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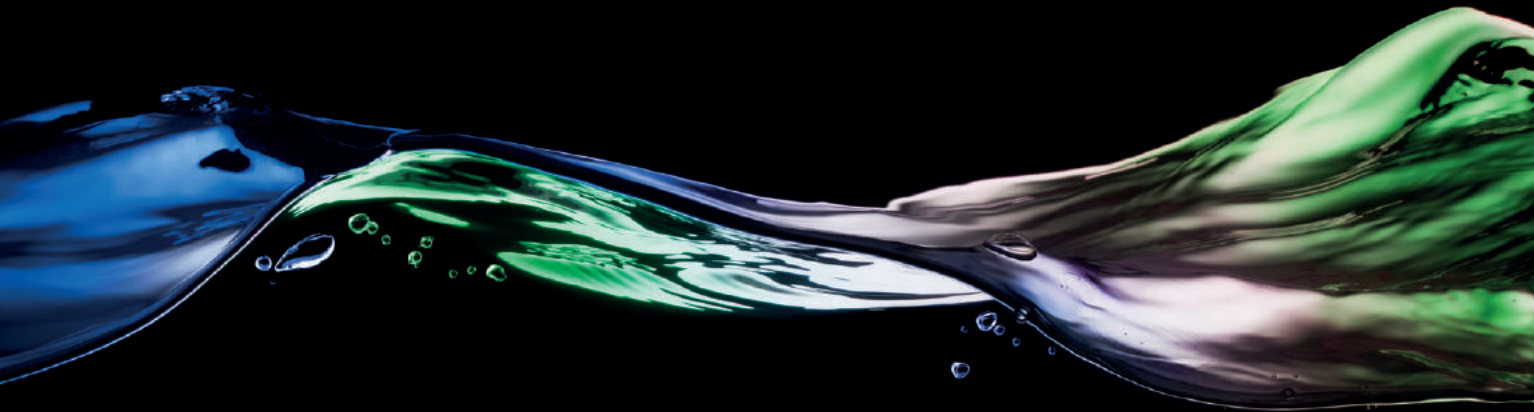

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Kenyan securities lending drive gains international support

Kenya's capital markets liquidity drive has received another boost as the country's Capital Markets Authority (CMA) looks to diversify available financial products with the help of several international bodies.

Securities lending was once again highlighted as an area of Kenya's capital markets that should be developed in order to improve overall market liquidity and continue the forward momentum enjoyed in recent years.

CMA chief executive Paul Muthaura said: "After a comprehensive review and analysis of the securities market, the CMA has identified several areas for improvement, including securities lending and borrowing, strengthening of collective investment schemes (CIS) reporting and structuring and, in line with the ambitions of the 10-year Capital Market Master Plan, positioning Kenyan securities and the overall market for inclusion in the right market indices."

"This week's [7 March] consultations are an important first step in building the capacity of the CMA and market participants to develop new products and services that will enhance liquidity."

Despite recent market growth, the CMA has acknowledged several challenges remaining in the market's landscape including the need for stronger market infrastructure and increased diversification of financial products.

According to the CMA, new and improved services are vital to cater to the growing needs of investors and issuers, and the need to improve the level of awareness among potential and existing investors regionally and internationally.

To further these aims, the CMA has partnered with the US Securities and Exchange Commission, the Financial Services Volunteer Corps (FSVC) and Bloomberg, along with other industry stakeholders.

FSVC is a not-for-profit organisation that deploys volunteer experts to emerging market countries to help strengthen financial sectors.

As part of the collaboration, representatives from these entities met with CMA officials and Kenyan regulators to present international best practices in adopting and implementing securities lending and CIS transparency.

The move to introduce securities lending into the Kenyan market first began to gather pace in October 2016 when the CMA, in conjunction with the World Bank, open its finalised capital markets regulation to enable securities lending and short selling for feedback from market players.

The latest version of the regulation outlines internationally recognised standards for appropriate lending behaviour such as the need for collateral provided to value at least 100 percent of the securities lent.

Bloomberg LP chairman Peter Grauer added: "Stronger trade and investment ties between the US and African countries are mutually beneficial, and East Africa is a region of enormous strategic importance as well as economic potential."

FSVC president and CEO Andy Spindler stated: "Drawing upon FSVC's significant expertise in the area of capital markets development, these consultations will help enable the CMA to develop new products and undertake key reforms to improve liquidity."

"Robust capital markets play a critical role in sustainable economic development by mobilising domestic savings and foreign capital for longer-term, productive investment."

"Kenya has already made significant strides in this area, and, thanks to the support of Bloomberg, FSVC will help the CMA establish a vibrant and competitive financial sector driving economic growth in the region."

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US equities have no chill, says ISLA report

London | Reporter: Drew Nicol

US securities lending activities endured a rollercoaster in its equity lines during the final months of 2016, according to the International Securities Lending Association's (ISLA) latest market report.

Pre-election jitters in October gave way to a quick rally following President Donald Trump's victory.

This in turn led to a harsh year-end drop off, which saw on-loan balance of equity borrowing drop by 8 percent in the final days of trading as buy-side firms scrambled to clear liquidity hurdles.

"Although the idea of banks and brokers managing to specific regulatory hurdles over key reporting dates is nothing new, the end of 2016 appears to have been more extreme," according to ISLA's sixth market report.

"Equity balances appear to be reduced disproportionately with priority being given to fixed income high-quaility liquid asset business."

The market's behaviour immediately before and after the US election mirrored that of around the UK's EU referendum.

"Much like behaviour prior to the UK Brexit vote, we observed a return of US equity loans ahead of the new presidential appointment, suggesting some clear deleveraging and closure of open risk positions."

"Trump's appointment, however, saw a marked shift in sentiment as both supply and demand for this asset class rallied towards year-end."

A closer looks at ISLA's collected data reveals that, for the first time since the association began reporting on the lending market in 2014, the global value of on-loan government bonds matched that of equities on loan.

Government bonds and equities each accounted for 45 percent of the total on-loan value, as of 31 December.

ISLA's report also reaffirmed the persistence of established trends in the market, including the dominance of pension funds and mutual funds on the lending side, which account for 66 percent of available assets.

Additionally, UCITS funds continue to struggle with their lending businesses, and represent a disproportionate relationship between supply and demand for securities in mutual funds.

"The increasingly restrictive regulatory environment facing many retail funds notably UCITS, which has led to a lack of appetite from borrowers to access securities from these lending clients, has become a permanent feature of borrower behaviour."

CloudMargin adds Nasdaq Clearing to web-based collateral platform

CloudMargin has secured Nasdaq Clearing as a user of its web-based collateral and margin management solution. According to CloudMargin, the relationship "will significantly enhance and streamline Nasdaq Clearing's collateral-related communications, including issuance of the most up-to-date eligibility schedules, reports, messages and instructions".

Lee McCormack, head of strategy at CloudMargin, said: "We believe this type of interoperability will set a standard for the industry going forward. CloudMargin's unique ability to offer a consolidated view and management of collateral needs is increasingly important as the volumes of margin movements rocket for both cleared and uncleared trades."

"Nasdaq is doing a great service to its market users by facilitating this capability, with benefits for sell-side and buy-side institutions and clearing firms alike."

Fredrik Ekström, Nasdaq's head of Nordic fixed income and European clearing, said: "Innovative and capital-efficient solutions are at the heart of what we do at Nasdaq Clearing. CloudMargin's effective and seamless web-based solution enables our clients to manage margin collateral across clearinghouses and bilateral counterparts."

"Nasdaq Clearing believes that distribution of risk is a key factor in protecting the financial sector from systemic risks. The CloudMargin offering supports such infrastructure in an efficient way."

CCP offers route to cheaper repo

Repo traders can reduce transaction costs by using central counterparties (CCP), according to the Office of Financial Research (OFR).

In a recent research note, the OFR said: "CCPs for dealer to-non-dealer repos may be attractive to dealers if netting results in smaller balance sheets and cost savings. On the other hand, central clearing would concentrate risk in CCPs themselves."

The OFR analysed data from its 2015 bilateral repo data collection pilot with input from the Securities and Exchange Commission.

Using a CCP cuts down on credit risk exposures but adds additional margin costs.

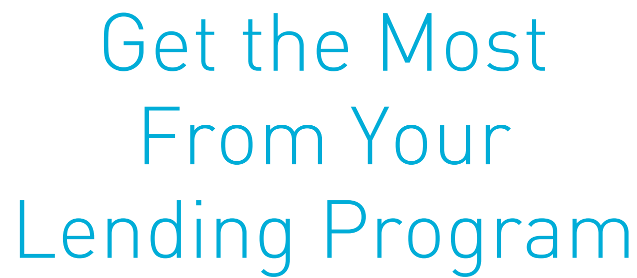
The OFR estimates that extending US treasuries repo CCP services to non-dealer counterparties would result in a reduction of up to 81 percent of risk exposures for dealers. This exceeds the 63 percent reduction from bilateral netting alone.

However, this expansion of CCP repo for non-dealers increases the risk exposure for the CCP by as much as 75 percent.

The pilot used data from eight bank holding companies that voluntarily provided snapshots of their trading books on three reporting days in 2015: 12 January, 10 February and 10 March.

In conclusion to its research, the OFR stated: "Whether the potential benefits outweigh the costs depends on the cost of bilateral repo activity relative to the cost of raising

Global Markets



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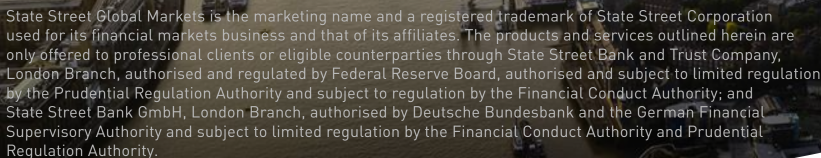

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additional funds to guarantee centrally cleared transactions. Several caveats apply to our analysis."

"We focus narrowly on direct economic benefits to market participants and increased exposures to the CCP."

"We do not consider other potential benefits, such as the increased transparency associated with transactions executed through central counterparties. Our findings are based on data collected from a limited number of dealers in a data collection pilot in 2015."

Linedata lines up analytics partnership

Linedata is extending its partnership with Morningstar to provide fixed income and credit derivatives analytics to its fund services clients.

The partnership is intended to address increasing demand from investment managers for global fixed income products.

According to Linedata, growth in the alternative mutual fund space and an increase in direct lending and private equity-type structures has led to a requirement for more robust and flexible systems.

