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US Panel

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Central bank lending saves EU year-end repo

The improved securities lending programmes of EU national central banks (NCBs) have been praised by the industry as a crucial antidote to year-end liquidity woes last month, according to the International Capital Market Association (ICMA).

In its first market report on the EU repo market for 2018, ICMA commented: "One of the notable changes since the end of 2016 is the improvement in the various European Central Bank (ECB) and NCB lending facilities, which has made it easier, and more incentivised, for banks to borrow bonds bought up in the public sector purchase programme (PSPP)."

"In particular, a number of market participants have commented on the improved accessibility of the Bundesbank's lending facility."

ICMA added: "While total borrowing levels had remained relatively stable in the lead-up to year-end, it has been suggested that the December numbers, when published later in January 2018, should see a large increase, and most likely being driven by increased borrowing of German and French bonds."

According to ICMA, as part of its survey for the report one dealer commented that "the main market issue with the lending facilities is the counterparty credit lines of the NCBs, in particular the Bundesbank and Banque de France, and that this is potentially becoming the main constraint to utilising the facility".

ICMA added: "It has been suggested that credit line constraints could have been one of the contributing factors that saw French specials tighten so aggressively."

Along with the improved securities lending programmes, ICMA also attributed the avoidance of a repeat of 2016's year-end liquidity crunch to market positioning, specifically, fewer open shorts in sovereign (mainly German) bonds and a break-down in the correlation between repo rates and the cross-currency basis, which ICMA noted had normalised by late December.

At the same time, there was a greater awareness of the liquidity risk posed by the new post-PSPP market landscape, and a subsequent improvement in preparation.

ICMA highlighted that firms were understood to be focusing on their potential year-end fund needs as early as September and October, and, "where possible, paid-up to lock-in for term over year-end, rather than rolling day-to-day".

"Meanwhile, it has been suggested that this time many buy-side holders of bonds had been reluctant to lend too far in advance of year-end, fearing that they would miss the potential exaggerated lending levels of the previous year, which in turn meant that there was more supply as year-end approached," ICMA added. **Continued on page 6**

Contents

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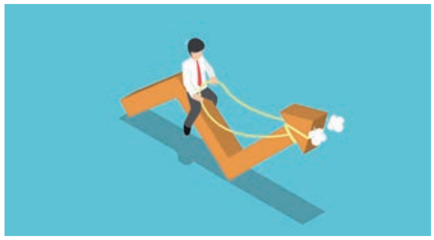


Central bank lending saves EU year-end repo

Continued from page 3

Commenting on the report's findings, Godfried De Vidts, chair of ICMA's European Repo and Collateral Council (ERCC) said: "This update on year-end pressure on the repo market contributes to the overall mission of the ERCC, which strives to ensure that market participants can finance the real economy as effectively as possible."

"The ERCC's semi-annual repo survey shows trends; enhancing market infrastructure issues has always been high on the agenda; and the legal robustness and protection afforded by the global master repo agreement is core to the well being of the international repo market."

German investment tax guidance overhaul is imminent, says ISLA

The Ministry of Finance of Germany (BMF) has confirmed that a revised draft of the the German Investment Tax Act (GITA 2018) guidance notes is due within 10 days, according to the International Securities Lending Association (ISLA).

EY spokespersons, acting on behalf of ISLA during the discussions, stated that it had been verbally confirmed that "the tax base for securities finance transactions will be capped at the level of the underlying gross dividend".

This means that where a manufactured dividend is paid on the basis of a regular lending agreement, then fees do not need to be taxed.

The wording aims to prevent counterparts agreeing to reduce or eliminate the taxable manufactured dividend and increase the non-taxable fee instead.

The German ministry also made clear that a foreign borrower couldn't "act as a withholding agent for tax by another party". This means the recipients of income including borrowers and lenders are taxable.

Although, the ministry might allow the lender and borrower to agree who collected the tax, this would be covered in an addendum to the GMSLA.

ISLA submitted a letter on 5 December to the German Ministry of Finance asking for further clarification and expressing industry concerns around GITA 2018.

The association stated: "Due to a lack of clear understanding across the industry, lenders may determine that the risk of lending securities is no longer low and therefore will withdraw from the market, rather than accept a higher level of risk or uncertainty."

With the latest clarification, work on a market standard German Tax Addendum from ISLA's side has been suspended and will only resume if there is a requirement to do so once the circular has been published.

ISLA confirmed it would continue to submit requests to the BMF for further clarification, where needed.

US class action lawsuit opens door to blockchain lending

Blockchain is the answer to flaws in today's securities lending market that motivated several US pensions funds to sue their agent lenders for malpractice, according to Lendingblock founder Steve Swain.

Swain has argued that innovations such as Lendingblock, a cryptocurrency and crypto-asset lending platform, "creates a parallel where those problems can't arise".

The blockchain startup is currently looking to raise $10 million with an initial coin offering (ICO) ahead of its projected launch in the third quarter of the year.

Lendingblock's primary target users are securities lending participants interested in trading with crypto assets.

Before launching, Lendingblock will hold a pre-sale in late February, followed by a crowd sale in early March.

Swain added: "We are building the equivalent to securities lending but for crypto assets, rather than moving into the existing securities lending market."

As part of the US class action lawsuit, the plaintiffs allege the existence of systematic

Lombard Risk share prices soars after Vermeg takeover offer

Dutch financial software provider Vermeg has set its sights on acquiring Lombard Risk with a £52.08 million cash-for-shares offer.

Under the offer of Vermeg, Lombard Risk shareholders will receive 13 pence for each ordinary share.

Lombard Risk's board stated that it considered the terms of the acquisition to be "fair and reasonable".

The takeover news has driven up the compliance software company's stock price to 12.5 pence from 6.55 pence as of 10 January.

Badreddine Ouali, founder and chair of Vermeg, said: "Vermeg's acquisition of Lombard Risk will create a leading global financial software provider, with the scale and network to service an increasingly global and consolidating customer base."

"With highly complementary offerings and minimal overlap regarding geographies and product portfolio, the combination provides a strong platform for future growth and value creation."

Philip Crawford, chair of Lombard Risk, said: "The combination of Vermeg and Lombard Risk has very strong commercial logic."

"The combined group will benefit from a range of complementary products and solutions, increased scale, a broader international presence and have the ability to accelerate growth through investment and wider routes to market."

suppression of free market development by the defendants, which include Morgan Stanley, J.P. Morgan, Bank of America, Credit Suisse, and UBS, between 2009 and 2016.

According to the complaint, the defendants formed a cabal in order to maintain high fees for their securities lending services by boycotting start-up lending platforms and threatening clients to do the same.

Blockchain advocates also point to issues with market transparency, price discovery, and accidental over-issue of securities, as key issues in the securities lending market that could be solved by the introduction of blockchain.

Lendingblock is one of several blockchain-powered lending platforms that are looking to disrupt the status quo of the securities lending market.

Patrick Byrne, the outspoken CEO of blockchain trading solution tZero, is also looking to utilise discontent among beneficial owners to undermine the current agent lender-beneficial owner dynamic by offering direct lending to lenders that traditionally relied on custodians.

Byrne also blamed the alleged over-supply of securities for lending by banks for rampant naked short selling prior to the financial crash.

Speaking at Money20/20 in Las Vegas in October last year, Byrne said: "They [the pension funds] figured out that they have been looted to the tune of about 2 to 3 percent per year ... by that craziness in the system."

Bryne claimed that Overstock's blockchain portfolio company tZero will soon conduct a market raid on the war chest of lending revenue of prime brokers by offering pension funds a 80/20 earning split via a blockchain solution.

Kenyan short selling and lending framework gets the green light

Kenya's Capital Markets Authority (CMA) has given the green light to the Nairobi Stock Exchange (NSE) to launch a short selling and supporting securities lending facility.

The short selling facility is expected to boost liquidity in the Kenyan capital market and also attract investors.

Although progress was made to develop a securities lending and short selling infrastructure in 2017, no specific timeline has been offered on when trading will be available.

The move was driven by recommendation of a 2015 World Bank study on the state of liquidity in Kenya that proposed several measures to improve liquidity, including the introduction of securities lending.

Paul Muthaura, CEO at CMA, said: "Making the Kenyan capital markets highly vibrant and liquid is a key priority for the capital markets industry and the securities lending, borrowing and short-selling regulations are expected to facilitate this."

Some of the elements of the World Bank report were the introduction of market makers, removal of pre-funding and pre-validation checks, the launch of circuit breakers instead of price bands, securities lending and short selling.

Muthaura explained that in the pursuit of this mandate, CMA has been implementing regulatory reforms as well as introducing new products and services aimed at deepening, diversifying and strengthening the securities industry.

BlackRock achieves securities lending revenue rise in Q4 2017

BlackRock's securities lending revenue for Q4 2017 exceeded the previous year's quarterly total by $12 million.

The world largest asset manager recorded $150 million last quarter, up from $138 billion in Q4 2016.

As a business group, the investment advisory, administration fees and securities lending revenue increased $410 million from the fourth quarter of 2016, reflecting the impact of higher markets and organic growth on average assets under management (AUM).

The combined investment advisory, administration fees and securities lending

revenue were boosted by a $104 million gain from the third quarter of 2017.

Laurence Fink, chair and CEO of BlackRock, said: "Some $367 billion of total net inflows for the year were the strongest flows in BlackRock's history, and included $103 billion in the fourth quarter."

"BlackRock's record 2017 results reflect the long-term investments we've consistently made in our business to better serve clients."

ESMA reviews short selling

Bans on short selling should instead only stop further increasing of net short positions, according to the European Securities and Markets Authority (ESMA) in its latest short selling regulation (SSR) release.

As part of its final technical advice the EU Commission, ESMA outlined amendments to SSR on the exemption for market making activities, short selling bans and the transparency of net short positions.

In terms of market making activities, ESMA suggests the EU Commission changes the definition of market making activities to include the different types of on-venue market making activities, described in the second Markets In Financial Instruments Directive.

On the reporting of short positions, ESMA pushed for a centralised notification and publication system across Europe.

ESMA said by proposing these amendments, it hopes SSR will achieve greater coordination and consistency between member states and will improve overall "relevance, effectiveness, coherence, and efficiency" in short selling.

The authority emphasised the limited feedback it received to the consultation paper — only 20 public responses were submitted.

The number of responses was significantly lower than in previous consultations.

ESMA received 43 responses to its 2013 technical advice consultation and 35 responses on a separate consultation on the ESMA's final report on the exemption for market making activities and primary market operations, also released in 2013.

