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B3 brings lending to new platform

Brazilian exchange and clearinghouse B3 has moved corporate bonds and equities lending to its new multi-asset clearing platform, in the latest phase of its post-trade overhaul.

The migration marks the second phase of B3's post-trade integration project that will consolidate its four clearinghouses into a single entity.

Once complete, the platform will manage all equities, derivatives, government and corporate debt securities and foreign exchange activities.

Derivatives and over-the-counter (OTC) products migrated earlier this year.

The clearing solution was delivered by Cinnober, built on its TRADExpress RealTime Clearing system.

According to B3, the completion of the second phase allows BRL 21 billion (USD 6.64 billion) of collateral to be returned to the market without compromising B3's liquidity standards.

This is in addition to the BRL 20 billion (USD 6.32 billion) that was unlocked in the initial phase of consolidation.

"With this launch, Brazil's financial and capital markets are obtaining new levels of operating excellence," said Cícero Augusto Vieira Neto, COO of B3.

"By integrating the markets in a single clearinghouse, using a real-time clearing solution we're able to offer more capital efficient post-trade services, improve daily liquidity, and reduce operating costs."

"With an infrastructure capable of absorbing ever larger volumes, B3 has paved the way for further market growth, and the system's flexibility lets us respond quickly to the market's needs."

Inside Securities Lending Times

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Transition period essential for post-Brexit derivatives trading

The International Swaps and Derivatives Association (ISDA) has urged UK and EU regulators to implement transitional provisions for derivatives trading after Brexit.

In a whitepaper, ISDA highlighted the need to secure legal certainty for derivatives trading between UK and EU counterparties after Brexit is finalised in March 2019.

The paper urged the UK and EU to "agree on post-Brexit transitional provisions for contracts under English law to reduce complexity and costs for all market participants".

The paper noted that the European Commission has identified a need for safeguards to support the financial and monetary policies of EU institutions, and added that, following Brexit, a "substantial volume" of cleared derivatives may no longer be subject to the EU supervisory architecture.

It said: "The vast majority of EU clearing currently takes place in London, but there are suggestions that EU regulators might introduce a location policy for euro-denominated swaps to be cleared in the EU."

In June, ISDA sent European Commission vice president Valdis Dombrovskis a letter, setting out some of the economic and financial implications of any such location policy for the clearing of euro-denominated derivatives.

These issues included: price volatility and execution costs; increased systemic risks; complexity and operational risk as legacy transactions have to be migrated; costs of splitting netting sets; and reduced access to CCPs for end users.

In its announcement, ISDA added that the UK and EU authorities should "instead agree appropriate arrangements for oversight and cooperation with respect to UK CCPs".

With regards to price volatility and execution costs, the paper noted that any location policy

Market adapting to liquidity crunch, says ISLA

London | Reporter: Drew Nicol

Quarter-end volatility calmed in the first half of 2017 as the market reinvested earlier and ahead of a potential squeeze, according to the International Securities Lending Association (ISLA).

In its seventh market report, ISLA noted that, while balance sheet reduction at key reporting dates has become a permanent feature of borrower behaviour, the recent quarter ends were completed in "a more steady and orderly manner than previously observed".

ISLA noted that, after unprecedented volatility and dislocation was seen at the end of December 2016, the market better anticipated the end of June liquidity squeeze by reinvesting from the middle of the month onwards.

The report continued: "We also saw a willingness to recall cash collateralised loans ahead of the 30 June and return any cash collateral to the borrower, thereby avoiding any reinvestment issues over half year end. Demand to borrow government bonds remained robust during the first six months of the year."

As part of ISLA's work with regulators to tackle market issues such as liquidity squeezes, the association commended the European Securities and Markets Authority (ESMA) on its recent opinion on minimum EU-wide segregation requirements for UCITS and alternative investment funds.

ISLA described the statement, which is part of an ongoing consultation, as a pragmatic and viable framework for this business to continue.

The work could have significance in relation to potential changes to UCITS regulation, which, as a securities lending market demographic, is struggling to contribute under oppressive collateral rules that limit term trades to seven days.

Inconsistencies in the interpretation of guidelines by local regulators has also made these fund types increasingly less competitive versus peers.

ISLA's latest data, which is sourced by the three main data providers in the market, continues to highlight that while mutual funds, including UCITS, account for now just under half of all securities made available for lending (46 percent), their proportion of all open trades still remains hamstrung at roughly 14 percent.

applying to certain contracts would artificially exacerbate differences in pricing between CCPs, raising concerns around liquidity in the case of a location policy coming into effect.

ISDA said: "As a location policy can only be enforced on transactions where at least one counterparty is located in the EU, it is to be expected that the clearing pool in the eurozone will be less liquid compared to the current globally integrated pool. Less liquidity will lead to less competition and less choice, and potentially wider bid/ask spreads."

The paper also pointed to the G-20 derivatives reform commitments, including the commitment to avoid fragmentation, protectionism and regulatory arbitrage, saying: "An EU CCP location policy would run contrary to the deference principle, and would fragment markets."

It added: "A CCP location policy would be damaging to EU economic interests, and should not be pursued."

Complexity comes from the fact that most cross-border trades in complex financial instruments in the EU are governed by English law. It is unclear, currently, whether this will change after the UK leaves the EU

"If transitional provisions are not put in place, it may result in an increase in complexity, more uncertainty and higher costs for market participants," ISDA said, concluding that, in order to remove any legal uncertainty around cross-border contracts, transitional arrangements should be implemented "until a proper system of mutual recognition is introduced".

Petrofac is UK's most shorted ahead of earnings results

Oil and gas service provider Petrofac was the most shorted UK firm in the wake of accusations of bribery by the UK's Serious Fraud Office, according to IHS Markit.

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Currently, Petrofac has 10.6 percent of shares out on loan as short sellers looked to capitalise on the heavy losses that the revelations instigated.

IHS Markit analyst Simon Colvin explained in a research note: "Petrofac short sellers were eager to take profit off the table immediately, and the demand to borrow its shares nearly halved in a few weeks."

"This restraint proved to be temporary, and Petrofac's short interest increased to the highest level in 18 months."

The only European firm with more short interest this week was German midcap Bertrandt Group, which helps automobile and aviation firms with design solutions.

IHS Markit noted that sell side analysts recently revised their guidance on Bertrandt, citing a lack of demand from its top customers, and shares fell heavily as a result.

The latest data shows Bertrandt trading at a five-year low and short interest is at an all-time high.

Colvin added: "Short sellers, who have been targeting Bertrandt for much of the year, should feel vindicated for their tenacity."

LSE and NEX among new providers under MiFID II

The London Stock Exchange Group, NEX Regulatory Reporting, Bloomberg, Tradeweb and Trax are all poised to publish post-trade transparency reports on behalf of clients to help them meet their reporting obligations under the second Markets in Financial Instruments Directive (MiFID II).

The UK Financial Conduct Authority has confirmed them all as approved publication arrangements (APAs).

These approvals mean that each solution provider has been certified as ready to publish post-trade transparency reports on OTC and systemic internaliser (SI) trades from January 2018.

The London Stock Exchange reporting service will be provided through TRADEcho.

NEX's approved trade reporting service will be offered through Abide Financial.

The decision to apply for APA status was driven by client demand, with most of the business' new and existing clients already in testing to ensure they are prepared to go live in January.

Bloomberg's MiFID II regulation process will be presented through its APA and in-house order management systems, TOMS, SSEOMS and AIM.

Tradeweb's APA service has also been approved. Tradeweb launched its APA-early facility in December last year.

It already has commitments to participate from sell-side firms representing an estimated 60-plus percent of OTC trades.

Trax's APA solution is Trax Insight. The company was an approved reporting mechanism under MiFID I.

Geoffroy Vander Linden, head of transparency solutions at Trax, said: "Being one of the first FCA-approved MiFID II APAs further demonstrates our ability to support the industry in this time of significant regulatory change."

Collin Coleman, head of NEX Regulatory Reporting, commented: "The use of APAs will be essential for efficient functioning under MiFID and we strongly encourage any market participants who have not yet commenced testing to do so immediately to ensure they can continue to trade post 3 January 2018."

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US SEC fines broker-dealer for ADR violations

Washington DC | Reporter: Drew Nicol

A second broker-dealer has been fined by the US Securities and Exchange Commission (SEC) for securities lending violations relating to the facilitation of naked short selling.

The SEC found that Banca IMI Securities (BISC), the US subsidiary of Italian bank Intesa Sanpaolo, violated American Depository receipt (ADR) pre-release lending rules and failed to "reasonably to supervise its securities lending desk personnel".

BISC accepted a $35 million fine without admitting or denying the SEC's findings.

The charge relates to SEC's finding that BISC violated federal securities laws when it requested the issuance of and received ADRs without possessing the underlying foreign shares.

The broker-dealer obtained pre-released ADRs and lent them to counterparties without satisfying the proper requirements between from at least January 2011 to August 2015.

This made it possible for these securities to be used for inappropriate short selling or inappropriate profiting around dividend record dates.

The SEC acknowledged BISC's cooperation in the investigation and its remedial actions.

"US investors who invest in foreign companies through ADRs have a right to expect market professionals to create new ADRs only when they are backed by foreign shares so that the new ADRs are not used to game the system," said Sanjay Wadhwa, senior associate director of the SEC's New York regional office.

"As our order finds, BISC's actions left the ADR markets ripe for potential abuse."

In January, international broker ITG was fined more than $24.4 million for similar securities lending violations relating improper handling of ADRs. It did not admit or deny the SEC's charges.

ITG engaged in 'pre-release' ADRs without owning the foreign shares or taking the necessary steps to ensure they were custodied by the counterparty on whose behalf they were being obtained between 2011 and 2014.

According to the SEC, many of the obtained ADRs were ultimately used for short selling and dividend arbitrage, even though they may not have been backed by foreign shares.

A former ITG securities lending senior trader was banned from the market in June for improper handling of ADRs.

ICMA offers MiFID II/R briefings and workshops

The International Capital Market Association (ICMA) has organised a series of briefings and workshops to help its members prepare for the 3 January 2018 implementation of the second Markets in Financial Instruments Directive and Regulation (MiFID II/R).

Amid concerns about the directive and regulation's effects on fixed income markets, ICMA is highlighting the main challenges of the legislation for primary and secondary markets, repo and collateral, and asset management.

A dedicated web page has been prepared to keep ICMA members informed.

According to ICMA, the extent to which repos and other securities financing transactions are in the scope of MiFID II/R "has been subject to some ambiguity".

"Many of the most critical issues have been clarified by now. Most importantly, it has been confirmed that pre- and post-trade transparency, most transaction reporting and some of the critical best execution requirements under RTS 27 will not apply to securities financing transactions."

But other MiFID II/R provisions still appear to apply, ICMA said, adding: "This creates challenges [such as] securities financing transactions concluded with EU central banks will have to be reported under MiFIR, and thus separately from all other securities financing transactions which are reported based on the Securities Financing Transactions Regulation framework."

The European Securities and Markets Authority has confirmed that securities financing transactions are not in scope of RTS 27, although firms will still have to ensure compliance with the related requirements under RTS 28.

