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ESMA issues final SFTR standards, but concerns remain

The European Securities and Markets Authority (ESMA) has issued its final report on standards implementing the Securities Financing Transactions Regulation (SFTR).

The SFTR reporting requirements come as part of the EU's bid for greater transparency in transactions resulting in a demand for a complete breakdown of their most intimate details.

Commenting on the final SFTR rules, Ben Challice, COO at Pirum Systems, said: "It's good to see that ESMA has listened to the industry with regard to items such as collateral reporting moving to value date+1, but it's clear that a lot of the concerns raised by market participants and infrastructure providers have not been addressed."

Challice explained: "The concept of an execution timestamp as a data field has not been removed, which is surprising given under the second Markets in Financial Instruments Directive, securities finance transactions are recognised as 'non-price forming transactions' in relation to best execution."

"ESMA has, however, included a one-hour tolerance when subject to reconciliation."

He added: "This has not addressed key concerns raised by market participants such as the fact that it is a principal level reporting requirement (but only the omnibus delivery would have a timestamp) together with the fact that the majority of transactions or lifecycle events (trade reallocations, corporate actions) are not executed on a trading venue and, therefore, within the securities finance industry there is no infrastructure to agree, record and maintain an execution timestamp."

As a result, "running the transaction through a reconciliation process before reporting is the only way to achieve the expected matching at the trade repository", Challice explained.

ESMA's final standards provide detailed provisions on a range of issues, including the use of ISO 20022 methodology for reporting, validation and access to data, the use of standardised identifiers such as LEI, UTI and ISIN, defined access levels for different public authorities, and the registration and extension of registration of trade repositories.

In addition to SFTR, ESMA has proposed certain amendments to the existing standards implementing the European Markets and Infrastructure Regulation (EMIR), to ensure a level-playing field for market participants when it comes to registration and access rules. The implementing measures are expected to enter into force by the end of 2017.

Market participants would have to start reporting their transactions to trade repositories 12 months after publication in the Official Journal of the EU. The reporting obligation will be phased in over nine months.

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Leverage Existing Connection
UTI at Point of Trade or Comparison
Transaction Timestamp

Matching

SIMPLIFYING SFTR

OUR INNOVATION. YOUR ADVANTAGE.

ESMA issues final SFTR standards, but concerns remain

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ESMA chair Steven Maijoor said: "Bringing transparency and oversight into the multi-trillion euro market of securities financing transactions is an important step in closing a regulatory gap. It is pivotal for financial stability that the risks associated with non-bank alternative credit provision are properly addressed."

"The SFTR will provide transparency on the use of securities financing transactions, and will allow identifying risks associated with the collateral and its reuse."

ESMA has sent its final draft technical standards under SFTR and the amended technical standards under EMIR for endorsement to the European Commission, which has three months to decide whether to endorse them.

Deutsche Börse-LSEG merger blocked

The European Commission has prohibited the proposed merger between Deutsche Börse and the London Stock Exchange Group (LSEG), saying it would cause a "de facto monopoly", and that the proposed measures to counter this were not enough.

Although LSEG's sale of its France-based clearing house LCH.Clearnet SA would have resolved concerns around single stock equity derivatives, it would not have addressed the creation of a monopoly in fixed income clearing.

Margrethe Vestager, commissioner in charge of competition policy at the European Commission, said: "The European economy depends on well-functioning financial markets. That is not just important for banks and other financial institutions. The whole economy benefits when businesses can raise money on competitive financial markets."

"The merger between Deutsche Börse and the London Stock Exchange would have significantly reduced competition by creating a de facto monopoly in the crucial area of clearing of fixed-income instruments. As the parties failed to offer the remedies required to address our competition concerns, the commission has decided to prohibit the merger."

In February, despite the proposed sale of LCH. Clearnet SA, the commission raised concerns regarding MTS, LSEG's Italian electronic trading platform for European wholesale government bonds and other fixed income securities.

Following market testing of the proposed merger, the commission ordered LSEG to sell the MTS platform. But the board of LSEG declined, calling the request "disproportionate". The board suggested structural changes that would mean MTS would account for less than 10 percent of its overall gross income.

In a statement, LSEG disputed the notion that these measures were inadequate and criticised the decision to block the merger.

The statement said: "LSEG does not agree with the view that a business of LCH SA's scale would not be a viable stand-alone competitor without the concurrent sale of MTS."

It went on to say that the package put forward was "clear cut, viable, and addressed the commission's competition concerns". While the statement affirmed LSEG's confidence as a standalone business, it also said: "LSEG believes the proposed merger with Deutsche Börse, in combination with the LCH SA remedy, would have preserved credible and robust competition in all markets. This was an opportunity to create a world leading market infrastructure group anchored in Europe, which would have supported Europe's 23 million small and medium-sized enterprises and the development of a deeper capital markets union."

Deutsche Börse also said in a statement that it "regrets the decision taken", and will now focus on other initiatives, including its Accellerate growth strategy.

Joachim Faber, chairman of the supervisory board of Deutsche Börse, said: "The prohibition

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Malaysia mulls short selling expansion

Kuala Lumpur | Reporter: Drew Nicol

The Central Bank of Malaysia is considering expanding the country's short selling and repo frameworks in a bid to improve market liquidity.

In a recent roundtable hosted by the central bank's financial markets committee, 30 delegates representing domestic and institutional financial entities discussed the health of the country's bond market.

Proposals were tabled for further expansion of the short selling framework to include bonds, as well as increasing participation in the repo, bond swap and interest rate swap markets.

In a statement on the discussion, the Central Bank of Malaysia said: "The further development of onshore hedging will complement the liquidity in the secondary market, particularly on the longer end of the yield curve."

The group also examined using repos as an alternative liquidity management tool and funding instrument for financial institutions.

The annual trading volume has been growing since the Central Bank of Malaysia liberalised short selling and reverse repo operations in 2015. The trading volume of repos averaged MYR 195 billion (USD 44.18 billion) per annum since 2012. According to the central bank, the roundtable highlighted the need to review existing regulatory frameworks to allow more diverse participants in the repo market.

Adnan Zaylani Mohamad Zahid, assistant governor at the Central Bank of Malaysia, said: "The next phase of development of the onshore bond market requires support and commitment from issuers, investors and market makers to improve liquidity, add breadth to financial market and support issuances for government and corporate bonds"

"The focus should be on diversifying the investor base, having a stable composition of investors and increasing transparency that will enhance market stability."

is a setback for Europe, the capital markets union and the bridge between continental Europe and Great Britain. A rare opportunity to create a global market infrastructure provider based in Europe and to strengthen the global competitiveness of Europe's financial markets has been missed."

Carsten Kengeter, CEO of Deutsche Börse, added: "Deutsche Börse is well-positioned on a stand-alone basis to compete at a global level with other market infrastructure players."

"We will continue to pursue our growth strategy, to strengthen our innovation capabilities and to even better serve market and customer needs. Through this strategic approach we want to create added value for our clients and shareholders and contribute to the positive development of Frankfurt as financial centre."