Todd Roitfarb, head of fixed income products at Morningstar, said: "As the global fixed income market becomes more complex and as more managers move to gain international exposure, dealing with these complexities can become quite a burden."

The partnership will pair Linedata's Admin Edge fund administration platform with Mornigstar's BondPro library of fixed-income and derivatives analytics an accounting calculations.

This will give fixed income and alternatives administrators access to broader instrument coverage and more agility, providing better automation and faster time-to-market for new functionalities.

Roitfarb said: "Understanding the nuances of each market, and being able to keep up as they evolve, require constant vigilance, access to knowledge not easily available, and an ability to have flexible software that can evolve as well."

Daniel Burstein, North America head of fund services at Linedata, added: "This partnership with Morningstar characterises our approach to providing timely, value-added services to our clients in the most efficient, cost-effective way. We know that an increasing number of our clients are dealing with the complexities of the fixed income and derivatives market."

"BondPro is the recognised leader in the provision of analytics and accounting calculations in this space and we are delighted to be able to make this software and expertise available to our growing client base."

UK and Japan to exchange info

Financial regulators in Japan and the UK have agreed on a cooperation framework to support financial technology companies in entering each market.

The UK Financial Conduct Authority (FCA) and the Financial Services Agency of Japan (JFSA) have exchanged letters outlining a regulatory referral system for innovator businesses.

Japanese businesses will be referred by the JFSA to the FCA, and the latter will provide support in launching operations in the UK.

The scheme is intended to reduce regulatory uncertainty, and help cut time-to-market for fintech businesses.

The two regulators will also share information on financial services innovation in their

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respective markets, in order to reduce barriers to entry and further encourage innovation in both countries.

Shunsuke Shirakawa, vice commissioner for international affairs at the JFSA, said: "This is our first case in creating a pro-fintech cooperation framework with any other countries."

"The UK is one of the world-leading fintech countries, generating £6.6 billion in revenue. We believe that this exchange of letters strengthens the relationship between the JFSA and the FCA and promotes innovation in our respective markets."

The agreement follows a similar partnership between the FCA and the Ontario Securities Commission, announced in February, which saw the two regulators agree to support fintech start-ups entering each market.

Christopher Woolard, executive director of strategy and competition at the FCA, said: "We are committed to encouraging innovation that has the potential to be of benefit to consumers using financial services here in the UK."

"Today's exchange of letters with the JFSA will help break down barriers to entry both in Japan and in the UK for firms with interesting new business services and products."

Clearstream sees GSF drop-off

Clearstream's global securities financing (GSF) volume outstanding fell by 8 percent in February.

Volume dropped to €489.4 billion last month from €532.7 billion the same time last year.

Year-to-date volume also fell by 6 percent, compared to 2016. Average outstanding volume hit €492.2 billion so far this year, down from €526.3 billion.

The drop off in volume was attributed to the ongoing asset purchase programme of the European Central Bank, which was extended in December 2016 to now run until December 2017.

Hedge fund assets tipped to rise

Performance-based gains will drive hedge fund assets to reach $3.14 trillion by the end of 2017, a new survey has predicted.

Deutsche Bank's annual alternative investment survey of 460 global hedge fund investors revealed that close to three quarters expect their portfolios to perform better in 2017 than they did last year.

A breakdown of 2016 showed significant return dispersions in hedge fund performance, with top quartile funds returning +11.22 percent on average, while bottom quartile managers were down -6.86 percent.

Investors, who are paying management and performance fees of 1.59 and 17.69 percent, respectively, are increasingly turning to quantitative strategies to boost returns. Some 79 percent of all respondents to Deutsche Bank's survey allocate to systematic strategies, up from 70 percent last year. Close to half of survey respondents also plan to increase their allocation this year.

Marlin Naidoo, Americas head of the hedge fund capital group at Deutsche Bank, said: "The rise of quant is accelerating with 79 percent of investors allocating to the space."

"The number of strategies available has been growing and now range from simple low fee alternative risk premia products to more complex high alpha products that have seen further enhancements due to the advances in areas such as machine learning, quantum computing and the cloud. This has contributed to the additional interest and demand."

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Brexit poses threat to success of EU capital markets union, according to Clearstream

London | Reporter: Drew Nicol

Strained political relations in the EU has put the harmonisation efforts of Europe's financial markets, such as the European Central Bank's Target2-Securities (T2S) settlement platform, under "severe stress", according to Clearstream.

"In order to fully harness the potential and wider benefits of such developments, we need to clear away some serious obstacles on the path to a capital markets union in Europe," said Marc Robert-Nicoud, CEO of Clearstream, which migrated to T2S in February.

"Further alignment will be necessary of the various European regulatory initiatives with the objectives of market integration initiatives such as T2S."

In a note to clients, the Deutsche Börse subsidiary said: "Nationalistic tendencies as well as the looming Brexit are subjecting the capital markets union project to severe stress. Against the current political backdrop, it is key for policy makers and stakeholders to focus on the execution of capital markets union objectives."

Despite this, T2S, which is currently heading towards its final wave of implementation later this year, "works perfectly", but it's yet to achieve its ultimate goal.

Robert-Nicoud added: "The technical integration of the European settlement systems can only be a first step. Now, the integration on the market level has to follow the lead."

"This is the only way how T2S can live up to its original promise: to make cross-border settlement easier and more efficient for market participants."

Clearstream's successfully migration to T2S, means the platform now has more than 80 percent of its expected volume.

The T2S project is scheduled to be completed with a final wave in September 2017.

Hong Kong's securities lending and repo proposal is 'disproportionate'

The Securities and Futures Commission (SFC) of Hong Kong's proposal to require fund managers to report securities lending and repo transactions to investors on an annual basis is disproportionate, according to law firm Deacons.

The Hong Kong office of Deacons responded to the SFC's November proposals to enhance asset management regulation and point-of-sale transparency at the end of February.

Under the proposals, which were put forward to ensure Hong Kong's regulatory framework meets international standards, including those formulated as part of the Financial Stability Board's investigation into and reform of shadow banking, fund managers would be required to report securities lending and repo transactions to investors on an annual basis or upon request.

In response, Deacons said: "While we appreciate the concern of regulators globally to be kept informed regarding repos and similar transactions in light of concerns over the potential impact of the 'shadow banking system' on financial stability, we believe that the disclosure and reporting requirements proposed in paragraphs 32 and 33 [of the SFC's consultation paper] are disproportionate."

"In the context of authorised funds, the investment products department of the SFC can and does require extensive disclosure regarding such transactions in offering documents."

"In the private fund arena, we believe it is a matter for the manager to make a judgement as to the extent of the disclosure required."

"Investors in private funds are in a position to raise questions regarding such investments if they cause them concern."

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DTCC and Euroclear team up for launch of cross-border collateral solution for EU and US

London | Reporter: Drew Nicol

DTCC-Euroclear GlobalCollateral is launching a collateral mobility solution for US and European securities.

The Global Collateral Inventory Management Service (IMS) promises to be a transformative solution enabling users to seamlessly mobilise securities as collateral between the two major markets.

In a joint statement on the launch, the Depository Trust & Clearing Corporation (DTCC) and Euroclear explained that the new product is their response to challenges of consolidating collateral pools and accessing a broader range of counterparties.

"With IMS, financial institutions can now optimise collateral across two of the largest global market infrastructures servicing a combined $78 trillion in assets," the statement continued.

Participants can use DTCC eligible securities in the US, including equities, corporate bonds and asset-backed securities, for collateral purposes within Euroclear.

Michael Shipton, chief executive of Global Collateral IMS, said: "This is a major step for Global Collateral. IMS delivers one of the joint venture's key objectives–to address what market practitioners have long recognised as a critical need to be able to directly mobilise and use collateral across borders and to move dollar assets into Europe."

"With IMS, firms have greater control and flexibility in the way they utilise their assets, while benefiting from improved efficiency."

Fund managers that engage in securities lending, repo and similar over-the-counter transactions should also put in place a cash collateral reinvestment policy that seeks to ensure that assets "are sufficiently liquid with transparent pricing and low risk to meet reasonably foreseeable recalls of cash collateral".

They would also be required to "stress test the ability of a cash collateral reinvestment portfolio to meet foreseeable and unexpected calls for the return of cash collateral on an ongoing basis".

The proposed changes will be made to two SFC codes of conduct. In November 2016, SFC CEO Ashley Alder said: "A robust and responsive regulatory regime is fundamental to the development and growth of an international asset management centre. As part of the SFC's broader initiative to enhance Hong Kong's position as a major international asset management centre, it is important to ensure that our regulations are properly benchmarked to evolving international standards."

Euroclear to enter US equity clearing

Euroclear is on the cusp of gaining access to providing limited clearing for US equities.

The US Securities and Exchange Commission (SEC) has agreed to an information sharing arrangement with the National Bank of Belgium (NBB)—where Euroclear is headquartered—thereby enabling it to refer to the NBB for Euroclear's registration information and fast-track the bank's entrance into the US market.

The SEC initially approved Euroclear's application to modify its exemption from registration to clear US equities in December 2016.

The SEC and the NBB added an addendum to their 2001 Understanding Regarding An Application of Euroclear Bank for an

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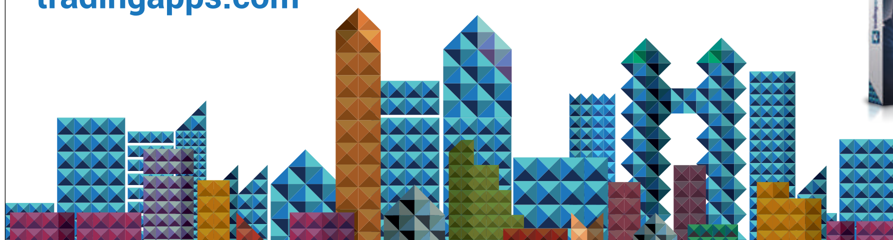

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Exemption under US Federal Securities Laws to allow for Euroclear's new US business lines.

The president of this exemption was set when the SEC originally allowed Euroclear's predecessor to provide clearing services for US government securities in 1998.

Paul Leder, director of the SEC's office of international affairs, said: "This addendum will expand the signatories' ability to cooperate and exchange information related to Euroclear Bank and augment the SEC's oversight of Euroclear Bank's activities under its exemption order."

Tax reforms could limit options

The US equity options market must stay alert and be ready to work with government to head off potentially damaging tax reforms on the horizon, according to OCC executive chair and CEO Craig Donohue.

In a recent blog post on the potential of tax reforms under President Donald Trump, Donohue highlighted that proposals offered by the previous administration "could make the use of listed equity options much less attractive to market participants than under current law" if they were resurrected.