Securities lending invaluable to insurers

"The securities financing transactions (SFTs) market benefits from insurers and insurers benefit from the SFT market", according to Richard Hochreutiner, head of global collateral at the Swiss Re Group.

Contributing to the International Capital Market Association's (ICMA) first quarter report of 2018, Hochreutiner added that "insurers are watching the developments in the SFT market closely, and strongly welcome all efforts that benefit market depth, collateral fluidity and liquidity".

In the report, Hochreutiner quoted an International Securities Lending Association (ISLA) survey that found between 5 percent and 6 percent of the global market for SFTs is estimated to be attributable to the insurance industry.

He said that percentage included securities lending and repos, but claimed the actual participation may be even higher.

In the report, Hochreutiner concentrated on risk reduction, yield enhancement and collateral.

Hochreutiner said: "Using collateral transformation transactions allows insurers to convert securities."

"SFTs – in this case SBL – is a highly efficient way to temporarily convert securities into other securities, without incurring significant changes in asset allocation and the related transaction costs."

Though he warned: "Should the SFT market no longer allow for efficient collateral transformation, insurers would be forced to adapt the way they invest [...] the impact of which will be a reduced return on investment for client and insurer alike."

Hochreutiner also said that yield, especially yield generated at marginal additional risk, is "particularly welcome on saving products with their long-term investment horizon."

He claimed that insurers in particular appreciate and abide by the legal frameworks in terms of securities lending and borrowing transactions, which is outlined in ISLA's global master securities lending agreement.

tZero to accept KodakCoin

tZero has selected KodakCoin as the first third-party cryptocurrency to include on its soon-to-launch security token platform.

The cryptocurrency will be introduced later this quarter and will bolster the recently announced KodakOne digital imagery platform.

tZero will also provide end-to-end advisory services, technology implementation and trading services for KodakCoin.

The Overstock's subsidiary offers encryption of accounts, price quoting, clearing and reconciliation services, and anti-money laundering and know-your-customer verification solutions.

Patrick Byrne, CEO of tZero, said: "As US regulators seek securities-law compliant applications for companies issuing security tokens, the issuance and trading of KodakCoin in compliance with securities laws will empower entrepreneurs and protect photographers' property and licensing rights, while achieving another critical step in defining a new wave of digital capital formation."

Building momentum in 2018

Securities financing experts analyse some of the key issues likely to affect the market in 2018 and what they feel beneficial owners need to focus on

Are you positive or negative about the prospects of the securities lending market this year?

Peter Bassler: We are optimists. We see a robust pipeline of potential request for proposals, as well as new entrants into the marketplace. Although US equity returns were challenged in 2017, we are hopeful that at some stage, we will see volatility return, which will translate into a broader specials market to drive lending returns. Generally, we want an upward stock market with good volatility, and all we have seen over the last few years is a strong stock market with little volatility.

This is likely to change at some point, and that should bring equity lending returns back up to a normalised level. Additionally, changing market dynamics for collateral is leading to further engagement with clients. We see collateral flexibility as key to optimising returns. Beneficial owners are embracing this and rethinking their parameters and guidelines.

Robert Chiuch: I'm also positive. Financial firms' balance sheets are in better shape to enable growth of their financing activities. The confluence of a steepening yield curve, the potential for favourable regulatory revisions relating to securities finance, changes in US tax policy that may provoke more corporate action activity and signs of growing strength in global economies, could all generate favourable trade winds. This may promote a return to more conventional markets and a general increase in hedging/shorting activity and other securities finance-related services. The prospect of higher balances due not only to higher valuations but, also, faster growth in volumes, will be a positive thing.

James Gerspach: The continued evolution in the regulatory environment and ongoing market rally presents challenges to securities lending and financing. Market participants are exploring new avenues of distribution, broader collateral types, better technology and multiple other initiatives that are aimed at increased lending activity and efficiencies. These and other efforts should create opportunities for expansion and increased performance as we move through 2018.

Joseph Santoro: We are extremely positive about the prospects for the global securities lending market this year. The steady improvement of the worldwide economies, as well as the low interest rate environment, should have investors looking to the global equities market for better returns. We also expect the worldwide demand for high-quality liquid assets (HQLA) to continue providing a consistent source of revenue for those holders.

The passage of new tax legislation, along with other growth-oriented economic policies in the US is a windfall for corporate earrings driving the business environment and financial markets in a more positive direction. Many US corporate and private equity executives surveyed expect an acceleration of merger and acquisition (M&A) activity in 2018, both in the number of deals and the size of transactions. While uncertainty remains regarding some aspects of Brexit, we may see more M&A activity in the UK and Europe as businesses position themselves for the change. Ideally, we hope this leads to amplified demand for specials, as well as HQLA.

Michael Saunders: At BNP Paribas, we anticipate that a variety of factors, driven by increased market volatility, will result in opportunities for our programme participants in 2018. The normalisation of the Federal Reserve's balance sheet, combined with the continued rate tightening cycle, should cause a return to volatility for both the fixed income and equity markets this year. Certainly, geopolitical pressures, which should not be underestimated, will also drive volatility.

Additionally, we believe the themes of pressure on the retail sector due to the 'Amazon effect', along with weakness in the commodity sector seen last year, will carry over well into 2018.

We also expect the insatiable demand for high-quality liquid assets to remain robust, leading to market opportunities for participants that are willing to engage in collateral transformation transactions.

Finally, with tax reform now completed, record levels of corporate cash will continue to lead to increased merger and acquisition activity, translating into opportunities.

Francesco Squillacioti: I am positive. On the one hand, I feel like, if nothing else, given the dearth of specials last year, something has to give in 2018. That said, my team is finding ways to capitalise on opportunities, even if the dearth continues. I also feel like we have done a great job working with our client base, and their interest level in engaging in or expanding securities lending mandates is quite high.

George Trapp: At Northern Trust, we are positive about the prospects of the securities lending market in 2018. Last year, we continued to generate incremental income for clients despite several headwinds including increased regulation, lower market volatility and rising interest rates. Some of those themes will carry forward to 2018. We will continue discussing the securities lending market with prospects and clients to help ensure their programmes meet their risk and return objectives. We expect that the securities lending market will continue to be favourable to our clients throughout the year.

> ***For beneficial owners the first order of business should be to do a careful review of their acceptable collateral profile to ensure optimal participation***
>
> **Robert Chiuch**
> Global head of equity and fixed income finance trading, BNY Mellon Markets

Matt Wolfe: Positive. We have experienced continued growth over the last several years. In 2017, cleared stock loan volume at OCC was up 22 percent from 2016's figure. We expect to see that continue in 2018 as we work to enhance our programme and add participants. Some of the enhancements we are working on include product enhancements as well as expanding OCC's membership criteria to support a broader set of lenders.

It seems that the investments made across the industry in order to better understand and manage the capital and balance sheet costs of transactions are showing benefits. It also appears that the industry has adapted to regulatory changes and is now better positioned to understand and identify opportunities. Hopefully that will translate to increased balance sheet allocations and innovative counterparty decisions that will increase both rates and utilisation.

What should be top of the list of concerns for beneficial owners in 2018?

Trapp: We continue to react to changes in borrower demand as a result of the borrowers needs to comply with various regulations. Clients should consider whether to accept a broader range of collateral given the continued demand from borrowers for loans against non-cash collateral. We expect borrowers to put greater emphasis on differentiating client types on certain transactions due to regulatory reasons.

> ***Borrowers have become increasingly focused on the principals they borrow from in securities lending transactions, with a move towards borrowing from the most capital efficient lender types***
>
> **George Trapp**
> Senior vice president, head of client services North America, Northern Trust

Borrowers have become increasingly focused on the principals they borrow from in securities lending transactions, with a move towards borrowing from the most capital efficient lender types. These include principals with low capital requirements, entities that are optimal counterparties as relates to certain measures like net stable funding ratio (NSFR) and those principals where legal enforceability of netting can be determined. Additionally, borrowers are looking for this information to be available on a pre-trade basis in the future.

Squillacioti: I think a theme this year, and recent years in general, is flexibility. Clearly, non-cash activity has been growing and doesn't seem like it will slow. At the same time, rates are rising, creating new opportunities for cash reinvestment. I think beneficial owners should make sure that they are able to take advantage of both.

Chiuch: For beneficial owners participating in securities lending, the first order of business should be to do a careful review of their acceptable collateral profile to ensure optimal participation in light of the entity's relevant eligibility prescriptions. Cash will once again come into favour and the ratio of cash to non-cash collateral may need to be reconsidered by borrowers.

The absence of intrinsic specials demand (low VIX readings and gradual rise in rates) will likely compress spreads which could result in higher balances and lower profitability. While compressed spreads will remain a theme for 2018, agile lenders with flexible collateral schedules that appropriately consider cash and non-cash collateral will generally outperform their peers in generating higher total earnings even with, albeit, conservative cash spreads.

Bassler: Collateral guidelines and understanding the new market dynamics as it relates to collateral and borrower preferences is crucial in today's market environment. Non-cash in the US market has increased across most lending agents and different borrowers will be looking for greater collateral flexibility as they prioritise who they borrow securities from in this enhanced regulatory environment.

This requires dialogue with your agent to understand risk and return trade-offs and showing collateral flexibility will go a long way towards optimising revenue for investor portfolios. Additionally, for non-cash collateral, understanding the account structure at the triparty agent is also important. A beneficial owner should look for arrangements where they have a segregated account with their specific approved collateral schedule. Commingled accounts for triparty collateral can lead to complications in a market stress situation.

Indemnification also continues to be a hot topic. Many feared that agents would strip them of this protection or raise fees. We have not seen that as overtly over the past few years. However, the large bank agents do have an increased cost due to new regulations, and that means they must adjust trading behaviours to meet profitability hurdles. In cases where they haven't taken away the indemnity or charged more in the way of fees, we are seeing some firms change lending patterns or collateral preferences that favour the bank's capital treatment. This may or may not be in the client's best interests, and we encourage beneficial owners to inquire about how increased indemnity costs will affect their agent and their programme specifically. Just because they continue to indemnify at the same fees doesn't mean your programme is unaffected. As an example, if you are a general collateral lender, this may be an area where your agent is cutting back due to indemnity costs.

Turning to new markets, the dividend yield enhancement markets in Europe have seen declining returns for many years. With this as the new norm, Asia has become a larger focus in terms of revenue generation. Markets such as Taiwan and Malaysia can be highly attractive from a revenue perspective so long as you and your agent understand the operational and legal complexities and what is necessary from an infrastructure and risk protection perspective. Additionally, we opened lending in Russia and are increasingly looking at new markets such as India, Indonesia, the Philippines and a few Middle Eastern countries.