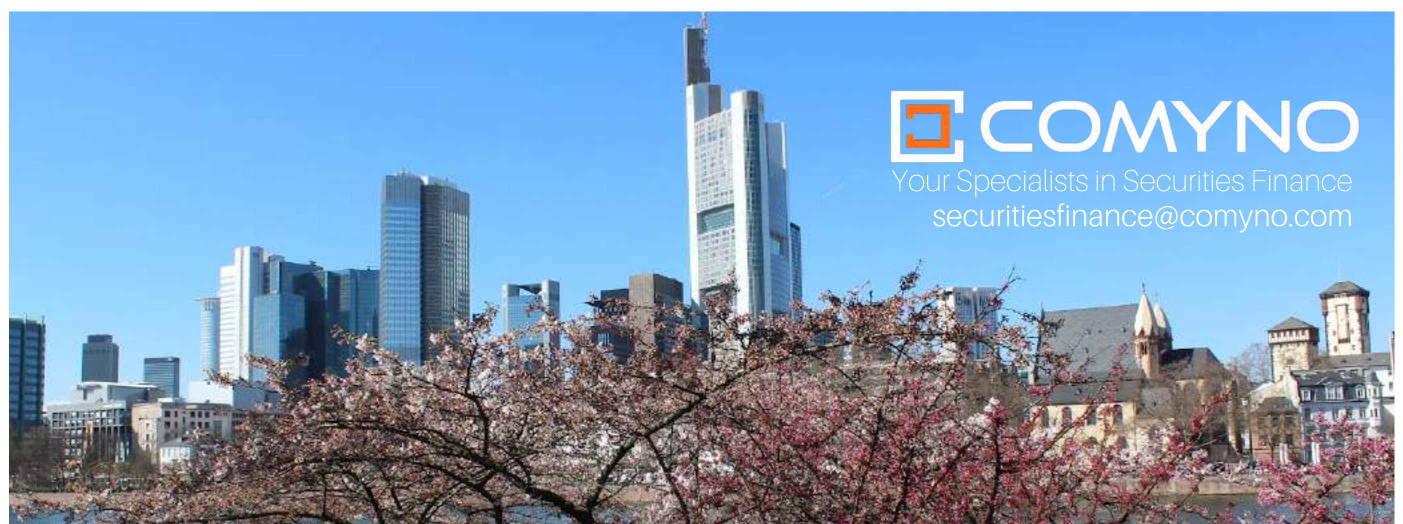
Liquidity aims of CMU face obstacles

EU legislators should open up UCITS fund securities lending and pay closer attention to the lending of government bonds to meet its liquidity targets when developing the capital markets union, the International Securities Lending Association has said.

Responding to an ongoing European Commission consultation on the capital markets union, ISLA said there is an increasingly disproportionate imbalance between securities held by UCITS funds that are available for lending and securities actually on loan, "showing major untapped potential for improving liquidity in the market".

The continued developing trend of government bonds, in particular EU government bonds, being used in securities lending transactions also shows potential for rising risks of a liquidity squeeze in those instruments, which could affect EU governments' costs of funding, ISLA warned.

ISLA blamed the availability-utilisation imbalance on particular UCITS directive



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provisions, such as those that favour the use of title transfer arrangements in respect of any collateral received from borrowers, forcing them to look for alternative sources of supply when they prefer to pledge.

"This also means that UCITS cannot consider any central clearing models for securities lending or repo transactions, which often rely on pledge structures. It seems strange that the regulatory drive to move to central clearing is currently closed to these institutions."

ISLA summarised: "From a market liquidity and broader market stability perspective, although the supply of assets made available for lending from UCITS funds remains broadly unchanged at circa €6.6 trillion, the demand for these assets has dramatically fallen since 2014.

"This means there are fewer securities available in the market to cover potential settlement fails and to support market making and efficient hedging of risk."

The European Commission should review those elements of the UCITS directives that restrict these funds' ability to fully engage with securities lending, ISLA recommended.

The situation with government bonds is more complex, but boils down to demand increasing as supply has fallen, with ISLA warning: "Should this trend persist (and notably as further liquidity requirements, such as the net stable funding ratio, are implemented), EU government bond markets could experience significant stress."

"From a capital markets union perspective, and in particular for smaller member states, we believe it is essential for Europe to have liquid and sustainable government bond markets—even more so post-Brexit."

"Therefore, in addition to the important work that the commission is coordinating on corporate bond market liquidity, we encourage the commission to consider conducting a similar effort for EU sovereign bond markets."

ISLA recommended setting up an expert group to analyse potential upcoming liquidity stresses in the EU government bond market.

Deutsche AM cuts collateral margins

Deutsche Asset Management has cut its securities lending collateral margin requirements for its db X-tracker exchange-traded funds.

Collateral margins for common stock and corporate bonds dropped from 110 percent to 105 percent for both collateral types, as of 22 March.

The new requirements only apply for transactions where BNY Mellon is acting as triparty.

In a note to clients, Deutsche Asset Management clarified that no costs related to this policy change will be borne by db X-trackers investors.

Subprime default spike lacks interest

US short sellers are yet to capitalise on the large rise in credit defaults in the auto loan and car manufacturing industries, according to IHS Markit.

In a research note on the uncharacteristic lack of activity, analyst Simon Colvin revealed that US subprime loan defaults recently climbed to the highest level since the financial crisis, but demand to borrow related stocks did not respond.

"Short sellers have proved to be some of the canniest investors when it comes to getting ahead of a large rise in credit defaults."

"Be it the energy slump last year or the real estate crash of the last decade, any surge in default rates from an industry over reliant on credit is sure to draw more than its fair share of shorting activity," Colvin explained.

IHS Markit data showed that the majority of short interest that did exist was concentrated in the smallest of the three listed auto loan originators, such as Credit Acceptance.

"The recent spike in defaults hasn't sparked much interest from short sellers as the demand to borrow Credit Acceptance shares has remained range bound between 10 percent and 12 percent of its shares outstanding for the last 12 months," Colvin added.

Short sellers also failed to cash in on the Ford's poor quarterly results, as demand to borrow its shares fell by more than 80 percent following a peak last summer.

Deutsche Bank defies Brexit fears with plans for new HQ in London

Deutsche Bank has signalled its commitment to staying in the UK post-Brexit by entering into negotiations over a new headquarters in London.

