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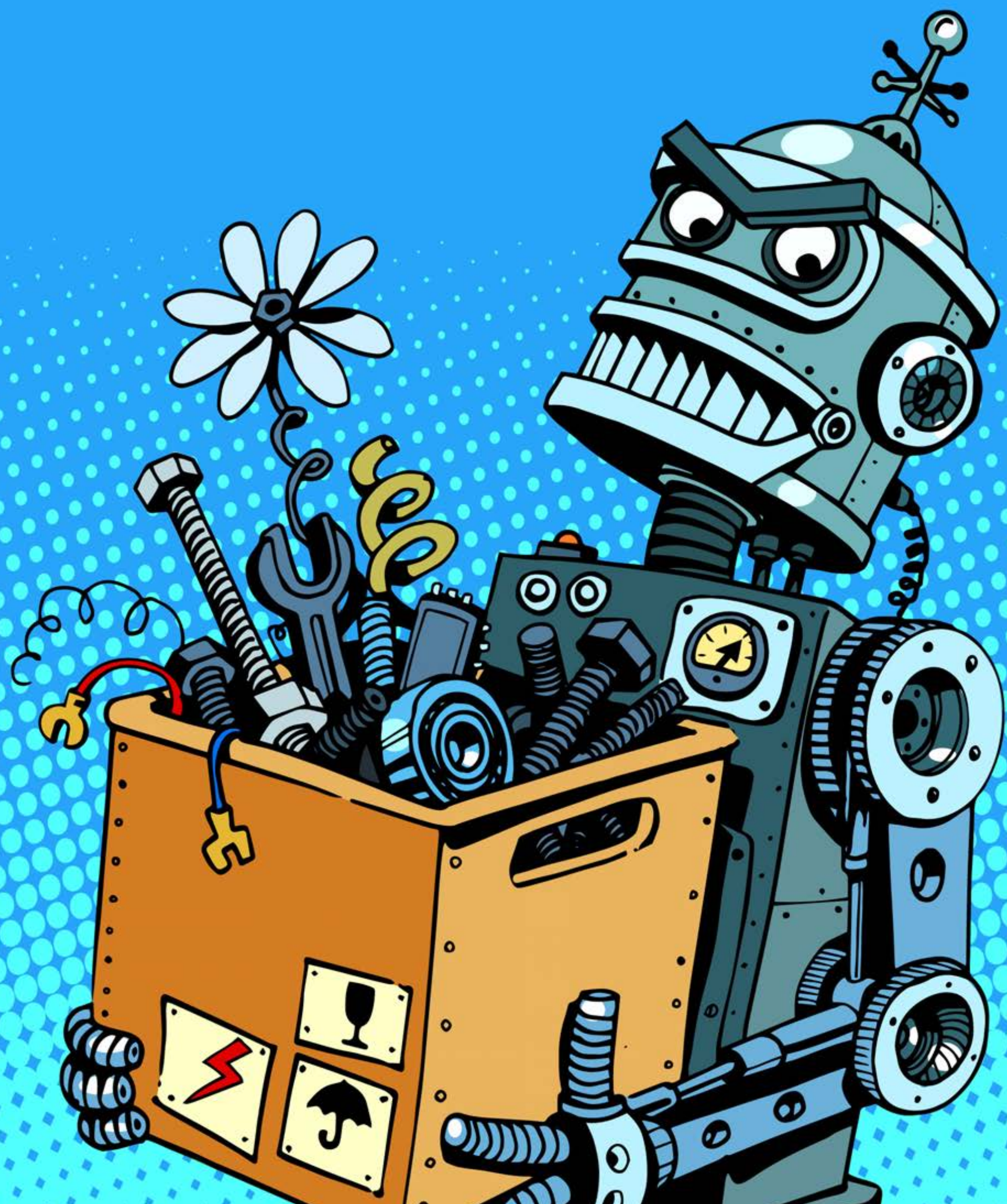

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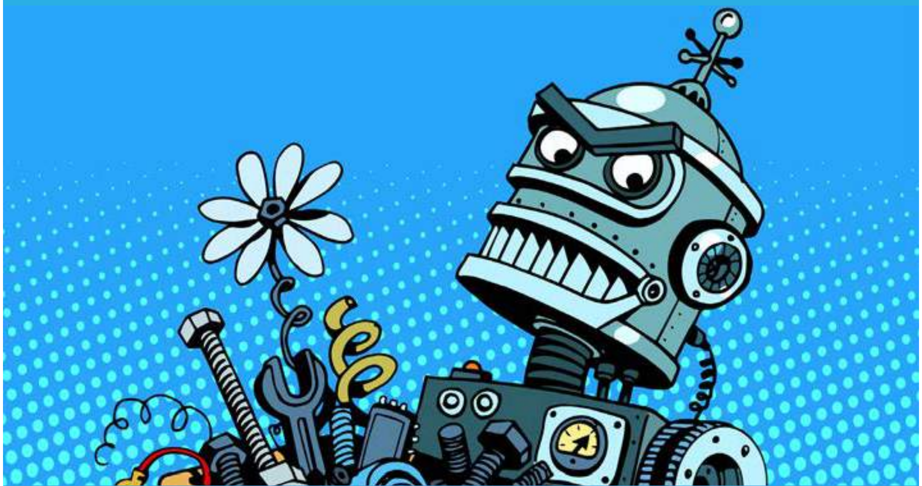

US Volcker Rule not fit for purpose, says SIFMA

The US Volcker Rule is too broad, excessively complex, and uniquely prescriptive, according to the Securities Industry and Financial Markets Association (SIFMA).

Responding to the Office of the Comptroller of the Currency's (OCC's) request for comments on the rule, SIFMA said: "[the rule] should be revised to better accomplish the purposes of the underlying statute and its impact on the efficient functioning of markets to facilitate growth."

SIFMA added that the complexity of implementing regulations and the difficulties inherent in having five agencies tasked with implementing and interpreting the regulations, mean that many key interpretive issues remain unresolved.

In its letter to the OCC, SIFMA set out several recommendations for reform, including revising the definition of proprietary trading to focus on speculative short-term standalone proprietary trading, simplifying the prescriptive compliance obligations of the proprietary trading and covered fund provisions and eliminate the quantitative metrics regime, among others.

"While we continue to believe the Volcker Rule is a solution in search of a problem, SIFMA appreciates the growing recognition by the Volcker Agencies of the problems with the current implementing regulations," said Kenneth Bentsen, SIFMA president and CEO.

"We remain concerned that the current regulatory framework goes beyond statutory intent and is overly restrictive, impeding beneficial market activity at the expense of the economy, and ultimately consumers."

"SIFMA fully supports the efforts of the Volcker Agencies to streamline and simplify the implementing regulations, and offers our members' recommendations on necessary revisions to achieve this goal."

The Volcker Rule has attracted a lot of criticism from financial market participants and regulators in recent months, including from the US Treasury, which declared it "requires substantial amendment" as part of its first report reviewing whether post-crisis regulation had overreached.

The rule is also under serious threat of being scrapped from potential Dodd-Frank replacement the Financial CHOICE Act, which is awaiting a review by the US Senate.

President Trump also ordered a review of post-financial crisis regulation shortly after his inauguration, with a view to rolling back rules that have adversely affected profitability.

Five US federal financial regulatory agencies have committed themselves to coordinating the efforts to review the regulatory treatment of certain foreign funds under the Volcker Rule, Section 619 of the Dodd-Frank Act.

Investment funds ordered or offered outside of the US are currently excluded from the definition of a 'covered fund', and are not subject to restrictions under the Volcker Rule.

A joint statement from the agencies called for regulators to rationalise and improve the risk-based capital regime for the securities lending and derivatives exposures of US banks.

It added that the Volcker Rule "could result in pro-cyclical behaviour and reinforce market volatility during periods of stress".

Shadow banking will not be banned, confirms International Monetary Fund

There can be many shades of grey between the riskier elements of so-called 'shadow banking', though it can serve useful economic functions, according to Tobias Adrian of the International Monetary Fund (IMF).

At a recent conference speech in Helsinki, Adrian suggested that erasing grey areas in

Hedge funds see record-breaking returns

Atlanta | Reporter: Jenna Lomax

The global hedge fund industry achieved its highest ever month-end assets under management (AUM) total in August, according to a new report by software provider eVestment.

Investors added an estimated $13.4 billion to hedge funds in August, bringing total AUM of $3.2 trillion.

Broken down by region, Europe-domiciled fund flows banked consistent positive returns in the past five months.

According to eVestment data, European funds benefitted from a significant drop off in redemption pressures, allowing new inflow to lift AUM. Total European hedge fund AUM reached $248.89 billion in August, compared to $926.82 billion in the US and $100.22 billion in Asia.

In its report, eVestment commented: “While the year has mostly been positive for flows, and universally positive for returns, at least at the aggregate, asset-weighted level, some concern lingers from under performing segments that house many large products.”

“September will be a telling month for the remainder of the year, but for now industry participants should feel good, providing they are among the remaining.”

shadow banking could give issuers new outlets for capital raising and lenders more avenues for portfolio diversification.

Among his five points of concern were the involvement of too many entities.

Adrian said: “Transformations are often performed along a chain of specialised and interconnected intermediaries and can thereby involve the balance sheets of many entities.”

Another concern was the the reuse of collateral. Adrian said one common drawback is that frequently reused collateral can give rise to heightened interconnectedness.

Adrian also named presumption of sponsor support as a risk of shadow banking that can cause contingent liabilities for the sponsor, often resulting in reputational damage if investor return expectations are not met.

Other shadow banking deals that “can have margins that are so low they cannot absorb the full cost a backstop by themselves”, were also highlighted as a problem area.

Adrian stressed that the IMF, along with the FSB and other regulatory bodies, has no desire to shut down the alternative financing industry but that some aspects of the market’s risk features must be managed.

In conclusion, Adrian said that the main obligation of the IMF is to “try to understand if there are motivations for creating these particular features that need to be taken into account by policy makers and market participants”.

Pension fund mandate for BNP Paribas

BNP Paribas has been appointed to provide global custody for £3 billion in pension fund assets for the West Sussex Pension Fund.

The West Sussex Pension Fund is the fifth appointment BNP Paribas has secured under


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the Local Government Pension Scheme (LGPS) National Framework Agreement.

Along with global custody services, BNP Paribas will provide investment accounting, investment reporting and performance services.

Jeremy Hunt, pension panel chairman at the West Sussex Pension Fund, said: "We were impressed by the expertise of the individuals we worked with and the technology underlying its services—particularly BNP Paribas's reporting tools, such as its data navigation analysis system."

Sid Newby, head of business development for the UK at BNP Paribas securities services, commented: "The UK pension market is currently undergoing significant change and we are committed to helping schemes facilitate and benefit from this."

"We are big supporters of the LGPS initiative and engaged early on with local authorities and their consultants as they were assessing various operating models."

Pirum joins South African securities lending association

Pirum Systems has joined the South African Securities Lending Association (SASLA).

In a statement on the new membership, Pirum said: "Pirum is delighted to be able to confirm our membership of SALSA."

"We recognise that connectivity and global reach are key to our customers. We continually strive to enhance our established global footprint and support new markets as they develop."

SALSA is chaired by Juanita Taylor, head of securities lending for Standard Bank of South Africa, who presides over an 10-strong executive committee of representatives of the South African securities lending market.

The association currently boasts more than 30 members including the Johannesburg Stock Exchange, HSBC and J.P. Morgan.

SASLA's mandate outlines its aim to promote the concept and understanding of securities lending and borrowing to the public at large. SASLA focuses itself on many detailed aspects of the product throughout Southern Africa.

Members are able to contribute to any of SASLA's working groups assessing specific issues in the market, and have prior access to any information prior to it appearing in the public domain.

SASLA also works with the International Securities Lending Association in London.

Commenting on Pirum's membership, Taylor said: "SASLA welcomes the experience and product knowledge that an international service provider like Pirum will bring to the association."

"SASLA currently has over 30 members consisting of service providers, banks, financial institutions, brokers, fund managers and other market participants."

"As such, we are always excited at the prospect of expanding our knowledge and expertise when high calibre members such as Pirum join the association."

AcadiaSoft expands user base for initial margin compliance

AcadiaSoft has welcomed six new clients to its AcadiaSoft Hub, which provides relief from initial margin (IM) rules for non-cleared derivatives.

The second phase of the IM rules went live on 1 September under the regulatory framework of the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO).

According to AcadiaSoft, all counterparty groups that are in scope for the new rules are using its

hub for IM calculation and reconciliation, while nearly all are also using the hub for IM call issuance and response.

The rules require a standard calculation of how much IM to exchange, which must be either schedule-based or based on an approved model, such as the ISDA SIMMTM, or standard IM model, calculation.

Mark Demo, AcadiaSoft product director, said: "Day-one average differences for phase-two firms were significantly reduced from day-one average differences for phase-one firms."

"The phase two firms have used their extra time wisely."

Phase three is set for 1 September 2018, and will include regional banks, pension funds and asset managers.

FCA takes pragmatic approach to MiFID II deadline

The UK's financial conduct authority (FCA) has indicated it will accept a soft roll out of the second Markets in Financial Instruments Directive in January.

Speaking at the AFME European Compliance and Legal Conference, Mark Steward, executive director of enforcement and market oversight, told delegates: "We [the FCA] have no intention of taking enforcement action against firms for not meeting all requirements straight away where there is evidence they have taken sufficient steps to meet the new obligations by the start-date, 3 January 2018."

Although undoubtedly reassuring to in-scope firms, the admission was prefaced by a warning, stating: "We have issued statements reminding firms not authorised for MIFID II activities or firms that need variations of permission that they needed to submit completed applications for authorisation or variations of permission by 3 July 2017 to be guaranteed their applications will be determined in time."

"Many firms have managed to meet this deadline, and some have not. Those firms really need to take action now."

Steward added that he expects MiFID II to significantly widen the FCA's net for data capture from 20 million to 30 to 35 million transactions per day, as well as more than 50 million orders per day or a total of over 1 trillion data points per year.

The looming pressures of Brexit mean that the FCA is unlikely to increase its investigative work against potential financial misconduct as the extra resources this would require are not feasible.

EquiLend and Trax partner for SFTR solution

Trax and EquiLend are joining forces to tackle the Securities Financing Transactions Regulation's (SFTR's) reporting requirements with a full front-to-back solution for mutual clients.

EquiLend will link its trading and post-trade platform to the Trax system to provide client trading and life cycle event information, while Trax will provide EquiLend clients with data enrichment, reporting services and access to multiple trade repositories.

Trax's cross-asset class regulatory reporting technology and repo trade confirmation capabilities promises to enable firms to enrich, validate and report eligible SFTR transactions in near-real time.

Meanwhile, EquiLend captures many key elements required for SFTR reporting at point of trade, including unique transaction identifiers (UTI), transaction timestamps and lifecycle events.

According to EquiLend, its expertise in the securities finance industry combined with Trax's

regulatory reporting and repo trade confirmation heritage will result in a comprehensive service covering all SFTR-eligible asset classes.

Brian Lamb, CEO of EquiLend, said: "SFTR is one of the most complex and data-intensive regulatory reporting requirements the European securities finance market has ever seen."

"This collaboration between EquiLend and Trax streamlines the process, offering mutual clients the simplest and most comprehensive front-to-back SFTR solution available."

Christophe Roupie, head of Europe and Asia for MarketAxess and Trax, added: "The manual nature and multitude of actors involved in the securities financing trade lifecycle, in addition to the immense data requirements of SFTR, means that the industry needs more sophisticated data management and operational processes in place."

"Leveraging the expertise and technical capacity between Trax and EquiLend will be key for firms to effectively manage their regulatory obligations under SFTR."

10-year T2S saga comes to an end

The Target2-Securities (T2S) pan-European harmonised settlement platform is finally fully operational, as the Spanish and Baltic markets completed their migration on 18 September.

Spain's Iberclear moved to the post-trade system, along with the central securities depositories in Estonia, Latvia and Lithuania, bringing the 10-year project to completion.

