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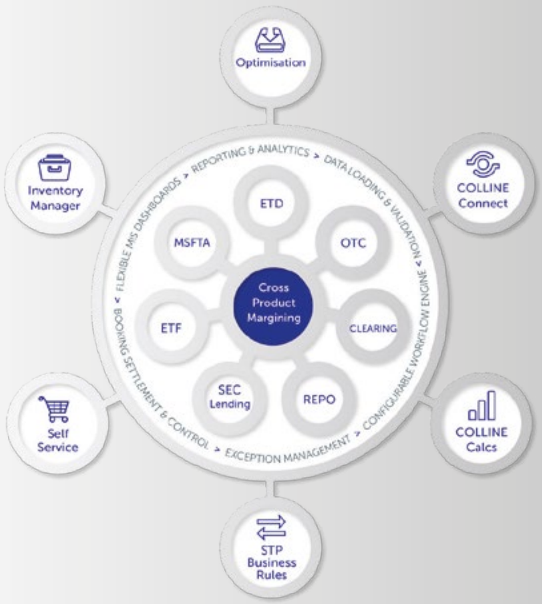

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Placing stock in the Nordics

The Nordic region’s year has been mixed, as you’ll find in the pages of this year’s dedicated handbook. Equity lending has taken a hit, much in the same way as it has elsewhere.

This, according to BNY Mellon’s analysis of IHS Markit data, is due to flatlining market volatility that has depressed demand for the shorting activity that drives the equity securities financing sector.

But it’s not all bad news for the Nordics. Beneficial owners holding core European bonds and high-quality liquid assets continue to experience healthy returns, says Northern Trust, which will be welcome news to borrowers keen to take those assets as collateral management continues to dominate the conversation. Lombard Risk provides the viewpoint on that activity.

Lago Kapital, SEB, Danske Bank and DNB provide reports on the markets of Denmark, Sweden, Norway and Finland, while IHS Markit breaks down each jurisdiction in terms of data.

As ever, if you have any feedback, don’t hesitate to get in touch via **editor@securitieslendingtimes.com.**

Mark Dugdale
Group Editor
Securities Lending Times


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Evolve and thrive

Nordic beneficial owners should consider new proposals while ensuring they match their risk and return profiles, says Northern Trust's Fiona Mitchell

What are you seeing in the Nordic securities lending markets right now?

We see greater interest than ever before in securities lending, including from organisations which have not lent before. This is being driven by the persistent low yield environment, increasing expenses, potential pension deficits, rising costs of regulatory compliance and the need to offset administration fees.

Securities lending offers the ability to generate low risk alpha and, in the current environment, this is an increasingly compelling proposition for clients with a strong investment culture. Our existing clients are expanding their programmes with the addition of new lendable assets, greater collateral flexibility, new routes to market or trade types, adding new niche borrowers and reviewing of their lending limits. However, this additional activity is being undertaken within the thoughtful and considered risk management framework and approach that we at Northern Trust provide to our clients. A feature of the Nordic markets is the collegiate approach adopted between client organisations—the extent to which our long-term securities lending participants are willing to offer their experience and share information with newer lenders.

Interest in new routes to market is also a growing trend. Beneficial owners are actively engaged in conversations around peer-to-peer lending and conduit lending. While we do not see this so frequently in the Nordics right now, it may become more prevalent in the future.

What has defined the Nordic markets over the past 12 months?

Strong equity revenue has been seen in Nordic markets from clients around the globe, largely driven by the continued returns with the key Swedish security Fingerprint Cards, a manufacturer of biometric identification technology for mobile devices. In fact, around 10 percent of all securities lending global revenue in 2016, across the industry, arose from lending three directional names: Fingerprint (Sweden), Tesla (US) and Celltrion (South Korea).

From a broader perspective, sectors that have driven significant revenue include pharmaceuticals, as this sector is facing ongoing pricing pressure and competition from both the new US administration and lower cost producers and also the oil industry is a powerful component of the Nordic economy, particularly in Norway. Sustained softness in global oil prices, relative to historical highs, has been the catalyst for continued short interest, especially in those companies involved in oil exploration and drilling. This has been driven by continued low levels of capital expenditure across the sector.

In terms of fixed income, beneficial owners holding core European bonds and high-quality liquid assets (HQLA) continue to experience healthy returns. Many Nordic clients regard the lending of these assets as part of good corporate citizenship as it provides liquidity to the market, especially given the scarcity seen over regulatory sensitive periods and due to quantitative easing programmes. This is particularly true in relation to sovereign debt of lenders' home countries. The emphasis on corporate responsibility and governance is a well-observed feature in the Nordic markets and our clients typically look to structure their programmes to ensure a certain level of voting in their domestic market.

What effect does regulation continue to have?

Regulation is a key driver in the evolution of the securities lending industry. For example, attention is now focusing on the pledge collateral model as there are regulatory capital benefits for borrowers in moving from title transfer collateral delivery to a pledge collateral structure. The central counterparty (CCP) arrangement also remains an appealing solution for borrowers from a capital standpoint, but it has been somewhat superseded by developments in the pledge collateral space. The International Securities Lending Association is working with the industry on finalising the legal documentation for pledge collateral.

UCITS clients are being particularly affected by regulations and Northern Trust is supportive of the industry's work with European Securities and Markets Authority to highlight the impact of these clients being unable to participate in term trades beyond seven days, as demand for these trades is high with attractive higher fees. Clarity is also being sought on collateral diversification rules and the ability for UCITS to potentially engage in pledge collateral and CCP transactions. We have recently been partnering with our UCITS and alternative investment fund clients to ensure the disclosure requirements for their prospectuses are met under the Securities Financing Transactions Regulation (SFTR).

Going forward, all client types will be affected by SFTR with the arrival of its reporting obligations (timetabled for 2018/2019) and this is a significant focus for the securities lending industry given the depth of the data obligations and strict reporting deadlines to designated trade repositories. Northern Trust is reviewing comprehensive reporting services to manage the required reporting on behalf of our clients.

The SFTR initiative has also prompted discussion in the borrower community around whether it would be possible to prioritise supply from clients with favourable attributes such as risk-weighted capital treatment or the net stable funding ratio (NSFR) on a pre-trade basis rather than the current post-trade basis. That said, changes under the present US administration may yet alter the regulatory landscape.