"Since the election, both President Trump and members of Congress leading the congressional tax committees have indicated that tax reform is a priority for 2017, and proposals are being drafted to ensure early introduction of bills to reform the tax code," Donohue explained.

The OCC CEO added that it's "likely that legislators and staff will refer back to prior financial products tax proposals".

"These proposals would treat all listed equity options as sold at the end of the year, treat appreciated stock as sold if a taxpayer enters into an option to manage risk associated with owning the stock, and radically alter the tax treatment of stock while a related option position is outstanding."

"Enacting these proposals would adversely affect individuals and other taxpayers using listed equity options to manage risks associated with investments in publicly traded stocks."

He added: "It would discourage use of options—distorting rational economic and risk management decision making and replacing the well-established and relatively simple tax rules for listed equity options with a burdensome and overly complicated regime."

Donohue confirmed that OCC, in its capacity as an industry body, is "paying close attention to this issue" and working closely with the US Securities Markets Coalition to ensure the best conclusion.

"OCC and the coalition continue to meet with members of Congress and staff of these committees to reiterate our deep concerns on behalf of the options market about the previous proposals, on which we submitted extensive comments and held many meetings."

EU participants too busy for CMU

EU financial market participants are too bogged down in regulatory implementation to make the most of capital market opportunities, according to a BNY Mellon regional chief.

Mark John, head of product and business development for Europe, the Middle East and Africa at BNY Mellon, has warned that many market participants are currently too focused on "keeping their heads above the water with the pace of regulatory change" to make full use of the opportunities that the capital markets union (CMU) offers.

He said: "It is without question a positive development, but in the short-term both the

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buy and sell-side are dealing with only the compliance aspects, alongside their more pressing Markets in Financial Instruments Directive (MiFID) II requirements."

John, commenting last week on the close of the European Commission's brief public consultation on its CMU plan, suggested that markets won't be ready to effectively review the past decade's worth of regulation until 2019, when the CMU project is bedded down.

The commission's consultation was cut short of the usual 12 weeks allocated for industry response in order to allow time for analysis in time for the June mid-term review.

"Firms on both the buy and sell side have been suffering from a tunnel vision leading them to compartmentalise regulatory projects, adding challenges and implementation costs," John said.

"Companies which build a holistic plan based on their desired end result will not only comply with the current cycle of regulation more efficiently, but will be best placed to take advantage of the innovation opportunities which follow in a strengthened and transparent financial world."

The EU's CMU involves a €315 billion investment plan and a renewed drive to improve the free movement of capital, which remains fragmented across member states.

In a statement on the consultation, the European Commission said: "The review will seek to strengthen the current policy framework for the development of capital markets by updating the proposed actions and integrating complementary measures in response to key challenges."

European Commission vice president Valdis Dombrovskis, responsible for financial stability, financial services and the CMU, said: "We have built good momentum behind the CMU project and we are well on our way to completing the first wave of measures."

Now, we want to move faster and be more ambitious. This mid-term review consultation will help shape the next phase of our work to build a single market for capital in Europe."

Jyrki Katainen, the commissioner responsible for jobs, growth and investment, added: "Progress towards building a CMU is crucial to strengthen the third pillar of the Investment Plan for Europe."

"It will contribute to creating an investment friendly environment and make it cheaper and more interesting for insurance companies and banks to invest in long-term infrastructure projects."

Lending due a fresh review

A European Securities Markets Authority (ESMA) advisory group has begun a new study of the EU's regulatory oversight of its securities lending markets, with a focus on a possible divergent application of the UCITS guidelines.

The securities and markets stakeholder group (SMSG), which acts as a conduit between the EU regulatory watchdog and key industry stakeholders, has voiced interest in undertaking its own initiative reports that would feed into ESMA's own peer review, scheduled for the second half of 2017.

The SMSG has formed a working group of interested members to pursue the matter, led by consumer representative Jean Berthon.

During a steering committee meeting, ESMA chair Steven Maijoor welcomed the initiative, stating that "work on this topic would be of most value to ESMA".

The SMSG provides ESMA with opinions and advice on its policy work and must be consulted on technical standards and

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guidelines and recommendations. It can also inform ESMA of any inconsistent application of EU law as well as inconsistent supervisory practices in member states.

The current SMSG is made up of 27 members from a wide cross-section of financial market stakeholders across 13 member states. The group is currently serving a two-and-a-half year term that began 1 July 2016.

Broadridge buys messaging service

Broadridge Financial Solutions has acquired Message Automation to bolster its suite of post-trade services.

According to Broadridge, the acquisition to allow firms to transform their risk and compliance capabilities, particularly for complex asset classes.

The specific terms of the deal were not disclosed. In a statement on the acquisition, Broadridge explained that the purchase is in response to the myriad reporting frameworks currently being implemented by various regulatory bodies.

Message Automation is implementing its solution for the second Markets in Financial Instruments Directive in preparation for the January 2018 deadline and is in "advanced planning" for the Securities Financing Transactions Regulation.

Message Automation was also chosen by Broadridge because it "has developed exceptional capabilities" in harmonising reporting standards.

Charlie Marchesani, president of the global technology and operations division of Broadridge, commented: "The addition of Message Automation will enhance our ability to help companies to reduce risk and enhance compliance while improving operational efficiency."

Securities lending industry breaks through $2 trillion mark for first time in four years

London | Reporter: Drew Nicol

Global on-loan securities are worth more than $2 trillion for the first time since 2013, according to market data provider DataLend.

The latest valuation saw on-loan securities rise by more than $180 billion from March of last year.

The amount of securities available for borrowing also broke DataLend's previous record to now sit at more than $16.4 trillion, up $2.75 trillion in 2016.

More than 45,000 unique securities are on-loan worldwide.

The achievement marks new heights for the securities lending industry, which has seen a steady rise in on-loan value over the past 12 months.

The International Securities Lending Association's latest industry report put on-loan securities at €1.9 trillion as of 30 June 2016—a 4 percent increase on the previous six months.

According to DataLend, lenders earned $9.16 billion in 2016, with North American lenders claiming the lion's share of $4.67 billion.

Europe followed on $2.64 billion, with the Asia Pacific making up $1.67 billion and the rest of the world accounting for the final $182 million.

The use of cash collateral fell by 6.4 percent over the same period to sit at 39.48 percent, likely due to persistent low and negative interest rates.

Speaking on the latest data, Chris Benedict, director at DataLend, said: "The recent rise to more than $2 trillion on loan in the securities lending industry is likely due to growth in the global capital markets along with the asset values of the securities on loan and in inventory."

"A major shift in the capital markets in the future would likely have an impact on loan and inventory values, either positive or negative."

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Asia under the microscope

The industry turned its focus to South Korea as participants came together in Seoul for the PASLA/RMA Conference on Asian Securities Lending

The flight to Seoul from Heathrow is just shy of 11 hours if you're lucky enough to fly direct, with a nine-hour time difference to boot once you land—14 hours if you're coming from New York.

This inevitably creates a lag in correspondence with headquarters, with Asia-based folks often getting updates a day after their western counterparts.

And at this year's conference, it was made plain that what is true for news also stands for regulation and other market trends.

Each time the industry is hosted by the Pan Asian Securities Lending Association (PASLA) and the Risk Management Association (RMA) for their annual event (now in its 14th year), the Asian markets reliably boast new levels of maturity, but they are still susceptible to the whims of larger markets in Europe and North America.

This year's gathering opened by addressing the macro-geopolitical topics of the day that are the bombastic President Donald Trump and the potential for widespread disruption of EU regulatory initiatives caused by the surge in nationalism across the continent—with Brexit Britain at the epicentre—and a rapid series of elections due in France and Germany threatening to double down on the union's problems.

South Korea leads the way

Closer to home for those in Asia, the spotlight was turned on South Korea and its neighbouring markets' developments in lending activity and regulatory frameworks.

Asia offers a diverse range of securities lending markets, in a variety of stages of development.

This year's conference, however, focused largely on its host country and the recent controversial rule changes that several in attendance accused of being more politically motivated than economically responsible.

Panellists throughout the three-day event protested that short sellers are being used as a political football, with participants facing burdensome regulatory requirements across the region.

Seoul-based market representatives voiced concerns that the recent hardening of short selling rules in South Korea would negatively affect their business.

This view was reinforced by an audience poll, which saw more than half of those in attendance citing the amendments to short selling as the "most influential rule change in the South Korean market".

A subsequent poll addressed the problem directly by questioning audience members on what the most reasonable response to complaints over short selling from the wider market should be.

Just over half of respondents opted for improving market accessibility of individual investors for short selling.

A further 23.3 percent voted for strengthening public disclosure requirements for short selling.

This drew further criticism from panellists as public disclosure was highlighted as one of the features of the new ruleset that simply pandered to public opinion and had very little actual merit in terms of financial security.

As part of the package of rule changes, financial penalties for failing to comply with public disclosure and reporting requirements were installed, where previously there was no punishment for failing to comply.

"If South Korea's Financial Services Commission (FSC) isn't the one making the decision on these rules then sometimes cooler heads might not prevail," one panellist commented.

Among other changes, the Korean Exchange will be handed new powers to withdraw "overheated" stocks that receive "extraordinary increases in short selling and sharp falls in prices" during a single day for a 24-hour cooling-off period, as outlined in a statement by South Korea's FSC in November 2016.

The political nature of the rule changes have caused industry participants to question the thought process behind some of the terms, such as a 60-day limit on term lending.

The limit was handed down without explanation and has since been described as an arbitrary limit with no clarity on whether strategic lending and borrowing is allowed to work around it in order to maintain a short position.

"The short selling rules aren't a big problem but the concern is if this rule is just the start of a wider initiative," a panellist who is based in South Korea commented.

It was noted in a later panel discussion that South Korea has been one of the most lucrative Asian markets for securities lending for the past two years, but these new requirements may dampen revenue in the future.

The balance of securities available for lending in the country has risen steadily over the past seven years, with local investors increasingly taking on a larger command of the market. Local investors only accounted for 20 percent back in 2011, but that percentage now hovers around 35 percent on average.

Beset on all sides

Short sellers are also under the kosh elsewhere in Asia. In Hong Kong, the Securities and Futures Commission (SFC) has instigated plans to bring in reporting requirements for short positions from 15 March, in a move that has been described as "disproportionate".

The Hong Kong office of law firm Deacons responded to the SFC's November proposals to enhance asset management regulation and point-of-sale transparency at the end of February.