The T2S platform will now settle an average of 550,000 transactions per day, according to the European Central Bank (ECB).

Wave four of the project was completed successfully on 6 February, with the addition of Clearstream Banking in Germany bringing the platform to 80 percent of the final expected volumes.

Speaking to the ECB in an MIP Online report, Indars Ascuks, associate vice president and head of the Baltic markets at Nasdaq, said: "Thanks to its interconnectivity, T2S makes cross-border settlement easier and more efficient, ensuring more integrated and cost-effective securities trading and post-trade services."

"We believe these changes will create valuable synergies for market participants, as T2S enables Baltic assets to be brought into the European pool and also makes foreign securities more accessible to Baltic investors. This will lead to an optimised market infrastructure and new business opportunities, meaning more efficiency and fewer risks to investors."

An Iberclear statement also noted that the move will allow Spain's post-trade system to be aligned with the rest of Europe, and will "increase its efficiency, optimise costs and enhance its competitiveness".

Iberclear CEO Jesús Benito told the ECB: "Links with T2S CSDs—which before migrating were complicated—have suddenly become delivery-versus-payment links that are fully harmonised with domestic settlement procedures. We believe this is an opportunity that Iberclear has to take advantage of for the sake of its current clients."

The ECB now plans to liaise with the market to assess the functioning of the new system over the next few months.

In October 2018, settlement for the first non-euro currency is expected to become available on T2S, with Danish CSD VP Securities, which migrated in wave four on 6 February, settling Danish kroner.

Margin rules changing collateral industry, says ISDA

New margining rules for non-cleared derivatives are significantly changing collateral practices,

according to the International Swaps and Derivatives Association (ISDA).

In its recently relaunched margin survey, ISDA also highlighted that the rapid increase in centrally cleared derivatives in recent years is also a significant factor in moulding the collateral landscape.

The new margin requirements for non-cleared derivatives went live in September 2016.

ISDA's survey found that approximately $1.41 trillion of collateral has been posted with central counterparties (CCPs) or with the 20 largest market participants for their non-cleared derivatives trades.

Of this amount, initial margin (IM) and variation margin (VM) posted for cleared derivatives totalled $434 billion, and for non-cleared derivatives totals $977.5 billion.

IM posted totalled $280.5 billion, made up of $173.4 billion for cleared and $107.1 billion for non-cleared.

Phase-one firms delivered $63.6 billion of IM in total and received $107.1 billion of IM for their non-cleared derivatives transactions.

Wematch.SecuritiesFinancing completes first trade

Digital broker Wematch.SecuritiesFinancing completed its first securities lending trade on 18 August.

The counterparties were Bank of America Merrill Lynch and ABN Amro, trading in French equities.

Wematch.SecuritiesFinancing launched in February with an initial focus on total return swaps and European equities.

The broker's securities lending and repo services went live on 18 September along with an expanded the list of available asset classes. According to Wematch CEO David Raccat,

Pilot repo survey reveals Japan as regional activity centre

London | Reporter: Jenna Lomax

A pilot survey of the Asia Pacific repo landscape by the International Capital Market Association (ICMA) found that Japan is the most active regional repo market and that Japanese government bonds dominate collateral usage.

ICMA's European Repo and Collateral Council (ERCC), in partnership with the Asia Securities Industry & Financial Markets Association (ASIFMA) Secured Funding Markets Committee, conducted the survey on 7 December 2016.

The main currency traded in the Asia Pacific repo market was Japanese yen, of which the reporting banks were net lenders. There was also some cross-currency repo with US dollars and Japanese collateral.

The data complemented the findings gathered from a larger December 2016 ICMA European survey that also detailed Asian repo activities.

When observing the different types of transactional executions, the report on the survey noted very little electronic trading.

Most transactions were executed directly on the telephone and electronic messaging systems.

Martin Scheck, chief executive of ICMA, said: "Our intention is that this first Asia Pacific survey will be the precursor of a similarly authoritative report for the fast-growing repo markets of the region."

Mark Austen, CEO of ASIFMA, added: "We believe that the time is ripe for a market-led initiative to offer greater transparency of the Asian market and that this information will help catalyse the further development of the market by promoting wider awareness and better understanding."

formerly of BNP Paribas, the platform promises to make the bridge between supply and demand with a focus on increasing liquidity.

The platform already received more than $1.5 trillion worth of interest and circa $8 billion of swaps have been confirmed, as of August.

Commenting on the first trade, Raccat said: "I am extremely happy to see that two top-tier counterparts have traded through Wematch on the very first day of the new release and we are all looking forward to seeing the liquidity growing in the platform now that all securities financing products and all asset classes are live."

UCITS funds enjoy assets boom in Q2

UCITS funds registered net inflows of €174 billion in Q2 2017, compared to €202 billion in Q1 2017, according to The European Fund and Asset Management Association (EFAMA).

As part of its latest quarterly statistical release, EFAMA revealed that UCITS funds attracted €377 billion in net new money in the first half of 2017, compared to €271 billion recorded during the same period in 2016.

The latest growth figures represent the highest level of net sales recorded since Q1 2015.

In Western Europe, Germany recorded the largest net asset growth (2 percent), followed by Ireland (1.5 percent) and Luxembourg (0.9 percent).

The largest net inflows into UCITS were recorded in Luxembourg (€70 billion), closely followed by Ireland (€68 billion) both of with saw strong net inflows into bond funds.

Equity funds in Ireland and multi-asset funds in Luxembourg also contributed to the strong results.

Overall, total net assets of the European investment fund industry increased by 0.6 percent to €14.89 trillion at the end Q2 2017, while UCITS assets grew to reach €9.17 trillion.

Euroclear-DTCC and Lombard Risk link collateral management programmes

Lombard Risk has partnered its Colline solution with DTCC and Euroclear's GlobalCollateral margin transit utility (MTU) programme.

DTCC-Euroclear GlobalCollateral is a joint venture between the Depository Trust & Clearing Corporation (DTCC) and Euroclear.

Through the agreement, Lombard Risk Colline users will be able to access MTU message statuses directly from their user interface and match collateral transactions in Colline and submit them for settlement in MTU. According to Lombard Risk, the agreement will enable a seamless and transparent collateral management process across all asset classes, by removing the need to enter transactions across multiple systems, lowering manual processes and promoting data accuracy.

Mark Jennis, executive chairman at GlobalCollateral, said: "We look forward to delivering our first project under this alliance, the linking of MTU and Lombard Risk Colline, which will simplify current collateral management processes, creating a more efficient and streamlined process."

Alastair Brown, CEO of Lombard Risk, added: "The combination of solutions coupled with Lombard Risk's deep industry expertise and proven track record will enable us to provide new and comprehensive services that help improve operational efficiency, and deliver real value to industry participants and customers."

Hazeltree opens securities finance services to Neuberger Berman

New York | Reporter: Jenna Lomax

Hazeltree has connected its securities finance and collateral management product suite with Neuberger Berman, a private investment manager.

Buy-side treasury manager Hazeltree will also provide automated workflows in reconciliation and margin management.

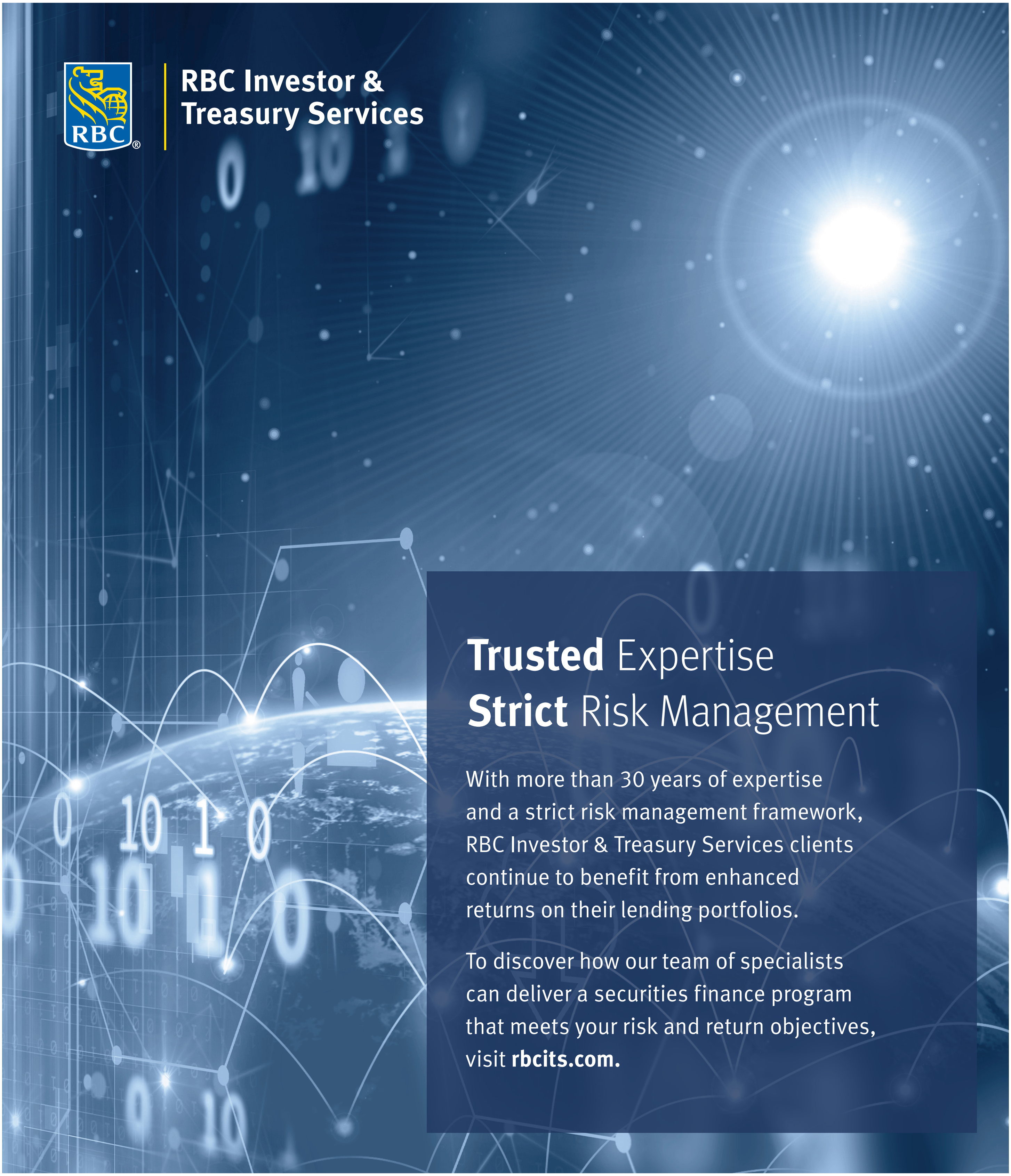
The solution is intended to create better efficiency, and provide scalability across these growing functions.

Headquartered in New York, Neuberger Berman manages $271 billion in client assets, controlling equities, fixed income, private equity and hedge fund portfolios.

Pat Lomelo, global head of operations at Neuberger Berman, said: "At Neuberger Berman, we continually work to enhance our infrastructure to best serve clients and the increasingly complex solutions they demand."

"Hazeltree has helped to streamline our treasury management function and has delivered leading-edge risk-reduction capabilities."

Sameer Shalaby, president and CEO of Hazeltree, commented: "The successful implementation of the full Hazeltree suite of products at Neuberger Berman is a testament to the flexibility and capability of our solutions for complex businesses of all types managing cash, collateral and other treasury functions."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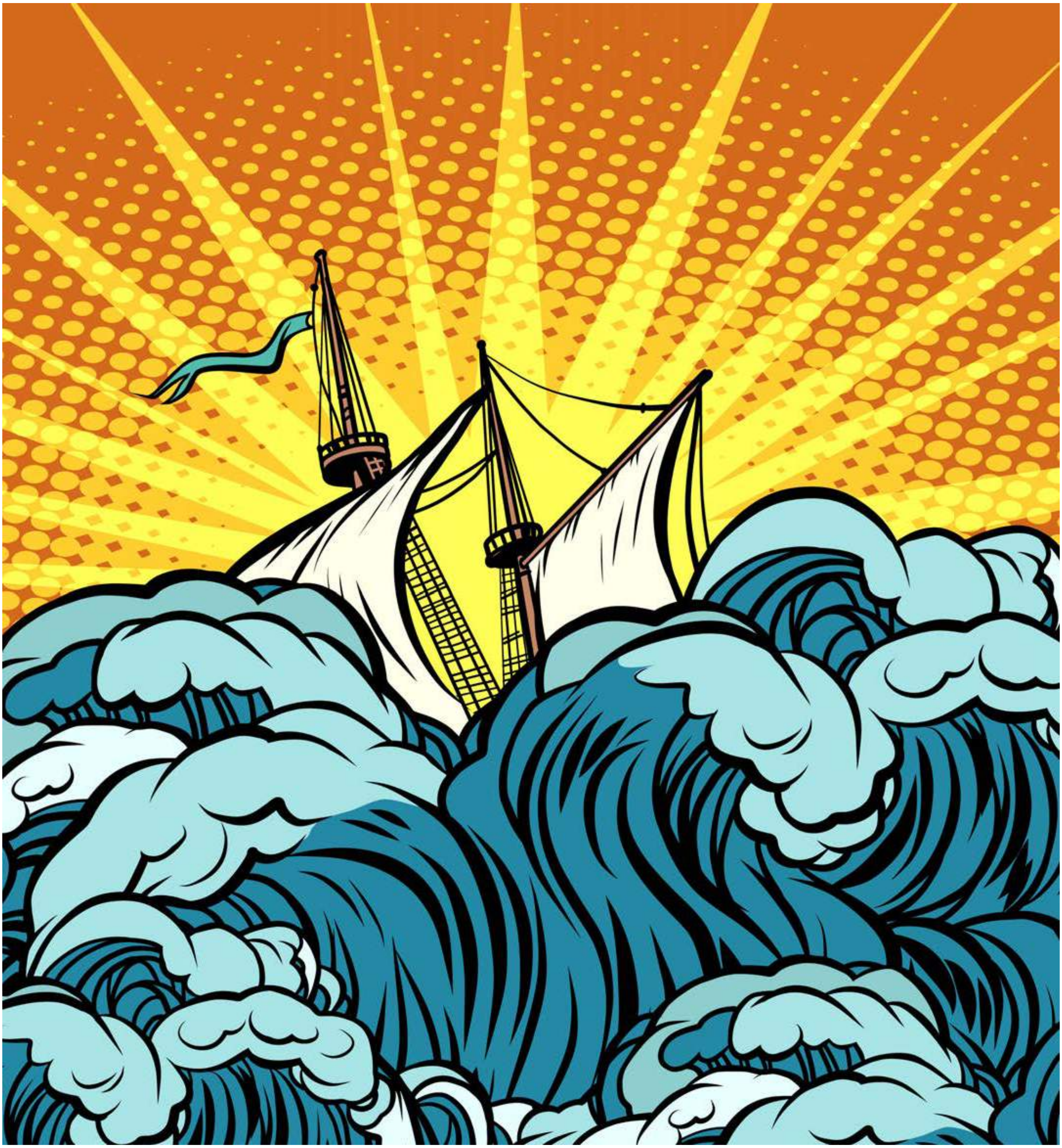


Roll back or roll on?

Donald Trump's presidency has caused all kinds of controversy, but what about his plans for banking regulation? Experts debate his plans to do a "big number on Dodd-Frank", Obama's flagship post-crisis legislation

Stanley Fischer, vice chair of the Federal Reserve, has described Trump's plans to roll back the Dodd-Frank Act as 'dangerous' for the financial system. Is he right?

Stephen Malekian
Head of US business development
Elixium

To the extent that banks are better capitalised, less systemically risky, and back to being profitable, while remaining one of the best performing sectors of the S&P 500 since the election, it's hard to muster a counter-argument that rolling back regulation won't put the banks back to where they were pre-crisis—and so vice chair Fischer is correct.

