon and J.P. Morgan to develop a draft set of legal agreements for custody accounts to provide equally perfected security interests for both OCC and lenders. Finally, OCC has developed requirements and will be working with technology providers to deliver robust and resilient technology solutions to support next generation needs of the securities lending market.

We believe that once successfully implemented, within a few short years we can grow those capital savings from $1.4 billion to over $5.5 billion. These significant savings will be shared amongst all participants, with OCC still only clearing about seven percent of the market.

At OCC, we feel certain that centralised clearing is vital to the health and strength of the options, futures and stock loan markets that we serve, as well as the nation as a whole through vibrant, robust, and healthy capital markets. One of OCC's core missions is stewardship; understanding our duty to build trust and ensure sound markets that serve not just our industry but the greater public interest. There are three macro-level benefits that demonstrate how central clearing does this.

The first benefit is that capital can move easily from investors to entrepreneurs and innovators. America was built by a nation of risk-takers; people with dreams and big ideas. American innovation has changed the world. Central clearing supports investors and risk-takers by giving them greater confidence to make investments and hedge their financial risks in an environment that mitigates their risk of losses due to their counterparties.

The second benefit is expanded economic participation and inclusion. Ensuring that people have access to reliable saving and investment opportunities helps to grow and strengthen our middle class. Central clearing helps to ensure that there is a sound financial market for risk-taking, investment, and hedging. Reducing counterparty risk through central clearing fosters an environment where banks can hedge their risk and lend more, and broker-dealers and investment managers can provide their clients with more and cheaper investment opportunities, which can provide consumers the opportunity to thrive.

The third benefit, and most directly connected to the need for buy-side clearing, is the ability for people to have a satisfying and secure retirement where their savings and investments are able to support them.

Secure lending programmes, where those securities can be lent out until they are needed, offer portfolio managers the opportunity to potentially provide greater wealth and security at lower costs to their clients. Cleared lending can help to support those clients by allowing more of their hard-earned assets to be lent out in a more secure manner than is possible in a bilateral market.

These three very 'human' considerations are often lost in discussions regarding regulatory capital, liquidity ratios, operational efficiency, and the like. However, they remain a motivating force for OCC's commitment to America to provide stability and market integrity through effective and efficient clearance, settlement and risk management services to help ensure the continued integrity and health of US capital markets.

What a difference a decade makes

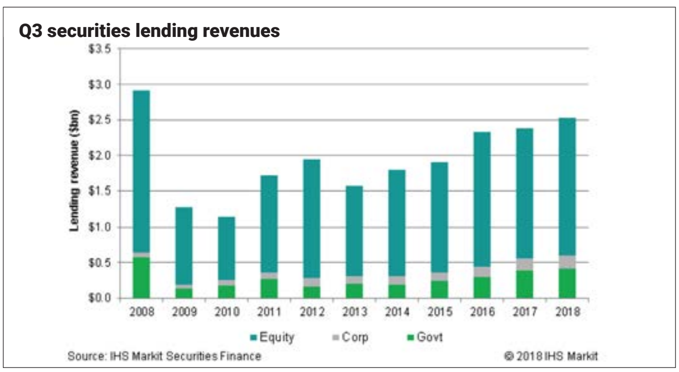
Sam Pierson of IHS Markit discusses how this year has welcomed an uptrend in lending revenues, boosted by a number of factors

Ten years ago, Q3 of 2008 delivered $2.9 billion in global securities lending revenue, a high-water mark which no Q3 has managed to equal since. However, the pickup in market volatility in 2018 (after an anemic 2017) has yielded a welcome uptrend in lending revenues this year. Extending the trend, the $2.5 billion in Q3 revenue was the most since 2008 and represents a 6 percent increase versus Q3 last year. The growth in industry revenues has been boosted this year by high quality collateral needs, increased emerging market equity demand, particularly in Asia, demand for corporate bonds and some special situations for equity lending. Adding the Q3 returns to the $5.8 billion in H1 revenues reveals that the first three quarters of this year have had the highest post-crisis securities lending revenue. For some context, that is still 27 percent lower than the first three quarters of 2008.

