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ISLA and the CBI tackle UCITS collateral rules

The Central Bank of Ireland's (CBI) director of policy and risk has confronted industry concerns around stringent collateral re-use and "arbitrary" fee splits for UCITS funds at a roundtable discussion.

Gerry Cross spoke to members of the International Securities Lending Association (ISLA) in Dublin on 14 November to address the challenge of allowing UCITS funds to interact fully with the securities lending market while remaining compliant.

"It appears that there may be an impression amongst some market participants of a regulatory preference for title transfer arrangements to apply to securities lending collateral arrangements," said Cross.

"Title transfer arrangements are of course optimal from the perspective of collateral receivers to protect against counterparty failure and the Central Bank requires that collateral received should be capable of being fully enforced by the UCITS at any time without reference to or approval from the counterparty."

Cross added: "However, title transfer arrangements are not mandated by the European Securities and Markets Authority (ESMA) guidelines or indeed by the central bank.

Rather, the guidelines (and the CBI UCITS Regulations) provide for the possibility of pledge arrangements with the proviso that the collateral be held by a third-party custodian who is unrelated to the collateral provider and is subject to prudential supervision."

"As this pledge model is already being used in the context of derivatives clearing through central counterparties, it is not clear from where this uncertainty originates."

Cross also used his speech to dispel latent theories around the need for UCITS funds to conduct credit ratings on received collateral.

To move away from "arbitrary" fee splits between UCITS funds and their agent lenders the CBI has changed the rules to ensure investors "are appropriately remunerated for lending their assets".

Cross said: "In short, all revenues arising from securities lending transactions, net of direct and indirect operational costs should be returned to the UCITS, and these costs and fees should not include hidden revenue."

"This rule was designed in order to move away from the traditional revenue sharing or fee split model to a more transparent and fairer arrangement where the UCITS (and investors) are appropriately remunerated for lending their assets."

Continued on page 4

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Latest News

Eurex Clearing has secured 24 early signups to its EU-alternative for interest rate swaps central clearing service

page 4

Latest News

UK-based TRs may have to shoulder additional third-party recognition fees to operate under EU regulatory frameworks

page 6

GSIB Guide

Todd Zerega, a partner at Perkins Coie, introduces the a new buy-side guide following the Fed's final rule on GSIB exposures

page 14

Margin Rules

The next phase of the BCBS-IOSCO margin rules is on the horizon, and the buy side could use it as a springboard for long-term gain

page 16

Data Analysis

David Lewis of FIS takes a look at how the industry has evolved over the past year

page 22

People Moves

Comings and goings at Deutsche Bank, Deutsche Boerse, HSBC, and Pirum Systems

page 28

Eurex Clearing's partnership entices strong market interest for IRS alternative

Frankfurt | Reporter: Zsuzsa Szabo

Eurex Clearing has secured 24 early signups to its EU-alternative for interest rate swaps central clearing.

Citigroup, Deutsche Bank, HSBC and J.P. Morgan Securities, to name but a few, signed up for the programme, which opened its registration in October.

Other early joiners include Commerzbank, DZ Bank, BBVA, and LBBW.

The partnership programme is open to all clearing members and registered clients of Eurex Clearing.

According to Eurex, the programme has been designed in close consultation with major participants in the interest rate swap market including dealers, end-clients and execution venues.

Globally, Eurex cleared around 180 million transactions per month this year.

The notional cleared in interest rate swaps at Eurex Clearing has crossed €2 trillion in July 2017.

Erik Müller, the head of the clearinghouse, said: "Clients are looking for a market-led alternative to clear interest rate swap—and we are a committed partner."

Charles Bristow, co-head of global rates trading at J.P. Morgan, added: "This initiative will bring greater choice and transparency to the market as well providing the opportunity for greater risk diversification and resiliency."

Stefan Hoops, global co-head of institutional client group at the Deutsche Bank, said: "Deutsche Bank has engaged early as a design partner in the programme. Our global client's value choice and transparency and the program is designed to deliver this."

ISLA and CBI tackle collateral rules

Continued from page 1

"Fee splits were deemed to be arbitrary arrangements where irrespective of costs the UCITS earned a pre-defined proportion of revenues and the proportion often favoured the service providers to the potential disadvantage of investors."

The issue of investors historically being left out of pocket as a result of aggressive fee structures with their agents has been forced into the spotlight recently, after several US pension funds filed class action law suits against major banks for lost earnings due to alleged misconduct in the securities lending market.

It was clarified that Ireland's domestic requirements for eligible collateral are consistent with ESMA guidelines and require that collateral is of a high quality.

Cross commented: "High quality is not defined and, as such, that determination is made by the UCITS, although where issuers are rated by an external credit rating agency (CRA), that rating must be taken into account in the credit assessment process."

He added: "Moreover, if an issuer is downgraded below the two highest short-term credit ratings of a CRA, the UCITS must immediately carry out a new credit assessment."

Cross acknowledged ISLA's concerns regarding collateral re-use and term trade rules, which had caused a significant gap between securities held by UCITS that are available for lending and the amount of securities they have on loan. ISLA's latest market report highlighted that investment funds including UCITS account for 45 percent of all securities available for lending only 15 percent of available assets on loan.

Cross added: "Proportionately funds lend less than other market participants and moreover ISLA has observed that lending by funds has declined over the last number of years."

EU Commission opens consultation of SFTR TR fees

UK-based trade repositories may be forced to shoulder additional third-party recognition fees to operate under EU regulatory frameworks after Brexit, according to proposed EU Commission rules.

The commission has opened the floor to industry participants to consult on proposed fees charged to trade repositories for incoming reporting rules, with all responses required by 14 December.

Fees levied under the auspices of the Securities Financing Transactions Regulation (SFTR) and the European Market Infrastructure Regulation (EMIR) will aim to cover necessary expenditure relating to the registration, recognition and supervision of trade repositories.

For all trade repositories, the application fee will reflect the expenditure necessary to accurately assess and examine the application for registration or extension of registration, taking into account the services to be provided by the trade repository, including any ancillary services.

A trade repository that does not provide ancillary services will be deemed to have a low expected total turnover and shall pay a registration fee of €65,000, while a repository that does offer ancillary services will need to pay €100,000.

In the event that trade repositories in the UK revert to third-party status after the March 2019 Brexit negotiation deadline, then firms will see a sharp increase to their annual fees in order to continue to operate in the continent.

A third-party trade repository applying for recognition under Article 19(4)(a) of SFTR shall pay a recognition fee of either €20,000, or the amount resulting from dividing €35,000 among the total number of trade repositories from the same third country that are either recognised by the EU, or that have applied for recognition, but have not been yet recognised.

There will also be an annual supervisory fee of €5,000.

Any late payments shall incur a daily penalty equal to 0.1 percent of the amount due.