If one, however, is focused on the broken transmission mechanism of the money markets, the fracturing of pricing and available credit intermediation in the financing markets, as well as certain onerous aspects of Dodd-Frank and the Volcker rule specifically prohibiting banks from holding inventory or taking proprietary risk of any size or duration on specific asset classes—then I think he is wrong.

Whenever regulators and central banks intercede in markets and endeavour to make the banking system "great again", there are inevitable repercussions, both positive and negative, that could be worth preserving as well as tweaking, respectively.

My question is: who is clamouring for the rollback of Dodd-Frank? The banks have already front-loaded adherence to the ratios on capital, leverage and liquidity, culled their client list, spent billions on compliance and widened spreads to meet their return hurdles on their internal cost of capital. Even Jamie Dimon, CEO of J.P. Morgan Chase and the self-appointed spokesperson for bank fiscal rectitude and moral virtue, is not calling for it.

Clearly the Devil is in the detail, but there is no ambiguity in what the soon-to-be-erstwhile vice chair Fischer is fearing. I share his concerns.

Alex Lamb
Head of business development for the Americas
and head of marketing
The Technancial Company

Opponents of any regulation are typically concerned with cost and liability, not to mention the limitations on adding new business in a firm. While these are real concerns, the victims of the latest financial crisis need a solid safeguard against wrongdoers.

While imperfect, the law brings self-examination of business practices into play: is this reasonable behavior? Are we entitled to do this? What are the consequences? Remove consequences and, as any six-year-old will tell you, it's game on.

Do we really believe that grown-ups are different? Leeson, Kerviel, Adoboli, Madoff, Bear Stearns, Lehman, mortgage-backed securities, sub-prime lending were all major situations—all in the last 20 years—that could have been avoided, saving innocent investors a huge amount of money. There were winners, but we don't hear from them, as they are probably pretty similar to those that were caught over-trading, misrepresenting themselves or their products, rigging valuations, and so on. There are too many bad behaviors to list, but plenty that are addressed in Dodd-Frank. If it was rolled back, it would be disastrous.

Paul Burleton
Head of strategy, regulatory, risk and compliance
GFT

Despite President Trump's bold promise to "do a big number on Dodd-Frank", there is still no clear way forward for regulatory reform in the US. The US Treasury paper published in June has given us a better understanding of the direction of travel, but there is still much to debate. The Volcker rule has been the subject of such debate since its introduction and there is validity in the argument that it is hurting smaller financial instruments and restricting market making activities.

Removing it completely would undermine the principle that banks protected by the Federal Reserve should not engage in speculative trading for their own account and, sensibly, the report does not propose this drastic step.

The other main area of debate is on the capital requirements. Here, many argue that the Dodd-Frank rules and subsequent amendments have made them overly complicated and restrictive. This is where Fischer has a point.

Although very few would agree with his statement that "everybody wants to go back to the status-quo before the great financial crisis", the US Treasury report is inconclusive on whether the Basel accord would continue to be followed, stating that the regime needs to "meet the needs of the US financial system and the American people".

Clearly, US banks feel constrained under the current environment, but they do need to be held to equivalent standards as their international counterparts.

Fischer's comments serve as a warning shot across the bows of Congress and the regulators alike. As ever, the regulatory reform road is long and winding, but it now seems that most are on board for the ride.

Timothy Smith
General manager
FIS, Kiodex and Astec Analytics

On 25 March 2011, the Wall Street Journal's headline was: 'Dodd-Frank's Threat to Financial Stability', and within the article there was a one-word piece of advice: 'stop'. We now hear that it will be

'dangerous' to roll back Dodd-Frank. As participants, we could be forgiven for wondering which view is the correct one.

As in all things, the correct position is somewhere between the two. Over the years, the industry has become used to, if not accepting of, creeping regulatory scrutiny. Whole departments have been created and technology has been developed by the major financial IT companies to cope with the additional global reporting.

On the other hand, there would appear to be a general feeling—and not just among the affected financial community, but the general populace as well—that the balance may have tipped too far one way. All involved hope the pendulum will stop its swing dead center. In the final analysis, it will probably be the case, as per usual, that the predicted dire consequences of removing Dodd-Frank will not arise, but neither will the exaggerated benefits of deregulation be as great as foreshadowed.

Larry Tabb
Founder and research chairman
Tabb Group

Rollback can mean many things and, depending, Fischer could be right or wrong. Completely rolling back Dodd-Frank is not only a mistake, but few even want this to occur.

While banks would like fewer stress tests, they don't want them to be eliminated. Similarly, the swaps trading mandate has pushed investors into non-standardised products just to keep them off a swaps execution facility. However, few believe that we should eliminate the clearing mandate.

While Dodd-Frank instilled a more rigorous regulatory environment, the level of compliance and oversight has been an anchor not only weighing down the financial sector but slowing economic growth by hampering lending and curtailing market liquidity. While 40-times leverage may be too much, at the levels of interest rates we have experienced over the past decade, 12- to 15-times leverage may be too low.

Many banks, and increasingly even regulators, are also complaining about the Volcker rule and its overly harsh interpretation of proprietary trading. While allowing banks to proprietary trade using insured deposits may not be a good idea, proprietary trading was not implicated in the crisis and the rule has made it difficult for banks to make markets and provide liquidity.

So, while Stanley Fischer is right about a complete rollback of Dodd-Frank, few, if any, are calling for a complete rollback.

If, however, we want our economy to grow, capital to be appropriately allocated, and risk to be shifted from risk-averse corporations to those more desirous, a rethinking and reshaping of Dodd-Frank is certainly in order.

Eric Litvack
Head of regulatory strategy
Societe Generale Global Banking and Investor Solutions

I don't think that one should frame the debate in terms of a 'rollback' of the regulatory framework.

Certainly we are not in favour of repealing or weakening the regulatory framework. A lot of work has gone into implementing Dodd-Frank and similar financial regulatory reform elsewhere, and the financial system is much safer than it was as a result.

But, 10 years after the financial crisis, and after wide-sweeping reform of all aspects of financial regulation, it does make sense to review and assess the regulatory landscape.

As is the case with many new regulations, the initial rollout of any framework is usually not perfect or all-encompassing, and this is certainly the case for the 800-or-so pages of Dodd-Frank. After all, securities regulations date back to the 1930s, but they're still regularly reviewed and improved. There is scope to streamline and simplify certain requirements to remove needless complexity—complexity that imposes a hefty compliance burden on intermediaries and end users for little benefit.

It's important that these firms can access financial markets and financial services in as cost-effective and efficient a way as possible, with an eye on ensuring that regulation supports sustainable economic growth.

The European Commission started the review effort two years ago with its capital markets union action plan and its review of existing regulation. A similar review of the Dodd-Frank framework is timely and healthy, which is why the Commodity Futures Trading Commission's Project KISS and the Treasury's review of financial market regulation are so important.

Henry Balani
Global head of strategic affairs
Accuity and Fircosoft

Bank regulation is key to protecting the financial system from abuse. Critics have, however, argued that over-regulation can lead to reduced innovation and effectiveness of the financial system, potentially limiting economic growth. Understandably, there is a variety of opinion on the effectiveness of regulation.

The key point to consider here is the promise of Dodd-Frank. The regulation has been positioned as protecting consumers from abusive bank lending and mortgage practices in the wake of the 2008 financial crisis.

Another key aspect is the increase in capital and liquidity requirements, strengthening banks' balance sheets. The third key provision is the Volcker rule, limiting proprietary trading. Proponents for rolling back the Dodd-Frank Act argue that regulations have held back bank lending.

The data, however, shows that this is in fact not the case, with bank lending increasing since 2013 as the US economy recovered.

Even lending to small businesses (another key argument for rolling back Dodd-Frank) has not been a limiting factor.

However, there is certainly room for tweaking the Dodd-Frank Act. Interestingly, bankers have supported the Volcker rule, agreeing that excessive proprietary trading represents a risk to their balance sheets.

A key request is reducing the cost of complying with regulations, which in turn would lower costs for consumers. Ultimately, wholesale rolling back of the regulation is dangerous, as US banks have benefitted by becoming stronger compared to their European peers, and are potentially in a better position to withstand the next economic crisis. **SLT**

Chile: leading the charge

Francisco Thiermann of IBM says the imminent launch of Chile's securities lending blockchain solution will provide a shot in the arm for the market

How did this project begin and how well developed is it now?

The Santiago Exchange and IBM have been working together for around 20 years, and the exchange itself has a very well developed IT team working on various projects. A year ago the exchange approached IBM to discuss the potential of using emerging technologies such as blockchain in order to improve the facilities for its clients.

At the end of 2016, the exchange had developed its understanding of the technology and was able to prioritise some best-use scenarios. In January the securities lending application was selected as the one to begin with.

Once the securities lending application is live, the exchange will expand this service into other service areas and is planning to link with other Latin American markets.

The infrastructure for this project was completed in mid-May and now, just as with any blockchain solution, we are bringing in new members and agencies to work within the network. In Chile, this means the institutional investors, which are predominantly private pension funds.

Once the final processes are in place the system is expected to go live by the beginning of 2018. The completed system will be a first-of-its-kind solution for the securities lending industry and will bring all sorts of opportunities for the Chilean market.

How does the pensions industry operate in Chile?

Chile moved all its public pensions funds into private funds 35 years ago. There are now roughly 10 different funds in the market and these are the main asset holders in the country. Between Chile's pension funds and the brokers, the exchange can capture a large part of the financial strength of the market.

Once the blockchain system is in place market participants will have the opportunity to automate a lot of the low-value transactions

Once the blockchain system is in place, market participants will have the opportunity to automate a lot of the low-value transactions, which should improve total volumes on the exchange.

How will it work, and how will it sit in Chile's financial infrastructure?

All the technical complexity of accessing the solution will be managed between IBM and the stock exchange itself. For the pension funds and brokers, there will be no need to engage in implementing the system, as the interface will be laid upon their existing systems.

There are several market participants working on blockchain solutions for securities lending but none are as far advanced as this. How did IBM and the Santiago Exchange get so far ahead?

In terms of why Chile is first, I have to say it's the knowledge and the willingness of participants in the local market to innovate that makes all the difference. For the exchange, it's a chance grab a lucrative business opportunity that will not only help its clients but also offers a valuable asset for the future.

At the same time, the close relationship between IBM and the Chilean exchange has played a major role in making this project a success. The fact that IBM is active in the IT sector, but also in the business consultancy sector, means that we had all the tools to get this project completed.

There are a lot of people with the technology who are unable to convince the decision makers of a business to move forward, and also a lot of business leaders that don't understand the technology but want to get involved. At IBM we have both, and here in Chile we found a home for this solution.

What are the benefits of this solution for the securities lending market in Chile?

The main benefits are significant improvement in transparency for the whole system and a major reduction in transaction and reporting costs. The nature of a blockchain solution means regulators can access transaction data first hand and this should also bring down reporting costs for market participants.

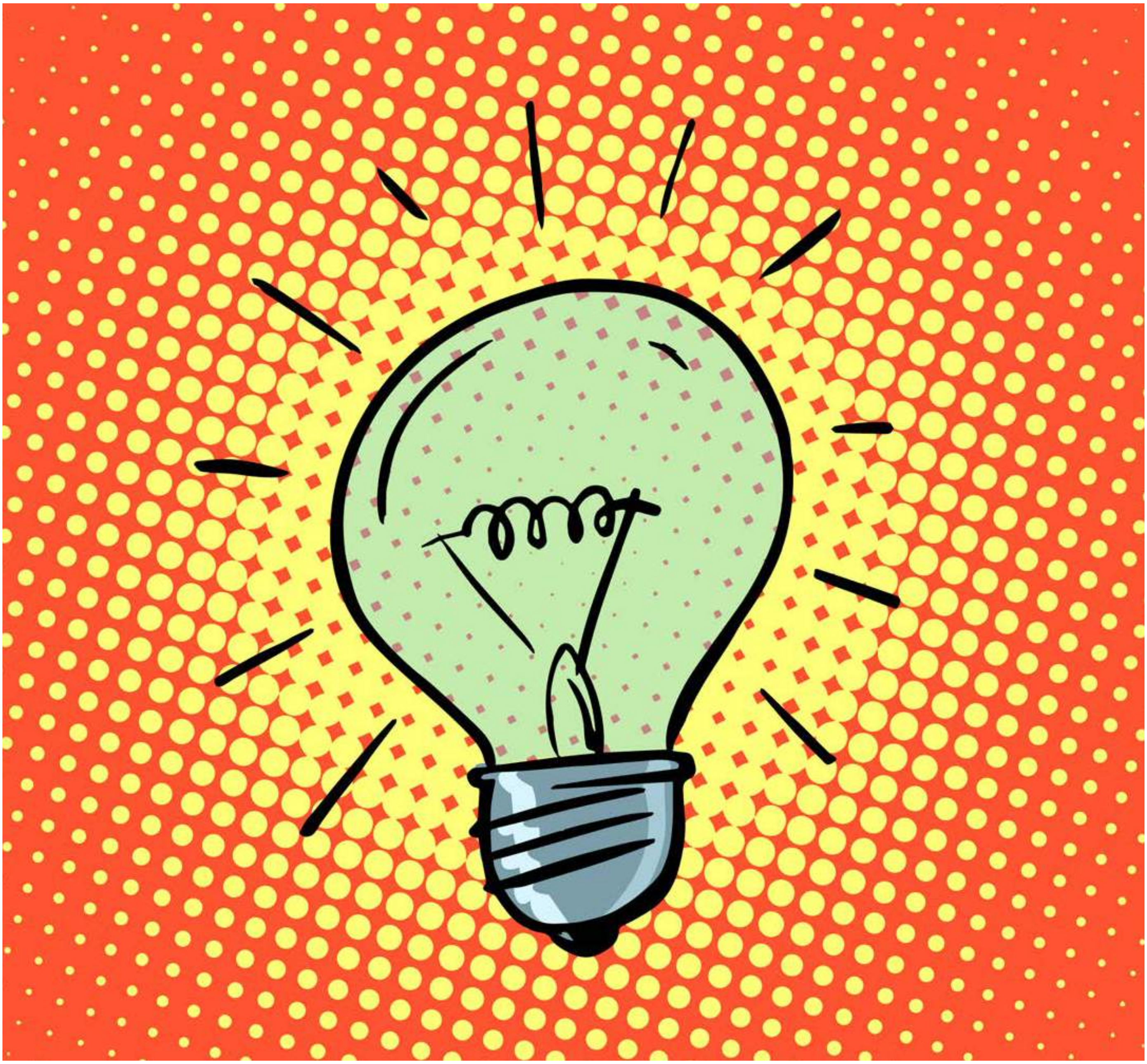
In terms of transaction costs, currently, a large percentage of securities lending and short selling transactions are done manually. It requires a lot of resources to complete a trade and that has hampered overall transaction volumes in the market. Only the most lucrative transactions are worth doing because of all the paperwork.

What's next for IBM and the Santiago Exchange in terms of utilising this technology across Latin America?

There are several other Latin American markets that could benefit hugely from access to a blockchain solution, specifically, Mexico, Colombia and Peru. There is an agreement between the stock exchanges of these markets known as Mercado Integrado Latinoamericano, or MILA, that could allow these exchanges to share technological advances such as this. For IBM this is a big achievement and we look forward to expanding into these markets as well. SLT

The nature of a blockchain solution means regulators can access transaction data first hand, bringing down reporting costs

Francisco Thiermann
General manager, Chile
IBM



Blockchain offers a light in the dark

tZero CEO Patrick Byrne explains why we may be on the brink of blockchain revolution in securities lending, to the benefit of all

Market regulators have criticised the lack of transparency in securities lending. Are the incoming reporting standards enough to fix the problem?

Over the course of history, opaque markets have proven to be the venue for the Devil's work. The lack of transparency in any market leaves the door wide open for unfair pricing, and it inhibits the free market from functioning fairly. The reporting standards of the Securities Financing Transactions Regulations (SFTR) are a good start but globally more can be done. Regulators are right to criticise the lack of transparency in the system, but we do not believe the new SFTR standards do enough to fix the problem as they only cover EU firms and EU branches of non-EU firms.