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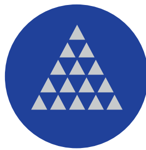

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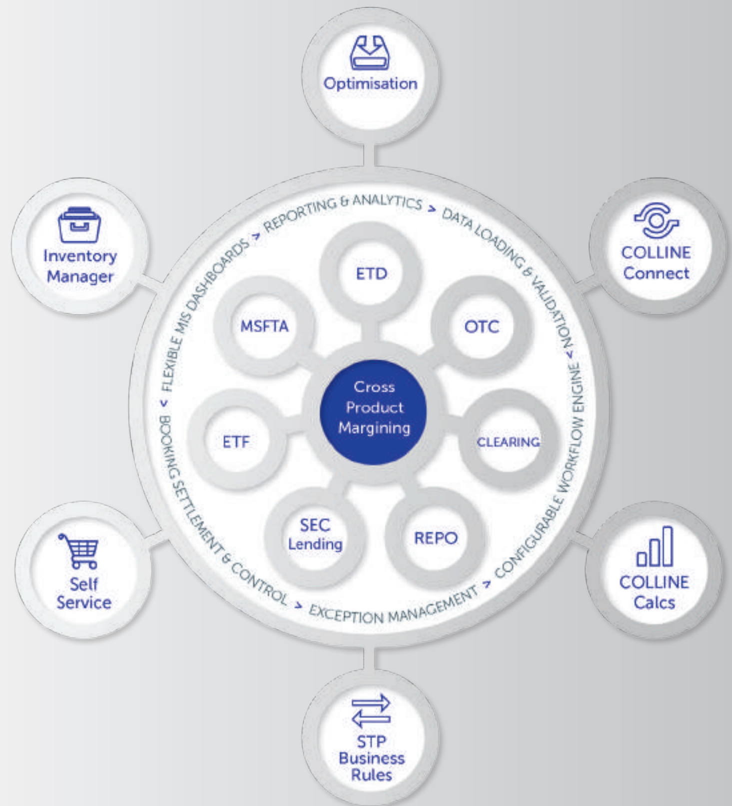

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Areas that require further clarification include record-keeping requirements and trade confirmations.

ICMA's MiFID II/R workshops are scheduled to take place in Stockholm (6 September), Brussels (4 October), Luxembourg (5 October), Paris (6 October), Madrid (19 October), Frankfurt (26 October) and Milan (27 October).

NSD begins servicing repos with Bank of Russia bonds

National Settlement Depository (NSD), Russia's central securities depository, has begun using Bank of Russia repo trades as a component of the basket of Bank of Russia bonds (OBR).

OBR operations are a flexible instrument for regulating bank liquidity. The OBR may be used as collateral for transactions, or as a tool for attracting refinancing from the Bank of Russia.

In this instance, the Bank of Russia placed bonds for a total sum of RUB 150 billion (USD 2.54 billion), with three months of maturity.

OBR operations will only be available to Russian credit organisations.

The value of repo transactions that the Russian Federal Treasury performed using the NSD collateral management system reached RUB 10.2 trillion (USD 169.9 billion) in Q2 2017.

In the same quarter, the value of repo transactions with the Bank of Russia performed using the NSD collateral management system stood at RUB 208 billion (USD 3.46 billion).

JCPenney and Snap are hot stocks

High street retailer JCPenney and Snap, owner of photo sharing app Snapchat, led the FIS Astec Analytics hot stocks list for the Americas for the week starting 21 August.

JCPenney saw short interest in its shares increase by 8 percent, which is a 12-month high.

Conversely, the retailer's share price also rose 7 percent to $3.85 following the launch of a new clothing line, Frank + Lulu, combined with the purchase of a total of 185,135 shares by two of the company's directors.

This was a small change given that the retailer is still a long way from recovering the 61 percent loss its share price has suffered since August 2016.

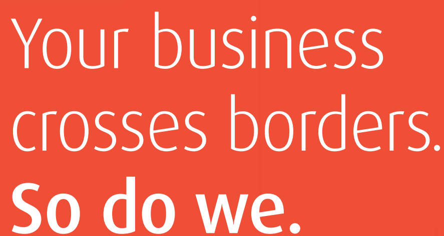
In the technology world, Snap experienced a short interest increase of 53 percent, representing a level of volatility that is to be expected from a product that is inexorably linked to user volumes.

The reasons for price fluctuations in stocks such as Snap are always up for debate, but FIS stated: "With borrowing costs relatively low, it is less likely that new lenders have been attracted by the fees on offer, but the recent upward trend in the share price—an increase of 25 percent over the last two weeks—could have attracted new institutional buyers into the share, hoping that the recent record low of $11.83 won't be repeated any time soon."

Expert group assesses post-trade barriers in EU

The European Post-Trade Forum (EPTF) has outlined how to improve EU post-trade services including clearing, settlement and collateral management by in a report written in May and released in August.

The EPTF, a European Commission group, assessed the "state of removal of the Giovanni Barriers", listed those yet to be dismantled, and identified new barriers and bottlenecks that could hamper the development of a "true capital markets union (CMU)".



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US Fed to draft three alternative repo rates

Washington DC | Reporter: Drew Nicol

The US Federal Reserve is to create three new "risk free" reference rates based on overnight repo transactions secured by US treasuries.

According to the Fed, the interest rates will be constructed to reflect the cost of short-term secured borrowing in highly liquid and robust markets.

"Because these rates are based on transactions secured by US treasury securities, they are essentially risk-free, providing a valuable benchmark for market participants to use in financial transactions," the Fed said in a statement.

The Alternative Reference Rates Committee selected the secured overnight financing rate (SOFR), which the Fed described as the most comprehensive of the three rates, as its recommended alternative to the US dollar LIBOR.

SOFR would include triparty repo data from BNY Mellon and cleared bilateral and GCF Repo data from the Depository Trust & Clearing Corporation.

Federal Reserve board governor Jerome Powell said: "SOFR will be derived from the deepest, most resilient funding market in the United States. As such, it represents a robust rate that will support US financial stability."

The second rate, to be called the triparty general collateral rate (TGCR), will be based solely on triparty repo data from BNY Mellon.

The final rate, to be known as the broad general collateral rate (BGCR), will be based on the triparty repo data from BNY Mellon and cleared GCF Repo data from DTCC.

All the proposed rates will be drafted with the assistance of the Treasury's Office of Financial Research.

Comments on the proposal to produce the three rates are requested within 60 days of publication in the Federal Register, which is expected shortly.

The Giovanni Barriers were identified in 2003 as issues that prevent efficient cross-border clearing and settlement in the EU. Since then, derivatives markets, securities finance activities, collateral management and post-trade reporting have become much more developed, while new products and new barriers have emerged. This means a "semantic transposition" of the original barriers would not be possible. Therefore, the new barriers will be termed the EPTF Barriers.

According to EPTF, significant operational barriers include fragmentation in corporate actions and general meeting processes, a lack of convergence in information messaging services, and a lack of harmonisation in exchange-traded fund processes—a point that did not appear in the original Giovanni Barriers.

Identified structural barriers include inconsistent application of asset segregation rules for securities accounts, a lack of harmonisation of registration rules and shareholder identification, and the complexity of post-trade reporting structures.

The EPTF also "refined and combined" two Giovanni Barriers into a fourth structural barrier, namely unresolved issues around International Securities Identification Numbers.

Regarding the three legal barriers identified in the Giovanni Reports, the EPTF said: "Progress in removing the barriers has remained limited and the rationale for such reforms is unchanged."

It also noted additional legal shortcomings highlighted by the 2008 financial crisis.

Uncertainty around the legal soundness of intermediaries' risk mitigation techniques, and of default management procedures, as well as deficiencies in the protection of client assets, shortcomings in EU rules around finality, and uncertainty around ownership rights in book-entry securities, all remain as legal barriers.

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A tax-related barrier in the "prevailing withholding tax regimes, that are currently characterised by various shortcomings, such as lack of tax exemption at source, non-harmonised reclaim procedures and in certain member states unduly long repayment periods", was also identified.

Welcoming the report, the Association for Financial Markets in Europe (AFME) suggested that this tax barrier should be given high priority for resolution, along with legal inconsistencies and fragmented corporate actions processes.

AFME also named inconsistent asset segregation rules, lack of harmonisation in registration and investor identification, and complexity in post-trade reporting as issues that should be of "the highest priority".

Werner Frey, managing director of post trade at AFME, said: "Europe needs a clear vision for its post trading landscape and a coherent strategy for delivering this goal. We believe that the CMU project will contribute to the dismantling of the remaining barriers to achieve a safe and efficient European post-trade landscape."

The EPTF report coincided with the release of a European Commission consultation paper on the current state of post-trade markets and the scale of any new or remaining barriers, as part of its CMU Action Plan.

Valdis Dombrovskis, vice president at the European Commission responsible for financial stability, financial services and the CMU, said: "Efficient and integrated post-trade markets are essential for EU financial markets and for a well-functioning CMU. We need to find the best solutions to remove all barriers to efficient and resilient post-trade services."

Responses to the paper can be submitted up until 15 November.

The EPTF was set up by the European Commission in February 2016, to assess the evolution of the EU post-trade landscape, and the progress in removing the Giovanni barriers.

CloudMargin and GlobalCollateral connect for Margin Transit Utility

CloudMargin is establishing a connection with DTCC-Euroclear GlobalCollateral's Margin Transit Utility (MTU).

Access to the MTU will expand CloudMargin's settlement capability and give users access from the cloud.

CloudMargin is the first technology provider to join GlobalCollateral's partner programme, with MTU integration efforts currently underway.

Ted Leveroni, chief commercial officer at GlobalCollateral, said: "This integration will enable a true end-to-end solution, allowing our mutual clients to streamline and scale up processes at a time of increasing collateral and margin call demands."

Simon Millington, head of product management at CloudMargin, added: "We are very excited about this integration with GlobalCollateral and look forward to bringing great new efficiencies to our respective users."

OCC's growth continues

OCC's securities lending CCP activity was up 25 percent in new loans year-over-year in August, with 200,844 transactions

Year-to-date stock loan activity is also up 22 percent from 2016 with 1.5 million new loan transactions.

The average daily loan value cleared last month was $141. 5 billion.

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The clearinghouse's cleared futures volume set a record in August with 14.9 million contracts, a 71 percent increase on the same time last year.

OCC's year-to-date average daily cleared futures volume is up 47 percent on 2016's January to August total with 570,923 contracts.

Fed rules demands further securities lending contract safeguards

The Federal Reserve Board has adopted a rule requiring US global systemically important banking institutions (GSIBs) to amend qualified financial contracts (QFCs) to prevent their termination if the firm defaults.

The rule, which also affects and the US operations of foreign GSIBs, relates to all QFCs, including securities lending, derivatives and repo transactions.

Under the rule, GSIBs must ensure that US resolution laws providing for a temporary stay to prevent mass terminations apply in all contracts.

A GSIB's QFCs cannot allow the exercise of default rights that could spread the bankruptcy of one GSIB entity to its solvent affiliates.

A transitional period is to allow GSIBs time to repaper their contracts will begin on 1 January 2019.

QFCs between two GSIBs must conform to the new rule with the next 12 months, while those between a GSIB and most other counterparties have an 18-month deadline.

In a statement on the rule, published 1 September, the Fed said that, given the large volume of these contracts to which GSIBs are a party, the mass termination of QFCs in the event of default "may lead to the disorderly failure of the firm, spark asset fire sales, and transmit financial distress across the US financial system".

Front-to-back operational shift is needed, says SimCorp's Baker

A fundamental front-to-back operational shift is needed to best fulfil investment objectives in an increasingly challenging market, according to Mark Baker, product manager at SimCorp.

Variation margin exchange for non-centrally cleared OTC derivatives, which came into effect earlier this year, is putting increasing pressure on the collateral management function, although it's not just a back-office issue. Baker said: "Though collateral management has traditionally been a back-office function, operating on a periodic basis, the new regulation will see it flooding into the front office's daily workflow."

Baker pointed to an ongoing survey to suggest one of the primary 'pain points' in collateral management, identified by buy-side firms, is increasing volumes.

Baker suggested these increasing volumes are "likely to surge, as pledged and received collateral will no longer be periodically exchanged in arrears and at high thresholds".

"Instead, asset managers will need to mark their books to market daily, and at much lower thresholds."

He added: "To add to these new and intensified volumes, trades with counterparties prior to and after 1 March 2017, could have not one but two margin calls, legacy and regulatory."

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GROUPE BPCE

Wematch Securities Financing goes live

Wematch Securities Financing founder and CEO David Raccat reveals that securities lending and repo are about to be added to the dealing platform

What is Wematch Securities Financing and what does it do?

Wematch Securities Financing has been live since February of this year. It's essentially a digital broker making the bridge between supply and demand with a focus on increasing liquidity. The platform connects market players active in financing trades and optimises the negotiation process.