The second Markets in Financial Instruments Directive (MIFID II) and associated Regulation (MiFIR), applicable from January 2018, also affect securities lending with the aim of increasing transparency for clients, for example, on execution of transactions and costs. While there is a transaction reporting element to MIFID II, securities lending transactions are not in scope as they will be captured by SFTR.

What should Nordic beneficial owners be doing going forward?

Continue to consider new proposals—whether for different borrowers, collateral or trade types—while ensuring these opportunities align with the organisation's overall risk and return profile. Lending limits and restrictions should also be regularly reviewed to check they remain suitable and achieve their intended objective.

Northern Trust will continue to work consultatively with our beneficial owners to ensure their lending programmes evolve to meet the changing market environment and their own developing requirements.

Fiona Mitchell
Head of Nordic relationship management
capital markets
Northern Trust

Collateral considerations

Babile Keita of Lombard Risk considers collateral management in the Nordic countries and the possible trends that might arise in the future

Most people would agree that the Nordic capital markets scene is a little different from the rest of Europe. But how different is it from a collateral management perspective? Are there any common trends with the rest of Europe? What impact will global trends have on collateral management in the Nordic region?

Although the Nordic region is at the vanguard of the technology scene, and to some extent the financial technology scene, it is often viewed as being more conservative than the rest of Europe.

This especially holds true in the collateral management space for several reasons:

- The market is dominated by a small number of local players. Market participants all know each other and tend to adopt the same processes—they each require a full understanding and complete transparency before acting

- Cash collateral remains very popular. Although government debts of Nordic countries are among the most highly rated globally, the region is one where you can truly say 'cash is king'. Banks, insurers and investment houses are cash rich—and cash collateral in euro and Scandinavian currencies are still prevalent. However, factors such as the low interest rate environment, the desire to expand business and a certain amount of regulatory pressure are leading many market participants to consider new collateral asset classes

- Businesses are often still run in silos within firms. Activities such as bilateral OTC, securities lending, OTC clearing and listed derivatives for a large part of market participants in the Nordics are still run as separate business lines with limited inventory management at a firm-wide level, and minimal optimisation

- Various hosting models co-exist (internalised, outsourced or a combination thereof) depending on the type of firm and its appetite for more or less operational control

Although the Nordics differ to some extent from the rest of Europe, the region is still influenced by common trends in: the regulatory environment (margin requirements for uncleared OTC derivatives, Basel III, the Securities Financing Transactions Regulation, the second Markets in Financial Instruments Directive, and so on); market and industry initiatives; and technology innovations.

From a regulatory point of view, it is fair to say that Nordic market participants were ready for the 1 March 2017 variation margin deadline. Most of the Nordic institutions prepared in advance with the majority ready by the end of December 2016. Operationally, impact appears to have been limited with the exception from a legal perspective where organisations had to sign new credit support annexes or modify existing ones. The common feeling among institutions is that regulation will not be decreasing in the forthcoming years, however, market participants do not foresee any major impact on their current processes with the next regulatory initial margin deadlines.

In terms of technology innovations, similar to trends in Europe, there is a strong drive and appetite from Nordic market participants for further automation as many post-trade processes around collateral management are still performed manually. Financial institutions also see greater integration and connectivity with custodians, triparty agents, central counterparties and between counterparties as key to improving straight-through processing in the collateral management workflow and reducing overall costs.

Discussions around blockchain, or distributed ledger technology, and artificial intelligence, for example, are becoming more and more mainstream. But a 'technology jump' seems a bit too soon for the markets in Scandinavia (especially for the buy side) as most firms are still struggling to understand the basics around distributed ledger technology and artificial intelligence, and how these technologies will improve their daily collateral management processes and potentially reduce operational risks and costs in the future.

How about market and industry initiatives?

As artificial intelligence and distributed ledger technology are being looked at from a conceptual perspective in collateral management (and to some extent in the broader capital markets space), there have been several discussions around the concept of utilities.

Some experts believe that the best way to smooth out the regulatory burden on market participants, as well as improve straight-through processing via greater automation and connectivity, could come from a collateral management utility model.

It is true that a utility model can bring market standardisation, straight-through processing and cost reduction for the market.

However, to achieve this, the model would need to use a best-of-breed collateral management solution with the following features:

- The solution would need to break down the silos to provide a holistic view of the firm's activities and centralise its inventory management. The firm could then optimise its inventory
- Complete end-to end workflow in terms of margin call/recall/delivery/return, dispute resolution, exception management, and so on
- Real-time dashboard to segregate activities between firm locations, desks and users
- Regulatory features that enable firms to comply with current and incoming regulations in terms of eligibility rules, haircut and concentration limits, wrong way risk, trade mapping rules, initial and variation rehypothecation rights, triparty require value and grace periods
- Fully configurable set of reports with audit trail capability
- Connectivity to central counterparties, triparty agents, custodians, data providers and instant messaging capability with counterparties (replacing email and fax communications with a more near real-time channel/tool) for straight-through processing

Who could provide such model? Given the investment needed in terms of infrastructure, technology and resources to build internally, it seems only fintech companies already offering collateral management solutions, and to some extent large outsourcers or depositories—it may also be a collaboration between these resources.

A full utility model may be viewed as a little premature to many, especially in the Nordic scene given its more traditional and conservative outlook.However, there have been some attempts by fintech companies in the rest of Europe to create a utility for some part of the collateral management workflow, particularly around electronic messaging. For the most part, Nordic market participants have responded with ample interest to these developments, with some even getting onboard.

This trend will most likely continue as regulations and the historically low interest rate environment erode market participant margins, and given that technology can help market participants improve their processes and reduce costs.

However, it is safe to assume that Nordic players will be closely observing industry developments in collateral management technology in the rest of Europe as they continue to evaluate their processes, rather than acting first.

Lombard Risk's global collateral management team of experts look beyond today's requirements to deliver technology solutions that help market participants adapt as industry challenges evolve.

Babile Keita
Collateral management consultant
Lombard Risk

Bonds soar in face of slumping equities

Equity lending revenue is falling amid rampant demand from borrowers for government bonds. BNY Mellon Markets explores how securities finance participants are adjusting to this bifurcated landscape

Although there are still a few months to go at the time of writing, it seems safe to say that 2017 is not going to enter the history books as a vintage year for Nordic securities financing—at least not on the equities lending side of the market. The story in the region is much the same as that across the developed world: flatlining market volatility has depressed demand for the shorting activity that drives the equity securities financing sector.

In stark contrast, fixed income lending has enjoyed strong revenues globally so far in 2017, with Nordic beneficial owners experiencing a brisk trade from borrowers eager to get their hands on high quality government bonds.