Each and every bit of incremental improvement in reporting standards will shed much-needed light on this, the last bastion of opacity in today's markets. US Supreme Court Justice Louis Brandeis said it best: "Sunlight is the best of disinfectants." Our new technology opens an enormous skylight so that sunlight can pour into this corner of the market.

Are emerging technologies such as distributed ledger technology the answer to the industry's transparency issues?

These technologies have enormous potential to increase the security, transparency, and auditability of the financial system, particularly in the area of securities lending. Today, there are a number of financial intermediaries that make the securities lending process opaque and complex, increasing friction and instability in the financial system. It is difficult to track not only ownership of underlying shares, but also to track that a given short sellers' locates correspond to any underlying shares on a one-to-one basis. With blockchain technology, shares and locates can easily and transparently be represented and tracked.

How is tZero approaching the issue of transparency and what can blockchain bring to securities lending?

For the better part of the last decade I have been the most outspoken advocate for more transparency in the securities lending space. The opacity in the marketplace and the nature of the current voice market has been the biggest impediment to free market price discovery. As evidenced by the recent class action lawsuit filed by multiple public employee retirement systems, the intentional actions of a few have caused tens of billions of dollars to flow to monolithic Wall Street prime brokers and custody banks rather than to the people who deserve it, the underfunded pension plans and retirement systems representing the hardworking men and women of America.

There is now public information proving 75 percent of the overall revenue of some of the largest prime brokers is derived from the lack of transparency in securities lending. In a time where pension plans are at great risk there is no excuse for prime brokers posting billions in profits deceptively expropriated from the retirees of America. The application of blockchain technology in an open transparent free market environment eliminates the opportunity for bad actors to profit from the lack of information.

tZero's blockchain-based digital locate receipt (DLR) platform ensures that valid locates are generated from valid underlying securities, while providing a more transparent marketplace for lending. A DLR is a digitised version of a traditional Regulation SHO locate. Regulation SHO established 'locate' and 'close-out' standards that are primarily aimed at preventing opportunities for unethical traders to engage in naked short selling practices. tZero has created a DLR platform that captures share inventory and audit trail information and stores that information permanently on a proprietary blockchain, ensuring that locates accurately correspond to underlying shares. Short Sellers are able to purchase DLRs on tZERO's platform, which runs an overnight auction on for the benefit of inventory providers (such as pension funds). Short sellers are then able to short the underlying stock up to the quantity of DLRs they've purchased. All DLR creations and purchases are registered to the blockchain, which prevents naked short selling that arise from inaccurately sourced locates.

New blockchain initiatives are launching every month, how long until blockchain is a mainstream topic in the industry?

Blockchain technology has quietly been investigated in the financial industry for three years, but in 2017 there has been an explosion of interest in the space. This was precipitated by a sharp rise in the price of cryptocurrencies in the first half of 2017, followed by a boom in the number initial coin offerings (ICOs) coming to market—over three times more has been raised via ICOs this year than via traditional VC funding. The attention these two areas have drawn has led to a more general awareness of blockchain, the technology underlying these cryptocurrencies and tokens. We believe that as this awareness continues to blossom, blockchain could be more disruptive to industry and society than the internet was, and we are only starting to see its potential unfold. Blockchain gained critical awareness in 2017, and over the next five to ten years, hundreds of industries will begin to introduce this technology to increase the efficiency of existing business processes (by as much as 80-90 percent, we believe), lower coordination costs, and introduce new business models. We believe this technology will cause a deep and fundamental change in the way that our societies conduct commerce.

Our DLR product currently has 4700 tickers in the system with approximately 25 percent deemed hard to borrow stocks; and we will be onboarding more soon. We have already gained traction among inventory holders and short sellers and expect to continue to see steady growth in the product

What's in the pipeline for tZero in the next 12 months?

tZero currently has the only US Securities and Exchange Commission (SEC) approved alternative trading system (ATS) for blockchain securities. We recently entered into a joint venture with RenGen and Argon Group to launch this ATS for the trading of security tokens issued in ICOs. As mentioned, there has been a boom of ICOs this year, accounting for $1.2 billion in funds raised, as of early August.

There was a lot of uncertainty around the regulatory status of these ICO tokens until July of this year, when the SEC announced that some of the coins being offered are actually securities. Because of this, these is huge demand to register and trade many of these ICOs within an SEC compliant trading system. Currently, tZero is the only such system that exists, and now with Argon and RenGen as partners, we can provide the advisory services and liquidity that issuers need to launch ICOs and trade in the secondary market. **SLT**

> Today, there are a number of financial intermediaries that make the securities lending process opaque and complex, increasing friction and instability in the financial system

Patrick Byrne
CEO
tZero

Trading Apps for broker-dealers

Chris Valentino describes how the Trading Apps stable of easy-access solutions can imbue broker-dealers with enhanced netting automation

Trading Apps has long been recognised for the automation and efficiencies it provides to its agent lending clients. However, it is just as important to recognise the solutions and, more importantly, the results in trade automation and efficiency being experienced by our clients on the broker-dealer side of the market.

Our goal at Trading Apps has always been to work intimately with our clients to carve out solutions that are fit for purpose, solve specific problems, and add efficiencies and scale to their business. Quite frankly, if you have a problem, we want to work with you to design or provide an app that can quickly solve it. One particular area of interest for us and our clients was devising a more efficient and automated process with regards to managing firm wide inventory at a broker-dealer.

As with many of our clients and prospects, the process by which this is done today is a bit disjointed, manual, and loaded with inefficiencies. The results of these inefficiencies are difficult to quantify but it's quite possible that speed of execution, missed opportunities and decreased revenue could all be likely candidates.

Let's start with the firm inventory (longs and shorts) at a broker-dealer. The goal for most of our broker-dealer clients is to manage their firm inventory as efficiently as possible. For many, this means covering their shorts with internal longs and distributing the excess inventory in the most efficient and optimal way.

Unfortunately for many this has been quite a manual and laborious process that takes time and interferes with the higher margin trading activities that the desk ultimately wants to exert time and effort on.

Go-go-gadget netting

The Trading Apps Cross Book Flattener and its series of related apps is specifically designed to inject automation into a process where it previously did not exist. The app uses real-time data from Trading Apps' Inventory Management App or your firm's inventory management system to determine which books are long or short, and books internal trades according to your internal account hierarchy, with the capability to include or exclude specific books to effect optimal netting.

The user can determine the pricing structure to be applied with the ability for the securities financing desk to apply costs and take a spread across non-related books. And, of course, once the app is configured and the trading hierarchies are set, all of this netting will happen automatically and before the trader arrives.

Once the internal netting is complete the remaining short positions are then automatically fired out to the street and covered through your normal liquidity channels. Any excess longs can be auto-returned, based upon configurable rules sets and pre-determined hierarchies.

What's left is the sensitive names and higher margin trades that require the expertise and hand holding of a professional.

While the cross book flattener solution is relatively new it contains several core characteristics that have become embedded in the corporate fabric at trading apps such as: collaborating with our clients to create custom solutions that are fit for purpose; injecting automation and process efficiency into the securities finance business; creating apps that are flexible, sophisticated and user friendly; and providing an architecture that is not only extremely reliable but very scalable from an integration standpoint. **SLT**

Balancing the demands of beneficial owners and borrowers

Beneficial owners come in all shapes and sizes, and it's important to understand each lender's risk, reward profiles, says Mary Jane Schuessler of RBC I&TS

As an agent lender, what is RBC I&TS' strategy for managing the sometimes differing requirements of beneficial owners and borrowers?

The RBC Investor & Treasury Services (RBC I&TS) securities finance programme focuses on delivering value and performance for our clients. This applies to both sides of the trade including supply (beneficial owners) and demand (borrowers). It's consistent with RBC I&TS's overall emphasis on client-centricity; client requirements are at the centre of our strategy.

The challenge is to optimise returns for beneficial owners based on their risk-reward profile, while also meeting the demands of our borrowers. Managing the needs of multiple stakeholders requires a high degree of open dialogue, combined with a detailed understanding of their specific objectives and requirements.

For example, the risk parameters of beneficial owners are driven by internal risk tolerances and regulatory requirements. Understanding these nuances and communicating the restrictions to borrowers is key to achieving an optimal balance.

At the same time, connectivity and understanding the changing needs of the borrower community help to provide transparency to the lender, and this is equally important. Delivering enhanced transparency has been a long-standing initiative at RBC I&TS. As agent lender, ongoing engagement with our borrower network helps ensure beneficial owners are aware of the lending opportunities that exist in the market.

How have the key drivers of industry participation evolved, and what impact has this had on RBC I&TS's securities lending programme?

The nature of borrower participation has changed over the past decade, including a shift from equity to fixed income loans, which now comprise a higher proportion of the total loan value. The demand for fixed-income assets has accelerated, along with the growing need for high-quality liquid assets driven by regulation, as well as increased financing/liquidity and collateral optimisation requirements. As a result of higher demand, beneficial owners are enjoying increased returns on their fixed income assets.

We have also seen an increase in the number of beneficial owners participating in securities lending as our custody clients continue to explore avenues to optimise un-utilised assets within their portfolios.

And the profile of beneficial owners is increasingly diverse across countries, regions and investment structures including varying regulatory requirements.

Given the changing needs of the borrower community, particularly relating to collateral, how are you helping beneficial owners adapt to these changes?

RBC I&TS supports its lenders through regular communication on the evolving market including demand-side trends, changing market practices and regulation, as well as the latest innovation and technology.

For example, a key market trend relates to increased demand for term lending in 30- to 90-day structures where loans consist of high-quality liquid assets versus lesser quality collateral. Educating beneficial owners on the various types of term structures (such as evergreen and extendables) and collateral types (such as equities and corporates) helps to optimise their assets, given these new demand scenarios.

Based on the changing collateral landscape, to what extent are beneficial owners open to wider ranges of collateral, given that default indemnity is typically offered?

Beneficial owners come in different shapes and sizes. It is important to understand each lender's specific collateral requirements, as there is generally a wide spectrum when it comes to the willingness of beneficial owners to expand collateral in line with borrower demand.

Some clients prefer to limit their use of expanded collateral types even though an indemnity is in place, while others are keen to maximise revenue within indemnified collateral.

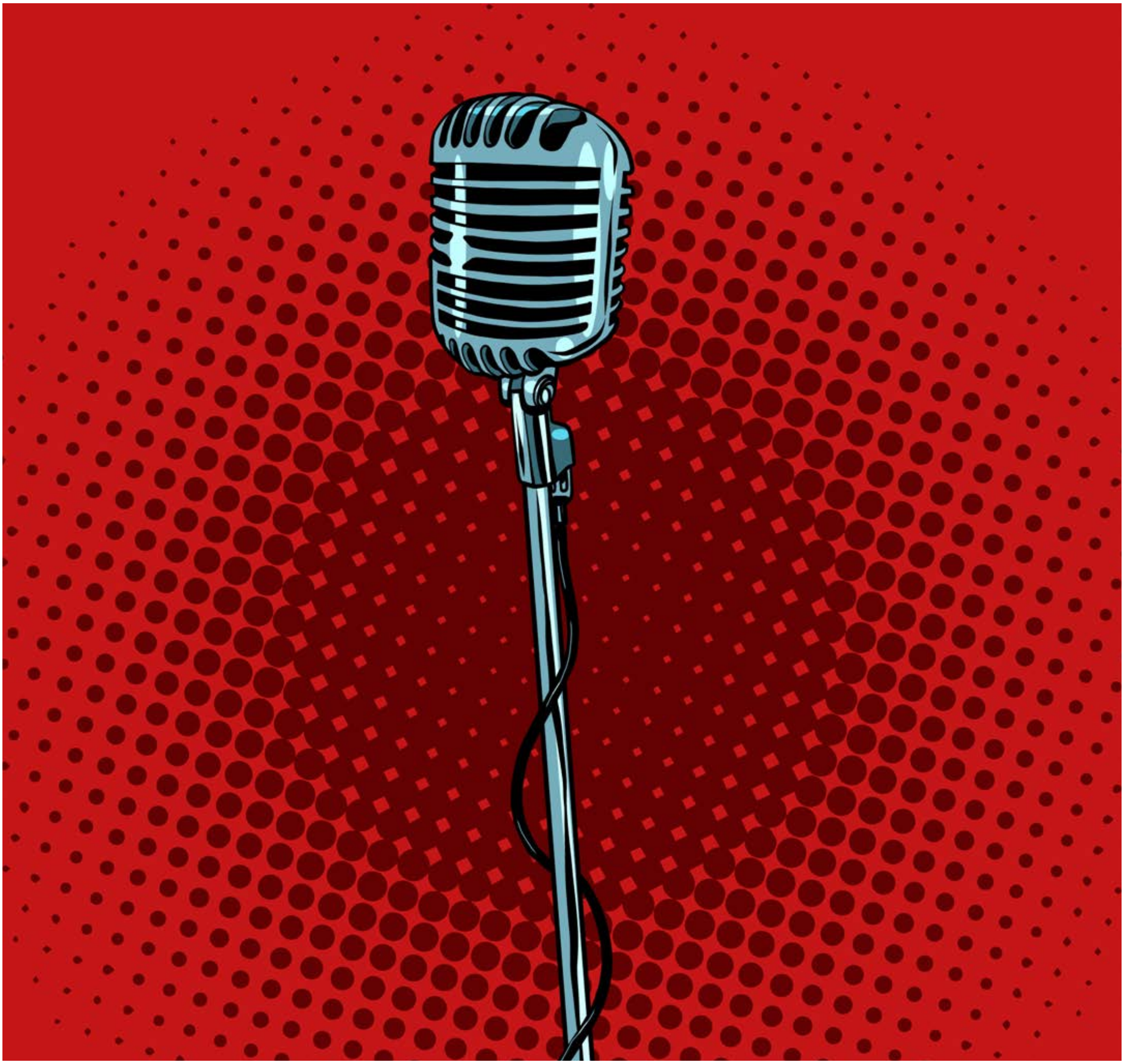
How has the recent implementation of T+2 settlement within North America impacted your beneficial owners and borrower counterparties?

In preparation for the transition to T+2 in Canada and the US, RBC I&TS made a concerted effort to communicate with our custody clients well ahead of the 5 September implementation date. This ongoing dialogue helped clients prepare for the new shortened settlement cycle, providing sufficient time to implement the appropriate internal processes and accommodate the change.

A beneficial owner's participation in securities lending should not impact the lender's day-to-day portfolio management activity, and this market change was no exception.

During the lead-up to T+2, we also actively engaged with our network of borrowers to help them prepare for the shortened recall cycle in order to avoid failing trades and potential buy-ins. This open dialogue contributed to the seamless implementation of T+2. SLT

Mary Jane Schuessler
Director of securities finance
RBC Investor & Treasury Services



PUMP UP THE VOLUME

Shifting market demands and regulatory change are making for an interesting year in the collateral marketplace, as Northern Trust's George Trapp explains

How have interest rate hikes in the US affected demand for corporate bond collateral?

Rate hikes in the US have an offsetting effect between cash and non-cash collateral. For example, you tend to see spread compression in the lead up to a rate hike. I've seen anticipation of higher rates recently, which created some improved value in cash collateral. At the same time, last year's money market reform in the US also created value in the investment of cash collateral.

From 2016, there was a differentiation between yield on US government bonds and yield in short-duration fixed-income credit product. That's where there was some value creation and difference between the overnight rate in the cash market for US dollars and

the three-month libor rate. But, in the first half of 2017, that spread difference has lessened so the benefit of taking cash has been reduced, compared to 2016.

Generally, the economy and the geopolitical environment, have adjusted expectations for interest rates and growth. Expectations are that the Federal Reserve's interest-rate hike cycle has probably slowed down relative to what the market anticipated in 2016. We saw rate hikes last year in December, and in March and June this year, but I don't think we'll see another one for the rest of this year. At the same time, the Trump administration hasn't generated the environment for growth that was expected. I think there is still a big question around the impact of higher interest rates on the securities lending market.