Under the proposals, which were put forward to ensure Hong Kong's regulatory framework meets international standards, including those formulated as part of the Financial Stability Board's investigation into and reform of shadow banking, fund managers would be required to report securities lending and repo transactions to investors on an annual basis or upon request.

In response, Deacons said: "While we appreciate the concern of regulators globally to be kept informed regarding repos and similar transactions in light of concerns over the potential impact of the 'shadow banking system' on financial stability, we believe that the disclosure and reporting requirements proposed in paragraphs 32 and 33 [of the SFC's consultation paper] are disproportionate."

The Hong Kong Exchange also tightened its criteria for securities eligible for short selling in mid-2016 to bring them in line with the state's equity market.

At the same time, Taiwan's stock exchange is now monitoring short selling volumes on its platform more closely for indicators of when securities become 'attention stocks', which are then liable for pricing limits, as of June 2016.

Strong the west wind blows

According to PASLA/RMA panellists, Asian market participants have more than just homegrown regulatory challenges to face.

Fresh regulatory requirements that are currently germinating in Europe are expected to spill over into Asian markets in the near future. One example offered by panellists was that beneficial owners across Asia must come to terms with stay protocols in the near future if they want to do business in foreign markets.

A stay protocol is a standard form that promises a globally systemically important bank (G-SIB) will, in the event of a default, freeze all relevant assets for a short time in order to avoid exacerbating market stress through a rush to reclaim collateral. The protocol is signed on a voluntary basis by participants in a few jurisdictions, but any entities wishing to access those markets for securities finance are also required to sign up.

One legal expert at the conference explained that the issue for lenders that are expected to adhere to these rules is that, in the case of a default of a major investment bank, the counterparty is forced to hold on to collateral whose value might be crashing.

The potential for lenders to take on losses as a result of a stay protocol has led some legal teams that are new to the requirement to attempt to negotiate the terms, or even to advise against signing.

The relative lack of G-SIBS in Asia means that local securities finance participants have so far operated without the use of stay protocols, but that time is nearly over, according panellists.

Currently, only the UK, Switzerland, Germany and Japan have finalised their stay protocol regulations, but the US is expected to catch up in the first half of this year. The EU passed rules requiring member states to publish legislation as of 1 January 2016, but progress still varies from state to state.

The fact that the stay is voluntary puts the onus for education about these rules on the industry, which is expected to outline the requirements to their counterparties in jurisdictions that may not have equivalent rules, but that are expected to agree to them to access to markets that do. Conference panellists advised attendees to seek legal advice on how to approach incorporating stay protocols in order to remain open for trading in these markets.

A Trump shaped spanner

While Asia and the EU double down on their efforts to manage the financial stability of their capital markets, the new US president appears to have missed the memo.

Delegates heard in the opening panel of the conference that the future of Basel IV has been thrown into question in the wake of a new wave of anti-regulation sentiment emanating from the US.

A panel of regulatory experts concluded that Trump's attempts to reopen the debate on the need for post-financial crisis banking regulation has put a significant roadblock in the way of future initiatives.

"There is some nervousness in the Basel Committee on Banking Supervision because of the uncertainty," one panellist explained.

Another panellist agreed and added that he is confident a further iteration of the Basel regulatory framework will be formed, but that it will likely be "so watered down that people will get some flexibility".

"It's better to have something agreed than nothing," the panellist said.

Basel IV will likely focus on aligning the many requirements of existing regulations around the world, including Basel III, which will finish being rolled out in 2018.

Trump laid the groundwork for an extensive review of US financial regulation in the opening weeks of his administration by signing an executive order giving the Treasury broad powers to scrap rules that do not comply with his administration's loosely defined 'core principles'.

Another panellist argued against ending preparations for upcoming regulatory deadlines on the assumption that they may be postponed, given the lack of appetite for significant rollbacks globally.

Nice to CCP you

No conference would be complete without a panel on central counterparties (CCPs). The tone of the CCP panel was set in a poll from the previous technology-focused panel that revealed that, in terms of allocation, only 8 percent of audience members saw central clearing as their biggest spend.

EU-based CCPs in Asia essentially find themselves back at square one in most Asian countries, although some, including South Korea, offer a CCP facility for securities lending trading.

As it stands, however, no non-state affiliated CCPs are operating in Asia.

Despite some optimism in the conference hall, the problem, at least in the short term, is that the widespread disparity on regulatory standards across Asia makes standardising for a multi-cross-border product highly complex.

This feature of the European lending market, it seems, is still in transit. **SLT**

> Beneficial owners across Asia must come to terms with stay protocols in the near future if they want to do business in foreign markets

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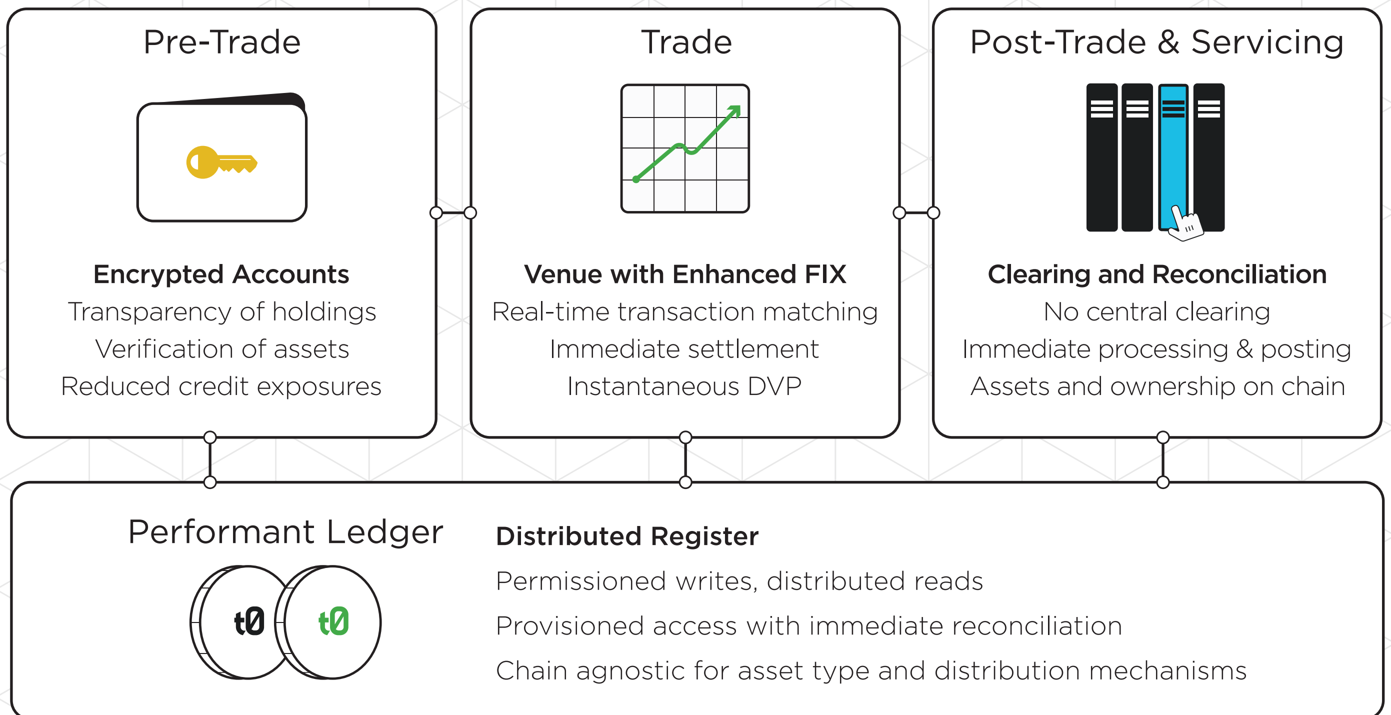

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Tred Talks US deregulation:

Will Trump make it happen?

Tred McIntire, formerly head of Goldman Sachs Agency Lending and a member of the RMA executive committee, gives his thoughts on how Donald Trump's presidency will come to bear on regulation of financial services

Despite losing the presidential election by more than 2.9 million votes, Donald Trump won the electoral college riding a wave of populist sentiment. After hitting an election night air pocket (the Dow Jones Industrial Average was down 827 points), the Dow has surged 14 percent (as of 9 March) since the election, and the Financial Sector ETF (XLF) is up 24 percent. The headlines have been full of optimistic Trump sentiment around the financial sector:

- "With SEC head's resignation, field clears for Trump to cut back regulations" (Washington Post, November 2016)
- "Trump vows to dismantle Dodd-Frank disaster" (New York Times, January 2017)
- "Trump moves to roll back Obama-era financial regulations" (New York Times, February 2017)
- "Top Federal Reserve official resigns as bank deregulation looms" (Reuters, February 2017)
- "Trump's man for the SEC: Time to ease regulation" (Wall Street Journal, February 2017)
- "Trump told Mnuchin he wants deregulation done in six months" (CNBC, March 2017)

What has happened to date?

Since the election, Trump has taken steps to begin the process of softening regulation of the financial sector, and this has resulted in certain high profile resignations and emboldened others to 'follow his lead':

- **14 November:** A week after the election, Securities and Exchange Commission (SEC) chair Mary Jo White announced her intent to resign on 20 January, the day of Trump's inauguration. Jay Clayton, a Sullivan & Cromwell lawyer who has represented Wall Street, is Trump's pick to replace White.

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- **30 January:** Trump issues Executive Order on Reducing Regulation and Controlling Regulatory Costs. The order states that "for every one new regulation issued, at least two prior regulations be identified for elimination".
- **31 January:** Republican Patrick McHenry, vice chair of the House financial services committee, sent a letter to Federal Reserve chair Janet Yellen criticising the Fed's "negotiating international regulatory standards for financial institutions" and participating "in international forums such as the Financial Stability Board, the Basel Committee on Banking and Supervision". He went on to say: "It is incumbent upon all regulators to support the US economy, and scrutinise international agreements that are killing American jobs."
- **3 February:** Trump issues Executive Order on Core Principles for Regulating the US Financial System. Highlights include calls for more rigorous regulatory impact analysis; advancing American interests in international financial regulatory negotiations and meetings; making regulation efficient, effective, and appropriately tailored; restoring public accountability within federal financial regulatory agencies and rationalising the federal financial regulatory framework. It also directs the secretary of the Treasury to report back to the president within 120 days.
- **10 February:** Federal Reserve governor Dan Tarullo, a vocal advocate for bank regulation, announces plans to retire on 5 April. Known by some as the "alpha dog of financial regulators", Tarullo was the Fed governor who assumed responsibility for heading regulation (a post created by Dodd-Frank), even though he was never formally confirmed for it. David Nason, a former General Electric executive and Treasury official under Hank Paulson, was expected to be nominated to replace Tarullo, however, he recently withdrew his name from consideration.
- **13 February:** Steve Mnuchin, former Goldman Sachs partner, confirmed as Treasury secretary.
- **24 February:** Trump issues Executive Order on Enforcing Regulatory Reform Agenda. The order requires federal agencies to appoint a regulatory reform officer. In signing the order, Trump said: "We're going to put the regulation industry out of work and out of business."