Stephen Kiely, Europe, Middle East and Africa head of sales and relationship management for securities finance at BNY Mellon Markets in London, says: "2017 has not been the greatest year in Nordic securities financing, but the business has been steady. It's nothing to write home about either way, but I think people will acknowledge that volumes are down on last year."

Equities: Headwinds and opportunities

Market data reveals the extent of the headwinds buffeting Nordic equity securities financing markets in the first half of 2017. Denmark saw revenues drop 69 percent in Q1 relative to the same period a year earlier and dropped 54 percent year-on-year in Q2, according to data from IHS Markit.

Revenues were similarly languid in Sweden, dropping 32 percent year-on-year in Q1 and 40 percent year-on-year in Q2. The situation was somewhat better in Norway, which saw revenues inch up by 9 percent in Q1 relative to a year earlier, only to experience a 39 percent year-on-year drop in Q2 (see Table 1).

While many of the challenges facing the Nordic market stem from the prevailing lack of volatility across asset classes this year, one bright spot has been the energy and commodity sector, which dominates the equities landscape across the three Scandinavian nations.

Oil in particular has proved a strong driver of securities financing activity as crude has remained largely range-bound at between $45 and $55 per barrel. The consequent negative effect on share prices has stimulated increased shorting activity and boosted securities lending revenues in those names.

Among the Nordic energy names that have seen pronounced directional interest in response to these

Table 1: Market Data for Equity Securities Financing in Nordic Countries: Q1 and Q2 2017

	Quarterly Revenue (USD)	YoY Change	Average Balances	YoY Change	Weighted Fees	YoY Change	Average Lendable
Q1 2017							
Denmark	4,522,584.50	-69%	3,068,696,118	-19%	0.55%	0.63%	50,776,040,061
Norway	14,177,814.63	9%	2,412,345,633	-1%	2.30%	10%	24,001,272,286
Sweden	41,717,659.59	-32%	8,133,939,849	4%	2.02%	-35%	95,108,524,351
Q2 2017*							
Denmark	4,000,000	-54%	3,700,000,000	16%	0.42%	-60%	58,600,000,000
Norway	29,200,000	-39%	3,900,000,000	-11%	2.96%	-31%	24,100,000,000
Sweden	64,000,000	-40%	10,700,000,000	-6%	2.38%	-36%	104,800,000,000

Source: IHS Markit Securities Finance Quarterly Review, Q1 & Q2 2017
* In Q2 Report, IHS Markit rounded all numbers to the first decimal place. We have kept to the Q1 Report convention for consistency.

pressures are Fred Olsen Energy, Seadrill, Prosafe, BW Offshore and D/S Norden.

Kiely explains: "There are continued opportunities around specials in the Nordic oil and gas sector and particularly in companies that provide infrastructure to this sector, due to the fall in the price of oil since mid-2014. Companies in this sector continue to struggle with earnings and cut backs to investment for future projects given the current price of oil."

The past year has also seen a rash of corporate mergers and acquisitions (M&A) among energy firms in the region, providing a much-needed shot in the arm amid disquietingly placid equity markets.

M&A activity attracts the attention of short-sellers due to the fact that a differential exists between the share prices of the merging entities—one company's stock will inevitably be overvalued relative to the other. As a result, there is often investor demand to short the overvalued company and go long on the undervalued firm, driving counterparties into securities financing markets to locate shares to borrow.

Once the disparity between the merging firms disappears, investors cash out as the overvalued shares reach equilibrium with the undervalued.

Nordic energy markets have also seen oil and gas producers move away from fossil fuels and invest more in renewable energy—but uncertainty over the long-term economic feasibility of some green initiatives has also tempted short sellers to enter the space.

Finnish oil refiner Neste saw renewable fuels rise to more than 20 percent of sales at the end of 2016, from just 2.4 percent in 2010. Similarly, Denmark's DONG Energy has agreed to sell its oil and gas operations to Ineos in order to enable it to pursue plans to focus on renewable energy.

These efforts have drawn the eye of short sellers and the market for borrowing these equities has been steady throughout 2017.

Fixed Income: Regulation driving market

If volatility-driven headwinds are holding back equities, regulatory-driven tailwinds are bolstering Nordic fixed income securities financing.

The first half of 2017 proved a bull market for the lending of government bonds, with global quarterly revenues climbing 25 percent to $388 million and weighted average fees climbing 35 percent, according to data from IHS Market.

One of the fundamental drivers propelling fixed income lending has been mounting global demand among financial services firms for high-quality liquidity assets (HQLA).

Under the Basel III framework, broker-dealers have to meet certain capital and liquidity requirements to demonstrate that are able to consistently fund themselves during stressed conditions.

The liquidity coverage ratio (LCR) requires banks to be able to fund themselves for up to 30 days, while the longer-term net stable funding ratio (NSFR) requires them to maintain funding resources for up to a year.

These liquidity and funding requirements have created huge demand for HQLA such as sovereign bonds, which in turn has translated into a booming business for beneficial owners in the Nordics only too happy to collect yield by lending out their corporate bonds.

Kiely explains: "The fixed income market is having a very good time this year for several reasons. Government bonds are at historically high prices, more securities are being required as HQLA to post as collateral, government bonds are viewed as the next best asset to cash, and these securities attract a better risk-weighted asset balance sheet treatment than other assets."

The situation for fixed income lending is somewhat unique in the Nordic market given the limited bond issuance that local governments engage in—preferring to fund public obligations through taxation and revenues generated by the region's considerable natural resources.

For Nordic beneficial owners, this means that in addition to inventories of Danish, Swedish and Norwegian debt securities, their fixed income portfolios are also comprised of extensive holdings of US treasuries, gilts, German bonds and other highly-rated government bonds to support liability-driven strategies favoured by pension funds and insurance companies.

These inventories leave beneficial owners well positioned to take advantage of the considerable international appetite for sovereign securities to meet HQLA obligations, ranging from mandatory central clearing of OTC derivatives and other instruments, to the ongoing phase-in of margin rules for non-cleared derivatives trades.

The economics of lending out these bonds on a secured basis have only become more attractive as falling yields on longer-dated US treasuries and other highly-rated government securities have driven up bond prices.

This has made the outright purchase of such securities less appealing relative to borrowing the paper through the repo and securities financing markets.

"If you are a beneficial owner sitting on government bonds, you don't want to sell them but the yield is dropping," Kiely says.