The US market has been shifting towards greater use of non-cash collateral. Are the recent hikes causing a blip in the trend or are we likely to see a more significant slowing or reversal of this trend?

I do think the trend will continue. In the US, some of our client base can take equities as collateral and the concern is how balances will be affected for those clients that don't accept a wide range of collateral. For example, corporate pension plans can't take them today, due to regulatory constraints. But, we do have public funds, foundations and endowments that take equities with collateral.

Cash is still a very efficient way to clear a securities lending transaction in the US. You have some restrictions around taking securities like equities as collateral in the US, both for mutual fund and Employee Retirement Income Security Act clients. I think those barriers affect the volumes increasing in terms of equities as collateral rising higher. Until those rules change, you will see cash as a popular form of collateral.

Do you see a push from your lending client base to achieve some regulatory reform on collateral usage?

I don't see that push coming from our beneficial owners, that push comes more from the borrowers, who are incentivised to have reform so that they can pledge more of their equities as collateral. That's probably one of the primary drivers.

Lending agents, like ourselves, working on behalf of our clients, also try to broaden that collateral to include equities, but I just don't see that push from them.

If Dodd-Frank is rolled back in a significant way, do you think it will have a big impact on securities lending?

It will have an impact, but I am not sure how big. The demand to borrow securities, generally, has been cut in half, even though the supply of securities to lend is back to where it was pre-crisis. A lot of leverage has come out of the system, and a lot of investment has gone into regulatory requirements and the capital required to support that.

If regulation is rolled back or lessened to the benefit of the industry, I think that there will be an increase of activity and some of the lower spread trades that aren't happening today may come back into favour. Any change in regulation that reduces that cost will ultimately help activity. It might not be immediate, but the market will react to it and benefit over time.

Might a regulatory rollback allow banks to re-engage in the market and subsequently curb the rise of all-to-all platforms?

That has a lot to do with diversifying counterparty risk, having more efficient ways to getting supply and demand together. I think some of that roll back of regulation would just generally stimulate activity in the marketplace, although I don't know what the direct impact would be on some of the peer-to-peer platforms.

I don't know if we would change our own activity in response to that. Northern Trust's activity has been pretty consistent and in line with the industry.

Currently, there is $2.2 trillion on loan and closing in on $20 trillion in terms of securities available. We've seen innovative new models come and go through the years and it's hard to say what a change in regulation would do to new platforms, other than continuing to stimulate activity.

Securities lending revenue dropped significantly in the first two quarters of this year. Was that more to do with a bumper 2016 rather than a downturn this year?

Clients that were taking cash collateral that could be invested in prime money market funds experienced strong returns at the end of 2016 and beginning of 2017, so it wasn't bad news for everyone.

But there was a drop in revenue from the intrinsic demand component in the equity markets for securities lending, as well as less demand for specific trades and trade activity. That probably had more to do with the lower volatility and higher equity prices.

There was less demand for the 'end user' of the securities and hedge funds that are borrowing.

The volatility in the marketplace has been at an all-time low, but I think those were really the main contributors to a lessening demand in the first half of the year for securities lending. **SLT**

We've seen innovative new models come and go through the years and it's hard to say what a change in regulation would do to new platforms

George Trapp,
Global head of securities lending
Northern Trust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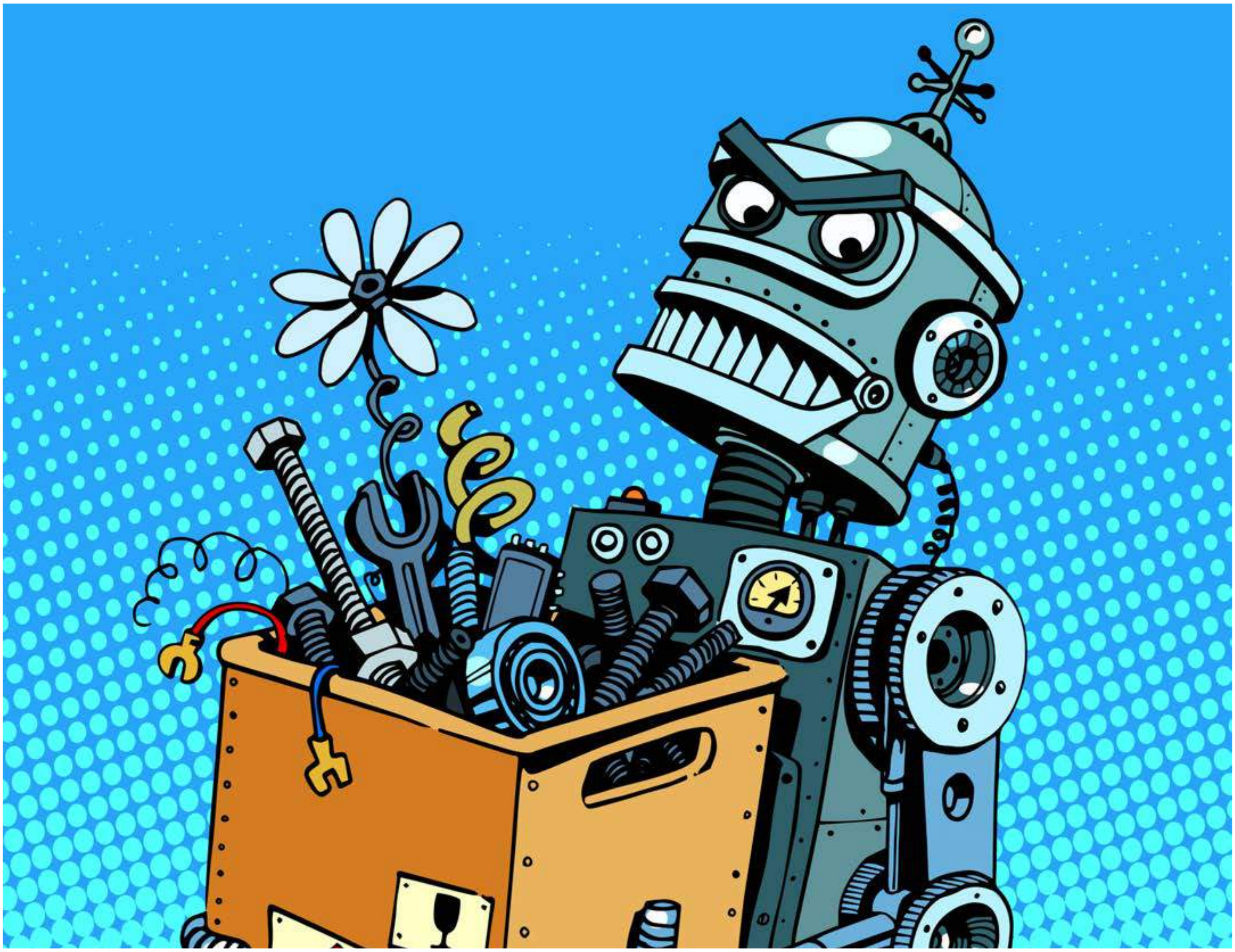


Staying nimble in an evolving regulatory landscape

Anand Krishnan of Natixis Americas explains how regulatory pressures are changing the rules of the game and buy-side entities are changing with it

As the banking sector's regulatory environment continues to tighten, financial resources are becoming increasingly scarce and costly. Constraints in many variables in both assets and liability have created a bigger need to optimise, make quick decisions, remain nimble, and be strategic. To adapt to the evolving market needs, Natixis believes that firms with infrastructure or platforms that can adapt to the new model will be able to provide better solutions and service to clients.

Solving counterparty risk diversification

To further complicate matters, and as a result of these trends, many institutions, particularly prime brokers, are reducing their balance sheets. And while prime brokers still offer valuable services, their ability to take on clients and new business is decreasing in conjunction with the size of their balance sheet, truncated by the ever-changing regulatory landscape.

As such, prime brokers are being forced to evaluate how they benchmark and score their clients, either because they can no longer offer space on their balance sheets, or because the individuals and entities seeking their business no longer meet their newer, elevated asset thresholds. This is in turn causing hedge funds, large asset managers, mutual funds and insurance companies to adjust the way they do business and extract the greatest value from their own collateral.

However, with change comes growth, and this latest evolution is no different. Natixis and other banks are working more closely with their counterparties and clients to offer balance sheet solutions in a way that allows counterparty risk diversification, where each counterparty still plays a meaningful role in the transaction. It's important to take a solution-based approach with one's clients, and that is how Natixis differentiates itself. We know all our clients' needs are different, and not all structures and solutions fit everyone. This approach requires strong financial engineering and structuring capabilities that allow us to deliver an array of products and solutions. Whether it's to hedge their risk or to provide collateralised financing, these solutions should be customised for each client.

Acheiving balance sheet flexibility

As we think about customisation and counterparty risk diversification, cross-asset solutions are a key driver facilitating this shift, allowing for balance sheet flexibility. Natixis recommends consolidating balance sheets between groups such as fixed income and equities. Doing so means that one can more effectively re-deploy capital, leverage and credit across a wider platform that reaches a larger audience, or one with multiple needs.

Providing high-quality liquid assets (HQLA) through collateral upgrades or downgrades, via innovative balance sheet optimal strategy, has been a key focus for lenders. As such, those who can take on those assets, either individually or through their counterparty network, are at a competitive advantage. And with demand for HQLA at an all-time high, asset managers are searching for more creative ways of extracting the maximum value from the collateral they hold, whether it's through physical trade structures, synthetic trade structures, or other less utilised, more innovative vehicles.

In the case of hedge funds looking to add size, for instance, and given that today's prime brokers offer less balance sheet, managers of these funds will be charged higher fees and other expenses to be able to utilise a prime broker's balance sheet. At the same time, generating large enough returns to absorb these costs and still return acceptable capital to investors has been a challenge for many hedge funds.

And if one's costs are increasing while returns are not keeping up, your business model risks becoming unsustainable. This becomes all the more pronounced amid the pressure that the traditional 2 percent and 20 percent model has come under from investors. Consequently, this shift is forcing hedge funds to reevaluate the types of funds and portfolios that they're running. Some funds are taking a more proactive approach because of these headwinds, but others are shifting to nimbler, more agile mid-sized banks, and for good reason.

Size isn't everything

Larger banks have historically leveraged their scale to more easily implement enterprise-wide enhancements and investments into their corporate infrastructure. This is particularly true from a regulatory perspective, where more stringent requirements have dramatically escalated compliance costs across the financial sector.

But while the ability to keep up with the cost of compliance can be an advantage in certain environments, today's regulatory space is evolving at a pace that is less friendly towards larger, multi-year overhauls. Large banks have invested so much in this infrastructure over a longer time period, and many of the rules that caused them to make these investments are constantly evolving. These institutions are now too heavily invested to be able to pivot without incurring significant expenses, some of which may have to be dispersed across counterparties.

When you couple that with the aforementioned pressure facing hedge funds to generate better returns while cutting costs, these funds must critically evaluate their current relationships and think outside the box as to how to better balance their business model. For this reason, Natixis is seeing a proliferation of hedge funds strengthening their partnerships with nimble, mid-sized financial institutions that can more easily adapt to the current environment.

Enhanced technology is critical

With cost being a binding factor underlying compliance-related strategy, there isn't any one regulatory shift or piece of legislation that has had a materially greater impact than any other. You must take all of them into account, and that's what makes things difficult. As a result, counterparties, banks and their clients are working more closely now than ever before. With increased regulation, and a more data-driven securities finance business, the need for enhanced technology is critical.

Seeing this trend evolve, Natixis has recalibrated its technology to meet more modern and stringent reporting requirements, allowing for greater interconnectivity across its domestic and international platforms.

Centralise for success

With that in mind, a mid-sized bank that can successfully execute global campaigns is paramount. As the consolidated model becomes increasingly sought after in today's business world, organisations that can increase touch points in a consolidated fashion by centralising their infrastructure are best positioned to succeed. While individual regions are held to their own local requirements, they can no longer be fully independent in how they operate, as clients become more global and operate in multiple markets.

The difference in capital ratio requirements for US versus European financial institutions is a prime example. While the requirements differ, a firm with a strong presence in both regions must take both standards into account and meld them into a broader, globally-compliant platform.

As such, it's easier, from a collateral management standpoint, to have one central hub instead of having multiple regions trying to do everything on their own or, worse yet, leading an independent initiative and being forced to later merge it into a broader, incompatible intercontinental effort.

This centralised approach recommended by Natixis also opens the door for providing additional solutions across other areas of a bank's platform beyond balance sheet lending, at both the product level as well as the intercontinental level. Multi collateral and currency structures are expected to be on the rise as groups will consolidate both locally and globally.

In sum, as regulatory pressure continues to escalate in the banking sector, it's critical to diversify your balance sheet lending sources in ways that are cost effective while still providing the necessary flexibility and capacity. Counterparty diversification remains paramount as lenders work more closely with their constituents than ever before.

While the prime broker market is long-established and should generally withstand these evolving regulatory headwinds, there are other alternatives with which to diversify your assets, particularly if you're having trouble meeting elevated asset/return thresholds. Whether that's general financing, long-short financing, or other services, Natixis can help clients diversify and remain nimble, which will be critical in the current regulatory environment, which has placed a high premium on efficient balance sheet management. **SLT**

Anand Krishnan
Head of global securities financing
Natixis Americas

Balancing optimisation and regulatory compliance

In a dynamic marketplace of constantly evolving business needs and regulatory requirements, a component-based architecture can be an effective approach, says Bimal Kadikar of Transcend Street Solutions

Financial institutions today are increasingly evaluating how best to manage their collateral needs in the face of dual challenges—how to adapt their business and operational structures to become more efficient and how to respond to and comply with ongoing demands around changing regulatory requirements. These issues resemble a seemingly difficult task, like transferring passengers from one train to another while both trains are in motion. Firms that approach front-office transformation challenges, decoupled from regulatory and compliance challenges, will miss opportunities to solve larger systemic issues in a strategic and integrated fashion. We strongly believe that technology strategy and architecture can play a critical role as firms evolve to meet these challenges.

This article looks at how businesses can strategically address their collateral and liquidity management operations and regulatory needs by adopting a more holistic integration approach that takes into account their organisational complexity, unique business requirements and their compliance mandates. Firms that get this strategy right will establish a competitive advantage and maximise limited budgets by significantly enhancing their front office capabilities, while also meeting regulatory requirements.

Managing business transformations and regulatory challenges simultaneously

Regulations such as the US Dodd-Frank Act, Basel III, the EU Markets in Financial Instruments Directive and the European Market Infrastructure Regulation (EMIR) are demanding significant changes to securities finance and derivatives businesses, which are primary drivers of collateral flow. An organisation's overall portfolio mix dictates the cost of doing business, and having an integrated view of the complete liquidity situation is critical and can't be done in isolation. These regulatory and economic forces are driving firms to integrate their collateral businesses that traditionally operated as silos.

Figure 1

At the same time, new global regulations are mandating that firms implement specific capabilities and requirements that are often quite broad, affecting many aspects of collateral and liquidity management capabilities. Consequently, these requirements are quite onerous to accomplish especially because they need to be implemented at an enterprise level.

What is required for front-office optimisation?

Typically, financial business units were structured and incentivised to take a highly localised approach in addressing the collateral requirements for their specific business lines. This historical constraint was driven by a need for domain expertise and reinforced by budgeting protocols and performance expectations that were more closely aligned with local returns on capital, revenue and income. In the current environment, making decisions within a single function misses the opportunity to achieve broader benefits to drive valuable optimisation across an enterprise. The outlying boxes in Figure 1 illustrate the standard, localised organisations that exist in most firms today, where individual business units make collateral decisions without consideration of their sister businesses' needs.

Firms that move beyond the silo approach and evaluate and prioritise collateral and liquidity requirements in a more integrated fashion across all their collateral management processes are better positioned to ensure the optimal allocation of capital and costs, realise efficiency gains and enhance profitability. Some organisations are doing this by establishing collateral optimisation units that have a mandate to implement technology and organisational changes across multiple businesses on a front-to-back basis. Potential areas that organisations are evaluating include maximising stress liquidity, streamlining operational processing, reducing the balance sheet by retaining high-quality liquid assets (HQLA) and improving the firm's funding profile by reducing liquidity buffers against bad trades for non-liquidity cover ratio (LCR)-compliant transactions.