New markets require attention and understanding and are a strong space to find new areas to extract value. Early entrants who understand the dynamics will benefit before the market becomes mature.

Gerspach: Beneficial owners need to recognise continuations of trends evident in 2017. We expect that borrowers will continue to allocate business based on a number of variables, including availability, counterparty credit, collateral flexibility and cost-minimisation. In 2017, US borrowers moved a significant portion of their US equity short positions to offshore entities, due to stricter capital rules for their US entities. They also continued to expand their use of non-US, non-cash collateral. Both trends are expected to continue in 2018.

> ***Agents and beneficial owners need to have open and frank discussions around what the indemnification actually covers, the costs of this default indemnification and the scope of risks covered in their specific programmes***
>
> **James Gerspach**
> Executive director, agent lending
> J.P. Morgan

Beneficial owners should continue to understand the risk and control framework employed by their lending agents as the market environment continues to evolve. New trades, collateral categories and counterparties will create an increasing necessity for oversight and interaction between lenders and their agents. Lenders should work with their agents to discuss programme structures, markets and trade opportunities to explore the potential financial benefits to them, and what risks exist in them.

Saunders: Market participants should continue to focus on monetising their portfolio of lendable assets. Extracting value from their lending programme will remain difficult for beneficial owners that are reticent about engaging in new, forward-thinking strategies.

One area of focus should be the increased use of technology to maximise the efficiency of their programme. This includes the use of blockchain, as well as the review of traditional operating structures typically associated with securities finance.

Beneficial owners would also be well served to examine the expertise of their agents, focusing on the investment their agent has made in technology, as well as the development of their agent's programme offering, including non-cash collateral, exposure to new markets, direct lending and asset class expertise.

Santoro: This year should be a year of agent-client engagement. With many regulatory changes in effect, and some yet to be finalised, beneficial owners in the US and overseas would be well served to engage their agent as to how change affects them, their agent, and counterparties. The new environment presents opportunities for those willing to invest the time in optimising their strategy and using securities lending in new ways.

Deutsche Bank has always put the interests of beneficial owners first, however, we would not be fulfilling our fiduciary role if we failed to communicate the challenges facing counterparties. Trading flexibility, such as collateral types and legal domicile, can provide counterparties with balance sheet relief while rewarding clients with measurable improvements in returns. Similarly, counterparties incur higher balance sheet costs trading with certain client types, so having flexibility in approving borrowers is increasingly important.

Will indemnification continue to be a point of contention for many agent lenders and beneficial owners? Is there a solution?

Bassler: Yes. Although many market practitioners may agree that indemnification may not be needed, if you talk to beneficial owners and their boards, you will quickly learn how important this protection is to retain. Every agent will have a different analysis as it relates to cost and how they run the business in order to meet profitability targets. For eSecLending, we have always had a hard dollar cost for our insurance indemnity. With our indemnity, however, we will not shift borrower preferences or collateral preferences based on new regulations. Our business will always be run with indemnification, and guidelines will revolve around individual client goals and objectives. We will continue to manage individual programmes for each of our clients.

Chiuch: Typically, custody/agent banks are not constrained by capital so incremental indemnified lending activity is not expected to be materially punitive. The impact of indemnification is further lessened through the use of netting agreements that help optimise risk across counterparties.

It might be useful to consider what drives the need for indemnification: generally, it's either a policy matter or a business decision for the beneficial owner. As a business matter, discussions can result in some flexibility and, indemnification could be open for negotiation.

Where indemnification is a policy matter, changes or revisions to a beneficial owner's stance, presuming collateral eligibility rules will allow for it, would likely require lengthy debate followed by formal stakeholder approval, usually in the form of board approval. This is a rare event at today's marketplace.

Squillacioti: Counterparty default indemnification will continue to be an important part of the comfort level that beneficial owners have when engaging in securities lending. I am not sure that this is contentious for either the beneficial owners or the agent lenders. Both sides, though, do need to work together to make sure that programmes are optimised to take advantage of what is being indemnified.

Santoro: Indeed, indemnification will remain a lively topic. There is no doubt indemnification cost is real. It is factored into relationship pricing. Similarly, as regulatory change has unfolded, beneficial owners have made it clear on panel discussions and via surveys, they consider indemnification essential. Further, nearly all beneficial owners are governed by investment policy or similar constraint, which makes taking on additional risk undesirable or impossible. While agents understand this, it remains to be seen how indemnification cost will play out across beneficial owner relationships. Relationships centered on trading low-demand assets are more likely to be approached about relationship repricing and/or renegotiating the terms of indemnification, if it hasn't happened already. Indemnification varies across agents, so it is worth exploring options. We're happy to consult with prospective beneficial owners on the finer points of indemnification and relationship pricing.

Saunders: Indemnification will continue to be imperative in lending programmes, as it plays a critical role in satisfying both board mandates and internal guidelines. Several providers continue to have excess capacity to offer indemnification on a variety of asset classes and the challenge for beneficial owners is finding those providers.

Market participants seeking indemnification should engage with providers capable of indemnifying a wide array of collateral, including equities and corporate debt. Beneficial owners willing to examine and understand the financial strength of the indemnifying party will benefit from maximised revenues, as there continues to be a first mover advantage to engaging a provider able to monetise underutilised asset classes.

Wolfe: I think that indemnification will continue to be an important consideration, but I believe that once a CCP solution is available for agent lenders and beneficial owners that indemnification won't be as contentious for cleared loans. When beneficial owners and agent lenders are able to clear their transactions, the counterparty becomes a systemically important central counterparty such as OCC with a AA+ S&P rating and a robust and transparent risk management practice. That should significantly reduce the cost and/or capital needed to provide indemnification. Or perhaps someday indemnification will be dropped altogether since the CCP's function is to provide a guarantee to the lender against any loss should there be a default by their borrower.

Gerspach: Indemnification plays an important role in the securities lending marketplace as lenders continue to place a high value on this form of risk mitigation offered by lending agents. However, agents and beneficial owners need to have open and frank discussions around what the indemnification actually covers, the costs of this default indemnification and the scope of risks covered in their specific programmes. The factors responsible for revenue generation from lending a portfolio of securities should be as transparent as possible, as should the variables impacting the costs associated with running the programme. Ultimately agents should be sufficiently compensated for running the lending programme, including the provision of risk indemnification.

I would not be surprised to see an initiative in the US similar to SFTR in order to better equip regulators with data to enable them to monitor and fine-tune requirements

Matt Wolfe
Vice president of product development
OCC

Trapp: Indemnification will continue to be an important aspect of our client's securities lending programmes. Prospect inquiries contain a variety of questions on indemnification proving that it remains an important aspect of the securities lending product. There are differences in the price and types of indemnification offered across the industry regardless of whether it is offered directly from an agent lender or third party.

Prospects and clients are interested in understanding the creditworthiness of the issuer of the indemnification and also the creditworthiness of the agent lender. Financial strength and experience should be the key considerations for beneficial owners as they evaluate an agent lender.

Will the rising interest rates in the US market have a significant effect on collateral in the securities lending market this year?

Chiuch: Given the prospect of accelerating rate hikes—possibly four more this year according to research by Capital Economics—evidence of a steepening curve is mounting. If rates rise too fast and risk-free rates of return begin to look more attractive relative to riskier assets and correlations between asset classes begin to erode, excess cash could find its way into collateral pools at an accelerated rate as markets rebalance and investors ponder their next moves. Assuming rates continue to move higher, I would fully expect cash available as collateral to grow.

> ***Non-cash in the US market has increased across most lending agents and different borrowers will be looking for greater collateral flexibility***
>
> **Peter Bassler**
> Managing director, business development
> eSecLending

The rule of thumb in securities finance for borrowers is to focus on the 'cheapest to deliver' form of collateral. Investors remain significantly long securities, especially with equity markets already up 3-5 percent globally this year. Therefore, non-cash collateral will likely continue to play a key near-term role as investors look to finance their long security positions.

Santoro: As rates rise, agents need to adjust their pricing for accepting various types of collateral relative to what can be earned versus the most conservative overnight investment allowed by the client when accepting cash. While counterparts will continue to optimise their long inventory for balance sheet efficiency, participants in the securities lending market need to remain aware of the ever changing internal cost of financing of different counterparts as well as the expected returns for external financing with cash.

Gerspach: The expectation of a continuation of rate hikes in 2018 will present opportunities for securities lending programmes as fixed income activity increases as a result of interest rate volatility. These opportunities will be seen as potential for increased borrowing of fixed income securities and for increased rates for re-invested securities lending cash collateral.

Saunders: Beneficial owners engaged in cash collateral lending will certainly have opportunities to realise increased revenue opportunities. As the market anticipates several rate increases this year, and as the Libor curve continues to reflect these rates increases, beneficial owners may monetise these opportunities through a variety of portfolio management strategies, specifically an interest rate mismatch strategy.

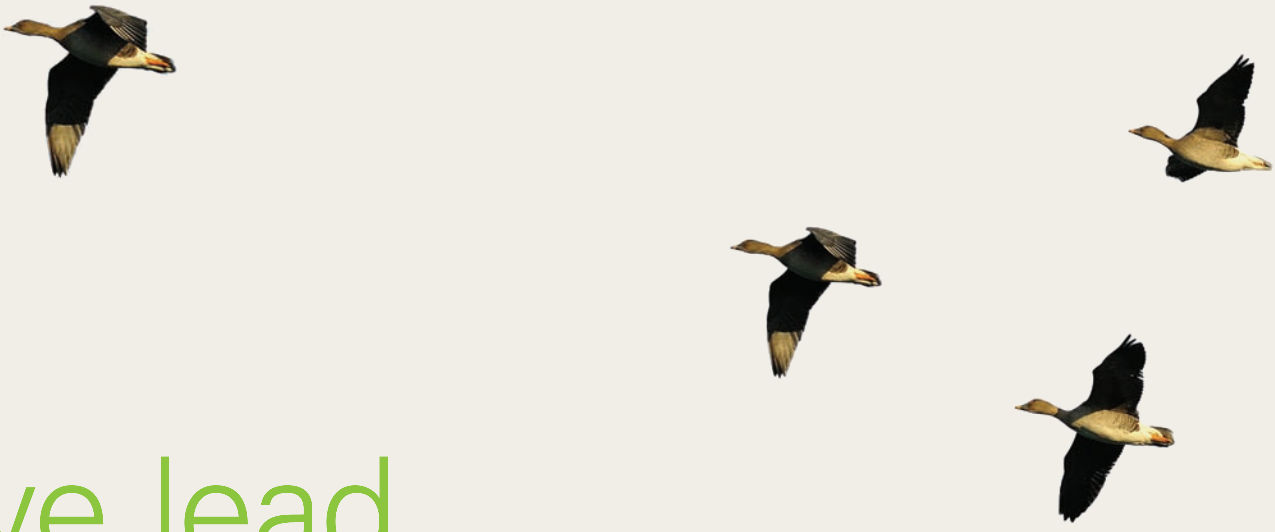
However, this should be conducted with caution — it is imperative to ensure ample liquidity exists in your loan portfolio to fund potential forward liabilities. Aside from cash collateral opportunities, rising interest rates will inevitably lead to increased volatility in markets, which will benefit securities finance in general.