"One simple way that investors can gather incremental yield is to lend those assets out, which is why we see more holders of sovereign bond portfolios willing to utilise the repo market."

"The fee to borrow those bonds is going up as bond prices have gone up and since buying bonds outright is very expensive right now, if you only need access to these assets on a short-term basis, the securities lending markets are the easiest way to access them."

The year has also witnessed steady demand for the upgrade trade in which borrowers pledge equities in order to borrow HQLA eligible bonds.

The upgrade sees the exchange of borrowers' equities for highly-rated government bonds that attract a more favourable risk-weighted asset treatment, potentially freeing up additional capital for the borrower.

Another element driving up eurozone government bond prices is a relative scarcity of supply arising from central bank policies such as quantitative easing, which has taken a significant portion of highly-rated government bonds out of the market.

According to IHS Markit's Q2 2017 Securities Finance Quarterly Review: "European government bonds drove [revenue] results forward over the quarter, but by a relatively tame 15 percent."

"This number was largely driven by better pricing power as the ongoing European Central Bank (ECB) quantitative easing has created a shortage of HQLA across the region."

The other notable trend seen across the Nordics and Europe generally in the past year has been the continuing shift away from overnight lending into term borrowing. Whereas as recently as five years ago as much as 95 percent of securities lending took place overnight, today BNY Mellon estimates that the proportion of overnight lending has fallen to just 25 percent of the market.

The remainder of the market is now occupied by lending varying in duration from one week out to as much as three months, although in recent quarters the duration has come in somewhat and the majority of term trades are focusing on a one-month to two-month tenor.

Regulation is once again the driver behind this trend, with the LCR and NSFR prompting borrowers to demonstrate that they can shore up stable funding for a defined period.

So far, 2017 has been a game of two halves in Nordic securities financing: challenging conditions in an equities market bereft of volatility, while the fixed income business continues to skate along at a healthy clip.

With mounting expectations that equity markets are overdue a correction, and amid the expected start of quantitative easing tapering by the US Federal Reserve and the ECB, market participants have many fundamentals to keep their eyes on as we enter the run in to the end of the year.

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

Total Daily Return: $9.6 million (61 percent decrease year over year)

Average Value on Loan: $5.28 billion (5 percent increase year over year)

Weighted Fee: 0.5 percent (63 percent decrease year over year)

Lendable Inventory: $55.98 billion (3 percent increase year over year)

Finland

All currencies USD

Total Daily Return: $35.5 million (46 percent decrease year over year)

Average Value on Loan: $5.24 billion (25 percent decrease year over year)

Weighted Fee: 1.8 percent (22 percent decrease year over year)

Lendable Inventory: $32.54 billion (9 percent increase year over year)

Norway

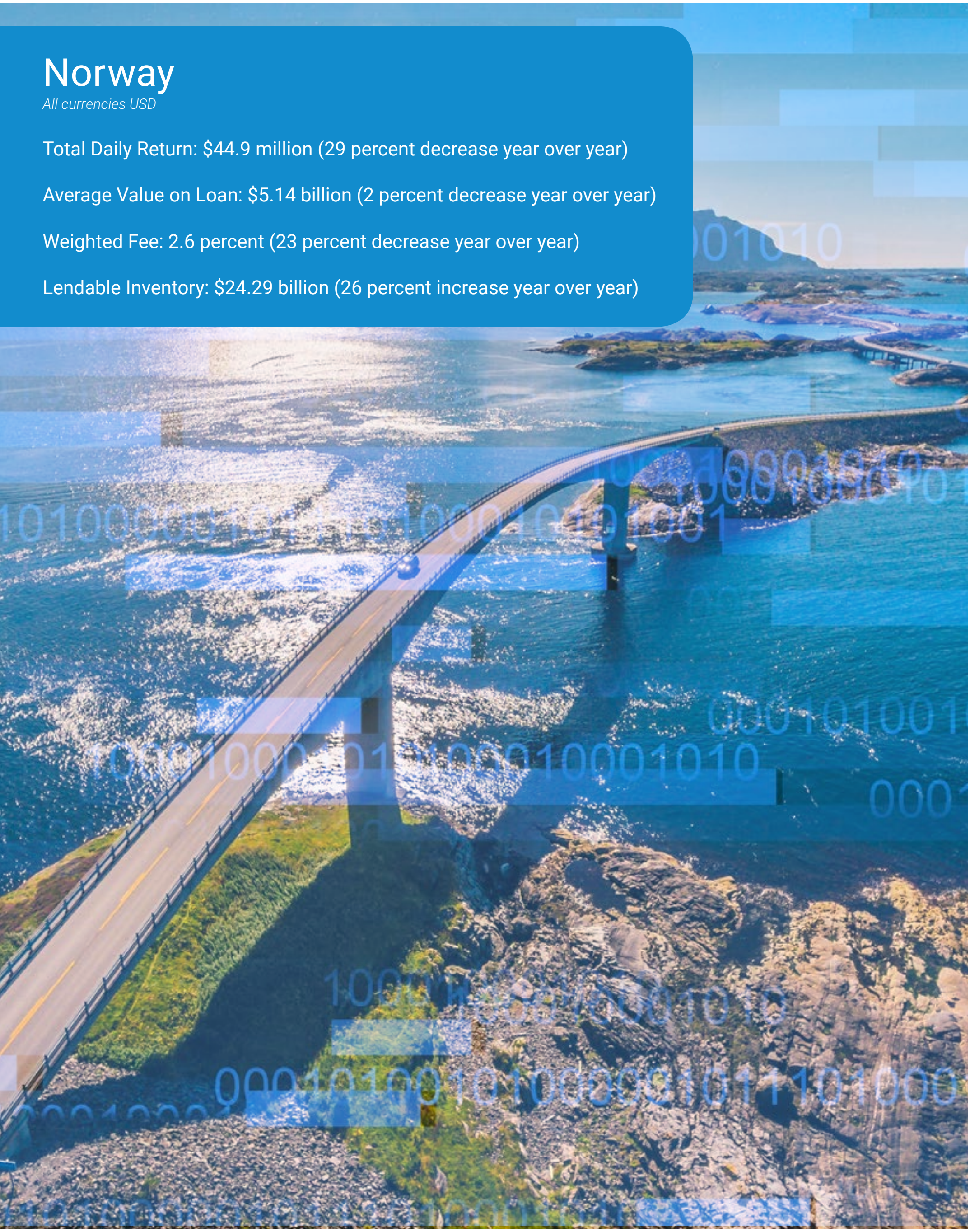
All currencies USD

Total Daily Return: $44.9 million (29 percent decrease year over year)