Its initial focus was on total return swaps and European equities, so quite a small niche in the financing market. Since February, the platform has grown quickly. Twelve of the top 15 banks that used to trade over the phone now use Wematch Securities Financing to input their interest in financing trades and to negotiate them. The platform has already received more than $1.5 trillion worth of interest and circa $8 billion of swaps have been confirmed. We are very happy with the volumes so far and the platform has received a very warm welcome from banks and lenders alike.

What's the next step in the development of Wematch Securities Financing?

The next stage of the rollout of Wematch Securities Financing is to enrich the product set, which begins this month. We are adding securities lending and repo to the mix, in addition to total return swaps. We will also expand the asset classes available on Wematch Securities Financing. On top of European equities, we are expanding to fixed income securities and the platform will manage US and Asian assets.

When Wematch Securities Financing is fully operational and live this month, we will be able to offer securities lending, repo and total return swaps on a global scale. We are excited about this launch because it will offer users a lot of options.

What are Wematch Securities Financing's unique selling points?

Securities finance has entered a new era. There is an ongoing demand for best execution, timestamping and pre- and post-trade reporting in securities finance, making the arrival of a platform such as Wematch Securities Financing quite timely.

The obvious example is the second Markets in Financial Instruments Directive (MiFID II), whose best execution requirements, while unclear in their application to securities financing transactions, are strong and present in everyone's minds.

Wematch Securities Financing is going to operate in compliance with MiFID II from the January 2018 implementation deadline so that we can give peace of mind as far as that regulation is concerned. Wematch Securities Financing will operate as an organised trading facility.

Day-to-day trading is where Wematch Securities Financing shines. The overall objective is to improve the negotiation process. Wematch Securities Financing is using the latest machine learning and artificial intelligence technologies available. Our algorithmic team has developed a patent pending system that focuses on optimising liquidity and market efficiency.

We want to take the platform's insight into users from its simplest—it knows who they are, what they do and what is of interest to them—to the much more complex. For example, if there is movement on a currency, Wematch Securities Financing can recommend adjusting the user's interest, because that's the way the market is going to go. With the right algorithms and analytics, Wematch Securities Financing is able to proactively suggest matches to users.

Users of Wematch Securities Financing will also benefit from the large flexibility of our system matching on a cross-product basis. When we launch securities lending and repo, if a user wishes to conduct a total return swaps trade on one side and another user on the opposite side is interested in a repo trade, Wematch Securities Financing will be able to show that match. Then, if those users are able to switch products, they can enter into negotiations.

Are you looking at partnerships?

Through our partnership with Pirum, mutual clients can execute trades on Wematch Securities Financing and manage their post-trade on Pirum, which also boasts downstream connectivity to infrastructure providers such as triparty agents and central counterparties.

Pirum will also enable Wematch Securities Financing clients to comply with transaction reporting obligations (for example, the Securities Financing Transactions Regulation) via Pirum's existing partnership with IHS Markit.

The partnership with Pirum is key for Wematch Securities Financing because it ensures that we have full integration. It is extremely important that we help to create, wherever possible, a fully automated process. We do not want to create additional operational risks, which will ultimately result in extra costs.

We are also talking to other market participants, such as IT providers, other post-trade services companies, and central counterparties.

What do you want to achieve with the Wematch Securities Financing platform?

What we want to achieve and maintain with the launch in September is the Wematch Securities Financing client experience.

Today, when clients want to access the platform or are asking for new features, they get what they need very quickly.

We have the resources to understand, integrate, develop, test and deliver within a very short period of time. We want to maintain this level of service. This means that we need to restrict the number of clients we work with.

Our aim is not to provide end-to-end scope with thousands of users onboard. The target is more to offer the best experience to hundreds or users. Wematch Securities Financing is at its best when it's tailor-made and delivered to users quickly. Our aim to maintain that level of customer experience. **SLT**

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David Raccat
CEO and founder
Wematch Securities Financing

Asset management approach: Why it's changing

Asset management firms that favour the risk-adjusted return characteristics of an intrinsic programme have every reason to stick to their guns, as John Wallis of Brown Brothers Harriman explains

Attend the recent conferences or read the latest industry commentary and you will hear stories of oversupply and falling revenues compelling beneficial owners to be more flexible in the collateral they accept, adopt term structures to lock in trades, or consider higher yielding cash reinvestment options. These changes would increase risk for the beneficial owner, and while that may be appropriate for some lenders, asset managers are asking if they also need to be making similar changes.

The first step in putting these developments into context is to recognise that securities lending is effectively two markets. The first—and by far the largest—segment is the general collateral market where the overriding goal is to maximise revenue. To achieve this, large volumes are lent at low fees with a flexible approach to accepted collateral. Industry-wide, 90 percent of securities on loan are priced at 50 basis points or less, according to IHS Markit, so it's easy to see why this part of the market occupies so much air time. However, very few asset managers are general collateral lenders. This type of lending is usually favoured by sovereign wealth funds, insurance companies and some pensions whose time horizons and liquidity constraints are dramatically different from a mutual fund.

The second securities lending market is the 'specials' space, which focuses on the few stocks that command the highest fees (for example, 200 to 2,000 or more basis points). Often referred to as 'intrinsic value' lending, this type of trade can generate 90 percent of its revenue from lending just a few stocks—often less than 5 percent of a fund's assets under management.

Those stocks are in high demand, meaning lenders do not need to compromise on the quality of collateral they accept. In the US, this means cash, reinvested in short-term, highly liquid money market funds and, in Europe and Asia, collateral is typically G10 sovereign bonds.

Many asset managers prefer this nuanced approach that prioritises risk-adjusted returns as they balance revenue, daily liquidity and risk. By lending a smaller proportion of their assets, it is easy to see how registered funds account for 40 percent of lendable assets across the industry, yet comprise just 15 percent of assets on loan, according to the sixth edition of the International Securities Lending Association Market Report. This leaves 85 percent of the securities lending industry serving lenders who are not registered funds, so it is not surprising that so much industry commentary seems not to apply to them.

The market is seeing record levels of oversupply and lenders need to be more flexible with collateral and term structures to maintain balances and revenues. But does this apply to asset managers? If they are a general collateral lender, yes, particularly if they are lending large volumes of high-quality liquid assets, such as government bonds. The current fees of 15 basis points anticipate lenders accepting main index equities as collateral and term structures of one to three months.

However, for the majority of asset managers, following an intrinsic value approach, collateral flexibility and term structures will add little value in terms of revenue or improved distribution. For example, look at the market utilisation levels of the stocks you have on loan and the percentage of your holding you have on loan. If market utilisation is high and your entire inventory is lent, then the stocks you are lending are probably in such high demand that you do not need to compromise your collateral standards to improve your loan distribution. If this is the case, your agent will have no excuse for not achieving the highest market fees.

Intrinsic value lenders are often encouraged to rethink their stance, ease their collateral standards, and lend more at lower fees. Every lender should review their stance periodically. However, asset managers that favour the risk-adjusted return characteristics of an intrinsic programme have every reason to stick to their guns—market noise to the contrary is largely addressed to a different area of the market. **SLT**

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> For the majority of asset managers, following an intrinsic value approach, collateral flexibility and term structures will add little value

John Wallis
Co-head of securities lending EMEA
Brown Brothers Harriman

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What is the cloud? Answers in an email

What defines a cloud and what does it all mean for securities finance and collateral? David Selwood of FIS Global takes a look

When it comes to the 'cloud', I am often asked some very similar questions about it by the people in our organisation—especially on the commercial side—and sometimes by our customers: can 'x' software work in 'y' provider's cloud? And does FIS have a cloud?

And I almost always respond with a question of my own: what is the provider's or the client's definition of 'cloud'?

You see, when I think of the 'cloud', I look at my phone or iPad and think about Spotify and how fantastic my playlist is, or BBC iPlayer, or Netflix. So, for a while now, many of my thoughts have been focused on defining this for our business solutions—and what it means for securities finance and collateral.

I believe that definition is key. In the past, this has been focused on the latest and greatest solution or innovation, be that a new database platform, software framework or delivery model. Even with the amorphous entity that is the internet, everyone was clear about the need to be on it and had an idea of what it meant from a commercial perspective.

Putting this into context with cloud solutions: can we define it as software-as-a-service or an application service provider? Does it have to do with legacy logins through sophisticated front ends? Is it all about app-delivered solutions?

A cloud solution can be a variation of some or all of these. Understanding its subtlety and definition is key as there is no single solution here. When I look at the software within the business, I see variations on a theme—and asking what the future holds is as important as delivering service now.

Future state

In my opinion, there is such closeness between technology and product that not understanding the technology roadmap will put you at a disadvantage when discussing the product roadmap. There is a distinct correlation to the underlying technology structure through product that can be far removed from a user saying, "I want this new field here on this screen."

For example:

- How will the screen be delivered within the user interface or user experience?
- Do we do it in the legacy product and the 'new' cloud model?
- What is the cloud model?
- Do we just create it in the new version or can we migrate the legacy application into this?
- What is the timeframe required for this field, versus our roadmap for new forms of platform delivery?

Now, I know these questions might not keep you up at night, but from a financial technology perspective, when working with products older than 'brand new', these questions are bound to come up repeatedly. Therefore, a clear roadmap model for transitioning into a cloud model is important to have and to understand.

It is safe to say that the cloud and whatever that means to you, is definitely here to stay. And it is at the forefront of the next generation of delivery.

We in fintech need to create our own model to work within. There is no right or wrong, but there is a very easy way to make it a mess. To avoid this, a focus on clarity, definition and strategic delivery planning for your old and new clients is key. **SLT**

A clear roadmap model for transitioning into a cloud model is important to have and to understand

David Selwood
Vice president and head of managed services (securities finance and collateral)
FIS Global

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Shining a light on collateral management

More efficient collateral allocations and better informed trading decisions are possible by improving visibility and understanding costs, says Pirum's Robert Frost

The need for efficient use of inventory, continues to be a hotly debated topic across the industry. Solving the problem is relevant not only for banks and broker-dealers, but also buy-side firms including asset managers, pension funds, insurance companies, corporates and central banks, and covers a range of activities, from securities finance to OTC derivatives.

With regulatory pressures and the associated increase in capital requirements, return on capital has become a primary focus, but liquidity of assets and the resultant predicted market collateral shortfall remain a large concern, leading all financial institutions to re-examine their collateral management processes and look to do more with what they have.

We believe there is sufficient collateral in the system, but mobilising this collateral in the timeframe stipulated by the new regulations is a challenge due to issues in market infrastructure, and a lack of visibility can lead to sub-optimal asset allocation exacerbating the situation.

Most firms now agree that it is it time to start looking at collateral management as an area of significant cost saves and process improvements. Many articles and whitepapers recommend removing functional silos and centralising the collateral management function, but this is easier said than done. At Pirum, we believe the process must begin with collateral providers and receivers having better visibility about what is eligible to post as collateral and where assets are currently being deployed.

Effective use of assets

Firstly, there are technical challenges to overcome to reach the goal of a centralised view of inventory given the typical number of disparate internal systems at institutions, and that is before considering the different execution options, such as whether the product is collateralised bilaterally, via a triparty custodian, centrally cleared, or exchange traded.

Efficient deployment of inventory requires consideration of a firm's specific constraints at that time and includes factors such as collateral utilisation, capital position, and balance sheet. We summarise our view of the key impediments we typically hear from our clients when trying to answer these questions in the table overleaf.

Build versus buy

Given the complexity of the problem, with the multitude of assets available, and number of collateral accounts in which they could be deployed, there are myriad risks and costs to minimise. With priorities changing within a business on a daily basis, driven by factors such as liquidity, profit and loss, or capital, the cost and time required to execute and manage any solution could be substantial.

Justification of modern technology projects within financial institutions requires not only realisation of monetary benefit or cost save or risk mitigated, but also needs to consider the iterative nature of the development of such a project together with the cost of ongoing support. We are of the belief that the non-differentiated technology layer, which allows efficiencies to be realised while reducing risks and costs (but does not specifically win client business), should increasingly be outsourced to a service provider.