All fees for third parties are non-refundable in the event that the application of recognition is rejected.

The European Securities and Markets Authority (ESMA), which has the delegated power to manage collected fees, has clarified that shall only be set at a level that will cover costs, without accruing a surplus.

Where there is a recurrent significant surplus or deficit, the commission will revise the level of fees.

The commission has noted that, where a trade repository is already registered under EMIR, fees will be adjusted to reflect only the additional costs related to registration, recognition and supervision of trade repositories under SFTR.

Hedge funds reach new highs in Q3

The hedge fund industry has recorded a strong performance in Q3 2017, after stumbling in 2016, according to Preqin.

The industry saw net asset inflows totalling $19.2 billion, bringing year-to-date net inflows to $43.9 billion. This means total industry assets have grown by 7.4 percent since the start of 2017.

Equity strategy hedge funds saw a reversal of fortune, recording net inflows of $1.3 billion, following six successive quarters of outflows. However, 40 percent of equity strategy funds experienced inflows, and 43 percent saw outflows.

Credit strategies and multi-strategy funds saw the greatest net inflows in the quarter, securing $13.9 billion and $13.3 billion of net inflows, respectively.

Europe-based fund managers saw net inflows of $17 billion. However, North America-based firms saw net outflows of $8.9 billion, marking the first quarterly outflow of the year.

Amy Bensted, head of hedge fund products at Preqin, said: "Overall, net inflows for the industry are not benefitting all fund managers equally, and less than half of hedge funds in each leading strategy reported net inflows in Q3."

"Although investors seem to be regaining some confidence in the asset class, there are signs that they are seeking to rebalance or adjust their portfolios more selectively."

"Nevertheless, each quarter of 2017 so far has seen net inflows of capital, with Q3 inflows nearly matching the strong asset raising seen in Q1, and there is room for optimism over the continued resurgence of the hedge fund industry."

India reviews SBL position limits

The Securities and Exchange Board of India (SEBI) has altered its securities lending rulebook, following market calls for change.

As of 1 January 2018, position limits of borrowed shares will be capped at 10 percent of the free float capital of the company in terms of the number of shares.

The rule change affects both institutional investors and clearing members.

The client position level limit will be 1 percent.

SEBI has also changed the tenure of contracts so they cannot exceed 12 months.

A framework for securities lending was first specified in 2008.

LEIs offer major cost savings, says OFR

Legal entity identifies (LEIs) offer significant cost savings and improved transnational accuracy and transparency, according to Matthew Reed at the Office of Financial Research (OFR).

In a blog post on the benefits of LEIs, Reed described how the system "now serves as a linchpin for making sense of derivatives data stored in repositories around the globe".

Reed noted that early academic studies found cost savings associated with adoption of the LEI approached $1 billion annually.

Regulations that require the use of LEIs, such as the second Markets in Financial Instruments Directive (MiFID II) are also expected to create cost savings and greater transparency.

However, the blog post also highlighted that the long-term benefits to financial stability from an LEI system are much harder to gauge.

"This 20-character code allows the precise identification of these firms regardless of who is seeking to identify them or where they reside," said Reed.

"As a basic building block of the global financial plumbing, the LEI improves companies' risk management, clarifies counterparty exposure, and allows government supervisors to better assess market functioning."

He added: "The LEI also enables easily combining information from different sources. In addition, the LEI answers two basic questions: who is who, and who owns whom?"

Reed noted that a lack of LEIs before 2007 prevented regulators and private-sector risk managers from seeing the total extent of exposure by market participants to Lehman Brothers.

As noted in an OFR brief earlier this year, without a basic ability to identify financial market participants and their corporate families, financial companies and the regulators supervising them would continue to struggle to understand the links and exposures throughout the global financial infrastructure.

A recent report by McKinsey and Company and the Global LEI Foundation found that at least 10 percent of operating costs for onboarding clients and trade processing could be eliminated with full adoption of the LEI.

Another $500 million could be saved by the investment banking industry in issuing letters of credit. Additional savings can be found in business cases explored in the study.

Reed's comments come a month after the European Securities and Markets Authority (ESMA) warned industry participants not to neglect a viable method to comply with the fast-approaching LEI requirements.

ESMA stated that the introduction of LEIs under MiFID II will improving market surveillance and transparency and play a key role in the new harmonised data-reporting regime.

In a statement on the LEI requirement, Steven Maijoor, chair of ESMA, stated that there is no room for negotiation, where LEIs are concerned, under the incoming MiFID II rules.

Maijoor said: "LEIs play a key role under the new MiFID II data-reporting regime as well as being essential in supporting regulators' work on transparency and market surveillance."

"It is vital that investment firms and trading venues make the necessary efforts to obtain their LEIs in good time."

ESMA's final MMF report reveals industry parting on haircuts

The European Securities and Markets Authority's (ESMA) industry consultation on money market funds (MMFs) has divided opinion on the best application of haircut rules.

The divide in industry opinion was revealed as part of ESMA's market research into specifying liquidity and credit quality requirements, applicable to assets received as part of a reverse repurchase agreement involving MMFs.

Of the 18 respondents to ESMA's study, five aligned themselves with ESMA in calling for standardisation of haircut rules for MMFs engaging in reverse repo trades, while six others emphasised the need for flexibility.

In its final report, ESMA outlined its argument for standardisation as offering more legal certainty while preventing influence by other counterparties, and suggested that it would be easier to impose haircuts, while guaranteeing that lower levels of collateralisation cannot be negotiated.

Standard rules "would stop practises that in the end result in lower industry standards".

"Furthermore, eligible assets are easier to classify with the Basel table and MMFs would be aligned with market practices."

Three of the five respondents said they saw no benefit from flexible haircuts.

However, the six advocating flexibility argued that this should be allowed so as to enable managers to do their internal assessment and analysis of market conditions to identify the adequate level of haircuts for that specific circumstance.

Respondents cited market conditions and credit quality of the counterparty and collateral as the main drivers for the determination of the haircut.

Moreover, standardised haircuts could lead to having levels of risk not appropriately reflected, while a flexible approach reduces the risk of losses.

Furthermore, according to the six, having standardised haircuts can potentially reduce the competitiveness of MMFs, compared to other repo users.

One respondent in favour of flexibility went as far as to say that the references to the banking sector should all be deleted, while another respondent stated that the proposed standardised haircuts do not sufficiently consider that only high-quality government securities that have received a favourable assessment will be accepted.

Another respondent highlighted that the proposed haircuts include ineligible asset classes not allowed under the MMF regulation.

Two respondents mentioned that the European Systemic Risk Board (ESRB) opinion on securities financing transactions considers the Financial Stability Board's approach to haircuts reasonable. ESRB has proposed that government securities should not be subject to standardised haircuts, and haircuts should be frequently monitored, assessed and adjusted.