Trapp: As a result of changes in the regulatory environment, demand to pledge cash collateral by borrowers in the securities lending market has decreased. Any changes in US short-term rates will have a lower impact than it would have in years past. Last year, reforms in the money markets, not changes in US rates, were the driver of higher cash reinvestment revenue. Looking forward, higher US rates relative to other developing economies may result in higher demand for US Treasuries. Other assets may witness higher demand including specific equity securities or sectors of the market, such as real estate related services if rates continue to rise.

Squillacioti: Yes and no. Yes, in the sense that rising rates clearly will have long-term benefits to securities lenders reinvesting cash collateral, and the additional spread opens various opportunities. No, in the sense that, as I stated earlier, I am not sure that the growth of non-cash will abate any time soon. The key is to be able, wherever possible, to take both kinds of collateral and open further the trading opportunities created.

Last year saw poor equities performance hold back lending revenues. Will 2018 be different?

Santoro: While yield enhancement has continued to wane and specials demand not as strong as previous years, we are confident we have built the ideal platform to harvest whatever returns the market offers. As mentioned earlier, we remain optimistic about 2018 for a number of reasons. Growth oriented economic policies, a strengthening business environment, and a positive outlook on merger and acquisitions (M&A), are all positives. In particular, we will continue to engage with our clients on optimising their strategies against the backdrop of regulatory change. Their ability to be flexible in structuring transactions, accepting different counterparts, and understanding how their flexibility will help propel earnings will



be difference makers. Deutsche has built a very successful third-party securities lending franchise that can lend assets anywhere that a client is invested, while interfacing seamlessly with any custodian. In this regard, 2018 will be a very busy year.

> ***While not insurmountable, the lending agents, borrowers, CCPs will need to come together on a workable CCP model***
>
> **Francesco Squillacioti**
> Global head of agency lending
> State Street Securities Finance

Trapp: In 2017, equity markets experienced generally subdued levels of borrower demand as share prices continued to push higher throughout the year and price volatility fell to historic lows. This environment saw many hedge funds adopt a net long exposure, buying equities to take advantage of climbing prices and contribute to performance. As a result, the short side experienced covering and spread compression for much of the year.

Equity market performance in 2018, and consequently the level of price volatility, will depend on a number of factors including progress towards the Trump administration's legislative agenda, actions of central banks in the US and abroad and global geopolitical events.

While continued strength in equity prices and lower levels of volatility in 2018 may continue to weigh on borrower demand, we would expect to see continued strong demand for securities in sectors of the economy that may experience elevated levels of price volatility including consumer discretionary, retail, energy and real estate.

Squillacioti: I like to think so, but absent any concrete knowledge, we have been working to be in position to maximise our activity regardless of how the equity market does, and have done a lot of work around collateral and other trade structures at State Street.

Saunders: We anticipate increased volatility across global markets in 2018, which we believe will result in new opportunities for programme participants. While the trends of 2017 will continue well into 2018, inevitably, short interest and volatility are expected to return in the second half of the year. We are examining new lending markets along with strategies to distribute the increasing supply of lendable assets across the globe in an effort to maximise client revenues.

Gerspach: US directional trades drove earnings in 2017, but trades of significance were few in number and concentrated among a few industry sectors.

The US equity rally is expected to continue in 2018, driven in part by tax reform and fewer regulatory burdens. The rally could continue to apply pressure to directional earnings.

Following subdued market volatility in 2017, when US indices typically traded within very narrow bands and the VIX closed at multiple, multi-year lows, analysts are expecting a gradual increase in volatility in 2018 which may add to revenue opportunities. However, lending fees and rebates will remain under pressure due to the abundance of supply relative to demand.

Overall for 2018, we expect to see corporate activity (M&A, capital expenditures, share buybacks and dividends) increase and small- and mid-cap companies outperform, while sectors with a growth bias and low domestic/higher foreign revenue exposure to underperform. We believe that investors are likely to shift from bonds to equities, from international to US equities, and from growth to value.

Bassler: The continued bull market in stocks with low volatility continues to hold back equity lending returns. This won't be different until we see things shift, and we are hoping for a higher VIXX in 2018.

Chiuch: 2017 was not a bad year for US equities and there are a number of positive signs pointing to even better performance in 2018. A return to more conventional markets and growing evidence of an improving economy will mean a steeper yield curve and a more traditional inverse relationship between stock and bond prices. Equity lending will continue to benefit from favourable tailwinds of higher valuations in the near term. Equities will naturally be more active especially if rates ultimately rise too quickly and the market rebalances. Fiscal policy measures in the US may also mean increased corporate actions, like M&A for instance, conducive to equity finance. We're in an environment where it's possible 2018 revenues will grow overall for both equities and fixed income.

Will 2018 be the year CCPs finally get a foothold in the market?

Wolfe: As the only US CCP for securities lending transactions where return of stock or cash to bilateral and exchange-traded securities lending participants is guaranteed, OCC already has a foothold in the securities lending market with over $75 billion in loans being cleared. This year marks 25 years after the launch of our clearing programme, but access has been limited. We are currently working on expanding our model to better accommodate the buy side through various enhancements and are very much looking forward to expanding our footprint and service to the securities lending market.

Saunders: The merits of a CCP are well understood by lending agents and prime brokers. However, a great deal of energy will be spent in 2018 educating beneficial owners about the benefits, risk protections and operating models of lending through a CCP. This will not occur instantaneously and will likely require several quarters, if not longer, of continuous education at the beneficial owner level to understand the economics of participation in a CCP.

Gerspach: Although we believe CCPs will continue to grow and become a larger part of the securities lending market, there are still many open issues that need to be resolved. These will include weighing the risk and reward of signing up a new counterparty, the types of collateral accepted, levels of indemnity and whether the default waterfalls are sufficient. It is possible that CCPs will become an avenue most suited to large sophisticated investors who have the time and resources to ensure that this structure suits their securities lending strategy. Another option is pledge collateral, which achieves many of the capital benefits as CCPs and seems to be gaining importance from the borrowers.

Chiuch: The general answer is yes, but with qualifications. There does not appear to be a one-size-fits-all solution at the moment. What we'll likely see in the near term is a multi-dimensional marketplace with various solutions available according to specific needs. Not all CCPs are created equal. Some are well along the development curve while others are still trying to define their model. For instance, a well-known US provider is already functional and active in the fixed income space, while another non-US CCP is finalising arrangements in hope of launching this year. Others still appear to have plenty of development work remaining. CCPs are not a panacea that everyone will embrace. While many market participants are keen on CCPs, others are working towards a pledge mechanism while others, still, are content to wait and see how things unfold.

Trapp: While progress continues to be made on CCPs as a potential solution to borrower capital constraints, development has been slow and pledge structures seem to supplant the need for CCPs as a solution. However, CCPs continue to be a major topic of conversation despite the slow progress. An increased number of market participants see CCPs for securities lending as a route to relief from punitive regulatory capital regimes.

The biggest challenge and contributor to the slow speed of a CCP development is the objective of preserving the current securities lending business model to minimise the impact on the various participants. For example, in a typical CCP framework, both parties to a transaction cleared through a CCP would be required to provide margin, contribute to a loss fund, and be subject to broader CCP risk sharing. These requirements do not fit well with the current roles of the client (or agent lender on their behalf) on a securities lending transaction. Therefore, prospective CCP providers are making significant adaptations to their typical CCP framework.

> ***A foothold? I'm afraid not in 2018, but hopefully there continues to be dialogue among agents, CCPs, and clients to establish an acceptable mechanism that is usable for the broader industry***
>
> **Joseph Santoro,** director and head of product sales for the Americas, agency securities lending programme at Deutsche Bank

Santoro: A foothold? I'm afraid not in 2018, but hopefully there continues to be dialogue among agents, CCPs, and clients to establish an acceptable mechanism that is usable for the broader industry. We would expect a few participants in the industry to transact in a CCP in 2018 on a limited basis. Our product development team has been hard at work and Deutsche Bank fully expects to print in a CCP during 2018. That being said, our expectation that the relative volume in 2018 for CCPs will be de minimis.

Squillacioti: CCPs have been discussed for some time now, though there now appears to be growing momentum behind the discussions. There is also a good amount of activity taking place, which leads me to believe that if CCPs do not see a rollout in 2018, they are likely to in 2019. I would caveat this by saying that there is a lot of work to do here. From the models I've seen, this represents some significant changes to the traditional agency lending construct. While not insurmountable, the lending agents, borrowers, CCPs will need to come together on a workable model that will cover the greatest possible swathe of activity.

Is the US market likely to see any major reforms to regulation affecting securities financing this year?

Gerspach: Although we don't anticipate any major new regulatory reforms coming, those already in place will continue to have an impact on the securities lending and financing market. Agent lenders are in the midst of the rollout of the second Markets in Financial Instruments Directive and many US-based lenders will feel its impact. Agents will also be working with their US mutual fund clients on the continuing requirements of the US Securities and Exchange Commission's (SEC's) Mutual Fund Modernisation Act as it continues on the implementation track.

Saunders: The general consensus among beneficial owners, and even lending agents, when discussing regulatory change is one of acceptance. Agents, prime brokers and beneficial owners have, for the most part, become adjusted to the impact of US regulation in conducting and operating their lending and borrowing business.

> ***One area of focus should be the increased use of technology to maximise the efficiency of programmes, such as blockchain***
>
> **Michael Saunders**
> Head of investments & trading, securities lending, North America, BNP Paribas

Certainly, we have our eye on several critical proposals which would impact the industry, such as the expansion of rule SEC 15c3-3. But until these changes are integrated, we will continue to focus on maximising revenue for our clients and monetising programme participants' underutilised assets with a focus on risk adjusted return.