Introducing PirumConnect

At Pirum, we have a track record in building such solutions which solve clients' problems, connect the industry and automate processes.

Our new application, Collateral Connect (see graphic overleaf), is an innovative tool designed to provide visibility, efficiency and risk data related to the collateral management process for both collateral providers and collateral receivers, beginning with the securities finance transaction ecosystem. It builds on the existing Exposure connect offering to enable true centralised collateral management.

Forming part of our new PirumConnect infrastructure, Collateral Connect utilises data from our current industry leading post-trade services—harnessing the power of our significant connections into industry-wide systems and infrastructure.

The application utilises the latest technologies to deliver a solution that is focused on user experience, whist providing access to several layers of key information.

The PirumConnect dashboard will act as a gateway enabling clients to access a vast amount of their data, allowing the user to assess various key risk indicators in their business and direct attention to those issues needing immediate attention, such as breaks, counterparty exposures and collateral inefficiencies.

Collateral Connect is a liquidity management system giving firms cross-business visibility of all inventory and collateral assets across collateral venues. A user can easily navigate to counterparty and venue breakdowns, to quickly see where more collateral is required to release trades or which assets could be eligible per the collateral schedules.

Instant visibility is provided to security level of assets used as trade and/or collateral. The system helps identify any collateral inefficiencies across counterparties and venues and choose assets, which are also eligible, but which would be more efficient from a cost or risk perspective.

The trend analytics help monitor performance relative to your metrics and goals, as well as managing costs, risk and regulatory capital drivers.

We aim to address the inefficiencies related to paper form collateral schedules and have begun to digitise the collateral schedule/credit support annex/exchange margin process, creating a standard across the industry. With agent lenders, lenders, prime brokers, and triparty collateral agents, all agreeing and amending collateral schedules linked to one central portal, there is potential to embrace new technologies, such as distributed ledger, as an implantation mechanism.

The ability for oversight of ever changing collateral allocations provides collateral receivers with the information they need to ensure that their collateral asset makeup is of the intended quality and diversity to mitigate counterparty risk. Future phased delivery will enhance the tool to include such functionality as displaying full sources and uses data, providing liquidity and capital reporting, beginning collateral benchmarking, and scenario analysis.

Pirum already receives near real-time data from many of the leading banks and broker-dealers, which minimises any technical build to go live.

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If a firm does not currently provide real-time data, Pirum's ability to accept files in virtually all formats is renowned, making it a simple and quick integration. In addition, now that we process more than $2 trillion of daily positions and $850 billion of triparty and bilateral collateral, this product is powerful and 'straight out of the box'.

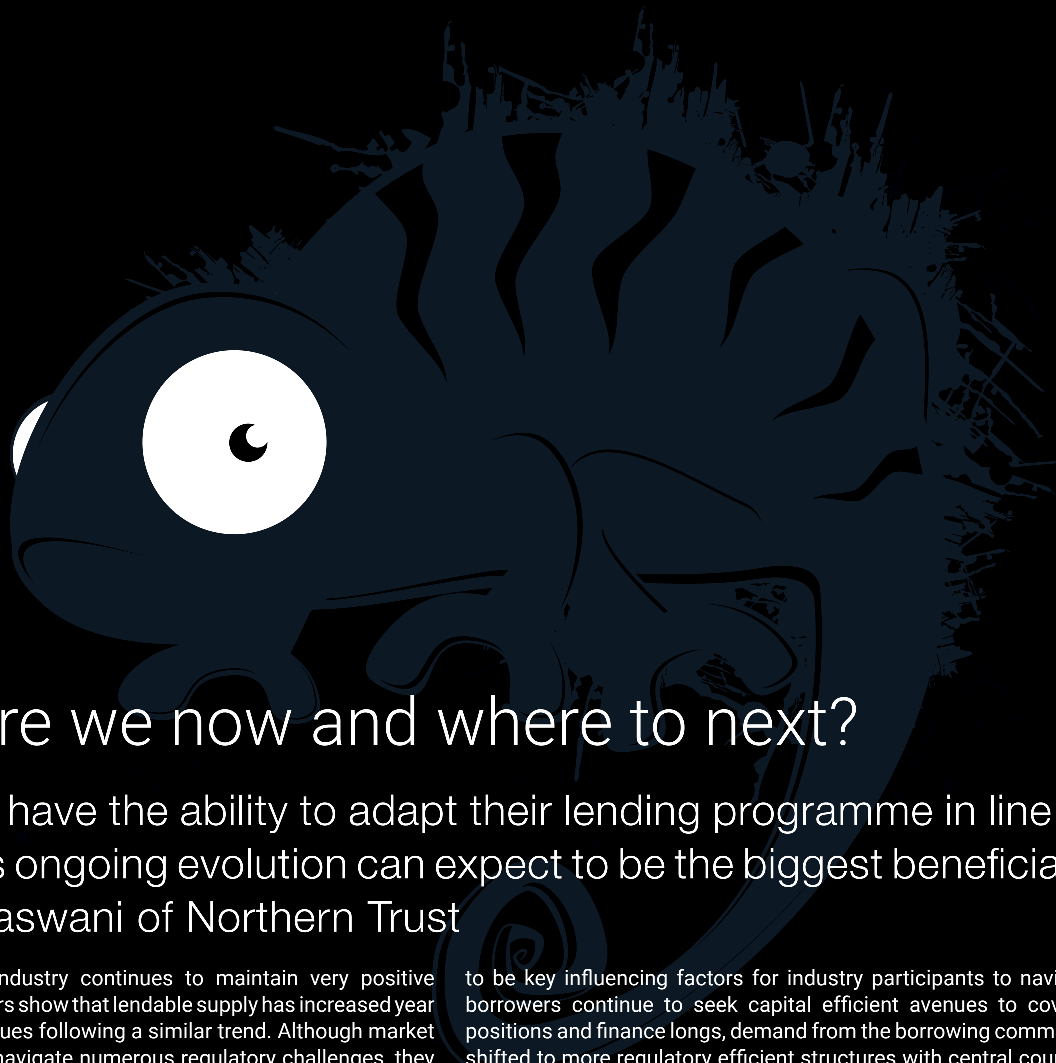
Enabling ease of connectivity and interoperability between platforms are key considerations for everything that we do as we evolve into a centralised automation hub. Pirum is the only post-trade vendor with connectivity to all triparty agents, the only vendor with scalable active flow through the Eurex Lending CCP, and is establishing exclusive linkage with the electronic trading venues Collex, Elixium and WeMatch Securities Financing.

Pirum's existing Exposure Connect workflow tool empowers operational teams by providing a global view of exposures, and a platform by which to identify, and agree exposures, to ensure they have an accurate portfolio, reconciled with counterparties.

Regardless whether collateral managers decide to centralise the collateral management function, we believe that visibility of all sources and uses of collateral and eligibility of assets is the first step towards building a more efficient collateral management function.

By understanding all the risks and costs, managers will make more efficient collateral allocations and traders will make better informed trading decisions, leading the industry to use assets more efficiently. SLT

Component	Aim	Keys to success
Visibility	Visualisation of all sources and uses of inventory across business units, centralised, intuitive system	Real-time view to monitor the relative performance of your collateral decisions together with a forward-looking basis, regardless of where the asset is held
Eligibility	See where your assets can be used as collateral and visibility of current agreements	Digitising and centralising collateral agreements, simplifying the BAU process, to simplify amending agreements or execute new ones
Regulatory drivers	Visualise regulatory risk drivers across all business lines. Understanding the WAM and counterparty mix of the book	LCR, NSFR, RWA, mandatory haircuts, EMIR and MIFID II
Risks	A holistic view of all firm-wide collateral assets, through various risk lenses	Risk metrics by trade, collateral and counterparty, highlighting correlation risk
Cost	Awareness of all costs involved: transaction, opportunity, funding, custody, CCP, collateral venue, and margin	Consideration of costs ensuring profitable decisions
Data quality/operational efficiencies	Accurate portfolio, reconciled with your counterparty, giving you certainty around your obligations	Automated mark to market and collateral RQV instruction, and collateral dispute management
Asset class analysis	Determination of optimal asset class and sub asset class mix, including classifications such as HQLA	Security level identification and knowledge of eligibility status per asset
Accurate current and future exposures	Tracking of inventory movements, settlement and fails alongside forward looking obligations and requirements	Real-time updates of all trade, collateral and inventory positions
Best execution	Choosing pre-trade the best opportunity alongside post-trade analysis	Risk and cost of each counterparty and comparison of trading and collateral venues
Scenario analysis	What-if analysis and a quick view of impacts on a real-time basis from a user friendly dashboard	Market price, exchange rate and ratings shocks and impact to exposure, collateral eligibility and regulatory requirements
Efficient allocations	What is the best use of the asset, how do I know which assets should be used as collateral for which trades?	Is an asset used as collateral in one trade better suited to collateralising a different trade?
How to mobilise	How do I get my asset to the most efficient place, while avoiding settlement failure and before market cut-offs?	Efficient mobilisation can only be achieved with a higher level of interoperability between CSDs, ICSDs, CCPs and custodians



Where are we now and where to next?

Lenders that have the ability to adapt their lending programme in line with the industry's ongoing evolution can expect to be the biggest beneficiaries, says Sunil Daswani of Northern Trust

The securities lending industry continues to maintain very positive momentum. Data providers show that lendable supply has increased year over year, with total revenues following a similar trend. Although market participants continue to navigate numerous regulatory challenges, they have also been capitalising on a variety of emerging opportunities that look set to help shape the future direction of the industry.

From a beneficial owner perspective, we have observed a number of pertinent trends helping to drive growth and innovation. While a global macroeconomic backdrop of lower interest rates, lacklustre growth and increased scrutiny on cost reduction has been a bane for many investors to navigate, it has been these very factors that have spurred increased beneficial owner interest for securities lending. With a need to offset falling investment returns and address unfunded liabilities, institutional asset owners have seen a behavioural change in their pursuit of alternative alpha generating avenues, particularly where these can be realised with a relatively low level of risk. For this reason, we have observed an increasing appetite for the securities lending product, particularly for investors who have traditionally opted not to engage in a programme. This has been an encouraging theme, which has supported the continued growth of lendable supply within the industry.

The macro and regulatory backdrop has also driven some beneficial owners to leverage the securities lending product in innovative ways to enhance performance, and as a vehicle to address their needs in the management of cash and liquidity through advanced concepts such as agency repo and peer-to-peer lending. It's clear that while there is a disparity 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.

From a borrower perspective, one of the most dominant themes which comes as no surprise, is the ongoing impact of global regulation. Challenges associated with increased capital consumption, higher funding costs and ongoing limitations in balance sheet capacity continue to be key influencing factors for industry participants to navigate. As borrowers continue to seek capital efficient avenues to cover short positions and finance longs, demand from the borrowing community has shifted to more regulatory efficient structures with central counterparty (CCPs) models, collateral pledge solutions and termed transactions positioned as key priorities. While current activity under CCPs and pledge structures remains limited, we expect usage of these conduits to grow through 2018 as beneficial owners and their agents adapt to major demand drivers related to the ongoing development of these frameworks. At Northern Trust, we remain engaged with our clients to ensure ongoing education in this regard, allowing them to make informed decisions on the extent to which these structures represent appropriate opportunities from a risk/reward perspective.

In addition, new transparency regimes, including the second of Markets in Financial Instruments Directive and Securities Financing Transactions Regulation (SFTR), which are designed to provide greater transparency and oversight within the market, remain key priorities for Northern Trust. These complex requirements are expected to drive significant changes in the way providers manage the securities lending product from both a client and borrower perspective.

Positively, the SFTR requirements could allow credit teams and borrowers to obtain transparency of loan activity with beneficial owners much earlier in the lifecycle of the transaction, and therefore be better equipped to actively manage their exposures. This could also pave the way for borrowers to be more selective in the types of transactions executed across beneficial owners—avoiding the most capital intensive trades or those that have greater impact on various balance sheet ratios. This may have an impact on some beneficial owners in certain jurisdictions and could force a change in the way agents structure their lending programmes.