What are the possibilities?

Given this backdrop of executive orders, public statements and personnel changes, what are the likely possibilities?

Dodd-Frank rollback: A wholesale roll-back of Dodd-Frank in 2017 is highly unlikely with only a 52 to 48 margin in the Senate. However, depending on what happens this year, the numbers in the Senate could shift in favour of a clear Republican mandate in 2018 with 16 Democratic seats up for election. Short of a full repeal, it is possible that certain elements of Dodd-Frank could be softened. For instance, the comprehensive capital analysis and review (CCAR) framework could be modified to reduce constraints on banks in regard to dividends and share repurchases. Secretary Mnuchin has also promised to 'kill' parts of the law, including the Volcker rule.

Single counterparty credit limits (SCCL): The limits are contained in Section 165(e) of Dodd-Frank. They are designed to limit the amount of net credit exposure that large banks, also known as systemically important financial institutions (SIFI, which are defined as greater than $50 billion of assets), to one another. SIFIs may have net credit exposure of no more than 25 percent of regulatory capital to other SIFIs. The top tier, largest banks, known as G-SIFIs are subject to even more restrictive limits on their exposure to one another (no more than 10 percent). Although Dodd-Frank was originally passed in 2010, a definitive timetable for implementation has not yet been set.

The likely impact of SCCL as drafted would be to limit the capacity of agent lenders and principal borrowers to transact with one another. As much of the volume of securities lending business is concentrated among the top prime brokers and agent lenders, it may lead to a mix of potential responses: reduced borrowing and lending activity, shifting business to smaller less creditworthy counterparties, allocating more capital to the business, or increasing efforts to develop a viable central counterparty model for the US market. On 4 March, the Fed released a proposed draft with comments due by 3 June. SCCL would seem to present a likely target for de-emphasis. Without active support and sponsorship within the regulatory community, it is possible that this element of Dodd-Frank may languish.

Net stable funding ratio (NSFR): NSFR was originally introduced in 2009 to address a perceived over-reliance by several banks on short-term wholesale funding. It effectively raises the overall cost of funding securities finance transactions and may reduce liquidity. Another potential effect is to encourage the insertion of a central counterparty into securities finance transactions. At this point, it is scheduled to be fully implemented by 1 January 2018.

In a comment letter sent to the Fed, OCC and the Federal Deposit Insurance Corporation last August, the Securities Industry and Financial Markets Association, the American Bar Association and several other industry organisations said that the NSFR is unnecessary due to "key reforms already enacted, including the liquidity coverage ratio". Like SCCL, the NSFR would seem to fall within the scope of Trump's executive orders and could clearly be de-emphasised.

Equities as collateral: SEC approval of the use of equities as collateral in securities lending transactions has been under review for nearly two years. After a flurry of activity and much enthusiasm in 2015, the proposal has been in limbo. With only two SEC commissioners at the moment and some questions about whether the change needs the formal approval of the commission, a decision has not yet been taken. This would appear to be an ideal cause for the new SEC chairman nominee, Jay Clayton, to push forward.

In addition to the much-touted benefits of correlation between collateral and loaned assets, this would also put the US market on a more equal footing with non-US markets, an important Trump objective for all aspects of the economy.

In addition to approving brokers' use of equities as collateral, the SEC's investment management division must separately approve the acceptance of collateral by '40 Act funds, and the Department of Labor would need to approve its use by Employee Retirement Income Security Act plans. At a minimum, these efforts are likely to receive positive support from the Trump administration.

Likely outcome

Trump has raised expectations for a significant easing of financial regulation, however, it remains to be seen how much he will be able to accomplish given the ambitious legislative agenda that he has proposed (ie, healthcare reform, a major tax overhaul and major changes in the federal budget).

Progress on deregulation (or at least at a slower pace) in the coming months seems likely in some respects:

- **Equities as collateral:** Probable in two to three months
- **SCCL:** Less likely to be implemented in short run
- **NSFR:** Less likely to move forward in short run
- **Dodd-Frank rollback:** Unlikely to change meaningfully before 2018 at the earliest
- **CCAR:** Possible 'softening' approach this year. **SLT**

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Optimising programmes through collateral flexibility

eSecLending's Simon Lee explains how tweaking your collateral parameters can significantly improve your securities lending revenue

The enormous amount of regulatory and structural change in recent years has created new revenue opportunities for beneficial owners that are willing to review their lending programme parameters in light of new market dynamics. In the 'Optimising Your Securities Lending Programme' series, eSecLending outlines the opportunities for beneficial owners to modify their parameters and take advantage of the evolving market.

In today's market, collateral flexibility is an important consideration for lenders looking to optimise programme returns. In what is a competitive environment, revenue optimisation is best achieved by addressing the requirements of both the supply (beneficial owner) and demand (borrower) sides of the lending transaction, relative to overall programme objectives.

At first glance, opportunities for lenders to increase earnings without unduly increasing risk may appear limited in today's market environment, but by recognising the joint dynamics of programme structure and collateral requirements, beneficial owners can benefit from the increased emphasis regulation has placed on collateral and its associated cost to the borrowers in your programme.

As the cost of collateral diverges across different collateral types, it becomes increasingly important for lenders to recognise the impact that their collateral choice has on overall programme performance, particularly as it relates to the type of programme in which they participate.

Lenders that employ a flexible collateral schedule enjoy advantages over lenders with restrictive collateral schedules. By accepting additional types of collateral, beneficial owners can attract a larger and more diverse set of borrowers, increasing on-loan balances and revenues. Lenders that restrict their collateral profiles constrain their distribution channels, which can reduce their balances and their revenues.

The acceptance of equity collateral has been increasingly recognised as a tool to improve programme performance. From the borrower's perspective, equity collateral has always been a preferred form of collateral due to its plentiful supply, relatively low costs and liquidity. However, historically, there was little demand from lenders and their agents as equity collateral was harder to administer, indemnity costs were higher and programme performance was not unduly hindered without it.

As indemnity costs become better known and managed, administration of equity collateral by triparty providers becomes more sophisticated. Employing a flexible collateral schedule is an actionable way to improve programme performance, and many beneficial owners that traditionally accepted only non-cash collateral have broadened their collateral guidelines and are now also accepting equity collateral.

Lenders are always interested to know how much they will be able to increase their revenue by when they diversify their collateral schedule.

It is important to understand how the type of programme the lender participates in also impacts performance. This is particularly true for lenders participating in a pooled programme where their assets are commingled with those of other lenders and loans are allocated through a 'queuing' system.

For example, a borrower wants to borrow a position that is held by three lenders in the pooled programme. Lender A and Lender B accept equity and government bond collateral, whereas Lender C only accepts government bond collateral.

Rather than allocate this loan across three lenders—with two different forms of collateral and two different costs—the borrower will source the supply from A and B that accept the cheapest form of collateral (equity).

This means Lender C, which only accepts the more expensive form of collateral (government bonds), will miss out on the loan entirely.

Lenders that participate in pooled programmes must always consider how changes to programme parameters, especially as they relate to collateral or programme enhancement, are viewed relative to other lenders in the same programme, as this can significantly influence the impact that any changes may have.

For lenders that participate in segregated programmes, where assets are not commingled across lender accounts, the question of performance relative to other lenders does not apply.

In these programmes, changes in collateral schedules can directly enhance the performance of the individual lender, given that their performance is not influenced by the parameters of any other competing lender.

For lenders that wish to take a more active role in enhancing securities lending performance, and where the opportunity to do so exists, lending via a segregated programme structure may be advantageous, particularly when considering expanding collateral schedules. **SLT**

Changes in collateral schedules can directly enhance the performance of the individual lender

Simon Lee, Managing director
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Thinking again

Fresh opportunities are arising and perceptions are changing for securities lending in Australia, as Dane Fannin and Mark Snowdon of Northern Trust explain

Australia has long positioned itself as one of Asia's most prominent and mature markets for securities lending.

Yet for several years, the limited appetites of asset owners for the product did not necessarily live up to expectations suggested by this title.

In particular, the financial crisis of 2008 damaged perceptions of securities lending in terms of its risks and rewards for participants. Sensing a mismatch, a number of asset owners chose to opt out of their securities lending programmes as a result.

Today, however, the prevailing economic and regulatory environment is changing this view, as well as presenting lenders with increasing revenue generating opportunities.

The world has moved forward—and given its attractive risk-reward profile versus other investment products—we are seeing a renewed appetite for securities lending.

Domestic drivers

According to data providers, lendable supply in Australia already boasts an impressive one fifth of overall Asian inventory. While a substantial portion of this is derived from offshore asset owners, a larger portion—which is set to continue growing—now originates from domestic funds.

Trends in borrower demand

On a relative basis, demand for Australian inventory has not yet risen to pre-2008 levels, in common with a number of other major securities lending hubs. Regulation, investor redemptions, systemic deleveraging, the increased costs of balance sheet and the drive to internalise inventories have all contributed to this dynamic.

However, demand to borrow Australian assets has been on the rise, and according to data providers, this has been reflected in overall loan balances seeing healthy growth over the last three years.

Available supply in equities remains skewed toward the more liquid and readily available ASX 100 inventory, although with the Australian economy's inherent exposure to global commodity markets, supply here will continue to thrive as investors look to employ strategies positioned to this theme.

Noticeably, there is a sustained trend in demand for inventory beyond the ASX 100—where typically securities are more of a small- or mid-cap nature and attract higher loan fees.

This is a global trend driven by the growth of quantitative investor strategies, which typically trade within this inventory set. The scarcity of this supply in the market means borrowers are able to pay healthy premiums, presenting attractive opportunities for those beneficial owners holding such inventory within their lending programmes.

The scarcity of this supply in the market means borrowers are able to pay healthy premiums

Dane Fannin, Head of capital markets, Asia Pacific
Northern Trust

A large slice of these assets are held by Australia's superannuation funds. This segment is the fourth largest in the world and these superfunds are poised to continue expanding further through increased mandatory contributions from members throughout the next decade.