NEX Optimisation and KVA Analytics announce new derivatives platform

NEX Optimisation has introduced capital valuation adjustment (KVA) analytics to its triCalculate valuation adjustment service (XVA).

KVA calculations determine the lifetime costs of capital as part of the pricing of an over-the-counter (OTC) derivative and the service will helps firms understand the capital costs an OTC trade will consume over the portfolio's lifetime.

triCalculate is NEX Optimisation's centralised, web-based service that provides independent trade valuations and XVA risk calculations for OTC derivatives that allows users to generate independent trade and netting set level XVA calculations as well as risk sensitivities.

Martin Engblom, co-CEO of triCalculate, said: "KVA can have a significant impact on derivative pricing since capital charges remain even when market risk is accounted for in the trading book."

"With regulatory pressures mounting and modelling challenges around pricing KVA, we continue to develop functionality to support complex market needs with the addition of advanced yet efficient KVA calculations to our secure, web-based triCalculate service."

Eurex launches fresh fixed income tools

Eurex has expanded its options offering on fixed income exchange traded funds (ETF) with three new iShares offerings, which will be available from 20 November.

The three new options include the iShares US dollar high yield corporate bond ETF, an iShares J.P. Morgan USD emerging market bond ETF, and an iShares USD corporate bond ETF.

iShares is BlackRock's primary ETF provider.

Eurex subsidiary said it expected the launch to be well supported as it responds to strong client demand.

In a statement on the launch Eurex explained that three large (unnamed) banks will provide liquidity for Eurex' options on fixed income ETFs.

The Deutsche Boerse Group noted significant end-user demand for European-listed fixed income ETF options, with institutional investors in Europe ready to migrate from US-listed options once the options are listed.

Brett Olson, head of fixed income iShares in Europe, the Middle East and Africa for BlackRock, said: "The growth of fixed income ETFs in Europe has broadened the range of investors and the way they use our ETFs."

"These investors are telling us they need options on our fixed income ETFs, to provide a way to manage volatility in portfolios using a tool that is more representative of the cash bond market."

Olson added: "With one eye on the growth in the US fixed income ETF options market, we believe these options will benefit clients that require a security that refers to a UCITS ETF."

Lee Bartholomew, head of fixed income and foreign exchange product research and development at Eurex, added: "Fixed income ETFs offer an exchange traded source of liquidity for fixed income exposure to investors."

"They allow for cost effective exposure to the corporate bond market. Furthermore, our new products provide investors with greater flexibility to hedge and manage their exposure to the fixed income, corporate and high yield bond markets."

OneClearstream now live and trading

Clearstream has launched OneClearstream, a new service aimed at automating collateral transfers across depositories.

The platform, which is now live, enables mutual customers of Clearstream Banking Luxembourg and Clearstream Banking Frankfurt mobilise assets across both the international central securities depository (ICSD) and central securities depositories (CSD).

Clearstream has already conducted the first collateral allocations on behalf of DZ Bank AG using OneClearstream collateral management service (OneCMS).

OneCMS, which forms part of Clearstream's integrated offering for Target2-Securities (T2S), enables full triparty interoperability between Clearstream's CSD and ICSD.

During this first collateral allocation where assets were mobilised out of DZ Bank AG's account at Clearstream Banking Frankfurt to use as collateral at the ICSD towards the Federal Reserve's Discount Window.

Previously, users had to realign their assets from the CSD to the ICSD to use them as collateral, but the new setup automatically realigns assets between both locations when needed.

The new platform represents the first phase of what Clearstream wants to achieve with OneCMS, where assets held at CSD level can be automatically mobilised and serve the customer's collateral management activity at the ICSD.

The second phase of OneCMS will involve the CSD offering a ICSD-esque collateral management services settling in T2S, including a euro triparty repo service settling in central bank money.

From Q2 2018, Clearstream will start to roll out its T2S Investor CSD from Q2 2018 on a market-by-market basis.

Olivier Deutscher, head of short term liquidity, repo and collateral trading/group treasury from DZ Bank AG commented: "We are pleased that Clearstream has implemented a single collateral management service enabling full interoperability between Clearstream's CSD and ICSD."

"This new model will improve our management of liquidity and collateral, therefore helping to further unlock numerous operational efficiency gains."

Fabrice Tomenko, co-head of GFF business and product development at Clearstream Banking SA, added: "We are in close cooperation with our customers to develop innovative T2S-based solutions."

"Forming part of our enhanced integrated service offering, OneCMS shows that we are fully committed to helping our customers make the most of T2S."

Clearstream: AI can lead to harmony

New waves of technology, such as artificial intelligence and blockchain could support the market in overcoming barriers to harmonisation, according to Clearstream.

In its October data report, Clearstream claimed that these new technological developments will also help to deliver efficiency gains and support risk mitigation.

The international central securities depository (ICSD) said that the biggest challenge going forward will be to find the correct means of collaborating with new business models and innovative technologies.

Marc Robert-Nicoud, CEO of the ICSD at Clearstream, spoke at a panel discussion on the digital transformation of the industry at the University of Luxembourg this week.

He said: "We at Deutsche Boerse believe that the market should embrace new technology and try to understand its potential in addressing industry needs."

"The better the quality of our technology, the more we can support the regulatory agenda and the better we can serve our clients and the real economy."

"Our goal is to shape a next-generation organisation that ensures a robust capital market infrastructure for the benefit of our clients."

Clearstream also stated that technological innovations would not just be limited to post trade.

The report continued: "Market infrastructure providers are well positioned to explore the potential of new technologies throughout the value chain from issuance, through trading, to clearing and settlement."

In its data report, Clearstream revealed that its global securities financing outstanding volume dropped by 10 percent in October, compared to the same time in 2016.

Volume outstanding fell to €444.1 billion last month from €491 billion in 2016.

Year-to-date volume outstanding was down 11 percent from €521.1 billion in 2016 to €462.1 billion as of last month.

BME Clearing to offer direct repo access

BME Clearing, the central counterparty (CCP) operated by BME, has introduced two new access models that will allow clients access to repo and swaps services.

According to BME Clearing, the agency model and the principal-to-principal model will contribute to greater capital efficiency and market liquidity.

The agency model will allow clients to directly posts margins in the CCP, while the clearing member will act as an operational agent and will be jointly liable with the client before the CCP.

BME Clearing explained: "Margins posted by the client are not the balance sheet of the clearing member."

So far, 16 clients have opened accounts that follow the agent model for the repo segment.

To follow the principal-to-principal model, a client has to be a direct counterparty with the clearing member.

The clearing member will be a counterparty with the CCP — the clearer being solely liable before the CCP.

BME Clearing said: "With this offer to all institutional clients multilateral netting is facilitated and capital efficiency is improved as well as market liquidity."

MTS and UnaVista collaborate on SFTR

The London Stock Exchange's (LSE) UnaVista is collaborating with electronic fixed-income trading market MTS to offer a regulatory reporting solution for firms operating under the securities financing transactions regulation (SFTR).