Finally, our prudent framework is set for 2018, including the ability to serve clients reporting capabilities, such as updates coming via the likes of the Investment Company Reporting Modernisation initiative set forth by the SEC. Maintaining client and regulatory compliance is a key focus of our programme in 2018 and beyond.

Chiuch: We expect that there will be changes to current regulations in 2018 that will reflect the administration's principles and implement some of the suggested changes identified in the recent Treasury reports.

These could include changes to the capital rules that may introduce a new standardised calculation methodology for credit exposure for securities lending transactions which was recently finalised by the Basel Committee which would more accurately reflect the actual credit exposure in securities lending transactions. We may also see a new single counterparty credit limit (SCCL) proposal that incorporates the above-referenced calculation methodology as recommended in the recent Treasury Report. Additionally, changes to the leverage ratio (SLR) could result in a recalibration of the enhanced ratio requirement based on the institution and/or exclusion of central bank deposits which may create more capacity and would be favorable for the market.

Trapp: Basel III rules establish the framework for agent lenders to calculate capital requirements to be put aside as a result of providing indemnification to clients. In December of 2017, the Basel Committee issued final revisions to Basel III, which included a more favourable exposure measurement for securities lending transactions and more balanced methodologies to calculate regulatory capital for banks and broker dealers under the Standardised Approach. A US proposal addressing the Basel revisions to the Standardised Approach would be a key development for the industry.

SCCL and NSFR are two important regulations that are yet to be finalised in the US. Similar to the Basel revisions to the Standardised Approach, adjustments to the exposure measure for securities lending transactions in the final SCCL rules would be a key development, particularly for agent lenders. The outcome for the NSFR rules could be meaningful for certain borrowers.

Specific to the EU, SFTR has received a significant amount of the industry's attention given the breadth of the requirements and the scope of impact. Although the SFTR reporting regulation is specific to Europe, it will impact various securities lending participants in the US as well. The industry continues to make strides towards meeting the requirements, and vendors are engaged to facilitate collection and aggregation of the data elements required to be reported to the regulators.

Santoro: The current administration has been very clear on their stance regarding major regulatory reforms, and while we do not expect anything dramatically new, we do expect some long-pending regulations to crystalise. Conclusions to single counterparty credit limits, equities as an acceptable form of collateral for equity loans in the US combined with Bank Recovery and Resolution Directive and progress pertaining to Securities Financing Transactions Regulation in Europe will be welcomed by the industry in 2018.

Wolfe: The regulatory changes implemented over the last few years have resulted in a more resilient financial services industry. I haven't heard of any major reforms that are in the works. And I would not be surprised to see an initiative in the US similar to SFTR in order to better equip regulators with data to enable them to monitor and fine-tune requirements. My hope for 2018 is to enable more of the market to realise the capital efficiencies and costs savings that are afforded to clearing within the current regulations. **SLT**

Surveying success

Securities lending associations around the world discuss the key issues in 2017 and what they will focus on over the next 12 months

Glenn Horner
Chair of the committee on securities lending at the Risk Management Association (RMA)

What was the biggest development in your region in 2017?

There were a number of key developments during 2017, including the finalisation of the US stay rules for qualified financial contracts (QFCs) and the new US tax laws. There were also many developments in other jurisdictions that will impact US lending participants, such as the Bank Recovery and Resolution Directive and new German tax laws.

The biggest development in the US during 2017 was a general shift in the goals of US regulatory agencies. This shift has been predicated on the election of President Trump and a Republican controlled Congress. In June of 2017, the Treasury Department issued a review of financial regulations of banks and credit unions. In this review, the Treasury Department recommended using a more risk-sensitive measure for the standardised calculation of risk-weighted assets (RWA) and single counterparty credit limits (SCCL) for securities finance transactions (SFTs). In conjunction with the recently finalised Basel III standards, which adopted a new more risk-sensitive measure for the standardised calculation of RWA for SFTs, we anticipate some relief for the capital requirements associated with SFTs.

Additionally, we have seen a shift in the key personnel at US regulators including Jay Clayton (Securities and Exchange Commission chair), Joseph Otting (comptroller of currency), Jay Powell (Federal Reserve chair, effective February), and Randal Quarles (vice chair for regulation at the Federal Reserve). The expectation is that these new key regulators will move from a policy of gold plating global standards for US banks to a more balanced approach that will look at both safety and soundness principals as well as competitive impacts of regulations.

What impact did these developments have on US markets last year?

The impact to date has been minimal, but some hope has been restored in the US in regards to gaining relief on the cost of capital related to indemnification, as well as the potential for the SCCL to be far less disruptive to the market than would occur if the current proposal is adopted in its current state. However, we anticipate that these changes will take place over a number of years and the full impact will likely not be realised for some time.

What were the RMA's biggest challenges last year and how did the association face them?

RMA's biggest challenges continue to be twofold. First, engaging with key regulators on proposed regulation to provide feedback that ensures an acceptable outcome for the industry. Second, educating and informing our membership about potential changes to the industry. RMA's legal, tax and regulatory committee and tax sub-committees continue to engage with key regulators and provide insightful comment letters. A perfect example of this is the comment letter related to the US stay rules for QFCs. Based on comments provided by RMA, the final rule in the US reflects changes to the original proposal that will result in significantly less disruption to the securities lending market and its participants.

We also continue to build on our industry outreach through our annual conference, operations and technology roundtable, institutional contacts meeting, and additional roundtables and workshops. We have worked closely with Debevoise and Plimpton to provide complimentary workshops and other activities for our members, such as the upcoming webinars on the final Basel rules.

Can you name a market driver in the US that industry players must be aware of in 2018?

Market participants must be aware of the potential for significant changes in routes to markets for securities lending transactions. This is a long-term trend and we will likely not see a single product or strategy replace the existing value chain. However, the potential for a central counterparty solution, peer-to-peer lending, and fintech solutions, such as blockchain technology, creating disruptions to the existing framework are all market drivers that industry participants should understand. The future of securities lending will require increased flexibility and enhanced tool boxes for all members of the value chain.

What will be the top securities lending trend this year?

The top trend in securities lending during 2018 will be the continued development and adoption of fintech solutions for SFTs. This development and implementation process is likely going to be an ongoing trend for a number of years, but the utilisation of blockchain technologies, machine learning, artificial intelligence, and robotics will have a far reaching effect on the industry for years to come. We anticipate that these technologies will significantly impact operations, trading, and distribution channels in the future. During our conference this past October, we had a panel on the impact of emerging technologies. Based on the industry response to this panel, it is clear that many participants are exploring how these technologies can impact their businesses. **SLT**

Juanita Taylor
Chair of the South African Securities Lending Association (SASLA)

What was the biggest development in South Africa in 2017?

The implementation of the new debt instrument solution (DIS) project on the Strate TCS BaNCS market infrastructure product. Strate's DIS project was the strategic project to replace Strate's previous UNEXCor bond settlement system and migrate bonds securities onto the TCS BaNCS market infrastructure platform.

What impact did this have on the industry last year?

The project is a significant development for the South African market as it is not only a replacement of the current technology, but also the implementation of a new bond clearing, settlement and asset servicing model utilising a securities ownership register (SOR).

This technology introduced numerous benefits. Post trading and pre-settlement processes will be automated with DIS and major changes will be made to the settlement model, including a greater flexibility for multiple settlement runs throughout the day and the introduction of cash payments for capital events via the South African Reserve Bank.

What were SASLA's biggest challenges last year and how did the association face them?

Firms are increasingly looking for solutions to help them meet and manage their reporting requirements under regulatory regimes such as the second Markets in Financial Instruments Directive, money market statistical reporting, and the Securities Financing Transactions Regulation. The association has been in close contact with the Financial Service Board (FSB) and other industry bodies to try simplify the regulatory reporting requirements.

What should South African industry players be most aware of 2018?

The Johannesburg Stock Exchange (JSE) will go live with the Integrated Trading and Clearing initiative (ITaC).The ITaC project is a multi-year programme of work focused on the introduction of an integrated solution for the JSE's trading and clearing services.

The FSB has recently issued a draft code of conduct that sets principles for parties involved in securities financing transactions (SFTs) and addresses some of the following topics:

- Lending agents and their responsibilities
- Principles of conduct for parties to SFTs
- Margin and collateral requirements and mark-to-market applicable to SFTs
- Reporting obligations in respect of SFTs (reporting all transactions to a trade repository)
- Disclosure of SFT activities

One of the biggest challenges will be how to meet all of the regulations without breaching others—there are a number of potential conflicts as well as some requirements that are open to interpretation and so run the risk of being applied differently.

What will be the top securities lending trend this year?

As we look forward into 2018 and beyond, we believe that banks and dealers will continue to be more constrained in their ability to further intermediate in the market, which will increase the need to optimise their activities in every way possible. A potential avenue being discussed in the context of balance sheet efficiencies is the introduction of central counterparties (CCPs). CCPs will allow market participants to more efficiently net offsetting cash transactions as well as achieve material risk-weighted assets-related capital efficiencies.

Paul Solway
Interim chair of the Pan Asia Securities Lending Association (PASLA)

What was the biggest development in your region in 2017?

Given the plethora of active markets we have in Asia, no one item stands out on its own. What 2017 did show us was that each market continues to evolve. To mention a few developments that caught the attention of Pan Asia Securities Lending Association's (PASLA) members and the executive committee:

- Philippine Stock Exchange looked to the market for input into their pending introduction of short selling and may consider revisiting their securities borrowing and lending (SBL) framework
- South Korea made changes to their short selling rules, specifically focusing on tighter controls over 'overheated' securities
- Securities and Exchange Board of India has been revising its Indian SBL framework as their ongoing initiatives look to encourage more onshore liquidity to its marketplace
- Hong Kong Stock Exchange continues to look at their delisting framework, which PASLA has taken an active interest in
- Taiwan amended criteria for eligible securities that can participate in SBL, certain other rules governing SBL rollovers and short sell daily controls were positively eased
- Malaysia added a Shariah-compliant sell and buying infrastructure for domestic managers, as well as modified up-tick rules and added a fails coverage facilitation model

PASLA has also seen the planning for shortening settlement cycles by Japan and Thailand, which will have certain unintended consequences for the onshore and offshore participants who lend/borrow in those respective markets.

What impact did this have on Asia last year?

None of the 2017 developments in themselves necessarily had a direct impact on flows around the region. Larger factors for Asian equities were mixed market volumes and lower spreads, similarly in other regions.

Speed of execution is becoming more important than ever, as global regulations impact participants in different ways.