Asset allocations remain largely domestically focused, particularly in equities, although there is evidence this is changing as the benefits of greater diversification and liquidity in global markets take hold more widely.

By the same measure, this trend will help to diversify and enhance securities lending revenue streams for local beneficial owners, with greater offshore exposure where expected returns can be more attractive.

The Australian market is noted for its close-knit domestic investment community, where local presence remains important for the purposes of relationship building and information flows, particularly for securities lending.

A large portion of lending activity is still transacted onshore with locally domiciled borrowers against Australian collateral—predominantly Australian dollar cash and Australian equities. Northern Trust's presence in Sydney and Melbourne provides capability and local expertise in the domestic market.

Trends in fixed income

One of the most compelling areas of demand growth relates to Australian fixed income securities. While global regulation can often be thought of as a counterforce to growth, in this case it has been the single biggest driver for increased demand within this asset class. Under Basel III and specifically the liquidity coverage and net stable funding ratios, borrowers have sought to fund themselves on a long-term basis with high-quality liquid assets (HQLA).

This, coupled with reforms compelling HQLA collateral to be posted against centrally cleared over-the-counter derivatives, has helped propel interest in this asset class globally.

Holders of Australian government securities (classified as HQLA by most counterparts) are able to benefit from termed trade opportunities that typically present a premium for the associated duration risk. This is presenting an important revenue stream for those beneficial owners with the appropriate risk appetite for these trades.

Apart from presenting incremental revenue streams for participants, the stability in earnings associated with these opportunities also help to offset any earnings volatility realised within an overnight

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programme, thus driving increased certainty and stability of securities lending revenue flows overall.

Super funds lead the way?

As the super fund sector has continued to consolidate and grow in Australia, this has encouraged healthy levels of dialogue and benchmarking among asset owners, helping to promote best practices and drive innovation in the market.

It has also been the backdrop for changes in perception among beneficial owners.

This is reshaping the lens through which investors assess the product's value proposition and has had a knock-on effect to all beneficial owner and intermediary segments.

Despite the fact that securities lending supply has already outstripped pre-2008 levels globally, Australia has been relatively slow to take advantage of what is a low-risk means of enhancing returns and covering costs.

Our view of securities lending continues to be that of a well-regulated practice providing obvious benefits to lenders in terms of its' risk-return profile. In addition, it carries the wider benefits of supporting the smooth functioning of capital markets through enhanced liquidity and price discovery.

While many lenders are returning to the industry and either growing or launching their programmes in Australia, challenges nonetheless remain. The decision to start a lending programme can be made more complicated by the need to convince a range of often diverse stakeholders. In particular, the potential opportunity loss of delaying or not engaging in securities lending should be considered by board and investment committee members alongside risk management considerations.

Industry professionals have a role to play in ensuring that these stakeholders are well educated in the realities of lending, and are able to take fact-based decisions by looking at the revenues and risk management of various lending options.

Northern Trust recognises the need for stakeholders to ensure their use of securities lending is structured in ways that are appropriate for their members.

Here, technology is helping to enhance the levels of control and governance that agent-providers can bring to the table.

Emerging opportunities

Beyond the momentum of new beneficial owner interest, many Australian asset owners remained committed to their securities lending programmes through the crisis, and have continued to evolve the ways in which they derive value from the product.

> It is crucial that lending agents continue to afford clients the means of fulfilling their long-term investment objectives

Mark Snowdon, Head of client management Asia Pacific
Northern Trust

Most developed markets have seen increases in the number of lenders and the value of lendable assets over the last few years, and signs are emerging that Australia is catching up fast. Recent data showed an increase to USD 16 trillion of lendable assets globally in 2016, with more than USD 2 trillion on loan.

With global investment strategies and regular mandatory funding injections, Australia's super funds are well-placed to benefit from the resurgence in securities lending activity. Education and lender agent partnerships have been instrumental in driving this trend, with beneficial owners now feeling more comfortable about the increased levels of control and governance they can exert on their lending programmes.

Taking control: Technology and client education

This enhancement is in part due to the innovation and technical developments brought to the market by agent lenders, including Northern Trust. Such enhancements are facilitating high levels of automation, and flexibility in securities lending, as well as bespoke programme structures, allowing solutions to be built to suit all types of beneficial owner, from the more conservative to the highly sophisticated.

We are seeing greater sophistication here, particularly in terms of the extent to which securities lending can assist treasury functions in terms of cash management and liquidity by utilising concepts such as peer-to-peer lending, agency repo and collateral optimisation.

It is clear that while differences exist across beneficial owners in respect of the evolution of their programmes, ultimately many of these concepts are helping pave the future direction of the industry.

It is crucial that lending agents continue to provide the ongoing partnership, flexibility and customisation that will afford clients the means of fulfilling their long-term investment objectives.

Australia remains an important securities lending destination, with compelling growth prospects for industry participants.

As local asset owners have struggled to fight the headwinds and impacts of the low return and low interest rate environment, the need to reduce costs and enhance performance has come to the fore.

This is driving a resurgence in securities lending—and its use as a tool by lenders to achieve their overall risk-return objectives. **SLT**

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Peer pressure

BNY Mellon explains how peer-to-peer trading is transforming securities finance

Securities finance has developed into an important front-office tool supporting the financing and collateralisation of many investment activities. Yet in the face of regulatory and market pressures, agent lenders are further adapting their approach to help meet client investment needs. Thus, while the objectives of investing cash on behalf of clients or releasing cash remain the same, the mechanisms to achieve this are evolving.

Cash release

Cash release* is as straightforward as it sounds: a securities lending agent, typically a bank, which holds a beneficial owner's cash collateral, allows the firm to access a portion of the funds.

"The agent lender is holding and reinvesting cash collateral on behalf of the buy-side beneficial owner," says James Day, business executive for securities finance, covering Europe, the Middle East and Africa at BNY Mellon. "The agent lender may release a portion of the cash collateral to be managed and invested directly by the beneficial owner."

Day continues: "Cash release is efficient. It allows the beneficial owner to access cash that the agent lender is holding on behalf of the buy-side firm. It unlocks trapped liquidity from buy-side firms' portfolios, which also helps the market overall. Then there's expense—otherwise buy-side firms might have to draw liquidity from unsecured credit lines or other financing transactions which could potentially cost more."

Obtaining cash release is dependent upon the nature of the assets within the beneficial owner's portfolio. Day says: "To use cash release effectively, beneficial owners should work with their agent lender to understand the level of cash loans they could sustain given their lendable portfolio. Securities lending trades are typically overnight transactions, and loan values can vary. This means that the level of cash collateral available for release can also vary. Beneficial owners have to make sure they have the right type of assets to generate a steady demand from borrowers."

Alternatives emerge

The long-standing market structure in which banks and broker-dealers are matched with buy-side firms to source cash or securities is becoming increasingly challenged.

Heightened capital standards and new liquidity charges introduced since 2008 have imposed constraints on bank/broker-dealer balance sheets, limiting their capacity to intermediate in the securities finance market.

At the same time, new collateral regulations are also having an impact on the buy side, which is now required to post collateral on more transactions. The combined effect has been to drive up the buy side's need to access liquidity at the very time when broker-dealer balance sheet capacity is constricted and costs have increased.

This has prompted the need to look for other ways to address this growing mismatch between supply and demand, and peer-to-peer securities financing alternatives are emerging as an increasingly important supplementary source of much-needed new liquidity to the market. As the name suggests, peer-to-peer transactions directly connect asset owners on either side of the transaction.

Reverse repo has long been a mainstay of cash collateral reinvestment in the securities lending space. In a reverse repo transaction, the cash collateral from a securities lending transaction is used to finance the purchase of securities from a counterparty.

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The BNY Mellon markets team has been at the forefront of the development of peer-to-peer securities finance alternatives and expect this valuable new liquidity source for cash and securities to grow in size and influence.

Larry Mannix, chief investment officer responsible for cash collateral reinvestment at BNY Mellon, explains: "Broker-dealers have reduced capacity due to capital regulations, and their matched books are not as large as they once were. As a result, we are seeing more interest from collateral providers to have direct relationships with cash providers without intermediation."

Bill Kelly, global head of agency securities finance, says: "Along with that, the demand for collateral and liquidity is growing, so market participants are seeking additional avenues to source the cash and/or securities liquidity they need. Developing a network of peer-to-peer alternatives is one attractive option."

"We are seeing many more requests from non-traditional collateral providers looking for cash providers," explains Mannix. "These non-traditional counterparties range from real estate investment trusts, insurance companies and pension funds to sovereign wealth funds and hedge funds."

Having more collateral providers gives beneficial owners more options for placing their cash, but these non-traditional counterparties can bring new challenges.

"Sometimes these non-traditional counterparties don't fit the typical mold of a traditional A-1/P-1 rated repo counterparty that a beneficial owner is used to approving," says Mannix. "It may be difficult to find publicly available financial information for some of these counterparties, and for some non-traditional counterparties, the information may not be sufficient for a thorough review."

However, having more collateral providers brings some benefit to the market.

"Any new source of cash or collateral increases overall market liquidity," adds Mannix. "And, if a beneficial owner is more open to non-traditional counterparties, there might be more opportunities for cash collateral reinvestment. As these opportunities expand, depth of market and scale could be added through electronic platforms.

Additionally, credit risk is mitigated through the provision of collateral to the cash investor by the borrower. For example, a pension fund can provide government securities to secure cash it has borrowed to meet margin calls."

DBVX

DBVX is a peer-to-peer collateral trading platform acquired by BNY Mellon in 2016. DBVX aims to bring collateral providers together with cash providers electronically. The platform should also help asset owners finance their collateral requirements, source eligible collateral or invest their cash in a secured deposit.

Mike Curran, global head of foreign exchange services, who has also assumed a leadership role for the US launch of DBVX, says "The DBVX platform can bring participants the benefits of scale, simplicity and standardisation of legal documentation, price transparency with pre-trade anonymity and straight-through processing efficiencies."

"For buy-side firms, opportunities for price improvement may result from being able to transact directly with other buy-side firms, while banks could realise a distribution benefit by connecting to new clients in targeted segments and geographies more cheaply and easily."

DBVX is a streamlined means of transacting among buy-side firms, but it also introduces the challenge of exposure to counterparty credit risk.

Curran says: "With electronic platforms like DBVX, buy-side firms will have to manage bilateral credit risk with prospective counterparties, unless they choose a central counterparty (CCP) settlement.

"However, while there might be an initial hesitancy around accepting the platform's standard documentation rather than using customised legal terms and bespoke schedules, faster and simpler counterparty diversification, offering greater liquidity, will be compelling."