The collaboration means that firms trading on MTS's new global collateral management (GCM) segment will be able to use UnaVista's trade repository for things like repo trades.

Market participants with a connection to UnaVista Trade Repository, and that trade repo contracts on the new GCM segment of MTS BondVision, will be able to match initial trade data fields.

This will create an entry in the UnaVista portal, which can then be populated with additional data.

MTS's GCM segment enables the trading of bilateral and centrally cleared repo contracts between buy- and sell-side participants. SFTR requires firms to report transactions including repo trades to an approved EU trade repository.

The proposed regulation, expected to come into effect in 2019, covers SFTs conducted by any firms established in the EU. UCITS funds and alternative investment fund managers funds will also be subject to SFTR.

The UnaVista Trade Repository went live for European Market Infrastructure Regulation trade reporting in 2014, helping clients to comply with reporting obligations.

LSE explained: "The collaboration will provide a single solution for the trading and reporting of SFTs with seamless front-to-back reporting of Unique Transaction Identifiers, timestamps, International Securities Identification Numbers and other product identifiers."

Fabrizio Testa, CEO of MTS, commented: "Our new GCM segment offers customers an automated, regulated and orderly market for repo transactions. Linking up with UnaVista to offer our clients a reporting solution for their repo trading ahead of the introduction of SFTR was a natural fit."

Startup presents industry's first P2P securities lending platform

SBL Network, a new London-based startup, has launched the industry's first peer-to-peer securities lending platform.

The new financial technology firm created the Aquila Network after two EIS-qualifying funding rounds that brought in approximately £1 million this year.

Participants will be able to negotiate securities lending transactions and benefit from access to anonymous pricing data providing complete peer-to-peer pricing transparency of the transaction executed across its platform, according to SBL.

The Aquila Network is currently being tested on a closed-circuit basis and is starting live operations with its first third-party clients before the end of this year.

In a statement on the platform, SBL stated that the Aquila Network was built in response to the growing demand for greater transparency in the securities lending marketplace. SBL Network was founded in 2016 by Peter Fenichel, who is currently chairman and boast previous experience as CEO of SL-x Group, SecFinex and Instinet Fixed Income Markets.

Tammy Phillips, formerly of Barclays Capital, was recently appointed CEO after joining SBL in January.

SBL's board also includes SBL CTO Alex Pilsworth and David Hardy, formerly head of market strategy at MF Global.

According to Fenichel, SBL aims to provide transaction and information services to the global capital markets industry.

Fenichel said: "We have seen a very positive response from the international stock borrowing and lending community to our pre-launch marketing. We believe the market is now at a pivotal point and is ready to accept a significant structural change which will allow direct interaction between participants, with all the benefits which will flow from such direct dealing."

"Clients of our Aquila Network will have access to a truly innovative means of arranging peer-to-peer securities lending transactions within a secure environment. Automating the process represents an effective, efficient and hugely cost-saving way forward for participants."

ICMA maps repo bond operations

ICMA has launched a free-to-read mapping directory for more than 80 technology solutions for repo and cash bond operations.

ICMA's Ops FinTech working group, which devised the report, directory, compared the capabilities of different providers across the market based on responses of practitioners who have extensive experience in collateral management and related areas.

The mapping directory is free to access via the association's website for the public.

The guide covers collateral management, corporate actions, exposure agreements, intraday liquidity, know-your-customer onboarding, matching, confirmation and allocation, static data and standard settlement instructions, workflow and communication and reconciliations.

Although ICMA considers the guide to be extensive it does not constitute an exhaustive list of providers in the market.

The mandate of ICMA's Ops FinTech Working Group (WG), which is a subgroup of the European Repo and Collateral Council is to develop a better understanding of existing tools and emerging financial technology solutions for collateral management and ancillary services.

Do you have a story we should cover?
Let us know via:
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The greater the challenge, the more important your partner.

GSIBS: Know your exits

Todd Zerega, partner at Washington-based law firm Perkins Coie, introduces the firm's new buy-side guide following the Fed's final rule on GSIB exposures

What's your involvement in securities lending?

I'm currently a partner in Perkins Coie's investment management team. I primarily advise clients on securities lending, repo, derivatives and other investment related activities. My client base is primarily the buy-side or end users, with smaller broker dealers and banks. I do not generally represent any of the global systemically important banks (GSIBs) or the global banks on their activities. Prior to that, I was part of Reed Smith's' Investment Management team for 12 years. I also worked in-house in the legal department at Federated Investors.

What is the final rule and how will it affect securities financing, specifically repo?

The main goal of the final rule is to facilitate the orderly resolution of GSIBs. To accomplish this, the Federal Reserve is seeking to limit the ability of the GSIBs trading counterparties to terminate their trades with a GSIB immediately upon the GSIB going into a resolution regime.

So they're concerned about a mass termination of trading agreements or contracts immediately upon the GSIB going into a resolution regime. In the US, the two main applicable resolution regimes are the Dodd-Frank Liquidation Authority, and the Federal Deposit Insurance Corporation's (FDIC) which are both similar. The final rule is really an effort to make sure that those regimes are enforced regardless of which court is involved in a proceeding seeking to enforce the terms of a trading agreement with the GSIB.

Specifically, there's concern that a foreign court could disregard the applicability of the resolution regimes in the US and ignore the stay requirements that are in those resolution regimes. In order to address the risk that foreign courts will ignore the statutory provisions, the final rule, in essence embedded the applicability of the regimes, and the associated stay requirements into trading agreements contracts. The affected contracts referred to in the final rule, known as 'qualified financial contracts' (QFCs), include repo and securities lending contracts.

Have you heard any feedback from the street on how this final version was received?

I have had several clients reach out to me on this issue. I know some of the trade groups are discussing issues in their committees. But I still feel like most of the street, at least on the buy side, are still digesting the rule and trying to plan out how it affects them. I have not seen much in the way of implementation. The key date is 1 January 2019 and I expect the GSIBs will seek to have their trading documentation amended by such date.

Are you surprised at the lack of activity on this so far, given the scale of the rule?

I think more education would be helpful, and certainly could not hurt, as it is a complex rule. When you add in the addition of having to understand the ISDA protocols it can be a tough lift for firms to get their arms around. Once a firm has an understanding of the rule and the ISDA protocols, it will have to survey its universe of trading agreements and catalog the agreements that will be required to be amended. Finally, they will have to consider whether they want to amend those agreements by entering into an ISDA protocol or by entering into bilateral amendments with their counterparties.

How do you envisage buy-side firms using this guide?