For similar reasons, fixed income had positive trends in terms of volume of activity, especially if global high-quality liquid assets could be sourced in the Asia Pacific timezone that could facilitate balance sheet efficiencies or provide additional pools of collateral.

What were PASLA's biggest challenges in 2017?

Again, there was no one big-ticket item this year that posed any serious impediment to the regional market.

One of our primary goals is the continuation of education in order to remove any evolving or remaining misunderstandings surrounding securities lending, especially as market sentiment changes. I think it's fair to say that market participants in this region are not as well informed across the region given the number of nuances that exist across the nine open, two restricted and two actively developing markets that exist in Asia today.

It is key for regulators, authorities and exchanges to strike a balance between their desire to protect and serve local investors and the need for additional liquidity that can be provided by international participants.

In early 2017, PASLA introduced market groups for different executive committee members to manage. Where appropriate, members outside of the executive committee added their expertise. This widened the resources available to PASLA and contributed to a more active association. More progress will be discussed and assessed during our Hong Kong conference coming up in March.

Can you name a market driver in Asia that industry players must be aware of 2018?

In addition to the obvious regulatory drivers, one of the really positive announcements that came in 2017 was the fact that the MSCI Emerging Markets Index began adding China A shares to its constituent weightings from last June. While this has no direct consequence for lending Chinese securities, the additional wave of investment into local securities will naturally add pressure to the capital markets to look for ways to deploy products around the additional liquidity.

One thing is certain: China will continue to develop as demonstrated by the progress of Hong Kong Connect. Investors need to be patient and watchful.

What will the top securities lending trend be this year?

Market-wise, fixed income flows are set to continue especially with 10-year US treasury yield climbing to the highest level in more than nine months, a looming glut of bond supply from the US, the UK, Japan and Germany coincided with a surprise cut in purchases of long-dated Japanese government bonds by the Bank of Japan. Facilitating such flows from Asia (the start of the global day) will continue to be important.

Technology just cannot be ignored this year given institutions' insatiable pursuit for greater efficiencies. Whether it is by automating certain aspects of trading, speed of execution, middle-office outsourcing or via the aggregation of data—technology will no doubt take this business to many new states of evolution in 2018 and beyond.

Andrew Dyson
CEO of the International Securities Lending Association (ISLA)

ISLA had a busy 2017. Did regulation take up a lot more time for ISLA than usual?

Since the financial crises we have seen a very clear path around the development of regulatory oversight and implementation of regulation. Last year was something of a watershed in some ways with the market working, at times, almost exclusively on the second Markets in Financial Instruments Directive (MiFID II) implementation. Following closely behind MiFID II has been the increasing focus on the Securities Financing Transactions Regulation (SFTR), which will run throughout 2018.

However, and notwithstanding the considerable effort to get these major pieces of legislation either over the line or into project plans, SFTR probably marks the beginning of the end of the post-crisis regulatory agenda. So, although 2017 was probably our busiest year from a regulatory perspective, and 2018 will be equally challenging, I do see the world around regulation beginning to change.

What were ISLA's biggest challenges last year and how did the association face them?

I would say that when looking back at 2017 I would judge our biggest challenge was being asked to look at multiple regulatory and legal work streams at the same time. In 2017, we were asked to engage on MiFID II, SFTR, the Bank Recovery and Resolution Directive (BRRD), as well as developing a pledge version of our master agreement. These activities demand resources, and understanding our member's priorities have been key to success this year.

What will the regulatory focus on securities financing be in 2018?

Inevitably, now that MiFID II is live we will move on to implementation of the SFTR. Once the technical standards are formally adapted into EU law we will be working with our members and other stakeholders to help a smooth run towards implementation in 2019.

Which EU market driver should your members be most aware of this year?

I would look at this in two ways. First, the SFTR could radically change how market participants engage with this market. With circa 60 percent of all outstanding loans coming from lending principals who will be outside of the reporting obligation, we could see these lenders taking a different stance towards Europe; especially if some of the proposed changes to the BRRD also gain momentum. The second way of looking at this question is simply one-word: Brexit. It is coming and will deliver changes.

What will be the top securities lending trend this year?

The word flexibility will be at the forefront of many discussions in my view. Borrowers are looking at increasingly varied ways of concluding securities loans and those lenders who can best match those requirements and demands could see greater flows of business.

Check-the-box mentality is over

Chris Ekonomidis of Synechron Business Consulting, discusses regulatory challenges, collateral trends and the use of blockchain

Synechron is one of the fastest growing consultancies. Describe your new role and what areas you will cover?

I was hired as senior director and US regulatory practice head for Synechron Business Consulting. I will be focused on risk and compliance consulting in the US.

Which regulations will be key for your clients in 2018?

Since our clients are global, we have clients preparing for all of the upcoming financial regulations. However, I think that in 2018 regulations such as the Fundamental Review of the Trading Book (FRTB), General Data Protection Regulation, Securities Financing Transactions Regulation, and Consolidated Audit Trail (CAT), as well as a continued focus on capital and balance sheet optimisation will be key. It will be interesting to see what affects the recent go-live of the second Markets in Financial Instruments Directive (MiFID II) will have on trading and liquidity.

What developments are you noticing in the regtech space? And what does your firm offer in that area?

Regtech will play a key role in financial institutions' strategies as they relate to new regulations, like FRTB and CAT, by implementing a tech-driven approach to proactively meet regulatory needs rather than the reactionary approach many financial institutions have taken in the recent past. Utilising a tech-first approach to regulatory requirements will lay the groundwork for firms to gain more long-term benefits from each obligation and better management of data and risk overall to achieve greater economies of scale.

It will also allow firms to provide additional business value by leveraging and extending their regulatory obligations past a simple check-the-box mentality. For example, know-your-customer mandates could be used to better manage the overall client lifecycle.

What collateral trends and challenges are you seeing at present?

Right now, banks are getting a better understanding of collateral in general, where it is placed, and how it can be best used. For example, how it can be leveraged to generate alpha, optimising regulatory capital, and the automation of margin calls collateral management processes. By utilising emerging technologies to tackle collateral challenges, banks and trading firms are beginning to explore moving collateral costs further upstream to the front office and displaying a more precise all-in cost prior to trade execution.

Improved transparency for pricing and liquidity from MiFID II could open up the bond market and allow firms to lend a greater portion of their inventories at better prices, based on enhanced market insight.

Is there an increase in the use of blockchain, and how far does Synechron see this technology developing?

Blockchain was a hot topic in 2017, and in 2018 we expect it to continue to dominate in moving from pilots and proof of concepts, to production. That being said, there is a huge potential for the use of blockchain in repos and securities lending market that will continue to mature in 2018.

What are your views on artificial intelligence and machine learning? And how do you see these developing within the capital markets space?

Like blockchain, artificial intelligence (AI) and machine learning (ML) will continue to hold a large part of firms' technology and innovation initiatives and budgets this year. Firms are now looking at using AI and ML to optimise collateral management and are making strides toward improved collateral transformation using these technologies. **SLT**

Chris Ekonomidis
Senior director
Head of US regulatory practice
Synechron Business Consulting

With the increasing velocity of change, the difference between who succeeds – and who merely survives – will be defined by clear thinking, quick decisions and rapid reflexes. This is where SIX Securities Services comes in.

As one of Europe's few truly international post-trade service providers, we have learned to adapt to rapidly changing landscapes, carve out our own innovative path and deliver industry-recognised performance. The result is satisfied customers who enjoy having us to help steer them to success. **Solutions for the future. Now.**

SIX Securities Services

Unlocking the potential.

Helix looks across the pond in 2018

Matthew Battaini and Bryan Vanderputten outline what sets Helix Financial Systems apart in the crowded technology marketplace and offer a taste of what the firm will offer in 2018 and beyond

What is Helix's core offering, and how does it differentiate from other firms competing for business in securities finance?

Bryan Vanderputten: Our core solutions are focused on securities financing. How we differentiate ourselves in the securities lending industry is through our depth of knowledge and our staff's ability to provide premium support.

We hire people with deep business and technology knowledge who work in-house. Our support staff and developers have been market participants in the various securities finance businesses, so we understand the needs of our clients as well as they do. For example, I have hands-on experience trading in the US and Canadian repo markets, whereas Matthew Battaini has a background in securities lending.

Better yet, we can anticipate those needs, providing cutting-edge, relevant solutions that stay ahead of the curve. We listen to our clients on a regular basis and include their feedback in our software development and road map planning.

Additionally, we attend all the major industry trade shows, conferences, and read industry publications to keep on top of the latest developments, regulations, requirements, and opportunities in the Securities Finance industry.

In the US, repo and securities lending are more bifurcated than they might be elsewhere, as there are a lot of differences between what a securities lending user and a repo user needs, so we have built different solutions and customised the user experience to give each desk exactly what they need. Having worked so closely with each other over the years, Matt and I have a unique ability to also understand the overlap in the two businesses and we've been able to build solutions for these overlaps—in terms of collateral management, risk, and profit and loss.

How did you fair in 2017, and what's in the pipeline for the coming year?

Matthew Battaini: From a securities lending perspective, we've seen a lot of interest from non-US customers. We see our business footprint growing to markets in Europe, Canada and possibly Asia. Our product has evolved from a US-centric tool to a global trading platform, capable of traditional securities lending as well as structured products lending.

We are beginning to offer hosting solutions for our customers, helping our clients get to market faster. It will also help us speed up the integration time with customers. It normally takes months, but we are now able to do it in weeks.

Vanderputten: Recently, we've had double digit revenue growth. We have two very robust platforms to offer in the securities finance markets in addition to our to-be-announced allocations platform.

We've also added in a third product recently: a reporting tool called HelixALARM. It sits on top of our repo and securities lending databases and provides balance sheet reporting and netting opportunities, collateral mix/management, calculations and other risk management tools, for post-trade management —MIS reporting— that adds value to the suite of solutions that we offer.

We are in the process of signing a UK/EU-based bank to offer our repo product. Our securities lending product is also going live in Canada soon. The plan is to continue to add more robust features and add-ons for Europe, the UK, Asia and Canada, as our client base and support staff in these regions continue to grow. We are heavily investing in this growth in 2018 and 2019.

What challenges will Helix be facing in 2018?

Battaini: In 2018, we'll be looking to expand our presence in Europe.

Vanderputten: Specifically, we'll be looking to replicate the success we've had in the US and will adapt it to the European market. We'll also be looking to hire for talented people on the ground to achieve this goal.

How does Helix support both its buy- and sell-side clients? How do their needs differ?