Revenue in 2017 has been buoyant, sustained partially by increased demand for fixed income securities as a function of central bank

monetary policy and the ongoing demands of regulatory capital compliance. Towards the end of 2016, pressure mounted in European sovereign markets as the European Central Bank (ECB) maintained its presence as a substantial buyer of government debt through its quantitative easing programme. In addition, regulatory obligations meant banks and end users were compelled to hold large inventories of high-quality liquid assets (HQLA) to meet liquidity ratios, particularly over sensitive reporting periods such as year end. Beneficial owners that hold HQLA have typically benefited from increased utilisation and spreads associated with these themes.

Elsewhere, fees from lending global emerging market bonds have narrowed since the start of the year, as sentiment towards this asset class improved as a result of reduced geopolitical risks. Perhaps the most interesting change has been a widening of spreads observed in the corporate bond space. With increased regulatory burdens and a subsequent reduction in available balance sheet, banks are less able to warehouse risk and hold expensive corporate bond exposures. Correspondingly, assets are more in demand from the agent lender community to satisfy market making responsibilities and cover settlement issues. As such, fees increased throughout the period as agent lenders were able to widen spreads.

From an equity perspective, the broader global macroeconomic environment continues to be the major influence on revenue generation in general. This year has seen a relatively softer start in respect of overall borrowing demand as investors have remained cautious in picking an adequate entry point against a rising market, which has lowered conviction in the deployment of capital on the short side, resulting in a reduction in the volume of traditional 'specials' activity.

Notably, however, the industry remains optimistically poised for a better environment in the long run, notwithstanding tail risk considerations relating to geopolitical risk. Sentiments have suggested that a shift from quantitative easing to fiscal spending under US President Donald Trump's administration would drive markets differently, helping to break down asset price correlation and provide a better environment for traditional long/short fundamental-based strategies, which would bode well for securities lending demand.

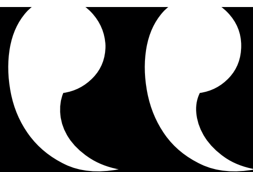
Emerging markets have continued to deliver strong performance for beneficial owners, and we expect the emergence of new markets to present compelling new streams of revenue for the industry. Demand for untapped jurisdictions, including China, Saudi Arabia, India and Indonesia, remains robust, although regulatory development has been slow to progress for securities lending. Market consensus is that China continues to present one of the most significant potential opportunities for the securities lending industry in the long term. Although the launch of both the Shanghai-Hong Kong and Shenzhen-Hong Kong stock connect schemes has opened the door to lending of Chinese shares, the framework offered is not conducive in its current form. However, the industry is optimistic for progressive change as China continues to liberalise its capital markets, and the recent inclusion of A-shares by the MSCI into its emerging market trackers is seen as a positive step in this regard. Saudi Arabia also looks like another market that, over time, could represent a significant opportunity for the industry.

The Saudi Arabian Capital Markets Authority has recently implemented a series of new regulations to help facilitate securities lending and covered short selling, the first for a Gulf state. More work is required before the platform is fit for purpose, however, this represents an exciting development in a region that potentially offers significant long-term promise.

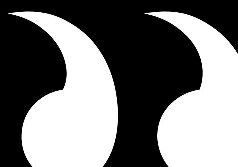
As in almost all financial sectors, technology is emerging as an important tool in optimising the delivery of the product. The increasing growth in quantitative-based trading strategies is transforming the way in which borrowers are consuming, pricing and executing securities lending transactions with lenders as they pursue reduced execution latency and a higher degree of automation. EquiLend's Next Generation Trading (NGT) is seen as an important tool to leverage in this regard, and the industry continues to expand efforts in deploying this technology to maximise the efficiencies it can bring to trading desks. Northern Trust has made a significant capital investment in the integration of NGT within its proprietary trading platform. As borrowers look to allocate business to lending agents that can offer the lowest friction trading solution possible, this is helping us to become a recognised market leader in this increasingly important part of an agent lenders product offering.

So, in summary, while challenges associated with the regulatory landscape remain an ever-present headwind, initiatives such as collateral pledge structures, more transparent beneficial ownership disclosure and CCPs should all be viewed as evidence of the industry's ability to evolve and adapt to change. Additionally, as further capital market liberalisation takes place, particularly in developing countries, we can expect the industry to continue to expand its global footprint as it looks to tap into new revenue streams. New technology clearly has a big role to play in the industry's future, both in terms of providing greater pricing transparency and better trade-flow efficiencies. NGT, blockchain and the growth of the financial technology industry will all be key to its ongoing success. Collateral flexibility will undoubtedly remain an ever-present theme. In a world of greater collateral mobility and optimisation, collateral flexibility will be instrumental in helping achieve out-performance.

Fundamentally, those lenders that have the ability to adapt their lending programme in line with the industry's ongoing evolution can expect to be the biggest beneficiaries. At Northern Trust, we remain committed to working in close partnership with our clients to ensure they can make appropriate risk-reward decisions so that securities lending can remain a core component of their global portfolio returns. **SLT**



Demand for untapped jurisdictions, including China, Saudi Arabia, India and Indonesia, remains robust



Sunil Daswani
Head of securities lending for EMEA and APAC
Northern Trust

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Updated best practices paper to be published in Q4

eSecLending is preparing to publish the third edition of its Best Practices for Securities Lending whitepaper. Here, the agent lender provides a preview

eSecLending is preparing to publish the third edition of its Best Practices for Securities Lending whitepaper.

The paper provides practical information for all beneficial owners as it incorporates best practice suggestions that are helpful inside and outside of the board room and covers topics ranging from market players, routes-to-market and types of loans to risks and programme oversight. The paper was originally published in 2012 with the help from other industry participants.

Below, please find an excerpt from the Approval and Oversight of Securities Lending Programmes section of the paper.

Those responsible for approving and overseeing their fund's securities lending service providers will play a role in defining the parameters of the programme and overseeing it on an ongoing basis.

The lender should be satisfied that full due diligence has been undertaken at the commencement of a securities lending arrangement, and that compliance and due diligence are regularly reviewed as the programme continues. On an ongoing basis, the lender should employ its business judgement to evaluate the nature and quality of the services provided by the securities lending agent, as well as the competitiveness of the fees charged by the agent.

Best practice notes: Some lenders have found it useful to form a small working group comprised of operations, compliance, portfolio management, risk management, trading, legal and tax departments to assist in monitoring the securities lending programme and performing due diligence with respect to providers. The group's activities focus primarily on monitoring the key elements of the securities lending policy and reporting periodically to an oversight board.

Securities lending policy

The lender should have written securities lending policies and procedures that have been approved by the oversight board. The securities lending policy should reflect the nature and extent of the risks the lender is willing to accept in the programme and set parameters that will ensure the programme will remain within its risk tolerances.

Best practice notes: In programmes where a lending agent is being appointed, the policies and procedures should state that the lending agent must be aware of the written securities lending policy and the securities lending agreement should adhere to this. Policy elements may include: choice of route-to-market, fees and revenues to be paid, approved borrower and selection criteria, restricted borrowers, approved markets and criteria to determine market choices, approved or excluded assets for lending, buffer to ensure lender receives corporate actions notifications, proxy voting, reinvestment guidelines, and many more.

Oversight board reporting

The oversight board should receive regular securities lending reporting from the working group (which monitors reporting from the lending agent). These periodic reports should include: compliance reporting, risk management commentary, income earned, performance benchmarking comparing your programme to your programme goals and to peer performance, market updates, and relevant information concerning securities lending trends.

External Information

In some cases, particularly for UCITS funds and US mutual funds, information about the lender's securities lending policy and activities may need to be disclosed for shareholders in the fund's prospectus. To further improve transparency, lenders may find it beneficial to have a public statement of their approach to securities lending on their website.

This should also be shared with other external facing employees, such as a call centre or public relations departments in the form of a frequently asked questions document. This allows for controlled and consistent disclosure when responding to external queries.

Changes to the securities lending programme

Proposed changes to the securities lending programme that require alteration to the securities lending policy must be approved by the oversight board. Proposed changes to the securities lending programme that are within the existing parameters set forth in the securities lending policy should be reported to the oversight board as an update. **SLT**

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To lend or not to lend?

Securities lending is a relatively low-return product, but any well-managed programme can be customised to mitigate the risks down to a level that justifies those returns, according to Simon Waddington of State Street

Of the adverse responses we hear when approaching new clients to enrol in our securities lending programme, there are two which are the most common by far.

The first is that returns are not high enough to justify the risk of the types of losses that occurred post-2008. The second is that securities lending supports short sellers and undermines the value of long-only portfolios.

Both of these arguments can indeed be valid, but only under very specific circumstances and neither should be an impediment to lending in today's market.

Regarding the risks of securities lending, the crucial point to bear in mind is that the only major losses resulting from the financial crisis were related to cash collateral reinvestment.

More specifically, they were related to cash collateral reinvestment into higher yielding asset types such as mortgage-backed securities, which both significantly dropped in value and also became mostly illiquid. For many years, these types of cash collateral investments generated extremely high returns for beneficial owners, but with hindsight the balance of risk versus return was weighted too far towards the latter.

What would stop this happening again today? Firstly the industry in general has changed immensely over the last 10 years. Today, the industry is significantly smaller—around $2 trillion of loans versus over $3 trillion globally in 2007, according to IHS Markit June data—and much more sophisticated in monitoring market exposure.

Agent lenders have more advanced risk frameworks that include stress testing versus numerous extreme scenarios, daily value-at-risk analysis and more detailed liquidity limits.

Beneficial owners are much better educated about the risks of lending and most have tightened their cash reinvestment guidelines to remove higher risk investments and reduce average maturity. Reinvestment guidelines that allow less liquid asset types such as mortgage-backed securities are very uncommon.

Cash collateral returns are also no longer driving the industry the way they were 10 years ago. According to IHS Markit, cash reinvestment was generating around $4.6 million per day for the industry at the end of May 2017 versus a peak of $44 million per day in 2008. Of course, that is partly due to the recent low interest rate environment, but it is also due to heightened risk management and tightening investment parameters.

Secondly, every client has the ability to tailor their programme parameters to meet their own requirements. There are many collateral options that allow clients to participate fully while removing components they are not comfortable with, as shown in the list in the next column.

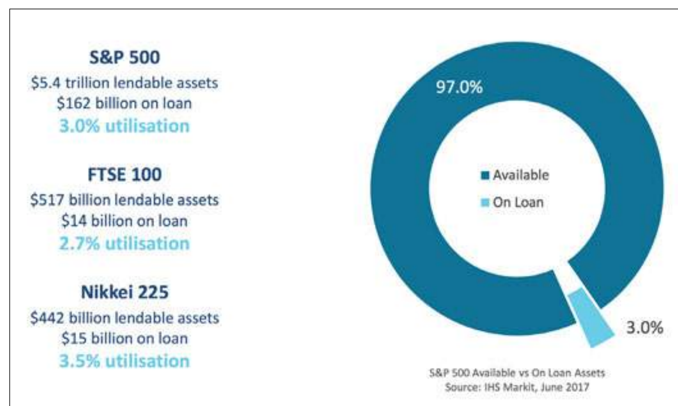
Any of these options would allow clients to benefit from securities lending returns while mitigating, or in some cases completely removing, the risk of the losses which occurred in the financial crisis. A non-cash collateral policy creates a very simple securities lending programme that captures the majority of the intrinsic lending value in clients' portfolios, while the other three options offer the benefit of also accessing the 37 percent of the global industry, which is versus cash collateral, according to DataLend, and potentially generating additional returns.

The second common argument against lending is that it supports short sellers and thus undermines the value of long-only portfolios. It is true that short selling would not be possible without securities lending, but those flood gates have long since opened. Consider the IHS Markit statistics on the market in the graphic below.