My colleague and I run a blog that is really geared to the buy side. But since it's a blog we try to provide short and concise guidance to our readers. So the guide that I wrote is not supposed to be an all encompassing summary of the final rule, but the goal of it is to succinctly outline what the final rule does and give our viewers an overview of it and what people can do to try and prepare for it. We expect to see implementation issues arise and I will probably have to amend the guide or write separate posts to address the implementation issues that I see the buy side encountering.

How does the final version of the rule differ from initial drafts?

The Federal Reserve did put in several helpful exemptions, that were not in the proposed rule. The most helpful being the one that states if for example, a repo agreement is subject to US law, and all parties to the agreement are incorporated or domiciled in the US and the agreement does not otherwise disclaim the applicability of the US resolution regime, then there's no requirement to amend your documentation.

The theory is that there's very little risk that such contracts will not be governed by the US resolution regimes. But in terms of repo counterparties what the Federal Reserve added was a helpful exception to the rule.

How will the final rule affect contractual default rights for QFCs, including repo and securities lending contracts?

The applicability of the FDIC and the Dodd-Frank regimes will now be contractually incorporated into repo and securities lending contracts. That is the main amendment we are talking about and includes the 48-hour stay on termination of such contracts upon the GSIB entering a resolution regime. That 48 hours is designed to give the US regulators the chance to move those contracts to a good bank.

There are also several prohibitions of what can't be in the trading agreements particularly with respect to certain cross default provisions that are tied to an affiliate of the GSIB entering into a bankruptcy or insolvency regime.

Additionally, applicable trading agreements as a general matter may not prohibit a credit enhancement, such as a guarantee, from being transferred in certain situations.

Can you expand on the scale of the re-papering job for banks going forward?

The final rule has a safe harbour for the ISDA Universal Protocol and the yet to be published US protocol which is a separate ISDA protocol. In essence, the Federal Reserve puts forth those protocols as a means to comply with the final rule.

My assumption is that, given the scale of a GSIBs trading agreements, they will likely want their counterparties to adhere to one of the two protocols and thereby amend their documentation to comply with the final rule.

The GSIBs have already adhered to the universal stay protocol, but most buy-side firms have not because that protocol is really designed to be a GSIB to GSIB protocol. My guess, and it's still early, is that US protocol may become the favoured protocol. **SLT**

> ***There's concern that a foreign court could disregard the applicability of the resolution regimes in the US and ignore the stay requirements that are in those resolution regimes***

Todd Zerega
Partner
Perkins Coie

When life gives you margin

The next implementation phase of the BCBS-IOSCO margin rules is on the horizon, and the buy side could use it as a springboard for long-term gain

The medley of regulatory frameworks currently slotting into place across financial markets make it easy to become absorbed in the pressure to meet a succession of deadlines, and to forget the fundamental reason these new initiatives are being enforced.

With so much going on, time is limited for crucial conversations that identify the opportunities arising and explore whether internal systems and processes are still fit-for-purpose.

One such regulation is the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commission (IOSCO) covering initial and variation margin requirements for non-centrally cleared derivatives.

Focusing on variation margin, daily exchange became mandatory for some major market participants on 1 September 2016, and for all other in-scope entities as of 1 March 2017. However, due to the complex logistical constraints in re-papering existing agreements, global regulators issued a 'no action relief' until 1 September 2017.

The next phase, scheduled for January 2018, will see foreign exchange (FX) forwards and swaps brought into scope, likely resulting in an exponential increase in the volume of margin calls. This not only places a strain on already-burgeoning workflows, but is also revealing worrying limitations of overburdened, siloed and often legacy technology, which is unable to support change effectively across the buy-side organisation.

Making lemonade

Mark Baker, product manager for collateral management at SimCorp, argues that the incoming margin rules present the buy side with a chance to change and integrate the technology infrastructure, front through back, and claim long-term business benefits that will ultimately affect the bottom line.

"BCBS-IOSCO margin rules mean that collateral management is no longer a periodic back-office function, the new regulation will continue to see it pervading into the front office's daily workflow," says Baker.

"The challenges in complying with this new front-to-back regulation, highlight the current limitations and siloed workings of many asset managers' technology and business infrastructures. If you're an asset manager and you do it right, compliance does not necessarily mean increased cost. There are overall performance benefits, which may have been previously overlooked, that will come into view, such as empowering the front office with crucial data that is often siloed away in the back-office domain, enhancing pricing, cash and securities forecasting and collateral optimisation."

Moving target

In a recent survey conducted by SimCorp and Asset Servicing Times, 60 percent of respondents admitted to not being fully ready for the BCBS-IOSCO regulation (see figure 1).

Commenting on the data, Baker notes: "This is unsurprising and certainly mirrors what we have heard from clients and the market at large. Back in March, there was a problem with physically re-papering agreements. The new regulation required updated agreements, but that challenge, for our customers at least, has now been addressed."

"What we are finding is that firms may have been prepared for the initial implementation, but this regulation has been far from static, hence, readiness is often difficult to define."

"What is clear is that the inclusion of FX forwards and swaps into the regulatory scope will significantly increase operational workflows and again puts the spotlight on examining existing operating models."

According to Baker, there are many reasons respondents may be yet to finalise their preparation for the BCBS-IOSCO regulation. Firstly, there are multiple facets to an end-state target operating model, which by their nature will take time to implement. Technology in this respect is both an element and an enabler of change.

Secondly, firms need to be cautious to ensure the change they are making is a long-term solution and not just a short-term fix, to safeguard against internal and external risks.

Those firms taking a truly front-to-back approach will not just be addressing automation and consolidating workflows concerning collateral management, but essentially optimising the entire front-to-back value chain.

Finally, when looking at margin exposure, the International Swaps and Derivatives Association (ISDA) Credit Support Annex (CSA) is just one of multiple margin call processes undertaken which will need to be optimised by the buy side.

When asked which margin exposure was largest, the ISDA CSA won out for 30 percent of survey respondents, followed by cleared OTC, exchange-traded derivatives, and repo, at just over 22 percent (see figure 2).

Unspecified margin exposure also claimed 22 percent of survey results, with global master securities lending agreements only being the largest exposure for just over 15 percent.

Operating model impacts

Baker divides the impact of the BCBS-IOSCO margin rules on the target operating model into first-order effects and second-order effects.

First and foremost, as of January 2018, buy-side participants must know their processes and underlying technology are sufficiently upgraded to allow them to easily scale processes for agreeing and exchanging margin, either via cash or securities collateral, in an efficient manner.

Adoption of electronic communication that enables automation of the margin call workflow is one example of the way in which both industry and technology are combining to facilitate this drive.

After that, there are second-order effects, as collateral moves up the buy-side value chain. This encompasses business users such as:

- Cash and securities managers, who require the ability to forecast potential margin calls and collateral eligibility and ensure access to the appropriate liquidity and collateral, either sourced internally, bilaterally or on a cleared basis;

- Risk managers, who must scrutinise and stress market data, liquidity, counterparty and concentration risks into investment and collateral portfolios, including haircuts;

Have you completed preparation for BCBS/IOSCO regulation?