Battaini: From a securities lending point of view, I typically don't refer to my customer as buy-side or sell-side. We evaluate their needs solely based on the style of business. Are they a clearing firm. Are they looking to run a conduit business. We support the different focuses of the business through flexible features that can be tailored for each business type.

Vanderputten: The software features and requirements of buy-side and sell-side clients are very similar, even though each might have a different business need or perspective on the market. Our solutions are adaptable to both sides of the business and can be scaled depending on the size of the client.

We're starting to offer more fully hosted solutions for those firms that don't have the immediate ability to get up and running, eg, they don't have a server inside their network to install our software or IT staff to support the environment. That's the biggest difference between the sell- and buy-side that we see. On the business side, the buy-side is just as sophisticated, but, in terms of technology, they might need an IT partner to help with trade entry, straight-through processing, and post-trade management processes, which is where Helix comes in.

With your expansion in Europe in mind, do you foresee any regional challenges with that, such as Brexit?

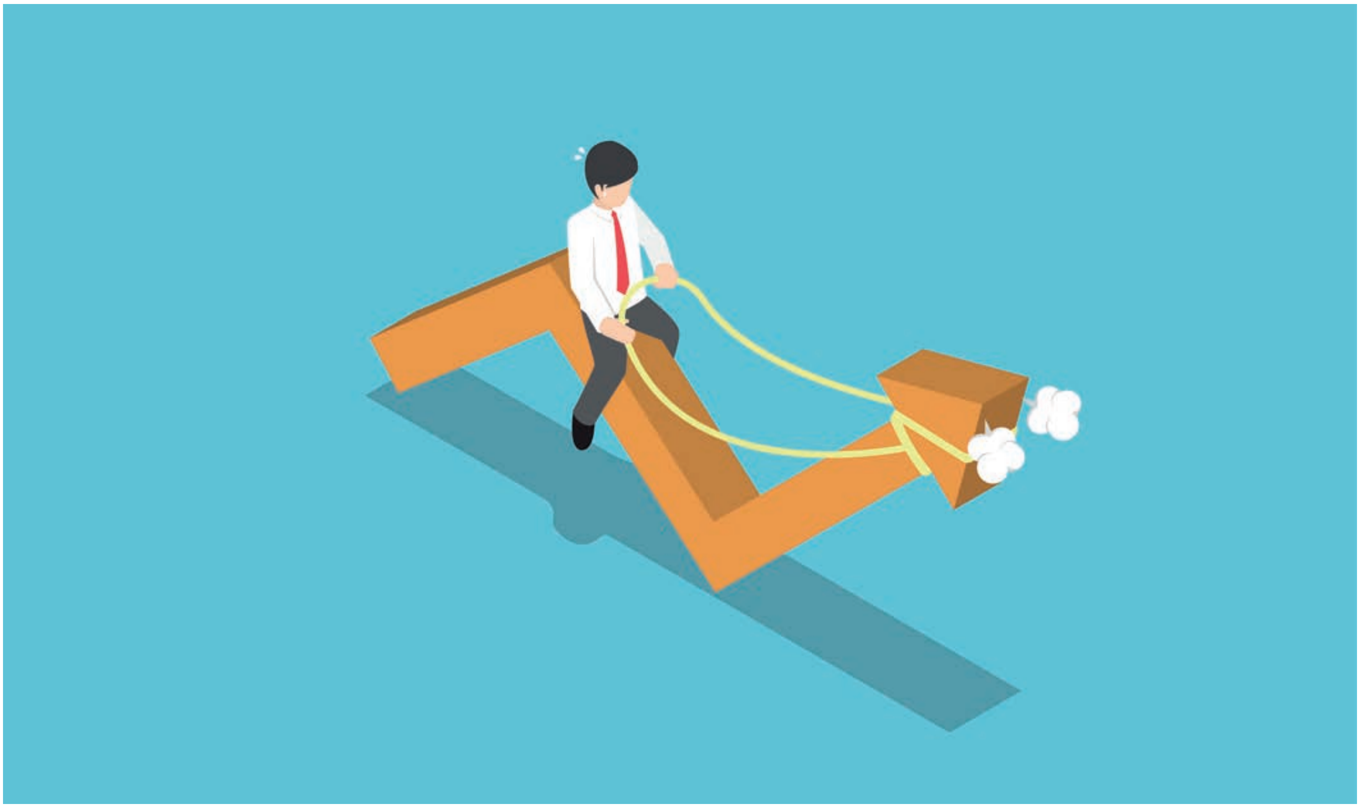
Battaini: There are regulations that will affect us and some regulations that won't. For example, Securities Financing Transactions Regulation (SFTR) is a requirement. We're talking to the European trade repositories. However, the implementation of Brexit does not appear to pose significant issues at this time.

Vanderputten: From what we know about the Brexit negotiations so far, I don't see Brexit changing our solution requirements significantly. Some of our client's businesses are clearly affected, but it has not reduced their need or demand for our technology. They have changed the way they use our solutions in order to be in compliance, and we have changed requirements with them when needed. In the US, capital requirements regulations, such as Basel III, have affected the size of balance sheets for banks. From our point of view, as a software provider, this doesn't change our level of our support. There may be more companies that need our solution. Regulations can be good for technology, it's been good for us.

Battaini: Brexit might affect a company's location and size in staff more than anything else. It might affect companies headquartered in London or the UK and their capital requirements, more than it would affect how our solutions work.

How do you fit into the larger framework of Cantor Fitzgerald?

Battaini: Being a wholly-owned subsidiary of Cantor Fitzgerald has allowed us to leverage in-house synergies and resources, so that we can concentrate on our core competencies and leverage non-core software related business functions such as human resources, legal, accounting, for example. We operate as a small targeted software company, while enjoying the security and funding of a global firm. **SLT**



Adaptability in an unpredictable market

Francesco Squillacioti, global head of agency lending at State Street Securities Finance, explains why 'adaptability' should be the watchword of the securities lending industry this year

Each of us in the securities lending industry has to weigh a number of factors as we look ahead into the next year: what is our best indication of what securities markets will do? What is our house view on interest rates? What regulatory factors are likely to come into play over the next 12 months? What other pressures are being brought to bear on the different participants in the securities lending market, and what could that mean for activity? While these types of considerations can only really be thought about in terms of best estimates rather than certainties, our responsibility is to be ready for 'it', whatever it is.

If I had to try to boil down into a single word what will be required to weather potential market challenges this year, it would be 'adaptability'.

When we think about the market we are really thinking about the combination of a number of different things: activity in underlying securities markets and its impact; regulatory and tax changes in various jurisdictions; and, of course, the actions of various participants in the market – beneficial owners, borrowers, agent lenders, etc. Each component of the market exists as part of a greater ecosystem, a single event in one place will have an impact throughout. Without adaptability, the ecosystem cannot function optimally. New considerations need to be absorbed and new equilibriums need to be reached.

Here are three areas that I think will continue to feature prominently for all of us involved in the industry, and are demonstrative of the need for adaptability.

Non-cash collateral

One of the themes we have seen evolve over the past few years was the growth of trade activity collateralised by non-cash, driven by balance sheet efficiency considerations. While equity collateral in particular has grown significantly, we have also seen the need to take on additional collateral sets. Not only has it been important for lending agents to ensure that risk management and oversight of these types of collateral has been robust, but it has also required that beneficial owner clients broaden their consideration.

More recently, we entered into a period of rising interest rates. While a rising rate environment can present short-term challenges, it is generally a favourable development for clients whose loans are predominantly collateralised by cash. In the years before we entered this rising interest rate regime, equity and other expanded collateral types offered opportunities to enhance securities lending returns by virtue of additional spread, volume or both. From a risk management standpoint, the liquidity characteristics of equities in particular made this type of collateral—properly margined and managed—a good option for both equity and fixed income loans.

As we move forward, despite the rising interest rate environment, equity and other non-cash collateral activity will continue to be both important and prominent. Moreover, the collateral space has been one of relatively constant innovation. Consideration of new types of collateral to be incorporated into securities lending, or looking into more balance sheet efficient ways of transacting with various collateral types, will be a focus.

From an agent lender standpoint, it is obviously important to understand how these types of innovations can impact borrower driven lending activity. It is also important in our role as agent to help work with both borrower and lending principal (beneficial owner) to ensure that the resulting construct is workable and beneficial to both sides. We must continually ensure that we employ rigorous due diligence in the introduction of new collateral types and structures.

Cleared lending

One area where some of these issues come together is that of central counterparties (CCPs). The idea of a CCP—or perhaps a series of CCPs—being in place to handle securities lending transactions has been discussed for the past three or four years, and was estimated for implementation consistently on a (rolling) 12-18 month timescale. Perhaps as a result of how long it has remained a mere 'discussion' item, general market skepticism around the timing of an eventual implementation has developed. However, there does appear to be a serious redoubling of efforts by firms looking eventually to offer a CCP solution for securities lending.

Again, adaptability on all fronts will be crucial to support an eventual successful roll-out. The rewards of a capital-efficient way of transacting remain very compelling. However, each party is understandably approaching the idea from quite different vantage points. For example, agent lenders, having to ensure that any new model works for both borrowers and beneficial owners, want a model that fits neatly into the current construct as much as possible. Borrowers and lenders approach the concept with a securities lending mindset. Meanwhile, the clearers approach things from their own mindset. There are points where things are similar in both worlds, but also places where there are different ways of approaching an issue.

Ultimately, for a model to be successful there needs to be alignment around collateralisation, operational and structural ease, and of course, documentation. In all of this, we should recognise that while clearing is not new, and while the application to things such as repo are also not terribly new, from the standpoint of the underlying beneficial owners having transactions go through a CCP will represent a new way of approaching securities lending. Of course, there is much to be finalised with respect to the model, and the needs and requirements of underlying lenders must be kept in mind alongside other participants. Adaptability of the lenders and borrowers, as well as client engagement, will be integral to the success of CCPs.

Regulation

In today's market, it would be difficult to write an article on securities lending that did not touch on regulation. In fact, relevant regulatory developments could warrant entire articles of their own, given that changes to the regulatory landscape have been pretty much a constant over the past few years. It is also an area that is not confined to any one market, and the effects of change can truly span across borders.

Topics such as the Securities Finance Transactions Regulation (SFTR) and the second Markets in Financial Instruments Directive (MiFID II) bear close consideration in that both impose changes to the way the participants in the lending industry have traditionally approached provision of the service, and this of course means that for all parties, there will be changes. Greater transparency is the eventual outcome, and generally speaking, is important to all parties, but this additional transparency does, however, come with the cost of additional reporting burdens for the various market participants. Significant volumes of additional data will need to be provided to satisfy requirements.