The CCP model

CCPs are becoming key players in the modern financial markets, and they are making inroads in peer-to-peer securities finance where the CCP sits between two buy-side firms looking to enter into a transaction with one another.

Mike Landolfi, securities finance product and strategy manager at BNY Mellon, says: "The CCP securities lending model is still very much in its infancy, but it will be an integral part of the future of securities finance. Counterparties agree to a trade and novate the trade through a CCP. The CCP then becomes the counterparty to the transaction, bringing regulatory benefits for the original counterparties."

The key benefit of having a trade novated through a central clearinghouse is that the CCP stands in the middle of the trade acting as buyer to the seller and vice versa.

Landolfi says: "The CCP model can help with managing credit risk because it's the risk averse CCP on the other side of the trade and not the traditional broker-dealer entity. Additionally, transactions through a CCP can allow for better capital treatment thereby leading to a deeper market with greater demand and better utilisation."

Clearing securities financing trades can involve a larger commitment on the part of buy-side firms relative to other peer-to-peer options, however.

Landolfi observes: "Specific to the CCP model, buy-side firms will have to agree to the CCP's terms and conditions, and this can require additional legal and credit work. Some CCP models may utilise unique collateral requirements for the buy-side firm or their agent lender such as direct or indirect default fund contributions or initial margining."

"The CCP model is evolving quickly. How it will function and the roles everyone will play are still being finalised but the buy side should definitely keep an eye on this space."

Peer-to-peer securities financing is a field going from strength to strength today. In the years ahead, buy-side firms can expect to see greater innovation. The future is bright.

"Peer-to-peer alternatives have the potential to help clients supplement their book of liquidity to meet their needs," Kelly concludes. "Undertaking reverse repo, cash release or indeed sourcing eligible collateral via electronic peer-to-peer platforms like DBVX gives buy-side firms additional flexibility to ladder their cash and solve for their unique liquidity requirements." **SLT**

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The securities lending industry: At a crossroads

It should be clear that standing still is not an option, as Ross Bowman, who works in securities finance business development at BNP Paribas Securities Services, explains

Over the course of the last few years, the securities lending industry has been the focus of a multitude of regulations that have affected its function and place in the capital markets, culminating in an unprecedented increase in the capital cost of the business, which has resulted in a reduction in revenues from some asset classes.

The securities lending industry is coming to terms with the fact that there is a significant cost associated with almost every aspect of the activity, from a balance sheet perspective and also from new and onerous reporting obligations that impact all market participants, whether a beneficial owner, agent or borrower.

We are now standing at a crossroads. These regulations combined with the current revenue context, bring to the fore a renewed focus on optimising cost savings for market participants, preserving the lending activity on one hand and extracting the most value of pockets of opportunity on the other. These developments are paving the way to meet the multiple objectives of the securities lending industry.

The tentative emergence of electronic platforms

The market has seen some success in the development of trade matching and execution platforms, which would streamline operational and technical process of a securities lending transaction. However, the bespoke nature of lender and borrower requirements have made the mass automation of trade execution in securities lending a very complex business.

Whether lending equities or bonds, taking cash or securities as collateral or whether trading on an open or term basis, there are still many aspects of a securities lending transaction that have thus far prevented the execution from being fully automated and from moving to an 'on-exchange' facility. Matching and settling via electronic platforms, occur only when lender and borrower criterion permit. A great number of securities lending transactions are still negotiated and executed between the trading desks of lenders, agent banks and borrowers, effectively trading 'off-exchange' and outside of any multilateral trading facility (MTF). Collateral upgrade and high-quality liquid asset (HQLA) fixed income term trades, high-value specials and yield enhancement trades are all good examples.

Transition to a central counterparty model

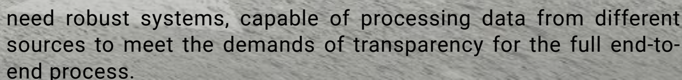
The use of a central counterparty (CCP) is looked on favourably by market regulators affecting the capital implication and altering the way in which agents and lenders transact with borrowers. However, mass adoption has so far eluded many market participants for a variety of reasons, so clearly further work is needed by all to understand the efficiencies such a model could deliver to the broader market.

Appetite for pledge agreements

Borrowers are also increasingly looking to reduce the capital costs incurred with running their securities financing operations. In the current securities lending market where supply outstrips demand, the regulatory driven needs of the borrower mean that the 'sell-side' is calling the shots and therefore agents and lenders can expect to see increasing demand from borrowers to provide collateral in 'pledge' form rather than as 'title transfer'. Such a practice, to further strengthen capital preservation, is already standard within the derivatives market for initial and variation margining, and it is only a matter of time before we can expect to see demand increase for pledge collateral in the securities lending market.

Reporting and transparency requirements

A fully transparent process and minutiae reporting requirements are becoming the new norm. From an operational perspective, lenders



need robust systems, capable of processing data from different sources to meet the demands of transparency for the full end-to-end process.

Reporting capabilities and their costs need to be managed not only from the point of view of cost optimisation, but also to enable lending programmes to grow and develop as a finely calibrated tool to aid the efficient management of a portfolio of securities.

Complimenting these reporting challenges are the application of best practices and code of conduct obligations that oversee the behavioural expectations of participating businesses.

All these principles and disciplines support and compliment the level of governance that securities lending clients and regulators expect to see.

All should now be considered modus operandi for securities lending programmes and factored into the cost of doing business.

Pockets of opportunity

Looking beyond operational and efficiency savings, lenders are positioning their programmes to optimise opportunities that arise from market movements and trends affecting the underlying cash equity markets. SCRIP dividends, specials, settlement fail coverage and directional short covering all represent pockets of additional revenue available to lenders.

Since 2015, the much welcomed HQLA upgrade trade in Europe has proven to be the stalwart for fixed income lending revenues as other sources of revenue income have shrunk.

Different dynamics are shifting demand in this market creating trends that mitigate demand on one hand while stimulating it on the other. Basel III regulation has increased the cost of holding equity inventory on-balance sheet for banks.

However, banks have worked to reduce the value of equities they hold and have thereby reduced the volume of equities they need to re-finance. This has resulted in a plateauing in the demand to borrow HQLA to satisfy liquidity ratio requirements. Conversely, global central bank quantitative easing programmes have reduced the volume of government securities available to borrow in the market.

As a consequence, the market has witnessed a sharp increase in borrowing rates for HQLA over key reporting periods, such as quarter end and year end, which have benefited those lenders holding HQLA.

Consensus for change

Where do we see the industry in five years? Regulation has already paved the way in guiding change.

Operational systems, settlement and billing technologies, trading utilities and collateral management platforms, are all common place in the securities lending market today.

However, there are still many processes that can be automated further.

Maximum automation of middle- and back-office functions will be critical to the effective profitability of the securities lending product, whether managed internally or through the use of an external vendor.

CCP and collateral utility links will need to be optimised to maximise the capital cost reductions that can be shared through the chain, as the requirements of a given borrower change from month to month and balance sheets are managed with fluidity.

Businesses should be prepared to streamline their operational processes as much as possible as automation will drive down unit processing costs and increase the ease of further automation in the future as the product develops.

The technical and operational infrastructure needed to execute and settle securities lending transactions has always been as significant in size and scope as the trading, operational and collateral management expertise required to support the product.

Such infrastructure investment requires commitment and resources that beneficial owners rarely have available when considering the various routes to market.

The writing has been on the wall for change for some time now and consensus among market participants will be key to driving the industry to where it needs to go, as it should be very clear to everyone now: standing still is not an option. **SLT**

All about the data

The securities lending industry stands on the cusp of a new, data-driven era. Participants need to be ready, according to David Lewis of FIS Astec Analytics

Articles and discussions about ‘big data’ abound across the financial industry as much as, if not more than, they do in other commercial or industrial sectors.

The securities finance and collateral industry has been fundamentally changed by both the demand for, and consumption of, what could be referred to as big data—both of course being the very reasons behind the existence of Astec Analytics.

Our industry is now standing ready to receive the final Securities Financing Transactions Regulation (SFTR) technical standards from the European Securities and Markets Authority (ESMA), which will underpin one of the biggest undertakings our industry has made in many years. The industry has faced seismic change before of course, with more than one financial crisis occurring during my more than 23-year tenure in the business, but market shocks are very different from the fundamental changes being brought about by regulatory changes.

The implementation of the Financial Stability Board’s (FSB) transparency directive by regional and national competent authorities is being led by ESMA, but others are already on the path to delivering

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their own requirements. Under the ESMA rules, any party to a securities financing or, very importantly, "an economically equivalent trade", must report it to a registered and approved trade repository within a given timeframe.

It is expected that late, under- and over-reporting could be met with fines from ESMA. Those repositories are then responsible for providing the data to ESMA, which, in turn, will provide aggregated data to the FSB in order to help build global images of the financing markets and their place in, what appears in many ways a negatively charged label, the so-called 'shadow banking' sector.

FIS has been involved in the process behind the development of these rules, almost from day one, through involvement with the FSB data experts group. Over the years, it has taken to reach this point, the development track has demonstrated a maturing of the underlying requirements of the FSB.

In early meetings, the FSB was keen to understand the trials and challenges of mass data collection experienced by companies such as FIS Astec Analytics and how they might be overcome. Such data requirements were, at that time, simply defined as the data that would be needed to fulfil the desire for transparency, without a clear understanding of what the real, underlying question actually was.

Transparency is not an end in itself, and this is something the FSB appears to have realised. Jump forward to 2017 and the picture regarding the requirements and aims of gathering such data are much clearer, although there are, of course, areas where market participants and regulators remain some distance apart as to the best way to answer those requirements. However, in a very well-attended market-wide meeting (organised by the International Securities Lending Association on 8 February) a well-known member of the market made an accurate, if blunt, observation that the "time for moaning is over" and the time for getting on with it is here.

It is certainly fair to say that the implementation of SFTR has finally reached the top of the regulatory, compliance and technical agendas of most market participants, including all those we speak to here at FIS Securities Finance.

As every eligible European counterparty to a securities finance transaction is required to report on a double-sided basis, the ESMA net is being cast wide over the market, encompassing beneficial owners, borrowers, brokers and end-users. Many entities may well take up the opportunity to delegate their reporting requirements, the most obvious example being beneficial owners, which are likely to rely on their agent lenders to report on their behalf, but it is not certain that those conversations will always be easy ones.

The additive effect of a number of pieces of legislation affecting the securities finance and collateral industry has added costs and friction to the market, such as the rising capital costs of indemnities extended by agent lenders. Each incremental effect puts downward pressure on the profitability of the financing function for certain clients, and as particular straws bend and break certain camel's backs, that beneficial owner drops out of the market, and not always voluntarily.