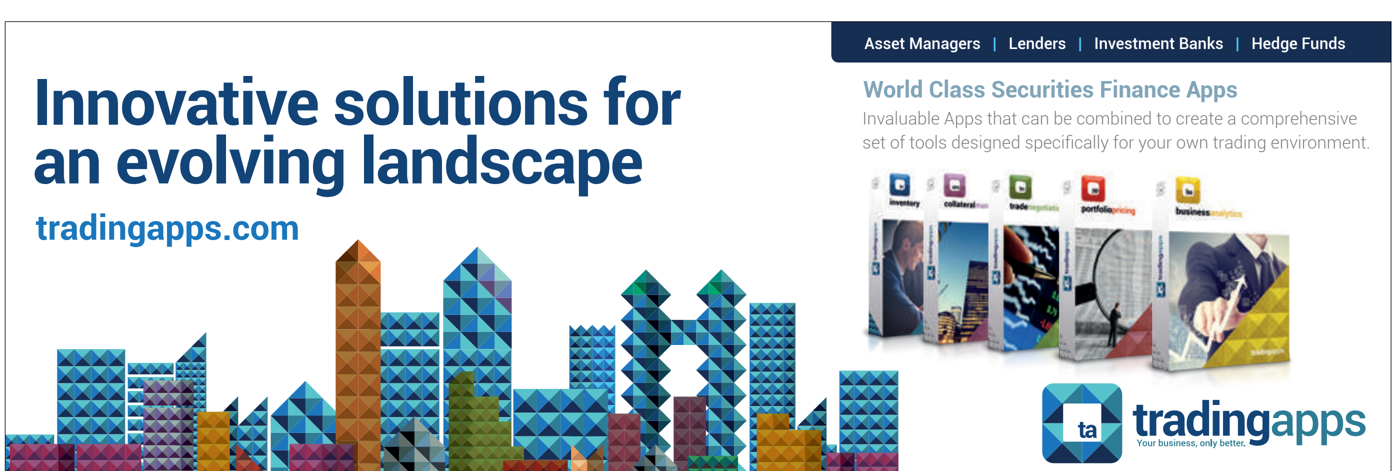
Staff were reportedly told on 23 March that the German bank would remain in the UK following the country's exit from in the EU in 2019 and move to a new building at 21 Moorfields.

Deutsche Bank UK chief Garth Ritchie reportedly said the move, scheduled for 2023, "underlines the bank's commitment to the City of London", where it currently employs more than 7,000 people across a dozen or more sites.

Site owner Land Securities confirmed 21 Moorfields is undergoing redevelopment, with demolition of the site's current buildings to be completed shortly, although it was reluctant to confirm that any pre-let deal with Deutsche Bank had actually been agreed.

The property company commented: "Land Securities is also in discussions with Deutsche Bank regarding a pre-let for the development which would require alterations to the design of the building above ground. These negotiations will take several months and there is no guarantee they will lead to a transaction."

Goldman Sachs was the last high-profile bank to confirm it would move jobs away from the



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UK and create a stronger presence in mainland Europe following Brexit. It did point out that these are contingency plans and didn't confirm any specific details.

Lending gives iShares ETF the edge

Revenue generated from the securities lending programme of the iShares ETF has allowed it to be one of US investment research firm Morningstar's "highly rated exchange-traded funds (ETF)".

The ETF, which tracks the Bloomberg Barclays Euro Government Inflation Bond Index, is physically replicated and levies a slightly higher ongoing charge of 0.25 percent.

In a research note on the effect of rising EU inflation on ETFs, Morningstar said: "At first sight, the fee looks a bit toppy."

"However, its tracking difference has routinely come in below the ongoing charge, partly thanks to revenues generated by securities lending."

The iShares ETF lent out an average of 28 percent of its assets for a net return to the fund of 4 basis points last year.

The research firm noted that "inflation in the eurozone has spiked markedly in the space of a few months", which adds to the attractiveness of ETFs and traditional index funds that can provide exposure to the market of eurozone inflation-linked bonds.

ESMA still unable to quantify haircut market risk, says report

The use of haircuts in EU securities finance markets can "contribute to procyclicality and financial instability by reinforcing asset price movements", according to the European Securities Markets Authority (ESMA).

In a report on the risks faced by the EU financial markets, haircuts in securities finance transactions markets was flagged as a potential vulnerability to financial stability.

ESMA said: "Haircuts are helpful risk management tools, but haircut levels are also part of the negotiation between counterparties trading bilaterally."

"Haircuts may thus change over time to reflect the evolution of market conditions, and can contribute to procyclicality and financial instability by reinforcing asset price movements."

The EU regulator also warned that "the data available on haircuts is sparse and little is known of current market practices".

The lack of transparency will remain until the reporting obligation under the Securities Financing Transactions Regulation (SFTR) begins in the course of 2018.

"Until SFTR data becomes available, the implementation and calibration of policy instruments run the danger of being based on partial or inconclusive empirical evidence."

"This would increase the risk of unintended consequences and could reduce the probability of achieving financial stability objectives in the context of haircuts."

The methodologies for calculating haircuts can be qualitative, quantitative or a combination of the two.

According to ESMA, quantitative methodologies tend to be used more frequently in repo markets, possibly reflecting the relative importance of banking counterparties. Quantitative methodologies sometimes involve back-testing or regular stress-testing using different scenarios.

Collateral and counterparty analysis are the two key components used to determine haircuts. Counterparty credit risk plays a role prior to the transaction, in deciding whether or not to trade, and during negotiation on the terms of the trade.

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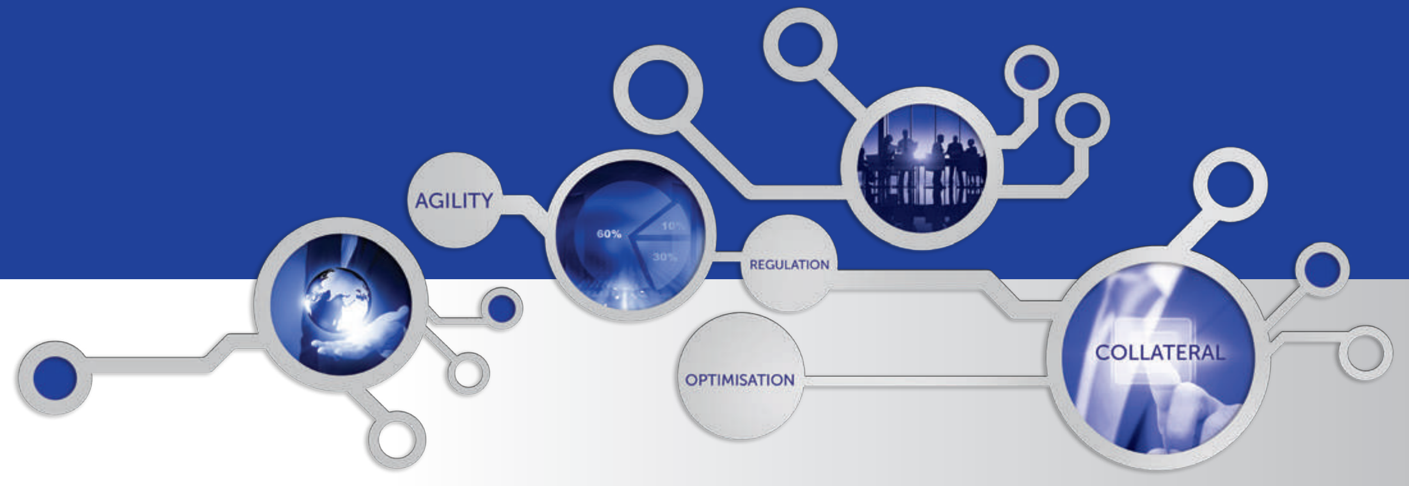

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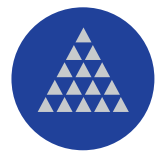