While demand for government bonds has increased significantly in recent years, lending revenues for government paper were 28 percent lower in the third quarter of this year compared with 2008, when extreme collateral needs boosted fees. Demand for government bonds has remained near an all-time high in 2018, just above $1 trillion. Commensurate with that, revenues have also increased—with the just over $1.3 billion earned in the first three quarters of 2018 being the highest post-crisis and 19 percent above the first three quarters of last year. While the demand for government bonds continues to increase, the rate of change has slowed over the last two quarters.

A similar story emerges for equities, with a 6 percent year-on-year growth in Q3, although the $1.8 billion in revenues was 15 percent lower than Q3 2008. Despite the rise of fixed income lending, equities still account for more than 76 percent of global lending revenue, down from 86 percent in 2014.

Asia has led the growth in equity lending revenue in recent years, with emerging markets playing an increased role this year. Asia equities delivered $563 million in Q3 lending revenue, the most for a single quarter on record; Combined with H1 revenues, the $1.5 billion total is the highest revenue recorded through the first three quarters of a year, going back to 2006. South Korea was a standout for Q3, with Celltrion delivering the most lending revenue for any security globally, as share price appreciation in the quarter did not reduce borrow demand.



A lack of specials demand limited North American lending revenues in Q3. Tesla remained in the warm space, with increased balances driving the stock's $35 million in revenues, the second highest for any security in the quarter.

In Canada, while the extreme lending fees for Tilray were much discussed, the weighted average lending fee for Cannabis stocks fell during the quarter. That largely resulted from some of the larger borrows in the space, most notably Aurora Cannabis, seeing borrow fees fall on increased share issuance.

North America equity revenues came in at $802 million, a decline of 8 percent compared with Q3 2017. An eleventh hour revenue boost came in the form of Fortive Corporation's exchange offer for it's automation business. That special situation lending opportunity drove over $19 million in revenues in the last week of the quarter for Fortive shareholders who were willing to forgo the opportunity to tender their shares.

European equities delivered $371 million in Q3, a 12 percent improvement over Q3 2017 and the most lending revenue generated in Q3 since 2012. Even better news for beneficial owners: Utilisation of lendable inventory increased in the seven of the 10 largest markets by revenue.

Interestingly, corporate bonds are the only asset class to post higher lending revenue year-to-date compared with 2008, with the $738 million in 2018 revenue nearly tripling the returns from a decade ago. That's partly a reflection of reduced broker-dealer inventories, which were a larger source of supply pre-crisis. The Q3 average global corporate bond balance of $196 billion is at the higher end of the range observed since late 2015, when credit concerns drove an uptick in demand.

> ***With demand robust across asset classes, the uptrend in revenues doesn't show any signs of slowing down as we move through Q4 2018***

This week marks the 10-year anniversary of the US Securities and Exchange Commission ending the ban on short selling of US financial stocks; the two and a half-week tenure of which saw a 40 percent reduction in US equity loan balances.

Despite the decline in revenues in the last week of Q3 2008, it retains the title of most lending revenue on record for the third quarter. That highlights a key aspect of securities lending: Revenues improve in down markets, helping to offset mark to market losses for beneficial owners.

While less extreme, the improvement in securities lending revenues this year has helped to offset declining valuations in some sectors, most welcome for emerging market investors. With demand robust across asset classes, the uptrend in revenues doesn't show any signs of slowing down as we move through Q4 2018.