What the graphic is saying is that the available liquidity in the average main index stock is massive. In general, around 95 percent of lendable equities in the market are not lent, according to IHS Markit, so in regular market conditions, anyone who wants to go short will have no problem at all borrowing stock. Market liquidity in these stocks is so deep now that the decision of any one client to lend or not to lend, however large they are, is very unlikely to have any meaningful impact.

This is clearly a generalisation and it will not be true for every asset type and market, but agent lenders are sophisticated enough to allow clients to choose which assets can be lent down to a security level.

Liquidity for the FTSE Smallcap Index in the UK, for example, will be much lower than the FTSE 100, but if a client held a large position in a FTSE Smallcap stock, their agent lender could review market liquidity in that stock to assess if their holdings would likely have an impact or not. If it was a concern, the agent lender would simply restrict that stock from being lent and that issue is resolved.



S&P 500 Available vs On Loan Assets
Source: IHS Markit, June 2017

It is fairly common for active fund managers to either restrict or limit loans in securities in which they hold a significant percentage of the market capitalisation.

Managing limits such as these is part of standard day-to-day business for agent lenders, as is approaching these clients to let them know if there is a significant revenue opportunity on these stocks so that they can make an active decision on whether to benefit from it or not.

In conclusion, these are two of the factors that potential clients should consider before joining a securities lending programme, but they are far from insurmountable.

Securities lending is a relatively low-return product, but any well-managed lending programme can be customised to mitigate the risks down to a level that justifies those returns. **SLT**

1: A non-cash collateral policy

Non-cash collateral such as government bonds or equities has no reinvestment risk at all, and none of the major losses post-2008 were related to non-cash collateral.

2: Cash collateral invested in reverse repo

A reverse repo trade collateralised by equities or government bonds has almost exactly the same risk profile as a non-cash collateral trade versus the same securities, and agent lenders may indemnify reverse repo trades in exactly the same was as they would indemnify a non-cash collateral trade.

3: Cash collateral invested in money market funds

This is a common choice for cash collateral reinvestment and allows clients to invest in regulated short-term funds such as State Street's UCITS-compliant AAA-rated liquidity funds. Global money market fund reform such as the move to low volatility NAV funds in the EU will arguably make these even safer options for cash collateral reinvestment.

4: A separately managed cash collateral account

The definitive option for any client is to have a separately managed cash collateral account which is invested based on their bespoke guidelines only.

Any well-managed lending programme can be customised to mitigate the risks down to a level that justifies returns

Simon Waddington
Head of business development and relationship management, EMEA
State Street

Sink, swim or build a boat

With the wave of incoming collateral rules far from breaking, it's become a question of evolve or die. In this year's SLT Collateral Annual, the industry's best and brightest outline the current challenges and offer potential solutions. Drew Nicol reports on the talking points

As the regulatory gods continue to mould the global collateral landscape to their liking, the way forward remains treacherous for the securities financing industry—but innovation and an ability to adapt may yet prove to be its salvation.

Ever increasing demands for ritual sacrifices in the form of margin calls and other liquidity buffers is testing the faith of both buy- and sell-side participants, with liquidity squeezes becoming most pronounced and painful during quarter ends. In response, technology providers, vendors and trading platforms are mobilising to offer technical and logistical relief.

After years of rumours and anecdotal evidence of a regulatory-driven liquidity drought in the global capital markets, BNY Mellon

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and PwC set out to quantify the scale of the problems facing the market in a survey of buy-side participants. The subsequent report states: "The picture that emerged during these discussions was of a buy-side facing unique and challenging funding circumstances. One common concern shared by all respondents was the impact that the introduction of forthcoming non-cleared margin rules will play in exacerbating their liquidity stresses."

James Cherry of Pirum Systems notes that the International Swaps and Derivatives Association estimates that encumbered collateral in support of non-centrally cleared activity alone will reach approximately $800 billion by 2020, and some estimates go to $1.7 trillion. At the same time, the Financial Stability Board's (FSB) proposed introduction of mandatory haircut floors for repo and securities lending are expected to further drive demand.

However, there is hope. The International Capital Market Association European Repo and Collateral Council's year-end report stated: "Dealers quickly began to scour the screens for offers in specials that were cheaper than the prevailing general collateral rates, while banks that traditionally could only take German collateral as HQLA quickly relaxed their policy in favour of other core sovereign credits".

According to Cherry, this represents "further proof that the market can swiftly adapt to change when necessity dictates".

The crucial part that adaption has to play was reinforced by the International Securities Lending Association (ISLA) in its seventh market report published on 30 August.

Drawing on data from its members and the three main data providers, ISLA stated: "While balance sheet reduction at key reporting dates has become a permanent feature of borrower behaviour, the recent quarter ends were completed in a more steady and orderly manner than previously observed."

The association revealed that, after unprecedented volatility and dislocation was observed at the end of December 2016, the market better anticipated the end of June 2017 liquidity squeeze by reinvesting from the middle of the month onwards.

ISLA continued: "We also saw a willingness to recall cash collateralised loans ahead of the 30 June and return any cash collateral to the borrower, thereby avoiding any reinvestment issues over half year end. Demand to borrow government bonds remained robust during the first six months of the year."

Know thy enemy

According to BNY Mellon, blame for causing these concerns should be laid squarely at the door of Basel III. According to the bank: "Funding stresses among US buy-side participants first appeared in 2015 as some clearing clients began to report huge increases in their OTC clearing fees from their clearing banks. These increases were so large that they effectively drove some hedge funds out of the cleared OTC derivatives market altogether in a process that the industry has come to euphemistically refer to as 'offboarding'."

"Both of these episodes share the same underlying cause: strongly improved bank capital and liquidity standards enacted under Basel III are mandating that dealers hold markedly more cash to meet bolstered capital requirements and highly-liquid securities to meet new liquidity ratios."

Cherry also highlights the European Markets Infrastructure Regulation and the US Dodd-Frank Act as "massive consumers of high-quality liquid assets (HQLA) as further drains on available collateral".

In the face of all these obstacles, it's become a question of sink or swim.

What's to be done?

As part of its buy-side report, BNY Mellon offers four possible solutions to the current collateral conundrum, but adds that "each of them comes with a caveat, however, likely meaning that no single solution will be sufficient to address the liquidity shortfall. What can be agreed is that technology will be at the core of whatever answer the market lands upon."

Euronext's Dennis Mullany says: "In response to the issue of intermediary costs, a number of 'all-to-all' platforms have been launched in the last two years with the aim of giving buy-side clients direct access to financing markets."

"At Euronext, we feel that this is an important development, not because the services that banks provide in financial markets will no longer be required, but because clients need to have other options during market turmoil or when a bank's appetite for providing that particular service diminishes."

Bimal Kadikar of Transcend Street Solutions explains: "To fully meet these compliance deadlines within the next 12 to 24 months, most firms do not have the luxury of adopting a strategic approach to reengineer their business and technology architecture and have been forced to take tactical steps to ensure compliance."

"However, it is likely that achieving compliance in a short timeframe will create huge business and operational overhead costs, as one-off solutions may not be tightly integrated and may require additional manual work and reconciliations over time."

"The ongoing need for changes to front-office business processes will have an impact on compliance solutions, potentially causing firms to significantly increase the operational overhead of supporting these businesses."

In the end, post-trade efficiencies will only get you so far and a long-term solution to the collateral problem will require fresh sources of high quality and liquid collateral to be found.

Richard Gomm of Lombard Risk reinforces this, saying: "Access to high-quality collateral positions via repo transactions coupled with competitive edge gained from technological efficiencies are vital to market liquidity and the elimination or easing of the collateral scarcity phenomenon."

For some, the answer is the already emerging use of exchange-traded funds (ETFs) as collateral, but even here there are problems. Mullany explains: "The use as collateral of assets such as ETFs, in which volumes in Europe have been increasing steadily over the last decade, is relatively low."

"There are a number of reasons for this, including the complex classification process for a product with such a diverse range of fund structures and asset classes."

"Also, historically, it has been difficult to systematically see through to the underlying components of some ETFs for risk purposes, which has restricted trading volumes and in turn makes them difficult to use for financing purposes."

The SLT Collateral Annual will be available at IMN's 22nd European Beneficial Owners' Securities Finance & Collateral Management Conference in London on 12 September. **SLT**

We value our people and embrace the future with an open mind.

Mirae Asset Financial Group is acquiring leading securities firm Daewoo Securities in 2016.

The reconstituted entity Mirae Asset Daewoo, will emerge as one of Asia's preeminent independent financial services companies. Its businesses encompass asset and wealth management, insurance services and securities brokerage; including prime brokerage and securities finance.

Its subsidiary, Daewoo Securities (America) Inc., is planning to enter the Prime Brokerage, Global Securities Lending, Repo, Delta One Trading, and Correspondent Clearing businesses in the US.

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Robert Akeson, Chief Operating Officer: (212) 407-0277

Passive funds gain upper hand

The collateral shortage has made the tough passive fund even tougher. IHS Markit analyst Simon Colvin reports

The term ‘disruption’ gets thrown around a lot today, however, there is no denying that the asset management industry has felt more than its fair share of disruptive innovation in the years since the financial crisis. Much like more parochial niches such as retail, food distribution or even mattresses, the twin siren songs of improved efficiency and lower cost promised by upstart passive funds have proved too much of a temptation for investors to resist. Spurred on by the desire to cut costs, and the growing realisation that the extra costs levied by incumbent fund managers don’t guarantee outperformance, what had been a trickle into passive funds has turned into a deluge.

Money riding this wave of disruption is showing no signs of drying up anytime soon, as it has only taken to mid-August for the global exchange-traded fund (ETF) industry to beat its previous full year inflow record.

The $4.3 billion now managed by ETFs globally, and the even larger sum allocated to passive fund trackers, is now starting to make waves in the securities lending space. In fact, these funds are now responsible for nearly two thirds of all global securities lendable inventory according to the funds contributing to the IHS Markit Securities Finance database. This share has, not surprisingly, grown over the years as passive funds were responsible for less than half of the global inventory before the crisis in 2008.

Astonishingly, these ‘boring’ funds are actually able to generate more revenues in the securities lending market than their actively managed peers. Over the past three years, passive funds have earned an average total return of 5.1 basis points (bps), which is 14 percent more than the 4.5 bps earned by actively managed funds over the same period.

One reason behind this outperformance is due to the fact that passive funds are, by and large, more pragmatic when it comes to the type of assets that they are willing to receive as collateral for securities lending transactions.

Our data indicates that 36 percent of active funds will only accept high-quality G7 bonds as non-cash collateral. Passively managed funds on the other hand are much less picky when it comes to collateral, as only 20 percent of these funds by assets under management will only lend securities against the highest quality collateral. This means that fully 80 percent of all passive inventories are available to borrowers with some sort of lower quality collateral, such as G10 bonds or equities.

These numbers may not seem drastic at first glance, but we all know that the industry’s chronic oversupply means this is very much a buyer’s market when it comes to selecting potential counterparties. The advent of derivatives clearing regulation has further fuelled this trend as borrowers now have to ration collateral to fuel other activities within their organisations. Ironically, these collateral shortages have created opportunities in the market, but mainly for lenders that are willing to lend out high-quality liquid assets to holders of relatively lower quality collateral.

European sovereign bonds, which is one such asset class, highlights this trend perfectly. The funds that are willing to lend out the asset class against assets other than G7 government bonds have been able to generate an average total return of 4.8 bps over the past three years. Pickier G7-only lenders haven’t been able to achieve even half these returns over the same period of time, mostly due to the fact that the utilisation rates achieved by their inventory has been half of that seen by their more pragmatic peers.