The logical defence is, typically of this age, technological efficiency. This is certainly something we are prioritising here at FIS, working with our clients and prospects to develop a straight through SFTR solution, bypassing the delays and costs that will be associated with inserting third parties into the reporting chain.

There are two sides to a profitability equation, of course, with the need to raise revenues every bit as important as managing the costs of doing business.

FIS Astec Analytics data shows that the market is continuing to pivot away from the reliance on lower-margin, higher-volume businesses and concentrating on more profitable opportunities. Capital requirements have certainly constrained some lenders who have actively moved into more 'special' equity lending opportunities and the increasing rates being earned in some segments of the fixed income markets.

Cost is not the only issue of concern of course. It has been mentioned by some participants currently outside the reach of ESMA that they are considering ceasing to lend to European entities that would be reportable under SFTR. Such business would instead be moved to non-reporting borrowers (ie, those in other jurisdictions) although, as the FSB's global transparency requirements roll out, this may provide only a short-lived extension of the anonymity they currently enjoy.

If current estimated timetables are correct, by the last quarter of 2018, the requirements of SFTR will become real for banks and investment firms, with more organisation types drawn in over the next three quarters.

Between now and then there is a great deal of work to do. ISLA is working hard to set an industry agenda, aimed at steering the business through the trials of implementing the requirements of ESMA's regulations, to the benefit of all the market's participants.

FIS is working closely with ISLA and others to help ensure that our market finds the most cost efficient, accurate, effective and friction-free way to not only comply with the regulators needs for big data, but to bring competitive advantages from doing it efficiently.

The securities finance and collateral industry is facing a new trial that will help shape the way it does business in the future, but there is sufficient capability within the market to turn the pressure to change into opportunities rather than threats. **SLT**

Many will take up the opportunity to delegate their reporting requirements, particularly beneficial owners

David Lewis, Senior vice president
FIS Astec Analytics

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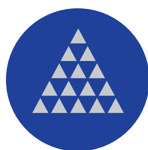

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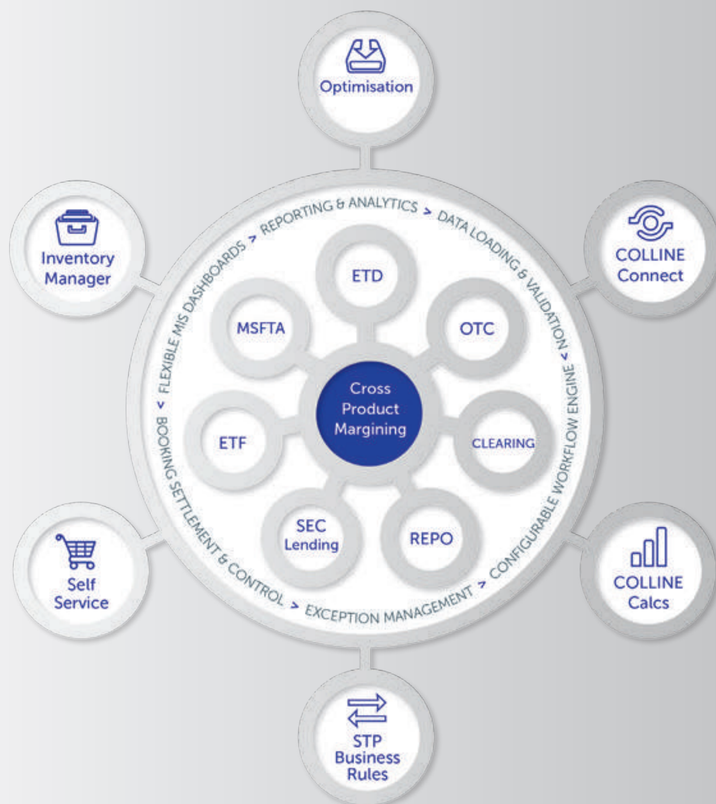

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Comings and goings at Lago Kapital, J.P. Morgan, BNY Mellon and more

Boutique securities finance firm Lago Kapital has bolstered its operations team with a spree of new hires.

Lago has brought on Olli Pohjonen, previously of Elite Asset Management, as sales director for Finland.

Tuomas Puotinen joins the firm's equity finance operations team. Puotinen previously served at Handelsbanken in global custody. Roope Moilanen also moves to Lago as a junior trader from United Bankers. All three will work out of the firm's headquarters in Helsinki.

J.P. Morgan has revamped its asset custody and agent lending desks with new talent.

Patrick Moisy will assume a newly-created role as head of custody and fund services (CFS), liquidity and trading services globally.

He will be responsible for risk activities within CFS, including agent lending, depository receipts, liquidity and collateral management. Moisy will report to Teresa Heitsenrether, head of custody and fund services.

Heitsenrether said: "Patrick Moisy is uniquely suited for this new role, with more than two decades of trading risk experience across asset classes. He also has spent the past two years optimising capital and funding across investor services and equities globally."

BNP Paribas's David Raccat will join Moisy's team in April as global head of CFS liquidity and foreign exchange (FX).

He will manage CFS client cash positions, with a primary focus on optimising on-balance sheet liquidity, and will be responsible for the CFS FX product.

Raccat moves to J.P. Morgan after 16 years at BNP Paribas, where he is currently ending his tenure as global head of markets services and head of Asia Pacific markets and financing services.

He will be relocating to London from Singapore for his new role. Other members of the CFS team include Stefano Bellani, who will continue as global head of trading services, with responsibility for the bank's agent lending and depository receipts businesses globally.

Michael Albanese remains as global head of collateral management, including securities and derivatives collateral management, while Robert Schwartz will continue as head of cross-line of business for off-balance sheet cash and liquidity markets product.

The Wall Street Blockchain Alliance (WSBA), a non-profit trade association, has recruited Banco Santander's Julio Faura to further its aims of bringing distributed ledger technology to financial markets.

Faura brings 20 years of financial experience, and also holds the position of head of research and development at the Spanish bank.

WSBA's mission statement promises to guide and promote comprehensive adoption of blockchain and distributed ledger technology across financial markets and to stand as a neutral, unbiased steward of education and cooperation between Wall Street firms.

Speaking on his latest appointment, Faura commented: "We are witnessing a rapid evolution of blockchain technology towards enterprise-grade readiness, unraveling the enormous possibilities of shared ledgers and smart contracts. I think it is now time to work collectively to better understand how this technology can effectively be used in a compliant and secure way."

"The goal is to advance the use of blockchain technology in order to offer customers services that are more efficient, faster and safer for numerous financial transactions."

WSBA chair Ron Quaranta said: "We are very privileged to have Julio Faura join our board. As a recognised expert on blockchain and innovation in financial markets, he will be instrumental in guiding the growth of WSBA and is a clear pioneer in the adoption of blockchain technology across global financial landscape."

BNY Mellon has named Dan Watkins as its new head of BNY Mellon Markets in Europe, the Middle East and Africa (EMEA).

Watkins will succeed Richard Gill, who is set to retire this month. Watkins and Gill will work together for a time, in order to ensure a smooth transition. In his new role, Watkins will oversee the growth of BNY Mellon Markets as regulatory and market structure changes lead to increased client demand.

Based in London, he will report directly to Michelle Neal president of BNY Mellon Markets, with regional accountability to Michael Cole-Fontayn, chair of BNY Mellon for EMEA.

Gill has been with BNY Mellon for over 20 years. He has also served of the Bank of England's Foreign Exchange Joint Standing Committee since 2017, and has sat on the Advisory Council of the Fixed Income, Currencies and Commodities Markets Standards Board since 2015.

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Watkins's appointment is subject to approval under the UK Senior Managers and Certification Regime.

Neal commented: "Dan Watkins will play a central role in further optimising the markets solution set to meet the evolving needs of clients."

She added: "His diverse experience and deep understanding of the pressures and opportunities facing all market participants will be particularly valuable as we intensify our client focus."

Cole-Fontayn said: "We would like to thank Richard Gill for his stellar contribution to BNY Mellon over the last 20 years."

"Under his leadership our EMEA markets business has garnered a reputation for exceptional client quality and performance."

Law firm Debevoise & Plimpton has bolstered its legal team focusing on broker-dealers and securities financing regulatory matters with the appointment of David Aman.

Aman has joined as a member of its corporate department and financial institutions group. He was previously a partner at Cleary Gottlieb Steen & Hamilton.

Debevoise & Plimpton described Aman as an experienced adviser to broker-dealers, other financial institutions and their counterparties on a broad range of product, transaction, insolvency and regulatory matters.

He has also represented leading financial institutions and trade associations on a wide range of matters stemming from broker-dealer and margin regulations.

Lee Schneider, head of Debevoise & Plimpton's broker-dealer regulatory practice, said: "Our broker-dealer clients require increasingly sophisticated products and other solutions to help them succeed in the current regulatory environment, and David Aman has consistently demonstrated the ability to help them meet their objectives."

"David's addition, particularly when integrated with the strong banking, insurance, derivatives and other practices in our financial institutions group, will further strengthen our position as a leading adviser to the most sophisticated broker-dealers and other financial institutions in the industry."

Aman commented: "Broker-dealers continue to face new challenges and opportunities in the ever evolving financial services landscape."

"I'm thrilled to coordinate with Debevoise & Plimpton's talented team of lawyers across the financial services spectrum to serve the needs of our clients."

Northern Trust has appointed Katharine Morris as head of sales for its UK global fund services business.

Based in London, Morris will be manage the investment operations outsourcing, fund administration and other asset servicing solutions available to UK-based investment managers.

Morris joins from HSBC Securities Services where she was head of UK sales.

Before this, she spent 10 years at State Street, holding various positions including global relationship manager.

In her new role, Morris will report to Douglas Gee, head of sales for Northern Trust's asset servicing business in Europe, the Middle East and Africa.

Laurence Everitt, head of global fund services for the UK at Northern Trust, said: "Her experience working with some of the UK's most sophisticated asset managers will be valuable as we continue to grow our global funds services business in the region working closely with prospective clients to tailor solutions that meet their specific needs."

Japanese bank Nomura has re-bolstered its equity finance team with the appointment of Tom Rafferty.

Rafferty, previously vice president and trader on Citi's stock lending desk, began his new role in March and is based out of the bank's London office.

The equity trading portion of Nomura in Europe, the Middle East and Africa was stripped back last year, including a swathe of the equity finance team, but the bank has now renewed its interest in the business. **SLT**

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