What is required for regulatory compliance?

While many front-office businesses typically focus on creating optimal technology architecture to improve financial return metrics, there are specific regulatory-focused technology enhancements that additionally need to be implemented. In most cases, these regulatory requirements are implemented by compliance and/or operations areas, potentially away from the front office functions. This is a big challenge as these requirements are at the firm level and most firms don't have a coordinated collateral architecture in the front. In particular, recovery and resolution planning (RRP) requirements, qualified financial contract (QFC) specifications and Securities Financing Transactions Regulation reporting are a few examples that have pressing deadlines in the near future.

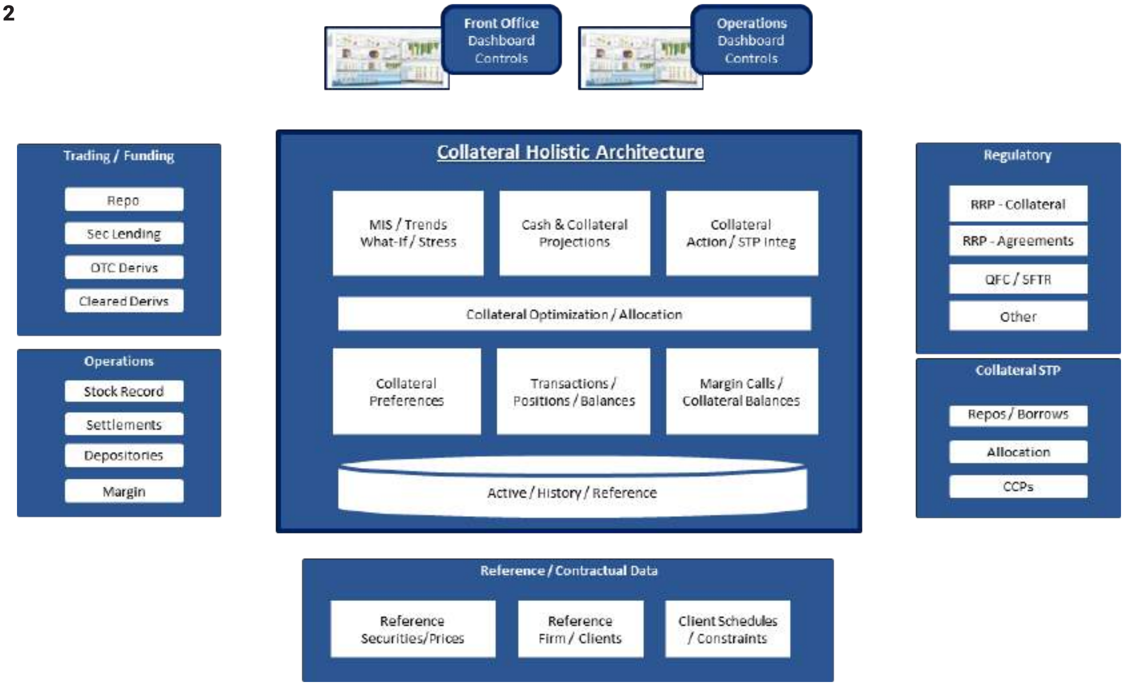
These regulations are creating significant demands on large institutions' business and technology architecture, including the need to:

- Track and report on firm and counterparty collateral by jurisdiction
- Track sources and uses of collateral at a security level across legal entities
- Conduct scenario-planning to simulate market stresses, such as a ratings downgrade or other environmental changes, that estimate impact on collateral and liquidity position in stress scenarios on a periodic basis
- Deliver daily information on their collateral and liquidity positions—specific QFC reports will cover position-level, counterparty-level exposures, legal agreements and detailed collateral information
- Report on all securities financing transactions

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.

This can lead to a rather unfortunate outcome, in that costs for collateral businesses can significantly increase, despite hard work to drive cost and capital efficiencies.

Figure 2



A better approach: Holistic architecture

Firms that choose to tackle these operational and regulatory challenges head-on and invest to create and establish an integrated collateral architecture across business lines will have a significant competitive advantage. In a dynamic marketplace where business needs and regulatory requirements are constantly evolving, a component-based architecture can be an effective approach. As seen in Figure 2, this allows seemingly complex processes to be managed through careful consideration of the distinct business and technology architecture elements of each stakeholder to achieve the appropriate balance for their strategy in an effective manner.

Here are some important drivers to consider in your planning:

- Real-time inventory management capabilities across business lines that can be leveraged by both the front and back office. This is a critical component of the strategic architecture, with the key requirement of knowing firm, counterparty and client collateral by jurisdiction
- A QFC trade repository that is integrated across all secured financing transactions as well as derivatives trades that can be linked with positions, margin calls and collateral postings
- Harmonised collateral schedules/legal agreements repository
- Enabling collateral traceability across legal entities with the ability to produce sources and uses of collateral will ensure regulatory compliance, as well as the ability to implement appropriate transfer pricing rules to drive business incentives in the right places
- Utilising optimisation algorithms with targeted analytics can maximise a variety of different business opportunities and most importantly recommend actions through seamless operational straight-through processing

This transition can be difficult for firms as it will need to cut across business and functional silos and it can have significant people and organisational hurdles, along with technology challenges. One key point is that these changes don't need to happen all at the same time and firms can prioritise the approach in a phased manner in line with their pain points and priorities, as long as leadership is behind the vision of the holistic architecture.

Many firms have started this journey and those who can make demonstrable progress in this evolution will have a significant competitive advantage in the new era. **SLT**

These changes don't need to happen all at the same time and firms can prioritise the approach in a phased manner

Bimal Kadikar
CEO and founder
Transcend Street Solutions

Securities financing markets in the shaker

David Raccat, CEO of Wematch.SecuritiesFinancing, offers a technological recipe for success as the market becomes more demanding and complex

The securities financing industry is going through a major change on different fronts. First of all, the picture of the market is changing dramatically. The $15 trillion lendable assets are showing a $1.8 trillion on-loan balance with a changing face. The business, which was for a long-time mainly equity-driven and US-centric, is moving towards an equal split between equities and fixed-income. Also, two other regions (Europe and the Asia Pacific) are growing significantly in terms of balance. The average maturity of the trades is pushed as well, and fixed-income securities are being lent on longer maturities, with 14 percent of the balance being lent over three months for European government bonds, as per the seventh International Securities Lending Association market report published in June.

Regulation-wise, both lenders and borrowers are being affected by major requirements. Lenders are seeing much more emphasis on best execution and reporting/transparency, while borrowers are heavily affected by capital and balance sheet constraints triggering additional costs.

The European Markets Infrastructure Regulation (EMIR) and the US Dodd-Frank Act are pushing banks to borrow more quality assets in order to meet their new margin requirements. Regulation can create complexity when, for example, lenders cannot lend their securities on a term basis (for example UCITS, in order to guarantee liquidity to the retail customers) whereas borrowers need to borrow for longer-term tenors in order to comply with regulatory ratios (liquidity coverage ratio and the net stable funding ratio).

The economy has gone through an unprecedented crisis and the market has been dramatically affected: negative interest rates; exacerbated spreads; surprising volatility, especially in the last days of 2016; and strong intervention from central banks trying to support the economy through massive purchasing programmes.

The consequences for banks are not only changing strategies (with portfolio rebalancing) but the market has also seen intense tension on quarter-ends, especially regarding the availability of high-quality liquid assets. The question of a potential squeeze has been asked, even though supply seems to be far above current and future demand. The International Swaps and Derivatives Association estimates that unencumbered collateral potentially supporting additional margin requirements is reaching $800 billion.

An industry entering in a new era

As a consequence, the dealing of securities lending is becoming more demanding and complex. The value of a trade relies not only on the securities lent, but also on multiple parameters, such as counterparty rating or risk-weighted assets, collateral schedules, collateral type (title transfer or pledge), and tenor.

At the same time, there is a growing need for automation in order to embrace the best execution principles, and to be able to face the whole market that is moving from a 'might do' to a 'must do'.

As with any other industry, securities financing is going through its digital transformation. The switch can be more or less gradual, depending on the institution or segment, however, the trend is pretty visible and tangible. Dealing platforms are changing the front-end landscape, and post-trade automation has never been so critical.

Looking first at the dealing side of things, dealers are expecting not only automation and user-friendly interfaces and features, but as well liquidity and a wide access to the market. This is a two-fold challenge for platform providers and the name of the game is to offer the best client experience with a superior access to market. Additionally, platforms will grow with their users and, with time, process the data smartly and to proactively suggest and push opportunities. The platform should aim at becoming a strong partner for its user, who can then focus on creating value and feeding the system with their expertise.

Working on a wider, and a more open and transparent market is another growing trend that deeply impacts the dealing process. The consequences are two-fold. Changing the trading pattern among existing market players might modify the dynamics of the market and more opportunities could arise. The other impact is the emergence of a peer-to-peer market, where agent lenders and prime brokers would end up disintermediated with beneficial owners facing directly the end borrowers.

There are multiple hurdles ahead before this happens in the short term, such as credit impacts, market risk management, the ability for borrowers to onboard multiple lenders, the management of the lifecycle of the trade, and potential capital and balance sheet considerations. Peer-to-peer lending might not be a short-term transformation, however, there is still room for improvement and for more efficiency.

Automation is also critical on the post-trade side of things, and no setup will be viable without straight-through processing flows allowing trade capture, lifecycle events, settlement, billing, and regulatory reporting. No risk can be taken on that front, and any solution does need to invest time and resource on post-trade management.

The recipe for tomorrow's industry

The industry is being shaken, the ingredients are being changed, and the length of preparation is pretty uncertain. However, it is a formidable and a very exciting time that we are living in, and the change is a reality in motion. All parties are now involved and playing for a better future with more automation, more efficiency, and more liquidity. And liquidity is obviously key when you have a shaker in your hands. **SLT**

> The industry is being shaken, the ingredients are being changed, and the length of preparation is pretty uncertain, but it's a very exciting time

David Raccat
Wematch.SecuritiesFinancing
CEO and founder

A practical approach to implementing Basel III

Tools exist that will help participants optimise the deployment of their capital, set prices and allocate resources, according to Andrew Powell of Softek

The Basel Committee on Banking Supervision's regulatory standards, better known as Basel III, introduced a range of capital adequacy and liquidity requirements that specify how much capital should be held against various kinds of risk.

As borrowers and lenders begin to implement the controls to support the new regulations, we are seeing structural change in the capital markets that securities finance operations are not immune to.

In order to operate effectively under Basel III, entities engaged in securities finance are faced with a complex series of challenges. The most apparent of these is the need to publish accurate and transparent calculations on a regular basis. The tools to do this will also need to show complete representations of the funding costs of both active and prospective transactions. Furthermore, managers will need to take this as input in the day-to-day operations of their business. Those who invest in these tools will be at an advantage when deploying capital, setting prices and allocating resources. Being better informed, they will also be in a position to develop innovative funding strategies in the face of structural changes in the markets due to regulatory compliance.

In the Q1 2017 International Securities Lending Association (ISLA) Securities Lending Market Report, ISLA noted “a permanent shift in borrowers’ behaviour as they look to borrow securities from entities that better match their own regulatory requirements”.

This has seen changes in the mix between non-cash and cash collateral, in the proportions of government bonds versus equities offered as collateral and in the terms of specific loan agreements.

ISLA also commented that “contraction of balance sheet and the high capital charges associated with equities means that banks appear to be holding less equities as inventory for trading and client facilitation purposes. The apparent shift back towards using government bonds as collateral in the securities lending markets could put pressure on the availability of high quality liquid assets (HQLA—defined in Basel III), as these are also sought after by market participants for broader collateral requirements”.

Interestingly, the increase in the demand to use government bonds as collateral will further pull HQLA supply from the market and in turn may affect a firm’s definition of the securities HQLA level—complexity abounds.

Softek has had early success at implementing regulatory compliance and business reporting to meet these new standards. In particular, we have the tools to help in the ‘cost of funding’ analysis that detail a trade or a future trade’s impact on HQLA, liquidity coverage ratio (LCR) and net stable funding ratio (NSFR), allowing firms to make informed decisions. So what makes a successful implementation?

Gather your data

For many securities finance business lines, a key challenge is simply being able to gather all the information. This often entails interrogating multiple internal systems in order to have a consolidated view of transactions, positions and internal charges. You will need to capture the base data by trader, counterparty, position, asset type and term.

This in itself is often a complex task given the lack of uniformity between systems in regard to, among others, security codes, descriptions, and field definitions. For many firms, expertise around data management may well be limited or non-existent.

The process of capturing the assets that are available to the securities financing business is further complicated since much of the product availability is determined through the segregation process.

This is embedded in legacy back office technology, which lacks the ability to filter and select the high-demand collateral. In addition, many of the long standing triparty agreements with custodians to provide products were also developed prior to the implementation of the Basel framework.

In the end, it is vital that each position be understood in the context of its source and uses. For example, is the asset segregated? What restrictions are contained within the counterparty agreements? Is there perfection over hypothecated collateral? Figure 1 below shows how management could view this detail.

Once you understand the sources of collateral, you then need your firm’s view of the HQLA level assigned to each asset. Treasury will have determined this based on the firm’s capital strategy. While there are some fundamental and market related characteristics of HQLA, when it comes to defining which assets fall into which HQLA bucket, firms may well interpret securities differently.

Take Japanese government bonds as an example. One of the measures used to help determine the HQLA level is the depth of the repo market. Some firms will assign Japanese government bonds as a ‘Level 1’ asset while others may view the market as limited in depth and assign these as ‘Level 2’. In another example, a loan in one business may improve inflows for liquidity coverage but in another business it may worsen it.

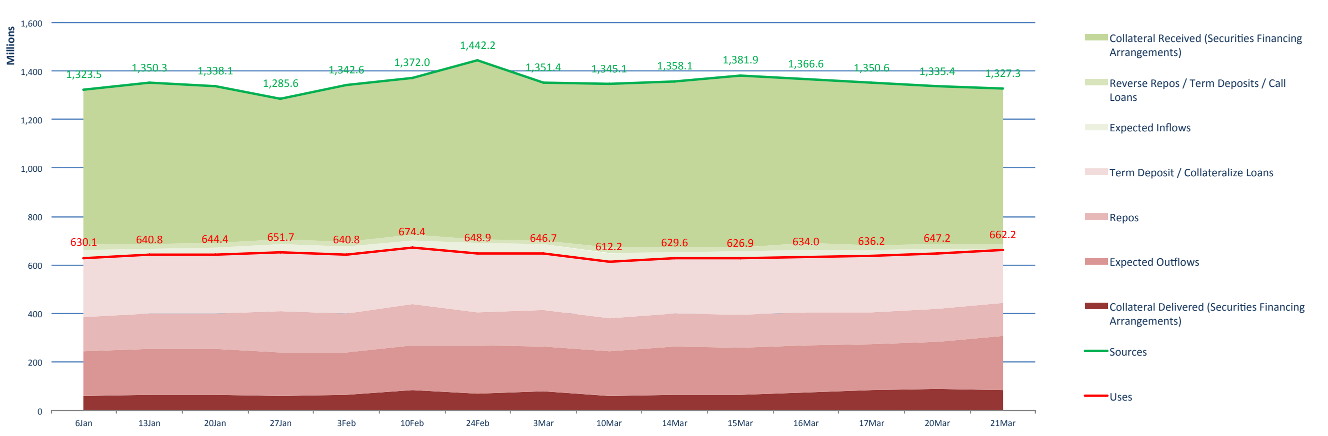
It is interesting to note that not only do firms have internal costs to take into account but also must understand how these could affect the ability to transact at a competitive level. As a consequence, desks may be tempted to go to the street for funding rather than approaching internal treasury.