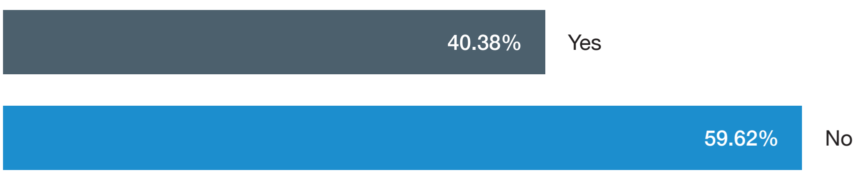

figure 1

What aspects of the target operating model does your firm find most challenging?

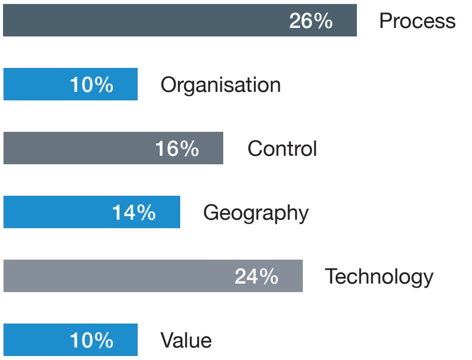

figure 3

- Execution traders, who will require additional analytics as simplistic transaction cost analysis measures may no longer meet updated definitions of best execution; and
- Portfolio managers, who require updated pricing models and forecasts of lifetime trade cost to be incorporated into optimal investment strategies.

The survey also quizzed respondents on which aspects of their collateral management operating model they found most challenging, with decidedly mixed results.

The data revealed that internal processes created the biggest hurdles, with 26 percent of the vote, followed closely by technology with 24 percent (see figure 3).

Of the remaining responses, 16 percent opted for control, 14 percent chose geography, and value and organisation were selected by 10 percent apiece. According to Baker, the responses “reflect the multi-faceted nature of potential changes to desired target operating models”.

Near-term limitations

The issues of process and technology are inevitably intertwined, and an effective solution to the collateral puzzle requires an adept focus on both. The most effective technology solution will only be as effective as the processes in place to utilise it.

According to SimCorp, an effective collateral management system will adopt automation to alleviate pressure, while also bringing a full front-to-back workflow to process data and manage margins.

Some buy-side firms appear to be cognisant and proactive on this issue, however, there is a risk that a number are behind the curb, and hence in danger of hitting rough conditions as margin call volumes continue to rise in 2018 and beyond.

Of survey respondents, 41 percent described manual workflows and the lack of automation in margin call processing as their biggest pain point around collateral management (see figure 4).

In fact, issues with automation were the most unifying issue of all surveyed areas of the industry, with the clearest majority in all areas.

Reassuringly, Baker says: “The overall process has evolved, and we are now dealing with some clients on a holistic front-through-back process. It represents a very different workflow for our buy-side clients than we were seeing even as recently as a year ago.”

“From an operations standpoint, our system is looking to automate as much as possible, from optimisation calculations to communications between counterparties. However, for organisational reasons, some processes outside of our system, especially notification flow, stubbornly sit in the manual column.”

To buy or build

In financial markets around the world, the buying-versus-building technology debate has tipped slowly but surely in favour of vendor solutions. For many, it comes down to a question of cost and control.

Market trends and regulatory requirements are increasingly demanding transparency and governance of investment data. With many firms expressing concern over outsourcing of data, and only

What are your primary pain points around collateral management?

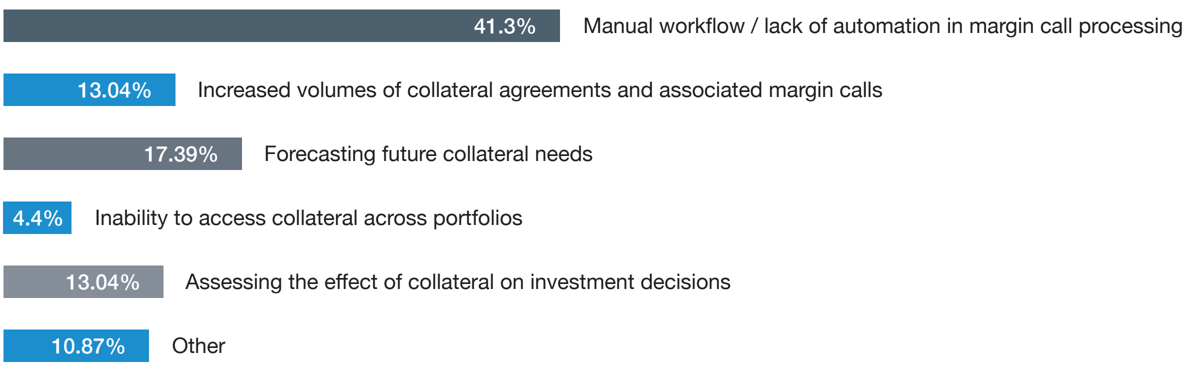

figure 4


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Those firms taking a truly front-to-back approach will not just be addressing automation and consolidating workflows concerning collateral management, but essentially optimising the entire front-to-back value chain

What system / tools do you currently use to manage the collateral process?

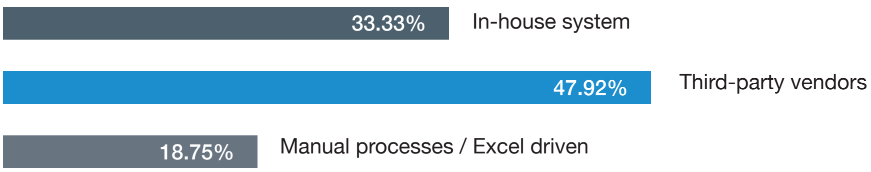

figure 5

the largest entities able to build systems in-house, vendor-deployed solutions are looking increasingly attractive.

As it stands, according to the survey, 48 percent of respondents currently access a vendor stack solution, while 33 percent build internally and 19 percent have trundled along with Excel-driven manual processes (see figure 5).

“Overall, we would expect third-party vendors to have the slight edge in the market split,” says Baker.

“Going forward, manual-only processes will be simply unsustainable. Outsourcing will also see a decline, as we continue to hear many firms express concern over lack of timeliness and control of data.”

“I would also question whether in-house builds are truly scalable and cost-efficient in the long run, and whether they are able to maintain and upgrade the technology in the same way a vendor can.”

Beyond the initial need to find a solution to new market challenges, savvy businesses will also have a view to maintaining a wider strategy to ensure seamless processing of transactions throughout their systems. The danger of utilising a patchwork of in-house and outsourced systems is the creation of a network that is unable to communicate effectively. SimCorp argues that pulling all collateral management processes under a single umbrella is the only way to ensure an efficient workflow.