Average Value on Loan: $5.14 billion (2 percent decrease year over year)

Weighted Fee: 2.6 percent (23 percent decrease year over year)

Lendable Inventory: $24.29 billion (26 percent increase year over year)



Sweden

All currencies USD

Total Daily Return: $110.5 million (38 percent decrease year over year)

Average Value on Loan: $15.03 billion (9 percent increase year over year)

Weighted Fee: 2 percent (38 percent decrease year over year)

Lendable Inventory: $101.79 billion (24 percent increase year over year)

Top Nordic Specials

Instrument	Ticker	Sector	Year to Date Revenue (USD)	Year over Year Change from 2016
Nordea Bank	NDA SEK	Banks	$15.8 million	-3.3 percent
Fingerprint Cards	FING B	Technology Hardware & Equipment	$13 million	-32.5 percent
Sampo	SAMPO	Insurance	$9.8 million	-2.7 percent
Statoil	STL	Insurance	$9.6 million	-2.4 percent
Swedbank	SWED A	Banks	$8 million	-1.3 percent
DNB	DNB	Banks	$6.9 million	-3 percent
Svenska Handelsbanken	SHB A	Banks	$6 million	-2.2 percent
Seadrill	SDRL	Energy	$5.9 million	-1.3 percent
SEB	SEB A	Banks	$5.7 million	-3.3 percent
H & M Hennes & Mauritz	HM B	Retailing	$5.1 million	-3.8 percent

Fundamental potential

Demand in Denmark will continue to concentrate in a select number of names with cross-border exposure and a focus on fundamentals, writes Dan Murphy of SEB Markets

In 2016, the Danish economy grew by around 1.3 percent, a little above expectations and the upward momentum is expected to continue through 2017 and into 2018 as global demand increases and domestic headwinds fade.

One such headwind has been in the financial sector with households facing a tightening of credit standards affecting private consumption, consumer sentiment, credit creation and the housing market.

Slower income growth, rising inflation and the tougher credit standards imply that private consumption in 2017 will most likely still face the headwind, with consumer spending growing but at a slower rate than otherwise.

Based on a favourable outlook for Denmark's trading partners, the export market looks positive.

SEB analysts expect an acceleration in exports from 1.8 percent in 2016 to 4.7 percent in 2017, giving a strong contribution to GDP growth this year.

Export-oriented sectors have seen more upbeat sentiment in recent months compared to domestically-oriented retail and service sectors.

Analysts note that unemployment at 6.5 percent is high, industrial capacity utilisation is low and wages are likely to grow at less than 2 percent annually.

Inflation levels in Denmark are expected to be in line with eurozone forecasts.

Current account surplus is expected to remain historically high at around 7 percent of GDP given the strong export situation versus limited domestic imbalances. The Danish krone (DKK) is also expected to remain strong over 2017.

How has the Danish stock lending market looked over 2017?

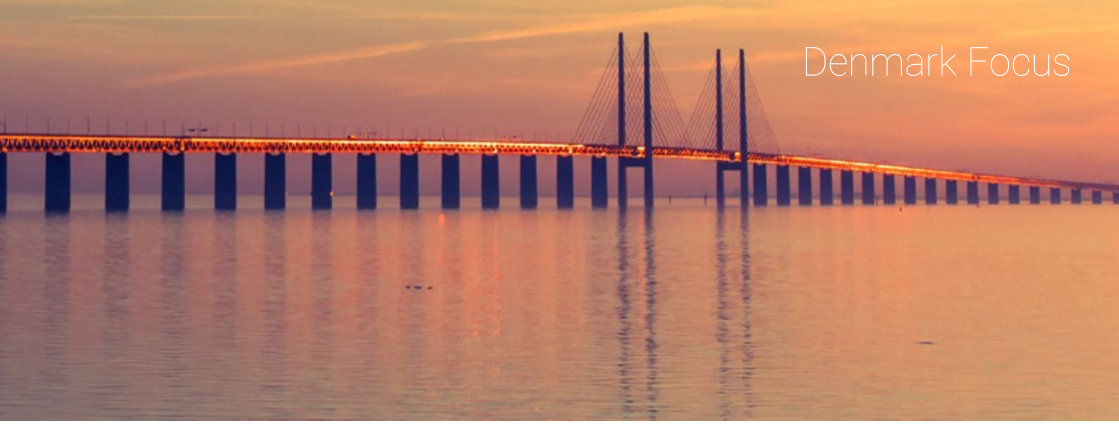
With around $50 billion worth of Danish equities in lending programmes, Denmark certainly has decent supply to offer the market. However, given that the Danish capital markets are often classified as a mainly fixed income-based market, the $3.6 billion of Danish government bonds that actually enter the securities lending world feels relatively small when compared to the eurozone, implying asset managers are either less keen to lend out bonds or, more than likely, the assets are used in, for example, the repo market and not included in the sampled figures. Alternatively, there may not be the natural demand for those Danish bonds within the securities lending market.

The assets found in the lending programmes are also dominated by the holdings in the major international custody programmes rather than directly from local players that have traditionally been less active in the stock lending market (outside of their custody programme participation).

This is a trend that we have started to see a change in though, with more clarity and transparency in the market drawing in portfolio managers who may have previously seen the market as too opaque and the potential earnings on equity portfolios as being too low.

Utilisation in the equity market shows that while there is good supply, the utilisation levels are relatively low when compared to those of their Nordic neighbours.

With a range of around 8 to 10 percent utilisation, this is, however, above the average lending pool utilisations across the eurozone, which currently land under 5 percent according to published data.



The largest part of the on-loan equity balance is from names in the main index (around 80 percent) with the remainder small and midcaps.

The largest on loan balances are in the healthcare and pharmaceuticals sector with significant on-loan balances in names such as Novo Nordisk, Coloplast, Lundbeck, William Demant and Genmab. This reflects the sector weighting of the all-share index, with healthcare representing more than 35 percent of the constituents. Industrials (25 percent) and Financials (15 percent) help complete the biggest part of the distribution.

Speaking as the largest Nordic prime broker, SEB sees a fairly broad spectrum of hedge funds active in Danish names, never really more than a handful in each name, but with significant positions in terms of the total flagged shorts. One can note that some names attract only one hedge fund with a position requiring flagging, so the interest can be fairly individual.