The calculations

Figure 2 illustrates the range of results required to fully understand the cost of funding a counterparty relationship. To be fully informed firms will require this type of view across all counterparties, across individual accounts and perhaps at the individual trader level.

The key liquidity measures are LCR and NSFR. LCR addresses the sufficiency of a stock of HQLA to meet short-term liquidity needs under a specified stress scenario for a 30-day time horizon.

Figure 1



$$\frac{\textbf{Stock of HQLA}}{\textbf{Net cash outflows over 30-day time period}} \geq 100\%$$

Short-term funding (LCR)

$$\textit{Stock of HQLA} = \sum_{\textit{Collateral}} \textit{HQLA Market Value x Rate} - \sum_{\textit{Loans}} \textit{HQLA Market Value x Rate}$$

$$\textit{Inflows} = \sum_{\substack{\text{Loans Closing} \\ \text{(30 Day Loans)}}} \textit{HQLA Market Value x Rate}$$

$$\textit{Outflows} = \sum_{\substack{\text{Collateral} \\ \text{(30 Day Loans)}}} \textit{HQLA Market Value x Rate}$$

$$\textit{Net Short-term Funding}_{\textit{Pre-treasury}} = \textit{Stock of HQLA + Inflows − Outflows}$$

$$\textit{Net Short-Term Funding} = \textit{Net Short-term Funding}_{\textit{Pre-treasury}} + \textit{Short-term Funding from Treasury}$$

Long-term funding (NSFR)

NSFR, on the other hand, establishes a minimum acceptable amount of stable funding based on the liquidity characteristics of an institution's assets and activities over a one-year time horizon. NSFR seeks to improve the funding profile by requiring a reliance on funding sources determined to be sufficiently stable and longer term in nature.

$$\frac{\textbf{Available amount of stable funding}}{\textbf{Required amount of stable funding}} > 100\%$$

$$\textit{Required Long-Term Funding} = \sum \textit{Short-Term Loans x 10\%} + \sum \textit{Short-Term Loans x 15\%}$$

$$\textit{Net Long-Term Funding = Available Long-Term Funding − Require Long-Term Funding}$$

Internal haircut

Any cost of funding analysis will need to take into account the internal haircut to be applied to a security. This will be 'bespoke' to the firm

It does this by measuring cash inflow and outflow, which by its very design creates a net cash outflow and should be covered by holding sufficient HQLA and may take into account risk measures such as concentration, value at risk or specific market stresses.

Overcoming the challenges

We've documented some of the challenges faced by securities finance firms implementing Basel III: acquiring and organising data, performing complex calculations, and providing transparency to the results. The outcome must then be presented in meaningful reports for all levels of the business.

Best practice reporting will produce:

- The ability to manage the funding cost for the liquidity and stable funding requirement for each desk, client, trade and stock loan demand
- The ability to select inventory for potential hypothecation obtained from the margin lending business to improve the starting position of the stock loan desk
- Comparison of the value of different sources of funding
- An understanding of the available liquidity coverage or stable funding as a potential business asset

Security finance operations face many other challenges. Another good example is the conflict between Basel III and the self-regulatory organisation (SRO) requirements for bank-owned broker-dealers.

Bank funding will be regulated by the standards defined by the banking regulator whereas the broker-dealer will be governed by the SRO.

It may well be capital efficient to own certain positions as hedges in terms of SRO requirements, but very inefficient when faced with Basel III-compliant treasury funding from the bank parent.

In order to provide true optimisation across these potential conflicting policies, it is necessary to have tools that concurrently evaluate both requirements and suggest collateral optimisation. **SLT**

Figure 2

Funding Requirement Summary

Currency **USD** — **Trade Date: 10 January 2017**

Counterparty		Asset Type		Collateral	Borrows	Net	Collateral Haircut	Borrow Haircut	Net HQLA
ABC-XYZ	Overnight Lending	Level 1 HQLA		3,000,000	66,547	2,933,453	-	-	2,933,453
		Level 2A HQLA		2,000,000	1,000,000	-	300,000	150,000	850,000
		Level 2B HQLA		66,182	2,872,613	-2,806,432	33,091	1,436,307	-1,403,216
		Other		-	560,000	-	-	560,000	
		Total		5,066,182	4,499,160	127,021	333,091	2,146,307	2,380,237
	Term Lending	Term Deposits/Loans		2,800,000	3,400,000	-600,000	-	-	-600,000
		Level 1 HQLA		1,200,000	908,000	292,000	-	-	292,000
		Level 2A HQLA		3,500,000	300,567	3,199,433	525,000	45,085	2,719,518
		Level 2B HQLA		1,890,000	4,320,000	-2,430,000	945,000	2,160,000	-1,215,000
		Other		-	-	-	-	-	-
		Total		9,390,000	8,928,567	461,433	1,470,000	2,205,085	1,196,518
	Collateral Pool	**Asset Type**	**Asset Sub Type**	**Collateral**	**Borrows**	**Net**	**RWA**	**Borrow Haircut**	**Net Collateral**
		Level 1 HQLA	Cash	2,800,000	3,400,000	-600,000	-	170,000	-770,000
			Sovereign Debt	4,200,000	974,547	3,225,453	-	48,727	3,176,726
		Level 2A HQLA	Sub-Sovereign Debt	5,500,000	1,300,567	4,199,433	-	65,028	4,134,405
		Level 2B HQLA	Corporate Debt (Qualifying IG)	1,890,000	-	1,890,000	-	0	1,890,000
			Common Stock (Non-Financial)	66,182	7,192,613	-7,126,432	-	359,631	-7,486,062
		Other	Common Stock (Financial)	-	560,000	-560,000	-	28,000	-588,000
			Corporate Debt (Non-Qualifying)	-	-	-	-	-	-
		Other	Other	-	-	-	-	-	-
		Total		14,456,182	13,427,727	1,028,454	-	671,386	357,069
	Current Funding	**Source**		**HQLA**	**Cost**	**Outflows**	**Stability Haircut**	**Short Term Liquidity**	**Net Liquity**
		Treasury (overnight)		-	0.0000%	-	100%	-	-
		Treasury (30 day ticket)		-	0.0000%	-	100%	-	-
		Treasury (1 year)		1,700,000	0.6580%	31	0%	1,700,000	1,700,000
		Total		1,700,000		31		1,700,000	1,700,000
	Liquidity	**Liquidity Type**		**HQLA**	**Inflows**	**Outflows**	**Required Liquidity**	**Available Liquidity**	**Net Liquity**
		Short Term (LC)		3,567,755	2,352,854	4,733,091	4,733,091	7,629,609	2,896,518
		House Surcharges		-	-	-	-	-	-
		Total		3,567,755	2,352,854	4,733,091	4,733,091	7,629,609	2,896,518
		Long Term (NSF)		-	-	-	1,664,159	1,700,000	35,841
		House Surcharges		-	-	-	-	-	-
		Total		-	-	-	1,664,159	1,700,000	35,841

Winds of Change?

Timothy Smith of FIS Global takes stock of how far the industry has come in recent years and speculates as to whether this is simply the eye of the storm

Hurricanes Harvey and Irma (and possibly more to come) could be viewed as a foreshadowing of the winds of change that are due to impact our industry as we gather in Naples this October. Once again, as has been the case over the past 30 years, we have to evolve and adjust to the new norms while simultaneously preserving the underlying focus. When we distill securities financing to its very essence, it is simply the efficient use of assets to maximise cost savings and revenue flows, minimise capital usage and ensure the orderly settlement flow within the global capital markets.

Maybe justifiably therefore we feel a certain siege mentality at the seemingly continual and some might say vindictive flow of regulation and scrutiny that is in place, coming or even a twinkle in some regulator's eye. We are an easy target … and we do not have a vote! Do these events signify a greater structural impact, a real insurmountable blockage, or are they just a temporary disturbance in the force?

Some have argued that we have brought some of this attention upon ourselves over the past few decades. It could be argued that we have pushed the boundaries of mainstream acceptance in terms of uses and policies. For example, borrowing to vote, offshore strategies and cash reinvestment policies. On the other hand, there have also been some actions that regulators have mistakenly understood to be deceptive but in reality have only been created as a result of the way the industry has developed organically. We are moving from a back-office settlements and treasury function to a front-office profit centre as external demand grows and the need to create more capital efficient usage is imposed by these same regulators.

Wrath of the regulator

The securities lending industry's problem is that we worked so hard at getting these processes and procedures in place that we ignored the very important issue of proclaiming our righteousness to the world in the form of greater reporting and transparency on a proactive basis. This innocent and unintentional reticence has led to suspicion and scrutiny over the past few years that far surpassed the level of appropriateness.

In the past, when facing strong regulatory challenges and oversight, the cry has been one of 'this will wreck the industry' and 'it is the end of the world as we know it'. If truth be told, however, just as an atomic powered ice-breaker steams gracefully through a couple of feet of ice on the water, so has the business of securities financing grown in importance, depth, breadth and reach latching itself onto so many integral practices of all areas of financial interest in perhaps an almost intelligent way of protection. If it is plumbed into so many business practices, then it is much harder to change, limit or even destroy; similar to the thinking of automakers

fitting entertainment systems that could once be unplugged and removed by thieves in a matter of seconds but are now impossible to take out without destroying much more.

This being said, is it now finally the case where we are being squeezed in a way that we have never have been. Have we now come up against a pressurized ridge of ice that is just too thick for us to power through and have to start beating a retreat to calmer waters. In fact, have we already started to see the impact in terms of business levels and revenue earned? The answer, as always, is not definitive and varies from region to region.

To cash or not to cash

One of the most significant pressures over the past few years has been the squeeze on capital usage and the search to find more ways to use current assets more efficiently and effectively. As a result, whereas a few years ago it was very easy to discern the split between cash and non-cash collateral business along regional lines this has become more blurred.

The US preponderance of cash collateral, driven by practice, history and regulatory directives has been changing. In addition, the European model of non-cash exclusivity, driven in part by arcane Inland Revenue rules in the UK that used to view rebates on cash as taxable income, has also been under pressure to move in the opposite direction. However, are the changes becoming more pronounced or are the trends reversing?

On a global basis it would appear that since the psychological 50 percent barrier was breached in 2015, that the trending is inexorably upwards. Indeed, the opposite trend for the historically predominantly non-cash collateral markets of Europe and Canada has flattened out and the US has continued with its move towards non-cash collateral as shown in Figures 1 to 4. So score one for the structural shift proponents.

Let us now turn to balances and revenue in recent years. The consensus of opinion is that there has been a switch to revenue coming from specials and the like as the cost of capital usage for borrowing has risen and the scrutiny given to what is done with cash collateral reinvestment has squeezed the return out of the general collateral type of deals.

The contrarian view of course is that, as the pressure to provide high-quality collateral has been ratcheted up by the regulators, so the demand to borrow this high-quality collateral has driven the demand to borrow—notwithstanding the high capital cost of borrowing. In other words, the regulators are making it more difficult to borrow securities but are also creating the situation whereby more securities are required to be borrowed. Another factor that needs to be mentioned is that as the desire by a growing number of global stock exchanges to speed up their settlement cycle, thus the demand for the traditional ‘fail coverage’ transaction becomes more and more.

We need to talk about Germany

One of the most overt changes to the structure of the business has been in the area of yield enhancement transactions. Long gone are the heady days of the 80s and 90s with the French avoir fiscal, Swedish dividend plays and German tax credits in the mid 40s percentile.

However, transactions were still taking place in Germany but these are now being squeezed out of the system in their entirety. The following chart shows how the return over the last four years in German securities has tailed off. For those who say that this

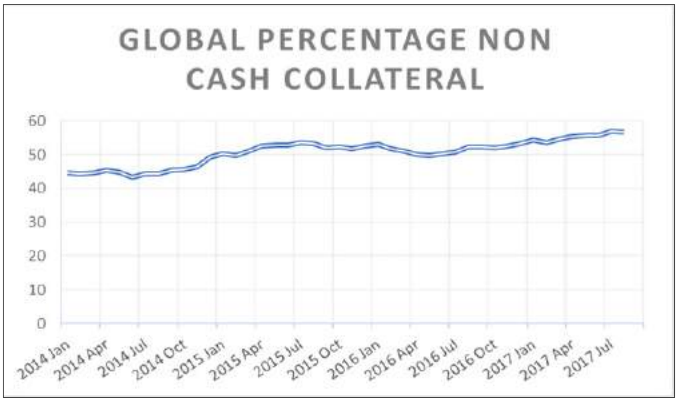


Figure 1

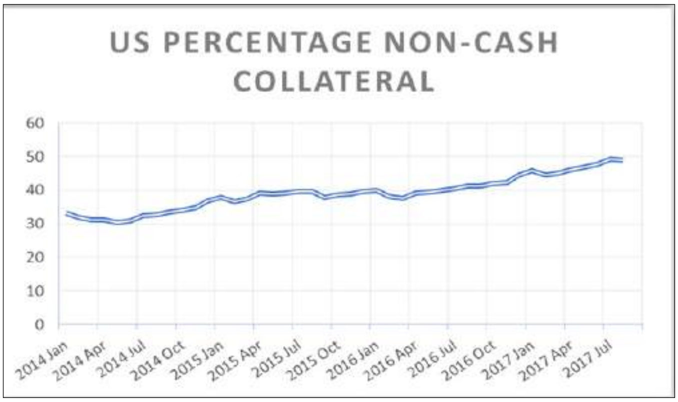


Figure 2

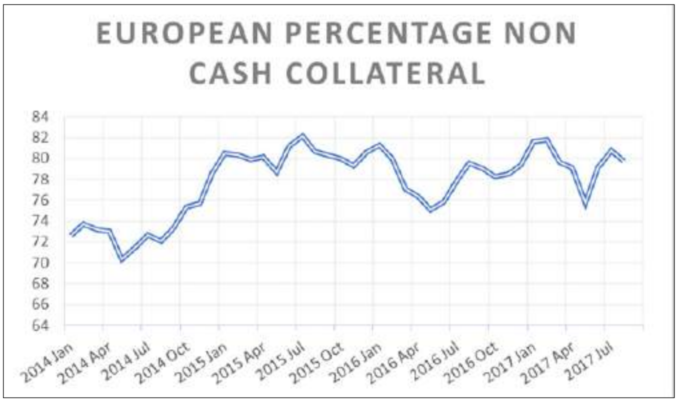


Figure 3

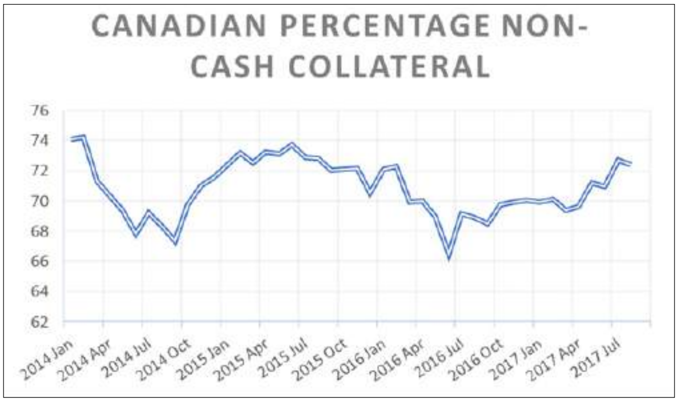


Figure 4

is just one country the next chart shows Europe as a whole and the impact that the lack of this type of business has had on balances and revenue. What does this mean for Europe? See Figures 5 and 6.

For three decades, securities lending in Europe has been defined on the back of the yield enhancement transaction. Over time the introduction of new regulation and the changes in dividend policies have squeezed the rasion d'etre out of the practice. It has to be said that even in the late 1980s it was often wondered for how long the practice could be practiced.