Baker concludes: “The results all point to the need for greater automation and, ultimately, consolidation that allows front and back offices to be unified, for the best way to counteract this issue and future regulations.”

“By making this operational shift, firms are not only complying, but creating opportunities to optimise investment and collateral allocation decisions in one system for both pre- and post-trade success.” **SLT**

How do you calculate initial margin?

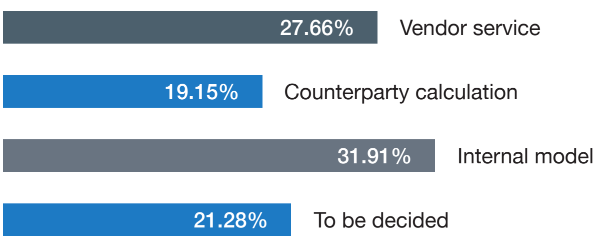

figure 6

The times, they are a-changin'

David Lewis of FIS Astec Analytics takes a look at how the industry has evolved over the past year, and analyses the inflection point we're at

Traditionally, this is the time of the year for looking back to review what has been done, as well as looking forward to what is yet to come. It is fair to say that our securities finance industry is certainly going through a period of review and renewal, yet again changing and adapting to the environment around it, an environment that seems to be changing at an ever more rapid pace.

The start of the new year will be dominated by the second Markets in Financial Instruments Directive/Regulation (MiFID II/MiFIR) and all the new obligations for prudential behaviour, reporting and transparency as well as the mandated use of legal entity identifier (LEI) codes, to name just one of the infrastructural changes. The new standards around best execution policies will demand ever more stringent controls over the transaction chain, demanding evidential proof that the right decisions were made, by the right person at the right time. Systems have been adapted to record ever greater levels of detailed information, supporting traceability and, therefore ultimately, accountability at a personal level for the actions taken. These changes are there, of course, to benefit and protect the client, the end investor and their money. This is a laudable endeavor for sure, but, as with many such regulations, the costs and process frictions they introduce risk damaging the returns that very investor is demanding.

With MiFID II soon to be up and running, the resources and attention are shifting to one of the other great changes and challenges our industry faces: the Securities Financing Transactions Regulation (SFTR). At the time of writing, the final technical standards remain under review by the European Commission, awaiting a final stamp from them and then the European Parliament. Timeline wise, this means we are all expecting the effective date for this new reporting regulation to be somewhere between the latter part of the first quarter in 2019 and the start of the second.

The ripple effect we have noticed, arising from SFTR, is quite striking. Having been involved as part of the FSB Data Experts Group from the very start, witnessing the development of the data requirement and then the spread of understanding across the market has been fascinating. Recently, this has been most apparent with the global spread of what is, with regards to SFTR, a European regulation. Over the past six months, we, at FIS, have seen a clear ramp up in interest from our non-European clients. Across Asia and North America, counterparts are beginning to focus on what they need to do in order to continue to trade with European entities subject to SFTR, and this process will roll onwards to include their own jurisdictions' response to the Financial Stability Board (FSB) Transparency Directive and their plans to implement it in due course.

Any new regulatory requirement can be seen as a cost, but it should also be seen as an opportunity. The securities finance industry has a long history of adaptation and innovation, enabling it to morph from a back-office settlement management process into a central collateral management and financing operation, key to almost every type of market participant. In order for that process of adaptation to continue to keep pace with the environment, we, as an industry, will have to move even faster than before.

The implementation of MiFID II will increase the use of LEI codes; observers from outside our market express wonder at how such a simple and obvious improvement has not been more widely adopted prior to a regulatory demand for it. With just six weeks to go before all trading entities mandatorily have an LEI to be able to trade, huge gaps still exist with regards to code adoption.

SFTR will do the same for LEI adoption across securities finance, but it has also opened up much more detailed discussions and examinations about the way our industry functions. Whether or not that is an intended or unintended consequence of what is, in reality 'just' a reporting regulation is open to debate in the same way that some commentators have suggested a 'regulatory plateau' is on the horizon, while others expect that the vast quantities of data being gathered across the markets will undoubtedly lead to new laws being put in place.

The differentiation between disclosed and undisclosed lenders and how these will be managed once SFTR comes into effect is being examined. Underlying lender disclosure is likely to edge closer toward the point of trade, with the suggestion that clients are grouped into differing credit qualities or approval levels to allow the parties to match clients with the economics of the trade. This may well, of course, create challenges under the best execution policies required under MIFID II and does bring to mind an announcement this week from British Airways, suggesting they will board passengers according to the price of their tickets, creating an unsurprising response from their market.

New technological capabilities will help of course, with ever faster data and analytics increasing the speed of trading and decision-making, as well as compliance management. UCL, for example, is developing smart contracts to verify compliance with the UK's Financial Conduct Authority Rulebook, which are already beating human counterparts on response times and accuracy. In securities finance, new systems are being launched including peer-to-peer platforms, potentially disintermediating certain aspects of the existing transaction chain, and banks are looking at increased automation of simple trades that don't require human interaction at all.

Our industry stands at an inflection point, where new challenges demand ever greater investments in technology, infrastructure and automation. These all come at a cost, of course, but the cost of not investing in change and not adapting to the environment will be much, much greater. **SLT**