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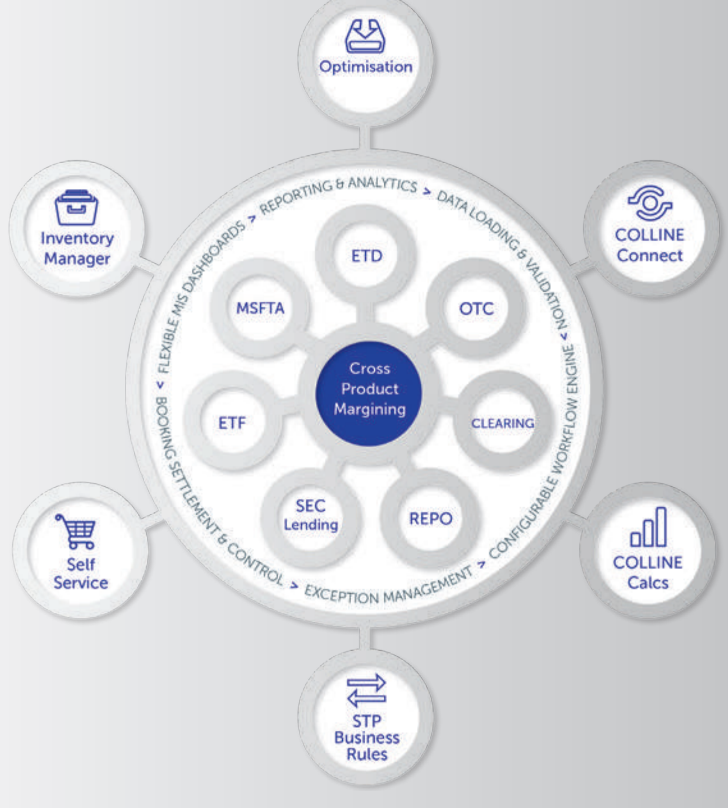

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Investment Association: Keep to the code

London | Reporter: Mark Dugdale

A UK asset management-backed industry code to standardise disclosure for charges and transaction costs has recommended specific treatment for securities lending to meet national and European regulatory requirements.

The Investment Association launched a public consultation on the standardisation of disclosure for charges and transaction costs on 27 March.

Its code "provides a blueprint for the reporting of charges and transaction costs using a consistent approach across the market and in line with regulatory requirements", including those set down in the Packaged Retail and Insurance-based Investment Products Regulation, second Markets in Financial Instruments Directive and the UK's final rules for disclosure in workplace pensions, known as FCA CP16/30.

Under the proposed code, any earnings from securities lending that are not paid to a unit-linked fund should be treated as a cost and disclosed as such, as should any other payments to agent lenders.

"The disclosure should enable the client to understand the total revenue generated and the proportion of the total they actually receive. The beneficiaries of the revenue sharing arrangements should be identified."

"Where lending arrangements exist between the client and custodian with no involvement of the manager, any reporting should be provided to the client directly by the custodian without involving the manager."

Jonathan Lipkin, director of public policy at the Investment Association, said: "The new code provides for the first time a common framework for enhanced disclosure across investment products and services. It is a major opportunity to consistently define and provide data on charges and transaction costs."

He added: "The Investment Association would like to work with the FCA to seek regulatory recognition for the new Code in the Financial Conduct Authority's Conduct of Business Sourcebook."

"This consultation is designed to encourage feedback from industry, consumer, government and regulatory bodies on the proposed approach ahead of the code's final implementation and we welcome views from all stakeholders."

The closing date for consultation responses is 19 May.

A final set of proposals will be published in Q3 2017.

OCC clearers due $47m refund

OCC has confirmed that its next instalment of refunds and dividends will delivered later this year.

Clearing members of OCC are due a refund of approximately $46.6 million, while a dividend of roughly $25.6 million will go to stockholder exchanges, according to OCC.

The clearinghouse clarified that these payments would be made "sometime in the third quarter of 2017".

OCC executive chair and CEO Craig Donohue said: "These actions taken under our approved capital plan are consistent with the operative fee, refund, and dividend policies approved by the US Securities and Exchange Commission and align with regulatory expectations."

SEC to move US to T+2

The US has moved to the shorter settlement cycle of T+2, after the Securities and Exchange Commission (SEC) formally introduced widely expected rule amendments.

The amendment of Rule 15c6-1(a), which was introduced on 22 March, is designed to enhance efficiency, reduce risk, and ensure a coordinated and expeditious transition by market participants.

Broker-dealers will be required to comply with the amended rule from 5 September, as recommended by the SEC's industry steering committee. From that date, all securities sales contracts must assume a T+2 settlement cycle unless otherwise expressly agreed to by the parties at the time of the transaction.

The rule change includes transactions for stocks, bonds, municipal securities, exchange-traded funds, certain mutual funds, and limited partnerships that trade on an exchange.

Members of the SEC's industry steering committee, including the Depository Trust &

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Clearing Corporation (DTCC), were quick to praise the commission on the amendment.

In a joint statement on the rule change, the committee said: "Shortening the time it takes to settle trades from the current three-day cycle, known as T+3, to T+2 will provide significant benefits to investors and market participants."

"A shorter settlement timeframe will reduce credit, market and liquidity risks, promote financial stability, and align the US with other T+2 settlement markets across the globe."

DTCC noted that, given the lower levels of risk associated with a shorter settlement cycle, the move will reduce the average daily capital requirements for clearing trades through DTCC's National Securities Clearing Corporation (NSCC) by 25 percent, or some $1.36 billion.

Murray Pozmanter, head of clearing agency services and global operations and client services at DTCC, stated: "We are pleased to see the SEC take important action to align the US settlement cycle with other key markets around the globe. We commend acting chairman Michael Piwowar and commissioner Kara Stein for their dedication and leadership on this issue."

"This critical step will ensure that market participants are working towards a common goal, which will ultimately reduce risks and costs for the benefit of the industry."

Stein, speaking ahead of the vote on the adoption of the T+2 amendment, of which she was a central player, praised the initiative to tackle counterparty risk, but concluded that, due to the technology that now exists in financial markets, trimming one day from the standard cycle should only be considered a stop-gap solution.

"Today's amended rule is an attempt to catch up with technology developments in the world around us. The current settlement cycle standard of three days after a trade is woefully behind the times," said Stein.

"Currently, standards vary around the globe, but most are moving to shorter settlement cycles."

Stein also recommended a new study be completed into what "further improvements" could be made.

The results of the study are due within three years of the T+2 compliance date.

"While movement to a T+2 standard settlement cycle is an improvement from the current T+3 standard, more can and should be done. At this very moment, technological, operational, and communications improvements exist that could enable T+1 and end-of-the-day settlement cycles," Stein added.

Hedge funds open to fee cuts

Hedge funds are slashing fees to woo back investors and recover from significant capital outflows in 2016.

The results of a Preqin survey of 276 hedge fund managers taken in November 2016 and released this week found "fundraising and retaining investor capital [by fund managers] to be significant challenges".

As a result, three-quarters of those surveyed stated they are willing to reduce their fees, and many intend to spend more on marketing in the year ahead in a bid to overcome investor scepticism about the value of investing in hedge funds, according to Preqin.