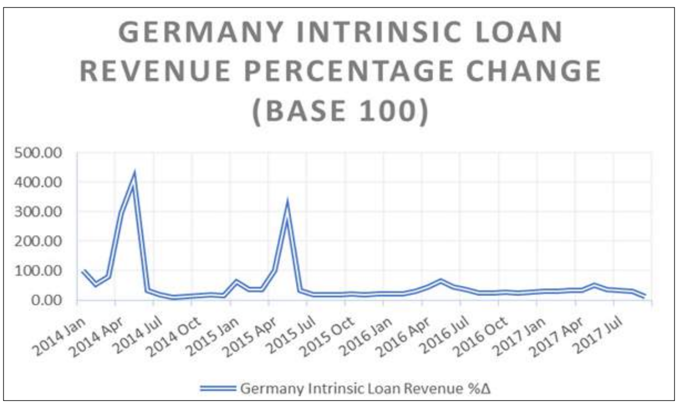
Outside of the 'season', markets were supported by several high-profile mergers and acquisitions. On top of that the use of equities and government bonds as collateral has continued to supply a place in the capital markets industry to be the oil in the engine of settlement. It does however seem that the ice-breaker in Europe at least has reached its high-pressure ice ridge.

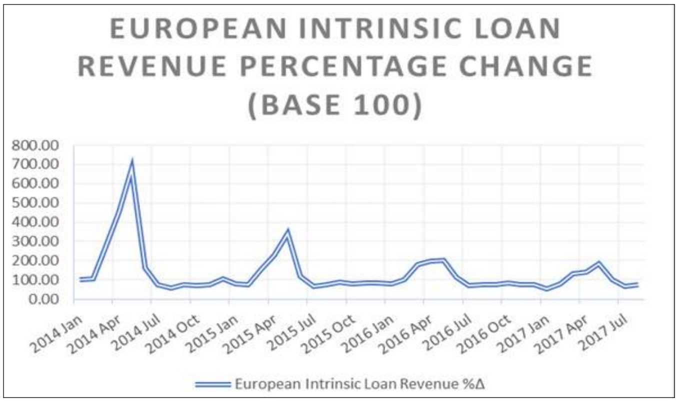
As a consequence, as per the famous quote from the film The Shawshank Redemption, it is time for Europe to "get busy living, or get busy dying". To this end, Europe, seemingly contending with the uncertainty of Brexit as well as the introduction of the Securities Financing Transaction Regulation, the second Markets in Financial Instruments Directive and the like, must reposition itself and conform to the new world order if it is to survive.

For the US market it appears that once again there is a divergence in approach. After years of introspection and almost self-loathing, we can detect the almost resurgent self-assurance of an industry proudly wearing the t-shirt emblazoned with 'what does not kill us, makes us stronger'. See Figures 7 to 9.

Let us look at some of the key indicators in the US market. US dollar cash collateral reinvestment premium is still up above what it was a few years ago even if there has been a wobble in the past year. It is still too early to say where it is going. Again intrinsic rate for treasury lending is still high, again with a slight wobble in the past few months. Equity return on lendable assets is still steady and higher than it was in 2014. These are just but a few pointers of many that appear to show the US market showing that it is once again able to deal with the ebbs and flows of regulation in a more agile fashion.

Returning to the current hurricane season, given the above, we can see that it is indeed rather symbolic of the global securities lending market. There are two main 'models' that are used to predict the trajectory of a major storm–the European model and the USA model. For Irma, there were fairly similar views as to what the system will do but for subsequent hurricanes such as Maria, Jose and the like there seemed to be a greater degree of divergence. Is this symbolic of the 'winds of change' appearing in our industry? Is the pressure to become more global in terms of control actually leading to a divergence in terms of business direction? I guess, only time, and the weather, will tell. **SLT**





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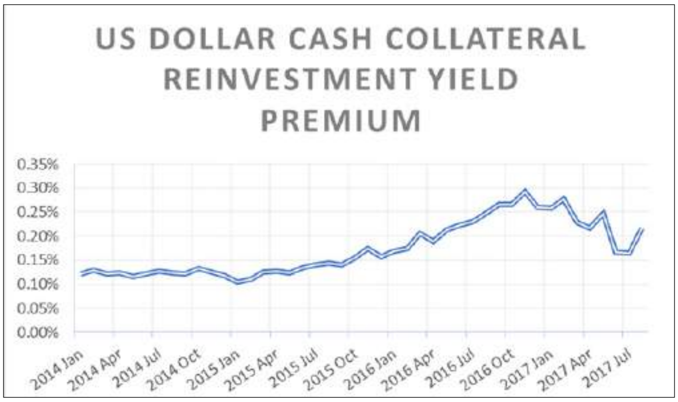

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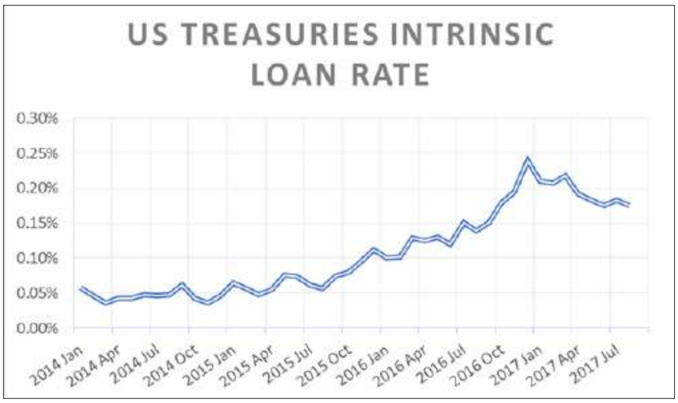

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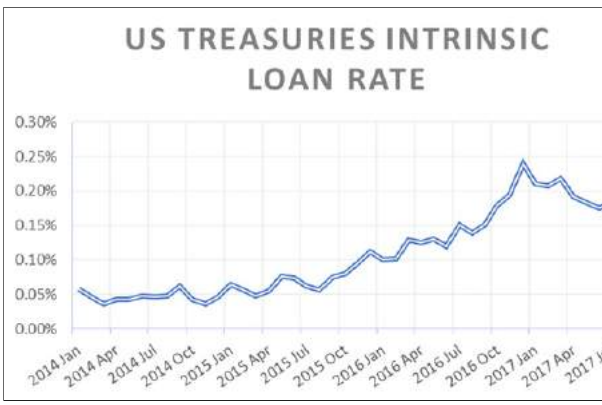

Figure 8

OCC shakes up senior leadership, while J.P. Morgan continues its hiring spree

Equity derivatives clearinghouse OCC has completed a comprehensive restructuring of its senior staff members including the promotions of David Prosperi, Jean Cawley and Kirstin Wells.

Prosperi, currently first vice president of public relations, corporate communications and the Options Industry Council (OIC), is being promoted to the role of senior vice president of public relations, corporate communications and OIC.

According to OCC: “Prosperi has been instrumental in furthering OCC’s efforts to transition from a low-profile market utility to a high-profile industry thought leader, which has had a significant and positive impact on enhancing OCC’s brand, reputation and the stature of OCC’s leadership.”

Prosperi will continue to report directly to Craig Donohue, OCC executive chairman and CEO.

Cawley, currently senior vice president and senior adviser to Donohue, is being promoted to executive vice president, and will remain in his senior adviser position.

OCC said Cawley will take on expanded responsibilities including supporting the office of the CEO in promoting an increased focus on diversity and inclusion opportunities at OCC.

Wells, currently vice presiden of enterprise risk management, is being promoted to the newly-created role of first vice president for regulatory policy.

She will be responsible for analysing regulatory and policy initiatives and working with OCC management to formulate policy positions.

Wells will report to Julie Bauer, senior vice president for government relations.

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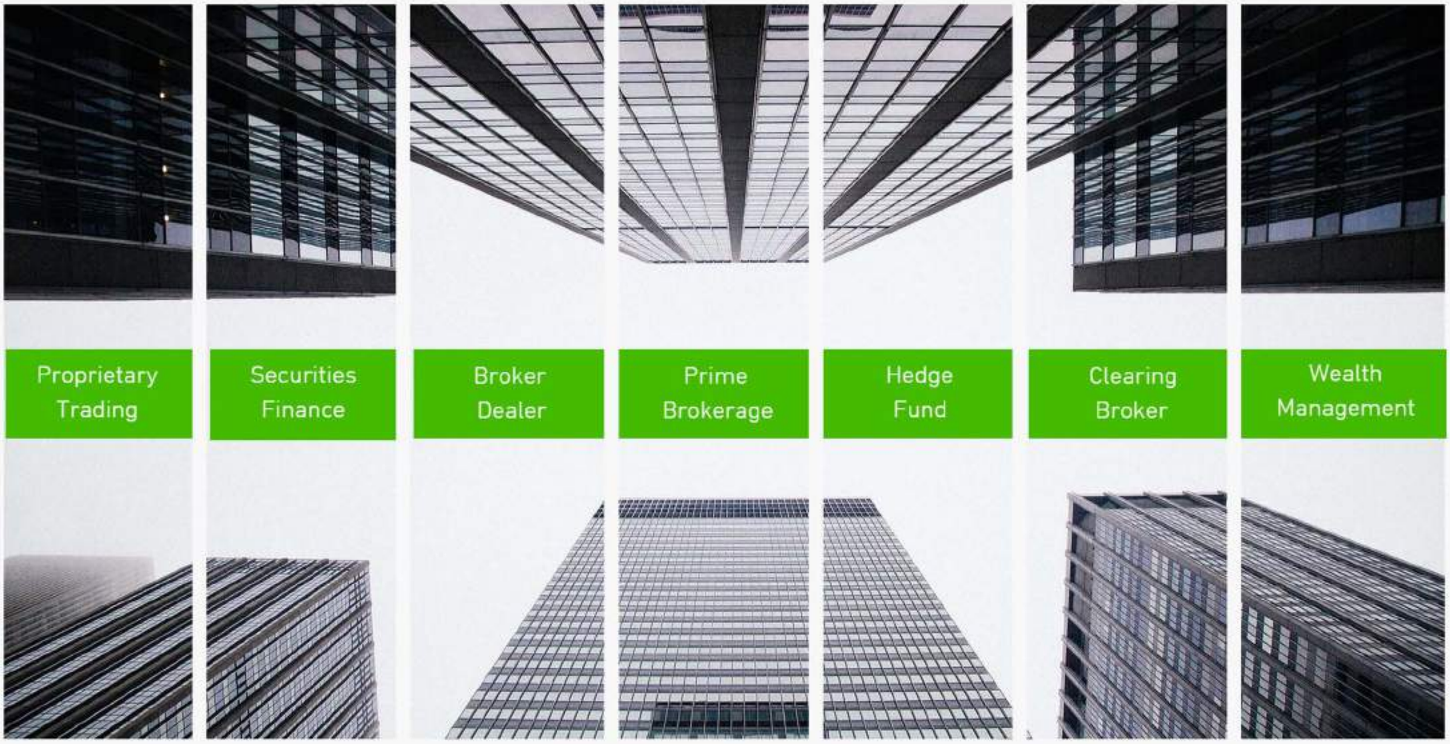

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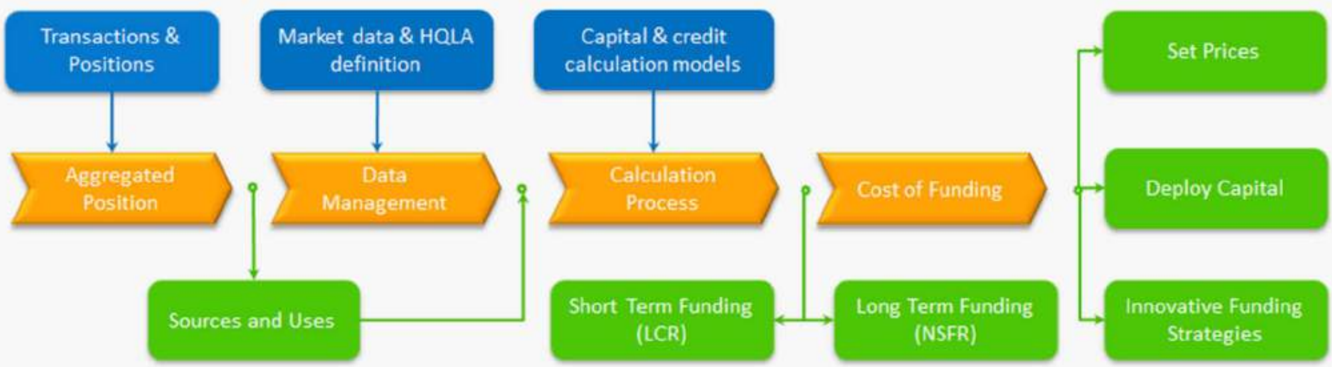

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In a statement on the new appointments, Donohue said: "To fulfill its role as an effective and efficient systemically important financial market utility and serve as a forceful advocate for the US exchange-listed options industry, OCC must be seen as a destination for top talent."

J.P. Morgan has added Pierre Streat to its securities lending team in New York.

Streat was previously an associate at the bank's prime broker investor services and custody.

Prior to J.P. Morgan, Streat served on the credit derivatives desk at Barclays.

J.P. Morgan is in the process of the major restructuring of senior staff, with several long-term staff moving on including Paul Wilson, who was previously global head of agent lending product and portfolio advisory.

Electronic Transaction Clearing (ETC) has appointed Jack Nicosia as managing director and senior vice president of securities lending.

ETC is a clearing, settlement and custodial services provider based in New York.

Nicosia will oversee ETC's securities lending efforts and will be responsible for managing its expanding team.

Prior to his appointment at ETC, Nicosia was managing director of the securities lending group at COR Clearing. He brings more than 20 years of securities lending experience.

Vincent Lupo, CEO of ETC, said: "As the head of securities lending, Jack Nicosia has the experience and dedication to expand our platform to serve our clients and grow our business."

Nicosia added: "This is an exciting time to join ETC, as the firm is well-positioned for substantial growth. I'm thrilled to be part of this dedicated team and I look forward to leveraging my experience to help grow the business."

Broadridge has recruited Martin Walker as head of product management for securities finance and collateral management.

Walker moved to Broadridge in August from business consultancy firm Maverick Works.

Previously, Walker served as a strategy and analytics consultant at HSBC and as global head of prime brokerage technology for RBS.

Walker, who is based in Broadridge's London office, marks the latest in a series of senior appointments by Broadridge.

The financial services provider brought on Paul Wilson from Sharegain as senior account manager earlier this month, and promoted Bob Santangelo to become president of international sales for Europe, the Middle East and Africa and the Asia Pacific region.

Prior to his promotion, Santangelo was senior vice president, responsible for Broadridge's global bank broker-dealer distribution channel in the New York office.

Chris Perry, president of global sales, marketing and client solutions at Broadridge, said: "Bob Santangelo has a proven track record of delivering for clients and has been a great team leader in identifying and developing our international sales associates."

IHS Markit has appointed Tom Cunningham as COO of thinkFolio, its cross-asset class order management programme.

Cunningham will lead thinkFolio's product management, services, support and managed service offering.

He will report to Spiros Giannaros, global head of thinkFolio and enterprise data management.

Before joining IHS Markit, Cunningham was chief technology officer at Jupiter Asset Management.

He also has prior experience using thinkFolio on the buy side.

Giannaros said: "I'm delighted to welcome Tom Cunningham to the growing thinkFolio team."

"[He] joins us at an exciting time when we are expanding our presence across regions and investing heavily in the next-generation architecture of thinkFolio, as well as adding the solution to our managed service offering." **SLT**

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www.securitieslendingtimes.com
Twitter: @SLTimes_

Acting Editor
Stephanie Palmer
stephaniepalmer@blackknightmedialtd.com
+44 (0)203 750 6019

Deputy Editor
Becky Butcher
beckybutcher@blackknightmedialtd.com
+44 (0)203 750 6018

Reporter
Drew Nicol
drewnicol@securitieslendingtimes.com
+44 (0)203 750 6022

Contributors - Barney Dixon • Jenna Lomax

Marketing Director
Steven Lafferty
design@securitieslendingtimes.com

Designer
James Hickman
jameshickman@blackknightmedialtd.com
+44 (0)203 750 6021

Publisher
Justin Lawson
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6028

Issue illustrated by studiostoks

Office fax: +44 (0)20 8711 5985
Published by Black Knight Media Ltd