David Lewis
Senior vice president
FIS

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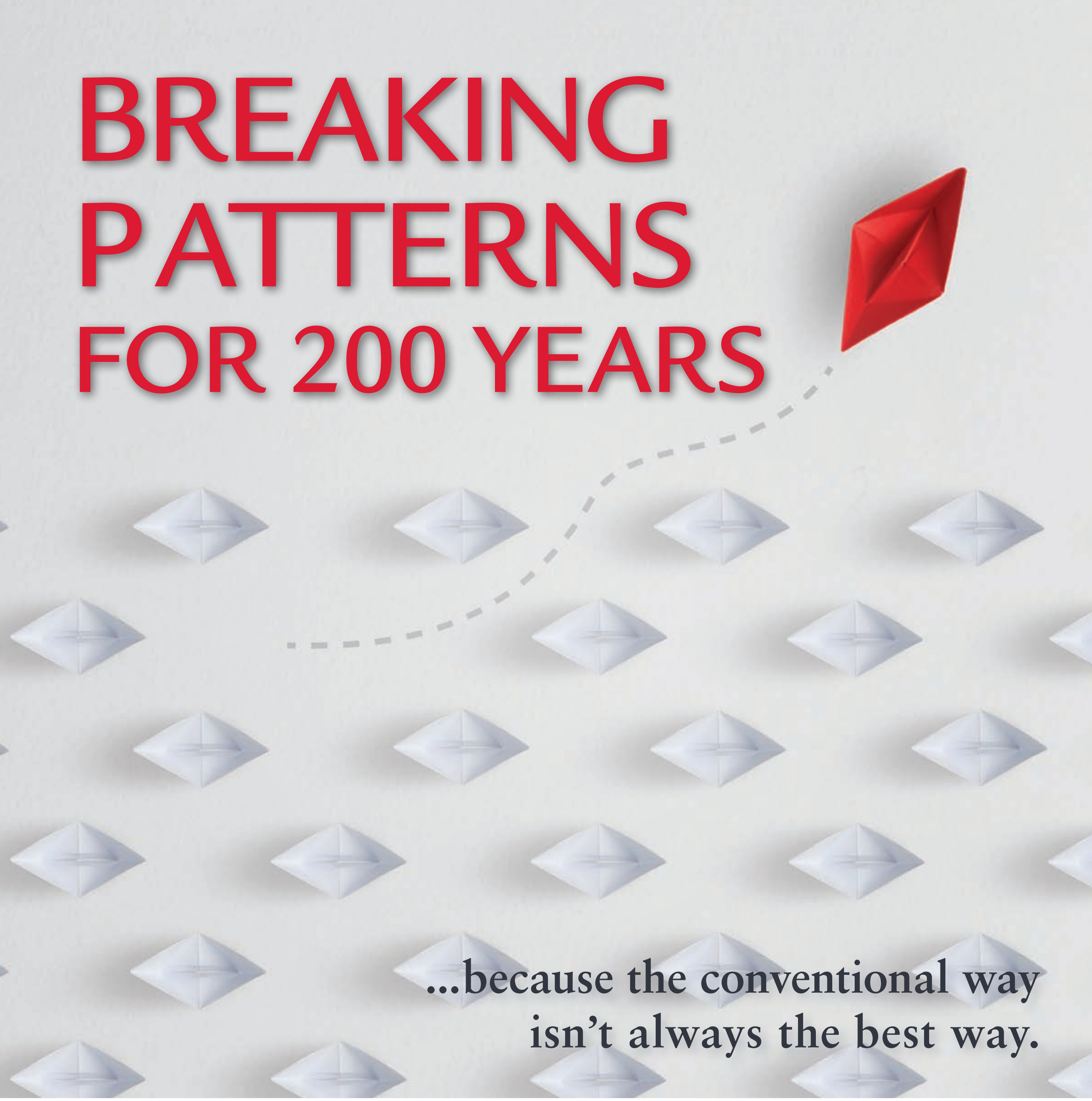
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isn't always the best way.

Comings and goings at Deutsche Bank, Deutsche Boerse, HSBC, and more

Deutsche Bank has appointed Kallinda Taplin to the securities lending operations team.

In her new role, Taplin will report to Daniel Casley, head of global prime finance operations for Europe, the Middle East and Africa.

Taplin returns to Deutsche Bank after working for the bank between 2008 and 2013 as head of securities lending, and 2013 to 2015 as manager of operations.

In her most recent role, she served as global head of prime services at Saxo Capital Markets, based in the firm's UK office.

Deutsche Boerse's head of Eurex and Clearstream, Jeffrey Tessler, has had his contract extended by another year by Deutsche Boerse AG's Supervisory Board.

Tessler is responsible for clients, products and core markets for the two business segments. Eurex and Clearstream boast the highest revenues within the group, according to Deutsche Boerse.

Tessler took on his current role in January 2016 as part of an extensive reshuffle of board member responsibilities aimed at bundling related areas of the business into single portfolios.

Previously, Tessler was responsible for the group's settlement and custody business.

Deutsche Boerse AG's Supervisory Board also confirmed the appointment of UniCredit's Theodor Weimer as Deutsche Boerse CEO.

Weimer will begin his new role, which is set for a three-year term, in January to replace Carsten Kengeter, who will leave Deutsche Boerse at the end of 2017.

At UniCredit, Weimer has been spokesman of the management board of HypoVereinsbank at UniCredit Bank AG since 2009.

Weimer joined the bank in 2007 as UniCredit Group's head of global investment banking, based in Munich.

Alongside Tressler, the board also voted to extend the contract of Andreas Preuss as deputy CEO. Preuss is responsible for IT, operations, the data business and the subsidiaries EEX and 360T.

Joachim Faber, chairman of the board, said: "By appointing Theodor Weimer and extending the contracts of Andreas Preuss and Jeffrey Tessler, it is possible to give the company new impetus on the one hand and ensure the necessary continuity in the work of the Executive Board on the other hand."

Kengeter decided to step down as CEO last month amid an ongoing investigation into insider trading activity.

At the time, Deutsche Boerse said he had taken the decision to allow the firm to focus on business, clients and growth, and to avoid further burdens caused by the ongoing investigation.

Credit Suisse has appointed Gerry Milligan as head of electronic products for the Americas.

Based in New York, Milligan will start his role in January 2018 and will report to Anthony Abenante, managing director of global markets.

Prior to Credit Suisse, Milligan spent 10 years at Instinet where he was head of programme and electronic trading services for the Americas.

Pirum Systems has appointed Peter Lane as a business support specialist for securities financing.

Lane was previously part of the securities finance and collateral management team at Maple Securities for more than 16 years, working with market participants to execute repo trades.

Prior to Maple Securities, Lane worked at Kleinwort Benson as part of the investment management team.

Phillip Morgan, chief commercial officer at Pirum, said: "Pirum is excited to announce Peter Lane as the latest addition to the team."

"[He] will be responsible for client service and brings with him a wealth of experience garnered over 20 years in the industry."

"He will be assisting in the delivery of our SFTR, collateral connect and contract compare products."

Jos Dijsselhof has been appointed new CEO of SIX, as part of a wider strategic and organisational change to securities services.

Beginning in January 2018, Dijsselhof will replace Urs Rüegsegger, who announced he would be stepping down in May.

Prior to SIX, Dijsselhof has been Group COO for Euronext in Amsterdam since July 2014.

He has also held positions at ABN Amro Bank, Royal Bank of Scotland and ANZ Australia and New Zealand Banking Group in various markets, including Hong Kong and Singapore.

Dijsselhof will oversee a major restructuring of SIX operations, including a realignment of its securities financing, which will see a bundling of all activities in the securities businesses under one unit.

SIX plans to merge exchange trading and post-trading areas into one organisational unit, among other changes.

Jane Karczewski has left her position as managing director of strategic risk solutions at Citi, and is set to join HSBC as head of global custody.

Karczewski has been with Citi since October 2010, joining as managing director and head of equity finance sales for Europe, the Middle East and Africa, and becoming managing director of strategic risk solutions in April 2015. She was also co-chair of Citi Women.

Before this, she spent time at Deutsche Bank and Morgan Stanley.

Karczewski currently sits on the board of directors of the London Women's Forum, and has previously held the chair position.

In her new role, starting in January, she will report to John Van Verre, global head of custody at HSBC.

Citi and HSBC each confirmed the move, but both declined to comment further.

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