The data revealed that 10 percent of respondents are considering cutting performance fees, while 37 percent would reduce their management fees, and 27 percent are open to reducing both.

A further 26 percent said they are not willing to reduce fees at all.

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CACEIS chosen to provide securities lending services to Munich-based Orca Capital

Munich | Reporter: Drew Nicol

CACEIS has been selected to provide securities lending services to Munich-based Orca Capital for its global securities and bonds trading business.

The securities lending services come as part as part of a wider mandate for CACEIS to provide cash equity clearing and settlement services.

The new partnership began at the end of 2016.

Wolfgang Burckhardt, managing director at Orca Capital, said: "We were keen to engage a local, German-speaking service provider with a flexible client-centric approach and responsive support teams."

"We look forward to strengthening this initial partnership, and are confident that CACEIS's expertise in cash equity clearing and asset servicing will benefit our company."

"The high levels of straight-through processing, combined with global market knowledge, meet our requirements in terms of speed and efficiency of securities transaction processing," Burckhardt added.

Holger Sepp, member of the management board of CACEIS in Germany, commented: "We are very pleased to be working with Orca Capital, which is active on the world`s leading stock markets."

"CACEIS offers market-leading cash equity clearing services out of its group servicing center in Germany. We are delighted to count Orca Capital among our many large national and international clients."

When questioned about key drivers of market change in 2017, performance and investor demands for more favourable fees were cited by 73 percent and 64 percent of fund managers, up from the 33 percent and 28 percent that highlighted these factors as key in 2016.

Almost most half of fund managers said it was harder to raise capital in 2016 compared to 2015, and 36 percent said that it was harder to retain assets.

Amy Bensted, head of hedge fund products at Preqin, said: "Investor dissatisfaction shows no signs of abating in the early part of 2017, and it is clear that addressing investor pressure around performance and fees will be the key challenge for hedge fund managers in the year ahead."

Managers will be looking to build on the three-year high returns of 7.3 percent seen in 2016 to restore confidence in the asset class as a whole, revive investor sentiment and begin reversing the trend of outflows from hedge funds.

Bensted continued: "Although investors show high levels of concern about the short-term performance of the industry, hedge funds have proved their worth in the portfolio of institutional investors on a risk-adjusted basis over the long term."

"Investors have also indicated that they want to see further reductions of hedge fund fees, and it seems as though managers are increasingly looking to provide them."

"Firms that can generate healthy returns for their investors and meet concerns over fees could truly set themselves apart from their peers in 2017."

Northern Trust retains Aus mandate

Northern Trust has received a new mandate from the Australian government employee and Defence Force pension fund to perform custody and related investment administration services, including securities lending.

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The pension fund, known as the Commonwealth Superannuation Corporation (CSC), represents AUS 40 billion (USD 30.6 billion) of assets and has retained Northern Trust as its primary asset manager and supplier of capital market services since 2011.

CSC manages 11 superannuation schemes and provides superannuation services.

The renewed mandate marks the latest push by Northern Trust into the Australian market after it established a second Australian office in Sydney.

The bank also acquired institutional equity brokerage Aviate Global in 2016.

Madeleine Senior, managing director of Northern Trust for Australia and New Zealand, said: "At Northern Trust, we work in partnership with all our clients to deliver the highest quality solutions to the ever-evolving requirements and challenges they are facing. Our global custody platform ensures our client's assets are well protected and our superannuation fund clients are positioned to meet the changing political, economic and regulatory challenges."

"Equally, as our Australian superannuation fund clients grow their relationships with us we have expanded our capital markets service offering to include securities lending, foreign exchange capabilities and brokerage. CSC values Northern Trust's flexible and scalable global investor services and we are delighted to have the opportunity to extend our long and rewarding relationship together."

CSC CEO Peter Carrigy-Ryan added: "CSC regards its relationship with its custodian as a strategic business relationship, and following a full market review, we are proud to continue our relationship with Northern Trust."

"Over the past five years, we have worked closely to ensure we collectively raise the bar for global best practice in investment operations. This endorsement supports CSC's strategic investment operational goals of automation, efficiency, robustness and transparency."

Commenting on the growth of Australia's securities lending market ahead of the Pan Asian Securities Lending Conference/Risk Management Conference in Seoul in March, Natalie Floate of BNP Paribas, said: "In Australia, we are seeing a change in approach and appetite for securities financing products from superannuation funds. This has been driven by the general return to focusing on fund performance after several years in which the agenda has been dominated by risk management and regulatory change."

Pension funds embrace alternatives

UK public sector pension funds are jostling to expand their alternatives exposure as a way to diversify their portfolios ahead of the launch of the Local Government Pension Scheme (LGPS) pooling project in April 2018.

A State Street-sponsored report into pension scheme asset allocation revealed a 61 percent spike in exposure to alternatives among the 89 public funds participating in the LGPS.

A further £34.7 billion in assets were given over to fixed income, leading to a 31 percent increase in those business lines.

The report explained that "traditional assets classes such as equities and fixed income remain core holdings for these funds with equities accounting for 48 percent, and fixed income accounting for 14 percent of their overall allocation".

State Street's data also highlighted a 13 percent increase in overall scheme assets, bringing the total to £251.8 billion. Overall exposure to equities went up by 9 percent to £251.8 billion.

Andy Todd, head of UK pensions and banks, asset owner solutions for State Street, said: "Mounting costs and pressures lower-for-

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German Federal Bank president calls for review of ECB bond purchase policy

Munich | Reporter: Drew Nicol

Strong EU-wide economic growth means the European Central Bank (ECB) should finally begin unwinding its "very loose monetary policy", according to the president of the German Federal Bank.

German Federal Bank president Jens Weidmann, who is also chairman of the board of the Bank for International Settlements, described the ECB's public sector purchase programme, which is currently buying up €80 billion worth of government bonds per month, as "a pure emergency instrument, for example, to avert deflation".

The current programme will be maintained until the end of March, at which point the monthly target will drop to €60 billion, until the end of December 2017.

"One thing seems to me to be quite clear in view of the current prognosis: we are now a long way from a deflation, ie, an expectation-driven downward spiral in which wages and prices are mutually profound. I have always regarded this fear as exaggerated in the past," stated Weidmann in a recent speech at the Rotary and Lions Club in Lörrach, Germany.

"The extensive purchase of government bonds blurs the dividing line between monetary policy and fiscal policy. Central banks in the euro area have now become the largest creditors of the member states. I consider this to be problematic in several respects."

The call for a review will be welcomed by the EU's beleaguered repo market, which has suffered from increasing severe month- and year-end liquidity cliff edges.

Speaking in response to Weidmann's speech, Roelof van der Struik of PGGM Investments, the second largest pension fund in the Netherlands, said he was less optimistic about the negative unintended effects of the combination of regulation, monetary policy and purchasing programme.

"The repo market may not be broken, but it is clear that it is not in good health and could break-down completely during a 'poorly' timed event or moment of market stress."