In terms of published shorts in the Danish market, Pandora tops the table with around $650 million in flagged shorts at the time of writing, more than double the size of the next biggest name, Novozymes, with around $260 million in value.

Pandora is a name that is familiar to both borrowers and lenders, with hedge funds building short positions on the back of earnings below consensus estimates. More than 11 percent of the free float is now being shorted, according to published data. This is a stark contrast to a year ago when the stock had returned to a low quantity on loan and corresponding low published short positions. It is an interesting case where hedge funds took a completely opposite stance to analysts who were generally advising clients to buy the stock. The challenging US market for the company seems to be the main reason behind the hedge fund's continued short interest. The value of the company has plummeted around 30 percent since the start of the year.

Vestas Wind ($260 million) and Ambu ($114 million) also have significant flagged short positions. Vestas is another name generally liked by the analysts, but shorted by hedge funds.

The renewable energy sector has generally seen a decent amount of short interest over recent times. Ambu, in the health sector, has had a rollercoaster pattern of outstanding shares on loan over the last two year, peaking in April of this year.

In terms of what the future holds for lending activity in Denmark, it is likely that demand will continue to be concentrated in a select number of names with cross-border exposure and a focus on fundamentals. Hopefully, we will see the trend continue and local players will become more active in the securities lending market, which would see some more niche holdings open up for lending.

Dan Murphy
Head of equity finance
SEB Markets

Securities finessing

Lago Kapital’s Jani Koskell discusses the current climate in Finland

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

Liquidity has improved a lot as more and more lenders join securities lending programmes. We have also been very active in bringing second-tier fund companies and institutional investment companies into the market, which has also contributed to larger availabilities.

Having said that, you can never have enough availability if a stock gets special.

The availability has improved in all Nordic countries. Norway is a perfect example of where almost every single stock used to be special 10 years ago, but now I would consider it to be a very liquid market these days.

We also see that lenders are opening their bond portfolios for lending, but unfortunately, we have not seen that much demand for bonds issued by Finnish corporates.

There would be a lot of demand for Finnish government bonds but none of our clients are holding those anymore.

What is the average fee range in Finland?

General collateral stocks are still around 20 to 25 basis points (bps) so we do not see that much change there.

Financing trades are also becoming more and more popular so a lot of general collateral loans are now booked as financing trades.

Illiquid names tend to get hot a bit too easily so we still have some work to do there.

One of the biggest challenges is to convince investors to lend out their general collateral holdings and not only the special ones.

Is Finland still following Sweden’s lead in financial sectors such as securities lending?

We are still behind when it comes to volumes but Finnish investors are more active in more exotic markets such as Russia, Turkey and Poland. Asia is also becoming more and more active.

The use of alternative ways to lend securities, such as single stock futures, swaps and financing trades, are also becoming increasingly popular.

Finland's close ties to the Russian economy had negatively affected its securities lending market in the past. Has this situation now improved or deteriorated further?

It affected the lending of Russian securities and we can still see a drop in volumes due to sanctions. On the other hand, all Russian local securities held by Finnish fund companies are regarded as very hot and somewhat more 'secure'.

How has Lago's place in the Finnish market developed?

We are still the only broker-dealer based in Finland. Swedish banks are active in the Finnish market but I would say we have a totally different client base. There might be some overlap every now and then but this has never caused any problems. We are mostly approaching smaller fund companies and investment firms that would probably not be interesting to larger banks.

We have also entered non-traditional markets where the Swedish banks are not that active. One example being the Hong Kong markets where our Finnish version of the global master securities lending agreement has been approved by the local tax authorities.

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

We have several lenders that only lend out their international holdings as their international holdings are more stable and they very seldom participate in annual general meetings.

The fact that most of our lenders prefer the cash option in a scrip dividend makes their availability even more attractive.

Jani Koskell
Founding partner
Lago Kapital

A tale of two Nordics

Denmark and Norway best reflect how the Nordic lending markets work. Danske Bank equity finance trader Christopher Kandimaa examines both

The Nordic stock markets of Sweden, Denmark, Norway, Finland and Iceland differ in structure and composition. Historically, Denmark and Norway have focused on debt financing while Sweden and Finland have been more prone to equity financing.

Despite the fact that the major exchanges, with the exception of Oslo, are owned by Nasdaq, the Nordic markets remain fairly fragmented with only a handful of companies dual-listed. The existence of four local currencies in addition to Finland using the euro is one explanatory factor. It is also a challenge to keep these markets liquid and relevant to investors as further integration takes place in the eurozone capital markets.

The securities lending market is in many ways a reflection of the cash market, with the larger Nordic banks acting as the go-between for local agents. Demand stems from the local bank's brokers, investment companies and asset managers, as well as the international market dominated by the larger investment banks, custodians and prime brokers.

Denmark and Norway illuminate best the differences and similarities in the Nordic countries, and in many ways reflect how the local cash and securities lending markets work.

The three top index names in Denmark and Norway make up close to 50 percent of the main indices, KFX 20 and OBX 25. Outside the five-to-six largest names, liquidity in the cash market tends to fall rather sharply.

A similar situation is also reflected in the stock loan market where shares quickly move into the special segment due to lack of stable supply and a solid base of lenders.

From an ownership perspective, one cross-border similarity between Denmark and Norway is that many listed companies are effectively controlled by one funding family, foundation or investment company that takes an active role in their management.

Denmark

Historically the smallest of the local equities markets, Denmark has grown in size, particularly on the back of its pharmaceutical industry, to become home to the largest company by market capitalisation in the Nordics, Novo Nordisk, which currently makes up about 29.4 percent of the KFX 20.

The local market participants and main suppliers of stocks for lending are fairly few and concentrated among the larger Nordic banks that are all active locally in Denmark. Much of the general collateral supply comes from some of the larger Nordic asset managers, government pension schemes and international pension funds via the international custodians. Small and midcap specials tend to come from local market participants, investment companies and hedge funds.

There is a bit of a blank spot among the local mid-sized asset managers that have been visibly absent from the local lending market in comparison to other European markets. While there has been pick-up in local lenders during the past few years, it is still a fairly undeveloped market. It is worth noting that equities make up a smaller proportion of the local funds' assets under management, which are still dominated by fixed income instruments.

Some structural changes were made in Denmark a few years ago to enable local lenders to enter the market. In particular, changes were made to the tax legislation, as previously lenders were forced to book stock loans as repo transactions and recall assets regularly to avoid lent assets being classified as disposed/sold and triggering capital gains tax. Despite these changes, local mid-sized asset managers have been hesitant to enter the securities lending market, despite yields in the midcap sector being fairly attractive.