For now, passive investment funds have been better able to capitalise on the collateral shortage as their willingness to be more pragmatic when it comes to collateral makes them better potential counterparts. Being able to use ancillary activities, such as securities lending, to drive down the cost of their already cheap products is part of the disruptive appeal of passive funds and the collateral shortage had made a tough competitor even tougher. **SLT**

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Robert Akeson, COO (left)
Richard Misiano, Head of global fixed income (centre)
Peter Volino, Head of global equities (right)
Mirae Asset Securities (USA)

Achieving strong momentum

Mirae Asset Securities (USA) is now operational in the securities lending, repo, foreign research distribution, corporate access and agency execution businesses. Its prime brokerage and correspondent clearing businesses are next, as members of the US senior management team explain

How does it feel to be in business?

Peter Volino: Being back in business feels great. The response from our clients has been overwhelmingly positive. Currently, we have 110 repo counterparties and more than 100 securities lending counterparties in various stages of the approval process.

Once OCC membership is finalised, and through the use of its stock loan programme, considerable growth in our securities lending balances are expected.

Also, we just started executing orders off our agency desk. Very shortly, we will be launching prime brokerage and correspondent clearing. Our time-to-market has been what we had expected.

Thankfully, because we are owned by South Korea's leading financial services firm, Mirae Asset Financial Group, we have had access to all resources required to undertake and successfully complete our business launch. For example, we launched with $260 million in total net capital. We also now have 60 employees.

In addition, Mirae Asset Securities (USA) has partnered with FIS on the technology front and uses its Securities360 platform. Securities360 is the first of its kind, fully-integrated solution that automates and streamlines critical tasks, from the front, middle, and back office, into a single platform, and it includes portfolio accounting for our hedge fund clients.

This facilitates operational efficiency and reduces risk—two big competitive advantages for our clients and us. Lastly, we have chosen BNP Paribas to provide us with global custody services in the Americas, Europe and Asia. This relationship will allow us to meet the global settlement and asset servicing needs of our clients.

Can you tell us more about the Mirae Asset Financial Group and its strategic vision?

Richard Misiano: Mirae Asset Financial Group is South Korea's leading financial services firm and operates in 16 country markets, including South Korea, Australia, Brazil, Canada, China, Colombia, Hong Kong, India, Indonesia, Japan, Mongolia, Singapore, Taiwan, the UK, the US and Vietnam.

As of 31 December 2016, the group's asset management business had approximately $300 billion of assets under management. Its various broker-dealer subsidiaries and affiliates have approximately $5.8 billion in capital. So we have significant and increasing global market breadth and depth.

Strategically, Mirae Asset Securities (USA) is an extension of the formidable asset management and brokerage franchise created by the parent. For example, the parent is now considering ways to enter the asset allocation business in the US with hedge funds and investment advisers. The plan is that these assets can be custodised at Mirae Asset Securities (USA), which will enhance the information flow to, and comfort level of, non-US investors.

What are the possible benefits to Mirae Asset Securities (USA) from the activities of the parent?

Robert Akeson: We see the benefits comprising the following. First, as earlier noted, we have begun operations with a significant permanent capital base. This reality combined with the fact that we do not roll-up to a bank holding company gives us tremendous added balance sheet 'runway' for our repo, securities lending, prime brokerage and correspondent clearing businesses. We will not be hobbled by Basel III and its ratios like other firms. Because of our globally recognised parent, our prime brokerage offering has the feel of a larger firm, but the nimbleness and attentiveness of a boutique.

Secondly, because of our parent, our clients will have access to a very distinctive foreign research product and related corporate access capabilities. We have a written content product covering a broad range of companies in South Korea, Vietnam, Indonesia and Brazil. We also have strategy pieces addressing East Asian market trends and beyond, written out of Seoul headquarters.

Finally, as the firm enters the asset allocation business, additional synergies will emerge with our prime brokerage and financing businesses and their clients.

As you gear up for the launching of your prime brokerage business, what can you tell us about it?

Volino: We are targeting emerging and small hedge fund managers and proprietary traders. These clients have been most adversely affected by Basel III and the US Dodd-Frank Act and the ensuing industry consolidation. We will also be working with introduced prime brokers who support smaller managers.

In addition, because of our balance sheet, we have been having conversations with larger funds that are seeking a significant and attentive counterparty for their secondary prime brokerage relationships.

Mirae Asset Securities (USA) offers a fully integrated prime brokerage platform capable of providing tailored solutions around portfolio reporting and analytics, risk management, and trading.

The platform will focus largely on supplying intelligent data to support our client's strategies. Taken as whole or in pieces, this platform will offer hedge fund clients operational efficiencies and risk mitigation tools.

In addition, we will provide hedge funds with a wide range of advisory services to assist them in launching, and operating their businesses, while better preparing to meet their operational due diligence needs. These services span areas including office space, enterprise technology, cyber security, compliance and human resources, and so on.

Recently, we hired industry veteran, Stephen Murphy, to lead our prime brokerage, correspondent clearing and agency execution businesses. Stephen has extensive sell and buy-side experience with Weiss Multi Strategy Advisors, Neuberger Berman and Merrill Lynch. **SLT**

Fan of the mismatch

Experts debate whether equities as collateral will ever be acceptable

As beneficial owners face pressure to accept lower quality assets as collateral for their HQLA, should they be accepting equities, or are their concerns about quality warranted?

Peter Hutchinson
Managing partner
Consolo

Traditional thinking is that the safest form of collateral is the asset that is most correlated to the asset being lent. This gives assurances that in a market crisis, the lent asset and the collateral against it will move in the same direction.

In the case of high-quality liquid assets (HQLA), the assumption is that in a crisis the market price will increase due to a 'flight to quality'. Therefore, it is logical that when lending HQLA, the best form of collateral is other HQLA. This is a safe assumption, although in the case of government bonds, not all are equal. However, there is little or no value to the borrower in like-for-like transactions for capital management purposes, and so in order to be commercially attractive, lenders need to move away from this tight correlation.

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Taking equities as collateral against HQLA may be a way beneficial owners can increase returns without necessarily significantly increasing risk, provided detailed analysis is undertaken and the equities carefully chosen.

Collateral is intended to be utilised when a counterparty defaults, and the surviving counterparty needs to replace assets that have been lent. This process in almost always undertaken in volatile markets where other firms are in the same situation of trying to close out positions. It is inevitable that it becomes a 'fire sale', and the most important aspect of the market is going to be the ability to trade.

On the surface, equity seems to be an unlikely form of collateral to accept against HQLA. Where HQLA is likely to increase in value in a crisis, equities are likely to fall, and the negative correlations can be seen in historical data over and over again. However, there is a predictability in these behaviours and any potential shortfall risk can be measured using historical data and mitigated by increased haircuts.

During the 2008 financial crisis, one of the biggest issues lenders faced was the ability to sell. Firms were caught out with highly rated corporate bonds that couldn't be sold because of the liquidity squeeze. The price to replace the lent HQLA was increasing while the collateral couldn't be sold and firms faced having to sell well below market just to realise the collateral. Firms that held equities had no such problems. In many cases, hedge funds were seeking to close out short positions and were active buyers of equities in the market adding to liquidity. Although markets fell, liquidity was maintained and provided the level of over collateralisation (haircut) was sufficient, lenders were able to replace lent HQLA without loss.

Of course, quality still matters and a lender needs the equity to be trading after a counterparty default. Due diligence is key but with sufficient analysis, and appropriate haircuts, I would strongly argue that equities can be good collateral against HQLA lending.

Tracey Adams
Regional head of product for the Asia Pacific
Lombard Risk

As high-quality collateral becomes scarcer, many institutions are concerned by the cost of high-quality liquid assets (HQLA). While some beneficial owners are willing to accept lower quality collateral, others prepare to compete on the quality of collateral they agree to accept. In an environment where collateral scarcity and mobility has become a fundamental concern, clarity and ease of use rank higher—even over cost. Cost will always be an important factor but the values of collateral must remain. This means collateral must be tangible, high-quality, liquid and easy to value. This is critical in maintaining the core principles of Basel III and the US Dodd-Frank Act.

Recent years have witnessed the growth in the use of equities as collateral and this is expected to continue. The market is moving further towards a non-cash collateral environment, with equities playing a major role. An independent study conducted in Q1 2017 found that cash collateral as a percentage of on-loan balance was around 40 percent while non-cash collateral was 60 percent, up slightly from 2016.

From a lending perspective, as well as providing greater returns, equities are widely available and on balance sheet. That said, this is only one segment of the market. There are many who believe there are limits on the use of equities as collateral. Even in terms of stock loans, many beneficial owners still regard price volatilities on equities as unacceptably high risk.

If we turn to other collateral market areas, central counterparties (CCPs) for example, equities are widely considered too risky. In many cases, equities are excluded (such as by LCH), while some CCPs such as Eurex Clearing, LCH SA and CC&G accept equities subject to strict limitations. This include haircuts, concentration limits and other requirements, for example, being part of a leading market index.

Equally, rulings under the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) framework have signified a clear move away from non-cash collateral in favour of cash collateral. Rather than a question of whether accepting lower quality assets as collateral for high-quality liquid assets (HQLA) is a good idea, firms should ask themselves if they have the best processes and levers for enhancing collateral values.

Many institutions have been proactive in upgrading technology and changing organisational structures to improve asset mobility, while others still need to consider the value chain and assess the steps that make it possible to select an all-encompassing securities inventory which includes availability, agility and robustness. At the basic level, this means getting the operations right. Is the system still defining eligibility the same way that it did five years ago?

Does the collateral and settlement solution have an unnecessary number of systems and portals in between one another, hindering the settlement process? Such measures include cross product (or enterprise-wide) collateral management solutions, where inventories and available assets are pooled, projected on, ranked in terms of high quality and linked to a robust and scalable optimisation tool.

In turn, the optimisation tool must be linked to the collateral management inventory to ensure that a true cost of collateral can be assessed, including the weighting on the balance sheet.

Collateral must be tangible, of a high-quality, liquid and easy to value—mainstream equities generally fulfil this industry criteria provided the equities are listed on a main stream share index. If termed, and with an appropriate haircut, one could argue that equities can easily be accepted as collateral against HQLA. Indeed, Rule 15c3-3 in the US has brought forward this very notion. However, aside from the lending argument, what remains fundamental is the proper collateral management infrastructure that enables the entire process, regardless of asset class.

Walter Kraushaar
Head of sales and advisory business.
Comyno

To answer this question, it is worth looking into the history of the securities lending business of the big US-based beneficial owners, where cash collateral is still 'king' and all the relevant risk management, trading and settlement systems were designed to mainly handle rebate trades on a delivery-versus-payment (DVP) basis.

All existing operational and IT infrastructure of the industry, ie, the core securities lending and repo systems, practices and technologies have been built around the DVP model. As such, all non-cash collateral was and still is, even in Europe, where fee-based cash pool trades have always been conducted.

Subsequently, the existing IT infrastructure is also still not managing non-cash collateral in a state-of-the-art and efficient way. Most purpose-built US securities lending systems try to understand non-cash/fee-based loans and borrows by treating them as pseudo-cash transactions in one way or another, which causes a lot of manual and expensive workarounds for the beneficial owners.

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However, the need of a general upgrade of the IT infrastructure is unavoidable, given today's global markets and regulatory environment.

In today's short-term interest rate environment, technically speaking, rebates on cash investment really don't exist anymore. Cash investment returns are so low that lenders no longer pay much if anything in rebates. The business has essentially become a fee-based business utilising an oxymoron–the negative rebate. A rebate that is 'negative' is just a fee under another name. In addition, borrowers are hit for larger capital utilisation costs than ever before. Under the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) calculations, resulting in more stringent capital reserve rules, the cost of using cash collateral against less liquid collateral (equities) has increased dramatically.

It is fair to say that from a pure risk perspective and without the infrastructural boundaries, equities offer some substantial advantages against cash and other non-cash collateral even for the collateral taker:

- In the case of the default of a counterparty, main index equities are always liquid and easy to sell at the various exchanges
- There is 'always' a market and a standard settlement process for this asset class—after all, it is traded on a stock exchange
- Lending out fixed income securities against equities is a 'non-correlated' transaction from a risk point of view for the beneficial owner
- Lending out high-quality liquid assets (HQLA) will result in a higher return for the beneficial owner

However, despite the obvious advantages of equity collateral, many beneficial owners are still struggling to open up their collateral policies into the asset class of equities as they have infrastructural issues revolving around risk and operational process. Equities collateral change the risk equation (and who carries the risk) in fundamental ways, and are far less of a straight-through process than cash collateral.