"There seems to be two main drivers for this: capital rules impeding/de-incentivising banks to provide repo market liquidity, and poor liquidity in the bond market due to quantitative easing." Van der Struik continued: "This translates into key liquidity risk and could result in, for example, pension funds unable to meet cash collateral calls while owning more than enough high-quality liquid assets."

In its latest report into the EU repo market, the International Capital Market Association (ICMA) didn't mince its words when it described the extreme volatility and dislocation during a year-end liquidity crunch in 2016.

ICMA's European Repo and Collateral Council has warned: "[The repo market stress] could heighten risks related to banks' and firms' ability to meet margin calls, which in turn could have systemic consequences."

The council described how a perfect storm of post-crisis regulation, the financial policy of central banks, along with other global market trends, are "very much acting in confluence to precipitate the perfect storm".

Weidmann touched upon a similar theme later in his speech, stating: "One thing should also be clear to us: as the duration of the ultra-loose monetary policy increases, the intended effects diminish, while the undesirable side effects become more and more visible. This includes not only the risk of unsolicited state finances. Low interest rates can also pose a risk to financial stability.

"Thus, low interest rates and unconventional monetary policy can increase the risk in some financial market segments or in the real estate market," Weidmann said.

longer yields have led pension fund investment committees to seek 'higher yielding' assets to assist them in meeting their strategies investment targets."

JR Lowry, head of State Street Global Exchange EMEA, added: "LGPSs are in a period of extreme change and technology will be the next stage of their evolution."

FCA sheds light on MiFID II rules

The UK's Financial Conduct Authority (FCA) has published near-final rules on its implementation of the second Markets in Financial Instruments Directive.

In a policy statement on the implementation, the FCA clarifies some of its requirements around data reporting service providers as a category of firm, reporting requirements and position limits for commodity derivatives.

The statement also outlines system and control requirements for firms providing MiFID investment services, and clarifies portfolio management as an investment service under the directive.

The FCA plans to finalise the rules in another statement due to be released in June, however, the regulator specified that any firms affected by the changes to the implementation plans should apply for authorisation, or a variation of permission, now.

Otherwise, such firms risk being prohibited from operating in the UK market after 3 January 2018, when the directive comes into effect.

Christopher Woolard, executive director of strategy and competition at the FCA, said: "MiFID II introduces substantial and wide ranging measures designed to improve investor protection and promote market integrity."

"Some firms will need to be authorised for the first time, others will need to vary their current permissions."

"It is critical that those firms submit their applications now. The FCA does not expect to make any significant changes to these rules before they are finalised in June this year, and therefore firms should not delay."

As a directive, MiFID II is prescribed at EU level, laying out particular aims and requirements. The rules are transposed into law in each EU member state, allowing local regulators some flexibility as to the method of implementation.

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UK kicks off Brexit with activation of Article 50

What should securities finance be doing to prepare?

The UK has officially pulled the trigger on Article 50 and commenced the two-year negotiation process that will end in its exit from the EU.

With the activation of Article 50 of the Treaty of Lisbon, EU legislators are convening to decide what positions they will take on a range of issues, from the rights of EU citizens in the UK to financial services passporting.

The Article 50 letter, which was signed by UK Prime Minister Theresa May on 28 March, was handed to Donald Tusk, president of the European Council, at lunchtime on 29 March.

May, addressing the UK House of Commons immediately after the UK's Article 50 letter was hand delivered to Tusk, said: "This agreement should allow for the freest possible trade in goods and services between Britain and the EU's member states It should give British companies the maximum freedom to trade with and operate within European markets—and let European businesses do the same in Britain. But I want to be clear. What I am proposing cannot mean membership of the single market."

Official negotiations between the EU and the UK's Brexit team are expected to commence soon, with guidelines circulating as to what position the EU 27 will take on key issues. The process can last no more than two years, unless the European Council approves an extension.

Membership of the EU is complex, with many aspects of UK legislation intertwined with or underpinned by regulations and directives designed in Brussels.

UK ministers will have to negotiate the terms of the exit from the EU, lobby for and begin discussions about a new trade deal with the 27 remaining member states, do the same with every other country around the world, and begin reforming its own laws. The mooted Great Repeal Bill will preserve EU law in UK legislation in one fell swoop, although this is still subject to parliamentary scrutiny and controversy surrounding how much power it will give ministers to tear up the statute book.

A leaked copy of the European Council's negotiating guidelines suggested that the so-called 'divorce' arrangements will have to be settled before any decisions on a future relationship can be made.

Speaking on the eve of the activation of Article 50, Andrew Dyson, CEO of the International Securities Lending Association, said: "Following the triggering of Article 50, we remain mindful of the potential effects on our industry and member firms."

"After the vote to leave on 23 June 2016, we emphasised how our legal constructs and routine operating procedures would remain unaffected by the vote in the short term and that remains the case today."

Dyson said: "However, as the process of negotiations to leave the EU develops we expect our member firms to be making important decisions about how they will be organised in a post-Brexit world. In that regard we remain opened minded in terms of how we respond to those challenges and will work with our members and regulators as the landscape changes."

For the securities finance industry, Brexit "may mean a rethink on how to structure, book, execute and report transactions", according to Michael Huertas and Kai Schaffelhuber of Allen & Overy in Frankfurt.

This includes a need "for market participants to remain cognisant on how the uncertainty that Brexit brings will continue to affect their business and those of their counterparties. This generally merits advance planning."

"Whilst it is inconceivable that the appeal of English law, as an international public utility in financial market transactions will diminish, the process of reassessing the location of activity has become a key topic for firms with an uplift in activity moving to the eurozone."

Huertas and Schaffelhuber added: "A lot will also hinge on how the EU views the concept of regulatory equivalence, a concept that is itself under review, and whether a post-Great Repeal Bill in the UK will be able to meet the equivalence standards of the EU in its new post-Brexit position as a 'third-country'."

"This is possibly the case even if large parts of EU legislation relevant to the securities finance sector are retained, or subjected, as is more likely, to carve-outs that grant exemptions for smaller firms or domestic transactions." **SLT**

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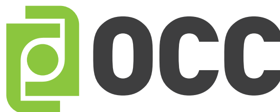

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Drew Nicol reports

Build it and they will come

Guy Usher, one of the masterminds behind Fieldfisher's new legal documentation platform for securities finance and derivatives, explains what Condor Alternative Legal Solutions can do at a time of regulatory upheaval

What does the Condor Alternative Legal Solutions platform offer clients?

At this time, we have three main product offerings under Condor Alternative Legal Solutions. First, we provide outsourced contract negotiations for both buy- and sell-side participants. We do this using our offshore facilities in Belfast and Cape Town, along with the legal layer and quality assurance here in London. This aspect of our platform can provide overflow capacity or effectively take out existing headcount for a firm that is already doing this, but may be struggling with costs or space.

The second aspect of our offering is the often much larger scale documentation projects, which could range from a very simple Securities Financing Transactions Regulation (SFTR) outreach or an upgrade to contracts.

Recently, this has been very regulation-driven. For example, in the over-the-counter world, we've been involved in a project on the re-papering of credit support annexes for the new margin rules, and we're bidding at the moment for some similar projects related to the second Markets in Financial Instruments Directive (MiFID II).