The local market for mutual funds is dominated by the tax-favoured UCITS set-up. Most of these funds are also listed and actively traded on the local exchange. This market is almost fully controlled by local market participants.

The majority of the demand side for Danish stock loans, meanwhile, comes from overseas, driven by Nordic banks and prime brokers.

The absence of local market makers, brokers and hedge funds can explain some of the hesitation among the local asset managers to engage in the securities lending market as there is definitely a knowledge gap in regard to how the market works and its positive impact on liquidity.

The apparent lack of supply from these mid-sized local lenders is the reason behind the liquidity issues in the market, where shortages are frequent, especially in regard to corporate action events. One notable side effect is the difficulty in composing and pricing fully weighted short index baskets.

It is reasonable to assume that the current market conditions will prevail for some time to come as there are few new local participants entering the market and the local Danish investment fund industry continues, with a few exceptions, to stay out of the lending market. One factor that could have a positive impact is the growth of plain vanilla index funds in the surrounding Nordic countries where some also offer Danish index exposure. Most are not locally registered funds, but they tend to be open to participating in lending programmes.

Norway

Like in Denmark, the Oslo Stock Exchange is dominated by a few companies making up around 50 percent of the index. Rather than pharma, the major sector is oil, gas and shipping. Given the sector's exposure over the past two years, many of the components have traded at distressed levels with a fair amount of recapitalisation issues to shore up balance sheets.

One thing that separates the Norwegian market from its Nordic peers is the lack of mid-sized local asset managers. Norway is made up of a few very big ones and lots of smaller agents. In contrast to Denmark, Norway has a very active broker market, driven by active investment companies and active owners. Due the sector composition, there is a fair number of overseas holders as well as dual-listed companies.

A lack of lenders has had an adverse effect on liquidity locally outside the three-to-five largest index names, but for lack of mid-sized funds rather than an reluctance to participate in lending programmes. The big difference to Denmark is that this supply shortage is in some way offset by the general demand for leverage among many of the investment companies, which in turn often post hard-to-borrow as well as general collateral names as collateral. The local Norwegian market is vibrant with a lot of local participants adding liquidity together with usual suspects the major Nordic banks and international custodians. Sector exposure also attracts a large number of international market participants and specialist brokers. In a comparison to Denmark, the Norwegian market is generally more liquid on the supply side, although lot of the securities have been trading at special rates due to macro events in certain sectors.

Demand side is driven by both local and international participants. Many local trading-intensive investment companies and family offices are not adverse to using gearing/leverage in their strategies. Internationally, prime brokers dominate demand, mostly due to sector exposure and recent corporate actions activity that have benefited both long/short strategies and event-driven arbitrage. It is reasonable to assume that this trend will continue for some time, which will further ease up securities lending liquidity in Norway. One of the big issues from an international perspective is the lack of transparency and visibility among some of the investment companies when it comes to recapitalisation and other corporate actions.

Swing high

Dan Eneroth of SEB reports on the trends at play in the Swedish market

The Swedish economy grew rapidly over the past 12 months. Stronger sentiment, hard production data and support from the labour market indicated GDP growth well above trend and consensus. This growth was, to a large extent, explained by the need for housing, public services and industrial production that has been favoured by an increase in international demand and a relatively weak Swedish krona (SEK). The SEK bridged over into 2017 trading at historically weak levels due to the Swedish central bank's (Riksbank) monetary policy over recent years, which has placed Sweden among the group of countries applying negative repo rates.

Since those early months of 2017, however, the SEK strengthened versus the euro (EUR) and dollar (USD) following an increasingly more hawkish Riksbank, making SEB predict a somewhat earlier rate hike than what the official repo rate path suggests. We believe the Riksbank will need to adjust its growth and employment forecasts upwards.

An approaching Riksbank policy shift was singled out as the most important factor of SEK purchases by market participants in a recent SEB Kronsyn survey. The same survey showed that even if companies had taken steps to position themselves towards currency appreciation, exposure is still high versus foreign currencies among Swedish firms and institutions.

Foreign exchange (FX) exposure could become very important to track going forward. It would be net negative for Swedish companies with further appreciation versus, for example the USD, which is why analysts have turned their focus towards chair Janet Yellen and the US Federal Reserve, in a bid to estimate the effect of an American rate hike on the Swedish market.

We predicted (as of August 2017) that should the SEK be 10 percent stronger against the USD and EUR, companies that would suffer negatively on their 2018 pre-tax profit (revision by -10 percent to -50 percent) would include: Ericsson, SCA, Holmen, Fingerprint Cards, Elekta, Sandvik and Haldex. On the contrary, companies that would see a positive effect on profit would include: Qliro, Mekonomen, H & M Hennes & Mauritz and SSAB.

Taking into account the foreign exchange movements seen over the summer of 2017, the OMX went down slightly when measured in EUR, but at the same time, a few percent higher when measured in regards to USD depreciation. FX aside, our macro models indicated an equity market moving sideways with a small negative tilt for the autumn as we saw a decline in momentum of global growth.

Turning to equity lending, public data showed that Sweden still holds the top position in regards to market size, with roughly USD 13 billion of assets on loan and an overall available asset base just shy of USD 90 billion. The Swedish market has gradually seen an increase in shares on loan from the yearly low of USD 11 billion in early 2017.

Looking at the sector distribution of Swedish loans based on value on loan versus the equity market cap, one sector stood out: healthcare. Getinge was in the very start of a SEK 4.3 billion (USD 534 million) rights issue, making any directional loan data rather diluted towards the expectation build-up for the event, which pushed the value of loans to more than 20 percent of Getinge's market cap. Healthcare aside, the other biggest sectors on loan based on value towards market cap were retail and tech.

Market data showed that the main contributor of the retail sector was H & M Hennes & Mauritz, which represented roughly 7.5 percent of market cap, or around 130 million shares on loan. H & M Hennes & Mauritz saw a long period of increased demand for loans. Yet, H & M Hennes & Mauritz still traded around general collateral levels, meaning the name is easy to borrow and trades at a low fee. Two names comes to mind when breaking out the main sector contributors in tech and which hold the biggest overall contribution within the sector in regards to value on loan versus market cap: Ericsson and

Fingerprint. Both are names we have identified as potential negative revisions if the SEK would strengthen further versus the USD. Ericsson has seen a steep increase of shares on loans over the past year, with loan balances almost quadrupling up to 200 million shares or around 6.5 percent of the market cap.