securities lending times

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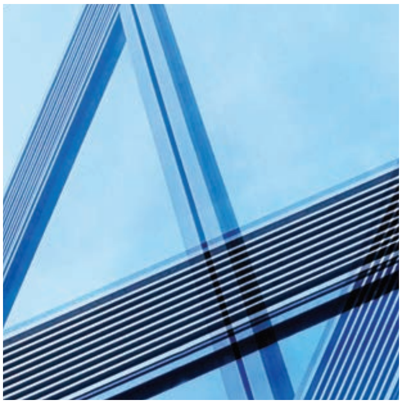
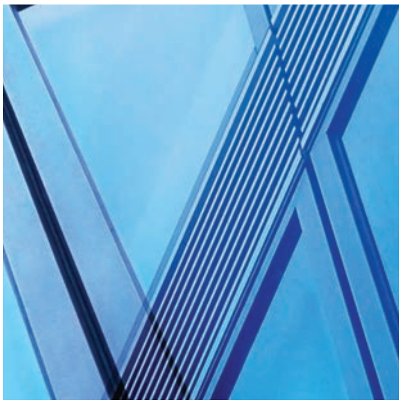
Agenda Day 3

7:30 A.M.	**Buffet Breakfast Cosponsored by:** BNP Paribas, Brown Brothers Harriman, Credit Suisse, DTCC, Natixis, Tradeweb
9:00 A.M.	**Keynote Address:Uncharted Waters: A LIBOR Transition to Alternative Reference Rates?** **Moderator:** Alexander Blanchard, Global Head of Repo Trading, Goldman Sachs **Panelist:** Ameez Nanjee, Senior Director, Asset-Liability Management, and ARRC Member, Freddie Mac Donald Sinclair, CFA, Head of Asset and Liability Management/ Capital Markets, and ARRC Member, The World Bank Sandra O'Connor, Chief Regulatory Affairs Officer and Chair of AARC, J.P. Morgan Thomas Wipf, Vice Chairman of Institutional Securities and AARC Member, Morgan Stanley
10:00 A.M.	**Cyclical and Structural Changes Around Cash Reinvestment** **Moderator:** Alex Roever, Head of US Rates & Short Duration Strategy, J.P. Morgan **Panelist:** Anthony Toscano, Managing Director, Deutsche Bank Brad Pedersen, Vice President, Asset Management, Northern Trust Guri Virdi, Managing Director, Head of Risk for Securities Lending and Reinvestment, BNY Mellon
10:45 A.M.	**Coffee Break with Exhibitors** **Cosponsored by:** ABN AMRO Clearing, CIBC, Dynex Capital, Inc. GLMX, Hanweck, Intuition Financial Placement, LLC TD Securities, Transcend Street Solutions
11:15 A.M.	**How does the U.S. Move Closer to a Comprehensive Triparty Model?** **Moderator:** Derrick Cusick, Director, Bank of America Merrill Lynch **Panelist:** Abhinav Chandra, Director, Barclays Daniel Awe, Senior Vice President, Northern Trust John Templeton, Managing Director, BNY Mellon Michael Katz, Executive Director, J.P. Morgan
12:00 P.M.	**Industry Leaders Future Outlook** **Moderator:** Jason Strofs, CFA, Managing Director, BlackRock **Panelist:** Andrea Dyson, Managing Director, Morgan Stanley Ben Challice, Managing Director, J.P. Morgan Jane Wagner, Global Head of Securties Lending, Vanguard John Stracquadanio, Managing Director, Scotiabank William Kelly, Managing Director, BNY Mellon
1:00 P.M.	**Closing Remarks and Thanks** Business Programme Adjourns for the Day
1:30 P.M.	**Golf Tournament** Courtesy of: RBC
6:30 P.M.	**Closing Reception** Courtesy of: BMO Global Asset Management Agency Lending



We clear the path

OCC has the largest centrally-cleared stock loan offering in the world with approximately $80 billion in cleared loan balances. Over the last 25 years, OCC has built an innovative and unique U.S. program for securities lending transactions where OCC steps in as the counterparty (with a two percent risk weight) and guarantees the return of stock or collateral. We continue to enhance and expand access to our stock loan program in order to offer clearing solutions and capital efficiencies for our members and the entire securities finance industry.



As the world's largest equity derivatives clearinghouse, OCC is committed to providing market participants with high quality and efficient clearing, settlement and risk management services. As a Systemically Important Financial Market Utility, we work to enhance our resiliency in order to reduce systemic risk, increase market transparency, and provide capital and collateral efficiencies for the U.S. capital markets.

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