Finally, Condor offers data extraction and analytics, meaning taking various documents, identifying the key data points—for all the key stakeholders in a business—so that clients can reconcile documents internally to multiple systems and analyse them in a multi-dimensional way.

Who are your target demographic for this product?

In terms of the size of our clients, there are clear economies of scale available. On trading documents, we are servicing tier-two banks who don't have their own service centres.

However, even large US-based investment banks are considering using our platform for additional support as their own teams are at capacity.

Large-scale out-reaches and data extraction lend themselves to tier-one institutions. It's the same with buy-side firms.

What makes Condor stand out from the competition, specifically technology companies?

While a potential client could go directly to some of the business process outsourcing solutions that are already out there, there's quite a lot of in-house legal work involved in those for the firm, and at the end they still have to take all the responsibility for contract negotiations.

This means it's rarely a total solution, whereas we're providing a package service that includes the use of third-parties, but also our legal expertise.

Again, with the data extraction there are some technology solutions that can do this up to a point, but our clients are telling us that it still requires a lot of work at their end because they are not legal solutions, they're tech solutions.

Existing solutions are also not well equipped to create bespoke data models for documents that are not homogenous.

What were the drivers behind the creation of Condor?

It's really the sheer volume of this type of work compounded by a lack of technology for clients to deliver on these internally.

Additionally, the cost model of bringing in a traditional law firm to do this work would be far too high due to the scale of the projects. For example, we were talking to one client that is looking to re-paper its terms of business on the markets side in the context of MiFID II for 50,000 clients.

The sheer scale of the regulation that's being implemented at the moment and the tightening of timeframes for compliance means that we saw the demand for this product before we built it. Although we officially only launched in January we were already working on projects in 2016.

All of the main regulations are driving banks to make wholesale changes to documents and outreaches that they never had to do so quickly before. The timescale between final regulatory standards being completed to implementation is getting ridiculously small.

Luke Whitmore and I had been working on creating Condor since November 2015. We then brought in Christopher Georgiou last August to help with the platform's construction.

Do you see Brexit as another reason for your product?

It depends on the client—Brexit is affecting a lot of people in very different ways. Part of the problem, which is similar to what we are seeing with MiFID II where the over-the-counter margin rules sucked out a lot of legal capacity until March, is that there are so many other issues immediately in front of people that it's quite hard to allocate resources to further off problems.

UK-based firms are thinking about how Brexit may affect their passporting of services onto the continent and what they will do if that becomes difficult, but it's hard to quantify a solution at this point because there are so many permutations.

Do you have plans to build the product out in the future?

There are non-financial regulations coming down the road that financial services haven't had to deal with before, or at least on this scale. We're already working on a new solution that focuses on the EU's General Data Protection Regulation. It's a non-core business line for Condor that has the same scale of outreach needed. Indeed, one of our clients that initially approached us for help on MiFID II-related challenges is now considering combining these two aspects as a single exercise. **SLT**

> Regulations are driving banks to make wholesale changes to documents and outreaches

Guy Usher, Partner, derivatives and structured finance
Fieldfisher

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Chinese arbitrage opportunities sprout anew

Short sellers are targeting Hong Kong-listed H-shares that trade at a premium to mainland-traded A-shares. IHS Markit's Simon Colvin explains

Arbitrage opportunities that can be exploited by shorting Hong Kong-listed H-shares, which trade at a premium to a mainland-traded A-share issued by the same company, disappeared in the days since the Hong Kong-Shanghai Stock Connect launched in 2014—but there are indications that the trade may be coming back to life.

Four H-shares now trade at a premium to mainland-traded A-shares issued by the same company. This marks a notable turnaround for arbitrageurs given that every single H- to A-share cross in our database traded at a discount in the weeks following the onset of the Hong Kong-Shanghai Stock Connect.

The resurgence of arbitrage opportunities in H-shares is only a symptom of a wider momentum swing. These stocks slid from commanding a 20 percent premium to A-share on average to trading at a 30 percent discount in the months surrounding the launch of the Hong Kong-Shanghai Stock Connect. That discount has since fallen by two thirds as H-shares are now trading at an 11 percent discount to corresponding A-shares on average. Most of this conversion can be attributed to the yuan's recent fall, which has driven up the value of H-shares relative to their mainland-traded peers.

The number of H-shares trading within 5 percent of their corresponding A-share peers has also jumped significantly in recent months, which could open up further arbitrage opportunities in the coming weeks should the rapid conversion seen recently overshoot. Whether any of the six H-shares, which trade within 5 percent of their mainland peers will trade at a premium remains to be seen, but the momentum is definitely on the side of the asset class as no H-shares commanded less than a 5 percent discount to their corresponding A-shares in early February.

Anhui Conch Cement leads the way

Short sellers have been more than eager to take advantage of this trend as the four relatively overpriced H-share listings have 7.1 percent of shares out on loan on average, which is over twice the average seen by H-shares.

Building supply firm Anhui Conch Cement, whose 15 percent H-share premium is the widest of the four, also attracts the most arbitrageurs as it has 14 percent of its shares out on loan, the most out of any H-share.

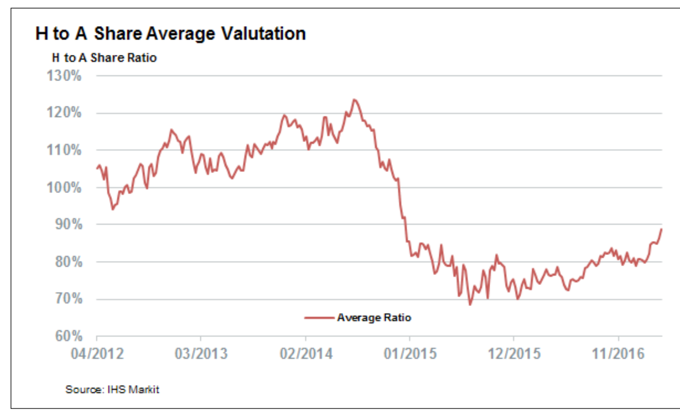
Arbitrageurs have benefitted handsomely from Anhui Conch's previously, as more than a quarter of the company's shares were out on loan back in 2014 when its H-shares went from commanding a 70 percent premium to trading at a 10 percent discount in a little over 12 months.