Fingerprint should not come as any surprise to anyone who has been following the Swedish market in recent years. Short interest has not picked off as yet, despite trading into double digit lending fees for more than four years, making it one of the best earners for beneficial owners lending equity in recent history. The number of Fingerprint shares on loan was close to 50 million, with an extremely high utilisation in the market and a value on loan of just over 15 percent versus market cap, according to public filings.

We have seen an active year in regards to corporate actions. SEB, holding the position of the leading Nordic prime broker, has been active in facilitating clients in regards to hedging and execution for the majority of Scandinavian rights issues and other event names throughout the year.

Starting off in late 2016 and focusing solely on rights issues, we have seen nine events of interest with varying results. We would place the following securities on the podium in regards to relative arbitrage performance: Tobii, VBG Group, Eltel and Probi all traded at positive spreads and returned good oversubscriptions.

Runner-up goes to Plazer Fastigheter, which traded at a nice spread, rights versus ordinary share line, but ended up with a poor result on the oversubscription. Tele 2 and Kungsleden both traded at negative spreads but managed to deliver great oversubscriptions.

Our final two cases are Dios Fastigheter and Aligmak Group, which finish last in the group as hugely disappointing events, both in regards to arbitrage spread and oversubscription. Our view is that both events were rather crowded as there was good availability of stock loans in relation to cash market liquidity putting pressure on spreads, along with higher than expected subscription participation.

As to what lies ahead, there are some interesting cases to pursue on the equity short side as fundamental share data is being increasingly challenged by the price effect caused by FX. On the flipside, geopolitical tension will have a continued effect on appetite for risk and even though the Volatility Index has risen since its July 2017 low, there is still some way to go towards the long-term average affecting the size of short-side demand.

Swedish public finances remain strong much due to support and expansion in the tax base in regards to employment, construction and spending. Numbers that, while leading us into an election year in 2018 and that should support an expansionary fiscal policy, will turn to a balancing act—having to appear responsible at the same time as presenting an aggressive election budget.

Even if many indicators point towards an autumn of equities going sideways, there are potential triggers that could get some price swings in motion.

Dan Eneroth
Equity finance trader
SEB Markets

The importance of being Nordic

The Norwegian market is yet to take up the mantle of non-cash collateral, as Dag Rudilokken and Karin Tell Aronsen of DNB explain

Activity in the Norwegian market in 2017 has increased thanks to the strong gains and high activity achieved in 2016. The market's already high volumes were given an extra boost in the past 12 months. International risk appetite for small/midcap names is still the flavour of the day, followed by the more general collateral daily business. Foreign participants differ from domestic participants in their tendency to borrow a wider range of names while domestic clients tend to focus on particular companies.

The biggest change seen in 2017 was the further increase on the supply side, mainly facilitated by the rule changes for mutual funds the summer before. However, this has attracted both lenders and borrowers of all kinds to the market as they see steady supply benefitting the marketplace.

DNB's location in Oslo attracts clients not only in Norway but also in the rest of the Nordic region and gives us a good opportunity for further expansion. DNB's securities lending desk has the full support of the bank and access to the many opportunities that being part of a large organisation affords.

We have a deep appreciation for the importance of having a local presence in order to effectively serve our clients with accurate information about relevant occurrences in companies.

The Oslo Stock Exchange is strong, especially among companies in the energy, shipping and seafood sectors. This attracts international demand for capital and liquidity for these shares. In the wider market, a sustained period of volatility, not only in Norway but across the Nordic region, has attracted market participants. As long as this volatility continues, opportunities are to be found and there will be extra revenue available for both borrowers and lenders.

DNB has a unique opportunity to benefit from the increased trading in these companies and we have access to lendable portfolios with a broad variety of securities. One of our main goals is to try to achieve stable supply to a broad range of securities, especially small and midcap names.

Norway or the highway

The introduction of EU regulations will inevitably affect the economics of securities lending. Will the industry absorb the additional cost or are we in for a change? This challenge is still very much in focus. Without a move in fees associated with low margin general collateral names, it could soon become uneconomical for providers to offer them. The question is: who will be the first to put their head above the parapet and shift their pricing, or will there be other solutions? One issue is the increased focus on balance sheet. Many borrowers are already seeking to cover much of their needs for general collateral shares via swaps. This trend is likely to continue and emphasises the importance of using flexibility in the products available.

Whatever changes we are facing it is certain that Norway will follow the EU's lead as it has always done. Being a younger marketplace allows Norway to be more agile and adapt quicker to the changing regulatory standards coming from the EU.

Collateral royale

We have seen an increased number of clients, both domestic and foreign, borrowing Norwegian stocks. This positive development, with an increasing number of transactions, raises demand for automation. Internationally, this has been a hot topic for years and there are solutions many are taking advantage of already. We are also developing our own solutions for local clients to put us in a better position to handle their increased number of transactions. We will continue to focus on delivering post-trade services with high quality. Given the additional cost associated with regulations, clients don't need penalty fees for fail trades on top. The ability to provide a strong post-trade service will be a competitive advantage. For local clients, the benefits of a simple integrated solution—encompassing elements such as reporting—are especially useful. Clients will seek quality in this area and demand continued focus on automation.

In recent years, one of the main issues in securities lending has been non-cash collateral. We expected an increased focus on this in Norway, but as a traditionally cash collateral market, the change have taken longer than expected. We are now finally seeing this coming to our market, along with demand for collateral trades. We believe there are several reasons why we see this coming at this point in time.

First, there are negative interest rates in several currencies that reduce the appetite to use cash. We also see new lenders entering the market and many of them find it easier to use non-cash collateral. Due to the increased interest in non-cash collateral, we now see more participants looking to do high-quality liquid asset trades.

Seafood and borrow it

Recently, the most attractive names connected to securities lending were from the energy sector. Many of those stocks have stabilised at somewhat higher than general collateral levels.

With ongoing volatility in the price of oil, fees will also be subject to significant swings for the foreseeable future. Increasing fees, together with local regulatory changes, have also helped to bring more local lenders to the market. In addition to the energy sector, there is demand for equities connected to the seafood sector.

There are several seafood companies included in the OBX Index. In 2016, the Oslo Stock Exchange established a seafood index, which increased interest in the sector and we believe this interest will strengthen during the 12 months.

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Lago Kapital Ltd 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.

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