There may not be a regulatory mandate, but there is a compelling business case to be made for tackling this issue once and for all. Every stakeholder will derive real financial benefit—straight to the bottom line.

John Arnesen
Global head of agency lending
BNP Paribas

Concerns about accepting equities as collateral are well documented and while the trend is moving to greater acceptance, it is still not fully acceptable under certain regulation in the US. Ironically, it is regulation that has led to a boom in the posting of equities via high-quality liquid assets (HQLA) term trades.

Beneficial owners need to consider several factors when reviewing lending opportunities with diverging levels of loan collateral credit quality. Before deciding on which collateral to accept, lenders need to assess the credit and liquidity risk of accepting collateral upgrade or downgrade structures within their programmes.

If working with an agent offering indemnification, lenders should assess the capital strength of their agent lender's balance sheet as well as examining their overall securities lending programme and track record. Lenders need to ask themselves: to what extent does the indemnification policy cover miss-matched collateral? Does the policy cover equities as collateral against fixed income loan transactions?

Beneficial owners typically earn proportionately higher revenues as the credit gap widens between the securities lent and the corresponding collateral. Indemnification can add to the mitigation of risks associated with a loan and collateral credit divergence as, in the event of a borrower default, the agent providing the indemnity will cover any shortfall in the value of the liquidated collateral. As principal to the borrower albeit through an agent, the lender is exposed to agent credit risk. To neutralise this risk, indemnified agency lending programmes provide access to a diversified list of counterparties.

Credit quality is one factor that requires consideration but the argument that liquidity is potentially a more important factor is valid. Taking government or high-grade corporate fixed income securities as collateral against loans of the same quality are clearly well correlated but unless deeply special, will not produce meaningful fees—if any fee or demand at all. Less well-correlated trades do present greater revenue opportunity as described in the typical HQLA transactions, which are generally collateralised by primary index equities. There is little argument about the liquidity of exchange-traded equities so despite the mismatch of asset classes, is this actually a readily liquid transaction?

The lion's share of our programme accepts equities as collateral and that isn't restricted to assets managers but includes central banks and sovereign wealth funds. The analysis these institutions undertake is rigorous so there is clearly a general recognition of the value of equities as an acceptable asset class as collateral.

Sunil Daswani
Senior vice president and international head of securities lending, capital markets
Northern Trust

Northern Trust has accepted equities as collateral for a number of years, versus both equity and fixed income loans. It is our role as a lending agent to have educational discussions with clients regarding these options, allowing them to make an informed decision on election strategies that fit their risk-reward appetite.
In order to optimise the value of a client's portfolio, one of the many strategies we employ is to accept equities for clients where this collateral helps achieve their lending objectives and is within their risk tolerances.

In the current regulatory regime, we are all accustomed to, our comprehensive and efficient risk, capital, and collateral management model is compliant with advanced risk requirements as detailed by Basel III. Northern Trust's systems and procedures have sufficient functionality to facilitate a flexible, rule-based collateral management approach. Acceptable collateral is thereby maximised according to lender, regulatory and bank rules, including concentration checks and sophisticated inclusion/exclusion rules. The model's underlying assumptions are reviewed frequently and these policies incorporate robust back-testing and stress testing procedures.

Ongoing asset purchase programmes from global central banks continue to drain the supply of sovereign and corporate bonds, making these expensive forms of collateral. Clients that want to maintain utilisation, while adding new revenue opportunities, should consider accepting equities as collateral. This trade type works well for clients with a deep and stable inventory of highly-rated sovereign bonds, particularly if they expect to hold the bonds over a three-month time horizon. Accepting equities as collateral can lead to increased borrower diversification, often allowing clients to face higher-rated counterparts they may not have transacted with previously, while in a stressed market environment, main index equities maintain liquidity.

As always, Northern Trust would only recommend accepting equities in a risk-controlled manner, forming part of well-diversified and well-laddered pool of collateral options. **SLT**

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New hires at Cowen Group, Deutsche Bank, Comyno and more

Cowen Group has recruited another of Jefferies's securities lending team.

Jason Sardina, who joined Cowen July, was senior vice president within the Jefferies fully paid lending, hedge fund coverage, structured products, swaps and delta one team, between May 2010 and June 2017.

He will continue to be based in New York.

Sardina follows the arrival of Matt Baldassano from Jefferies, who moved in 2016 to become Cowen's head of securities finance.

The appointment marks the third senior hire for Cowen's securities finance offering in recent months, following the recruitment of Bernard Minsky to its international prime services team as head of risk management.

Minsky, who joined Cowen in April, is based in London and reports to Kevin LoPrimo, head of international prime brokerage.

In January, Ross Levin joined Cowen Group from Pleeco as director of global securities finance to help build its securities finance and equity trading and clearing business.

Deutsche Bank has appointed Anand Rengarajan as head of securities services for Asia Pacific (APAC).

Rengarajan will be based in Singapore and will report to Satvinder Singh, global head of securities services. Regionally, he will report to Lisa Robins, head of global transaction banking for the APAC region.

Since joining Deutsche Bank in 2000, Rengarajan has held various roles within the company, most recently serving as co-head of investor services for APAC.

Singh said: "With his wealth of experience in building businesses across APAC, Anand Rengarajan will be an invaluable resource in driving further growth for the securities services business in this important region."

Robins added: "We are pleased to have chosen Anand Rengarajan to lead our securities services business in APAC. His track record and long tenure at Deutsche Bank will serve him well in his new role."

Fidelity Investments has snapped up Jeremy Meade from Goldman Sachs for its securities lending desk.

In his new role, Meade is director of securities lending based out of Fidelity's Boston office.

Meade moved to Fidelity in August after 12 years at Goldman's agency lending business where he managed clients' financial and reputational risk via market sell-fail management.

He also described himself as an industry thought leader in areas of buy-in best practices, agency lending disclosure and the industry's move to T+2 settlement cycle.

Comyno has appointed Walter Kraushaar as head of sales and advisory business.

Kraushaar will oversee all aspects of Comyno's advisory business and will establish a strong sales and advisory team to cope with the growing customer demand for the company's business and infrastructure solutions for the securities finance markets.

He will join on 1 January 2018 after finishing a sabbatical year and will report to Markus Büttner, founder and CEO of Comyno.

Kraushaar was previously head of treasury and securities lending at MFG and also served as a managing director at DekaBank and Dresdner Kleinwort Wasserstein.

Büttner said: "We are excited about Walter Kraushaar's addition to the Comyno team. He brings the proven track record of success we believe that we need to achieve our goals and grow our business and we look forward to his leadership as we continue to strengthen and expand our sales and advisory business."

Simon Martin has joined HSBC Securities Services from J.P. Morgan.

He has taken up the role of head of multi-sector sales and business development at HSBC Securities Services.

Martin spent seven years at J.P. Morgan, most recently as securities lending sales and relationship manager.

He was responsible for securities lending sales and client management for clients across Southeast Asia, Australia and New Zealand.

J.P. Morgan saw Paul Wilson leave his role as global head of agent lending product and portfolio advisory in August.

State Street has promoted William Han to head of agency lending in Asia.

In his new role, Han manages State Street's client and agency securities lending product relationships, as well as new business acquisition activities, in the Asia (excluding Japan) region.

Han previously led client sales and relationship management for State Street's agency securities lending solution in Southeast Asia.

He has worked at State Street since 2003.

State Street earned securities finance revenue of $179 million in Q2 thanks to a boost at the bank in enhanced custody, as its assets under custody and administration exceeded $31 trillion for the first time.

Securities finance revenue was up significantly on Q1 2017's $133 million and Q2 2016's $156 million, reflecting higher revenue from, and growth in, enhanced custody.

Assets under custody and administration at State Street reached $31.04 trillion in Q2 2017, surpassing Q1 2017's $29.83 trillion and Q2 2016's $27.79 trillion.

RBC Investor & Treasury Services has recruited Aneet Shah as head of global client experience.

Shah joins the the bank's global client coverage team and reports to Paul Stillabower, global head of product management.

Based in London, Shah will be responsible for enhancing client experiences and will focus on ensuring that product and technology developments are fully coordinated with client and industry needs.

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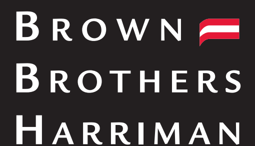
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Shah joins RBC from J.P. Morgan, where he spent 11 years in senior product management positions for its securities services business.

His most recent role was as regional head of product for investment operations middle office outsourcing for Europe, the Middle East and Africa where he led the development of strategy and client pipeline for this business.

"RBC Investor & Treasury Services has a long history of partnering with our clients to deliver services that meet their evolving needs. Aneet's deep industry experience will be of significant value as we continue to enhance and develop new products and technology," Stillabower said.

RBC Investor & Treasury Services has also recently announced the appointment of Wendy Phillis, who joined as governance and regulatory solutions for Europe and the Asia Pacific.

KAS BANK has appointed Glenn Brown as senior relationship manager.

Brown will be responsible for building long-term relationships with the service provider's UK pension fund clients, assisting them in delivering their strategic goals.

Prior to KAS BANK, Brown spent 18 years with Northern Trust, where he held various client-facing managerial and sales positions.

For the last two years, he has been a client relationship manager for Northern Trust's Institutional Investor Group.

Brown has also held positions with Lloyds Bank Securities Services.

Pat Sharman, managing director of KAS BANK, said: "The pension landscape is changing rapidly, and schemes are increasingly in need of careful guidance and bespoke data to help them tackle growing governance challenges."

He added: "Glenn Brown has a proven ability to cultivate successful long-term collaborative client relationships, and that's exactly what schemes need right now."

Brown said: "KAS BANK proved, with the launch of its cost transparency dashboard, that it's serious about improving the pensions market, helping schemes with the many governance challenges vying for position at the top of their to do lists. I can't wait to get started."

BNY Mellon's Pershing has promoted Jim Crowley to the position of COO, effective immediately.

Crowley has been at Pershing for almost 35 years, working in relationship management and operations, and is already a member of the executive committee.

He is moving on from his position as chief relationship officer, which he had held since 1995.

Crowley is credited with building a strong client relationship network and with leading development of Pershing's client experience strategy.

He has also sat on the board of trustees of the Securities Industry Institute since 1988, holding the chair position between 2007 and 2009.

Pershing CEO Lisa Dolly said: "We believe the client experience is driving business decisions today, and will into the next generation. Jim Crowley has been working closely with our clients to understand their needs, and his leadership will help us to continue to deliver solutions that empower our clients and improve the overall experience."

Brian Shea, vice chairman and CEO of investment services at BNY Mellon, commented: "Jim Crowley possesses a deep understanding of our business and a reputation for doing what's best for our clients."

He added: "Lisa Dolly and Jim Crowley have a great deal of experience working together on client-focused solutions, and their skill sets will undoubtedly complement one another as they continue to move the business to a higher level of success."

Northern Trust has chosen Yen Leng Ong as its new country head of Singapore and Southeast Asia.

Ong will start her new role in December, subject to regulatory approval. She will continue to report to William Mak, head of the Asia Pacific region.

In her new role, Ong will be responsible for leading Northern Trust's asset servicing business activities and driving the growth of key business lines, including asset management and capital markets, across Southeast Asia.

She has worked at Northern Trust since 2009 and was previously CAO for the Asia Pacific and head of product management.

Mak said: "We are delighted to appoint Yen Leng Ong to drive the momentum of Northern Trust's business and client footprints in Singapore and Southeast Asia. As part of our Asia Pacific leadership and Singapore management teams, Yen Leng Ong has been instrumental in growing our client base in the region. Her valuable experience in product strategy will ensure our APAC clients benefit from our asset servicing solutions designed to help them navigate challenges and increasing complexity in the market." **SLT**

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