Engine manufacturer Weichai Power is also rapidly attracting arbitrageurs as the ratio between its H- and A-shares rose from 60 percent to 110 percent over the last two months. Short sellers jumped on the trend shortly after H-shares started to trade rich to their mainland-traded cousins and more than 11 percent of Weichai shares are now on loan to short sellers, the most since the days before the Hong Kong-Shanghai Stock Connect in 2014. **SLT**

Anhui Conch Cement Co Ltd

H to A shares ratio — % Of Shares on Loan

Source: IHS Markit



> There are indications that the trade may be coming back to life

Simon Colvin, Analyst
IHS Markit

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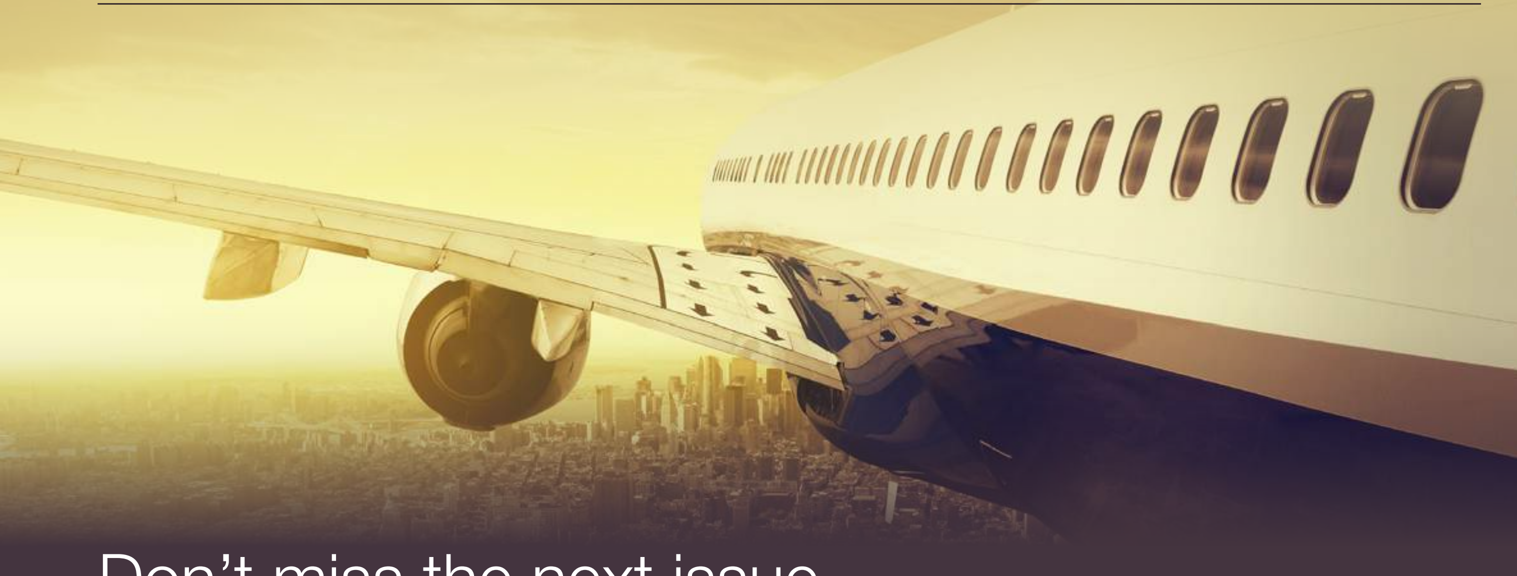

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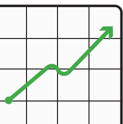

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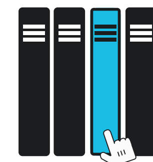

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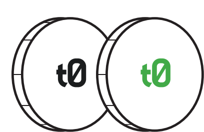

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Comings and goings at Goldman Sachs, Northern Trust and FundRock

Goldman Sachs has promoted Kevin Kelly to global head of securities lending, following the departure of William Conley.

Kelly, who joined Goldman Sachs in 2000, is currently co-head of the US securities lending desk. He was previously a member of the prime brokerage sales team where he had oversight for the credit and multi-strategy client base.

He was made a partner in 2014 and will continue to be based in New York.

Conley joined the bank in 2005 as part of its equity finance division and was made a partner only a year later.

In an internal memo on the restructure, Goldman Sachs also announced the creation of a global funding and inventory management team. Puneet Malhi and Cyril Goddeeris will become co-heads the new team, while working closely with Massimiliano Ciardi.

The memo continued: "This unified group across equities will enhance the existing strong collaboration between global synthetics and prime services, leveraging expertise across the equities franchise to expand our global footprint."

"The team will focus on equities resource optimisation, product and new structure development, and strengthening our risk infrastructure."

Baroness Tanni Grey-Thompson, the UK's most successful paralympic athlete, will be closing out the International Securities Lending Association's conference in Berlin.

Grey-Thompson, who won 11 gold and four silver medals, as well as a bronze, across five Paralympic Games as part of the British Wheelchair Racing Squad, will be speaking at 12:30pm on 22 June.

This year's ISLA conference, which will be held in Berlin's Ritz Carlton Hotel, focuses on five key topics: collateral management; conduct

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and accountability; regulations; key market developments and dynamics; and the German market and economy.

ISLA has added educational sessions to this year's conference, as well as a daily newsletter, run in partnership with Securities Lending Times, which will include conference news and commentary, as well as interviews with delegates and speakers.

The association has also secured the European Central Bank's (ECB) Marc Bayle de Jessé as the opening keynote speaker.

Jessé, who leads the general market infrastructure and payments directorate at the ECB, will open proceedings on 20 June.

He previously managed the Target2-Securities programme, along with dossiers related to the promotion of market integration and the definition of the eurosystem's operational framework, focusing on payment systems and market infrastructure.

The Deutsche Börse Global Funding and Financing Summit held earlier this year also featured ECB speakers, including board member Yves Mersch, underlining the increasing role that central banks are playing in the oversight of financial markets.

The addition of central bank and regulator speakers has been widely praised for enabling a two-way dialogue on industry challenges.

Northern Trust has made a round of top-level appointments in Europe, the Middle East and Africa following the promotion of Peter Cherecwich to president of corporate and institutional services.

In London, Penelope Biggs has been named chief strategy officer for corporate and institutional services, while Toby Glaysher has been named head of global fund services international.

Clive Bellows has been promoted to head of global fund services across the Europe, the Middle East and Africa, but will retain his role as Ireland's country head.

Jon Dunham has been promoted from head of Americas sales to head of global sales for corporate and institutional services.

Lastly, Robert Frazer, who was previously head of UK pensions for the bank, has been appointed country head of the Middle East. He will be based in Abu Dhabi.

FundRock has appointed Louise Harris as head of legal and compliance for its Irish branch.

Harris brings expertise in fund law and regulation, including product structuring, trading, corporate governance and regulatory reporting, and brings local legal and regulatory experience to the firm.

Formally a barrister, she moved from private practice into the financial services sector around 10 years ago.

Since then, Harris has held several senior compliance positions at investment firms, including spending eight years at Abbey Capital Limited as as head of legal and compliance and then as general counsel.

According to FundRock, the appointment is part of a long-term strategy to improve its investment management services for Irish-domiciled funds.

Ross Thomson, director of FundRock's Irish branch, said: "FundRock has been servicing Irish funds since 2012 and we continue to invest in our people and our knowledge in this market."

She added: "Louise Harris's expertise will help us realise our objective to offer our global clients a value-added solution for all their investment management needs in Ireland and across our other European locations."

Harris commented: "Funds domiciled in Ireland are required to be managed and governed to the highest of standards.

"FundRock, with its long heritage in fund governance developed over 80 years, is very well positioned in this regard.

"Its robust platforms were developed with an investment banking expertise and its governance systems continue to be developed with award winning innovative regtech."

Do you have an appointment we should cover? Let us know via: drewnicol@securitieslendingtimes.com

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