Having been in the industry for some time, it seems that the market presents both challenges and opportunities daily. Whatever one's overall position on the year ahead—and from my perspective it looks like it will be a busy one—there are likely to be a number of areas where lenders, borrowers and agents will need to be more closely coordinated—and more adaptable—than ever before. **SLT**

Francesco Squillacioti
Global head of agency lending
State Street Securities Finance

Pirum Systems: unblurring the lines

Tonia Noschese offers an insight into automation in the lending industry and ISLA's current rules surrounding billing, payments and exposure

Beyond compare: ISLA is accelerating industry change with automation as the catalyst

The securities financing industry has seen an increasing blurring of lines between functional groups within organisations. Front- and back-office distinctions and divisions between product groups are gradually becoming less relevant. The requirement to do more with less in an efficient manner has never been more prevalent when viewed against the backdrop of continually challenged margins.

Additionally, recent media and thought leadership content within the industry, suggests we may be on the cusp of a new technology revolution with the possible introduction of ground breaking and disruptive solutions into the ecosystem, such as artificial intelligence and machine learning and distributed ledger technology, commonly referred to as Blockchain.

As a technology company and innovator, we embrace these new opportunities, however, what is remarkable is the extent to which inefficiencies are abound in the current process model.

The recent best practice paper published by the International Securities Lending Association (ISLA) in October 2017, highlights these areas of inefficiency and looks to suggest a standardised approach to these operational challenges. These are not aspirational or ethereal ambitions for the industry, but rather areas that demand and require collective review and attention. This revised paper looks to offer a road map for the industry and goes way beyond just the comparison of contracts. It is a practical guide that looks to accelerate market efficiency including the suggestion of employing vendors to assist in achieving connectivity and straight-through processing (STP) of the post trade lifecycle.

Although steered by the high-level principles of conduct set out by the Bank of England's UK Money Markets Code, ISLA's guide offers a blueprint for risk mitigation and process improvement across the global securities finance ecosystem.

As offshoring and outsourcing increases, securities finance services become increasingly fragmented, both geographically and functionally. This emphasises the need for unified standards for process management.

The best practice paper promotes procedures to help mitigate these challenges and looks to improve processes in:

- Trade reconciliation
- Exposure management
- Collateralisation
- Payments and notifications
- Billing process
- Corporate action events

In the following piece, we look to summarise the proposals and provide a guide to adherence.

Trade reconciliation and confirmations

Systemic post trade reconciliation, on a batch basis, has been available to the market for over a decade, with initial focus on contract comparison for key economic fields, for example, fee and dividend rates. In the intervening years, this has moved into real-time pre-and post-trade matching of up to 32 fields and will evolve in the coming years to up to 97 fields with the onset of the Securities Finance Transactions Regulation (SFTR).

Although we have seen a marked increase in the adoption of pre-settlement and real time matching services, it is surprising to learn that many prominent market participants still do not use this robust and efficient service to improve controls, matching and settlement rates.

Market vendors can provide a standard settlement instruction (SSI) repository with trade comparison. Further enhancements to STP can be achieved through intra-day loan release, linking the release of new loan instructions to real time required collateral valuations.

Thus, instructions are released earlier to the market, SWIFT network costs reduced and risk mitigated by automating the release of loans. Intraday matching and automated returns are further encouraged by ISLA and the reporting timeframes under SFTR and shorter settlement cycles under Target2-Securities (T2S) will make faster communication across market participants a necessity.

Furthermore, European Securities and Markets Authority's Central Securities Depository Regulation (CSDR) will introduce penalties for failed trades. This will mandate timely tZero automated matching solutions as firms look to reduce risk in advance of the settlement regime.

The ISLA best practice paper reiterates "It is strongly encouraged that a robust trade matching and post trade contract compare process is in place between parties in order to mitigate risk."

Billing

The best practice paper states "ISLA continues to support the use of automated vendor solutions as best practice for billing delivery and reconciliation". The market standards expect bills to be issued within the first seven days of the month, with identification of disputes completed by the 14th day and many participants will be working towards even shorter timeframes, particularly where their billable income is needed for onward distribution to their clients.

Vendor solutions can systematically send month-end fee and rebate statements, automatically identifying accrual discrepancies within moments of receiving the counterparties bills. Existing automation reconciles the previous calendar month's statements matching the industry's bill payment lifecycle. This enables the borrower and lender to agree in advance of the stringent 10 working day turnaround for a bill payment, with less manual effort. Furthermore, daily use of the contract comparison tools will identify discrepancies impacting billing before month-end, preventing costly profit and loss write-offs for the desk.

The increase in bond borrow activity has led to new operational challenges for the fixed income community. The billing file content listed in the best practice paper was not accessible as a month end statement due to historic infrastructure for fixed income rebate collection being centred on cash repos, where interest is typically moved on term or collected during the daily mark-to-market process in the US.

This year, the value of bonds on loan matched the value of equities, at 45 percent of global on loan balance for the first time and has therefore become a key area of focus. As month-end unpaid fees represents an uncollateralised risk for the lender as well as an operational and trading risk for the borrowers, embracing automation to improve workflows has never been so important.

Exposure management and collateralisation

Regulatory frameworks from Basel III and the Dodd-Frank Act continue to shape the trends within the securities lending industry including the rise in use and demand for collateralised transactions. These forces combined with commercial demands have added routes to market, expanded transaction venues and increased the complexity of day-to-day trading. This diversity of settlement, counterparty and operational infrastructure has led to a highly complex collateral landscape.

Reconciliation

For the securities lending and repo markets, the ISLA Best Practice paper states "matching required collateral to cover a loan should be done via an automated reconciliation platform". Where US equities make up almost 56 percent of all equities on-loan, automation is already a mature offering in this region which is required to allow for scalability and correct collateralisation. The automated mark-to-market process through a vendor enables the borrower to match the lender price (within tolerance) and post this marked value into both counterparties systems in order to match the cash-equivalent value on the loan. Vendor tools provide visibility to any exceptions and highlight valuation differences, for example price, foreign exchange and margin which results in faster dispute resolution.

Payments

The ISLA best practice paper references the efficient management of daylight or intraday exposure with respect to the settlement lifecycle and billing payments. Market participants in the US predominately move USD cash between their Depository Trust and Clearing Corporation (DTCC) accounts via special payment orders (SPO's). Automated workflows enable SPO charges to be calculated from reconciled mark-to-market positions and executed directly in DTCC. This reduces processing times, removes the risk of human error and seamlessly links underlying trade activity with free of payment cash processing.

Exposure

Managing daylight exposure also forms part of the ISLA best practice paper with a particular focus on non-cash collateralisation and pre-pay management. For securities lending and repo, the non-cash transactions form a large part of the current market (60 percent globally, 82 percent to 93 percent Europe for equity/government bond). This large and rising use of non-cash collateral, coupled with an increasing desire to collateralise on a same-day basis has increased the demand for tri-party collateral agents to manage the diverse collateral profiles.

Triparty collateral management is where the parties to a bilateral non-cash loan transaction pass responsibility for the management of the agreed collateral to a specialist collateral management service provider. The triparty agent then maintains the required collateral value, including any eligibility requirements, for the collateral over the life of the loan.

Despite advances with technological capabilities in the last two years, a lot of the exposure management processes remain manual and time-consuming. This has driven the industry to look at automation to provide a scalable low-cost solution, simplifying the management of the increasing number of separate exposures with the same resources.

Automation from vendors empowers operational teams by providing a near real-time global view of exposures, and a platform by which to identify, and agree margin requirements and to ensure they have an accurate portfolio reconciled with counterparties. As well as linking together the borrowers and lenders, vendors have formed partnerships with tri-party providers to allow the automation of communicating daily required values (RQVs) whilst obtaining visibility to intra-day collateralisation including details of the allocated collateral.

Enterprise wide

In addition, vendors are now looking at tools to enable end-to-end, enterprise-wide collateral management which centre on the efficient and optimal use of collateral in terms of managing margin exposures, utilising eligible inventory and covering requirements through collateral mobilisation. As such, providers are attempting to enable a more holistic approach to exposure management, better mitigate risk, more efficiently processes collateral movements and help to promote compliance with new regulations. Real-time exposure and inventory views can now provide projections, looking at future dated transactions to ensure accuracy from the point of booking. This is not only more efficient with anticipating funding requirements but also less resource intensive by allowing prioritisation of breaks to be resolved in advance of the collateralisation date.

Corporate actions

Managing corporate events, including both on loan and collateral positions, remains one of the most manually intensive and most risky of operational tasks. The lack of critical mass and collective desire for an automated platform has hindered automation levels and there seems limited consensus on the direction of automation.

The lack of standardisation of messaging between beneficial owner, custodian, agent lender and borrower often leads to missed or incorrect elections or claims, disagreement on event details and entitlements, and late elections because of inconsistent cut-offs due to the changing nature of a stock loan and the fact that a single election must be passed on multiple times. Often, that single election can also take multiple forms through the chain starting, for example, as a SWIFT, then transferred into a spreadsheet, then onto an email and even then, as a fax.

The late payment of dividend entitlements is also becoming an increasing challenge for the industry as lenders are required to set aside capital for the unsecured credit risk exposure whereby a lender has paid the dividend entitlement to their beneficial owner, but not yet been paid by the borrower. If there is a discrepancy on the underlying entitlement, these claims can sometimes take several days or even weeks to be settled fully.

Some advancements have been seen with the advent of cleared activity, however, this remains a very small proportion of the overall population. When a central counterparty (CCP) is used in conjunction with a gateway service that can manage downstream events, processing of voluntary corporate actions and dividends is dramatically improved as the CCP will ensure all entitlements are paid on pay date. The best practice paper covers mandatory and voluntary events, from preliminary checks approaching event announcement, to actions on pay date and suggests this should be a key area of industry focus.

Conclusion

Although the securities finance industry is evolving, there still seems a commonality of issue in terms of the processing ecosystem. The ISLA best practice paper highlights these areas of post trade inefficiency and suggests that they should demand our collective attention for resolution.

Technology continues to challenge and potentially revolutionise our approach to process delivery in this and every industry. Whilst institutions can build in-house to resolve areas of concerns, increasingly service providers are seen as an efficient and robust solution to non-differentiating problems, providing it is done in a connected and interoperable fashion.

In addition to consolidating data feeds from the borrower and lender, technology now allows unprecedented levels of transparency beyond comparison of contracts. Near real-time instructions for returns, marks, visibility of collateral with triparty vendors, and trade repository links, have improved audit of activity bringing additional controls and management oversight.

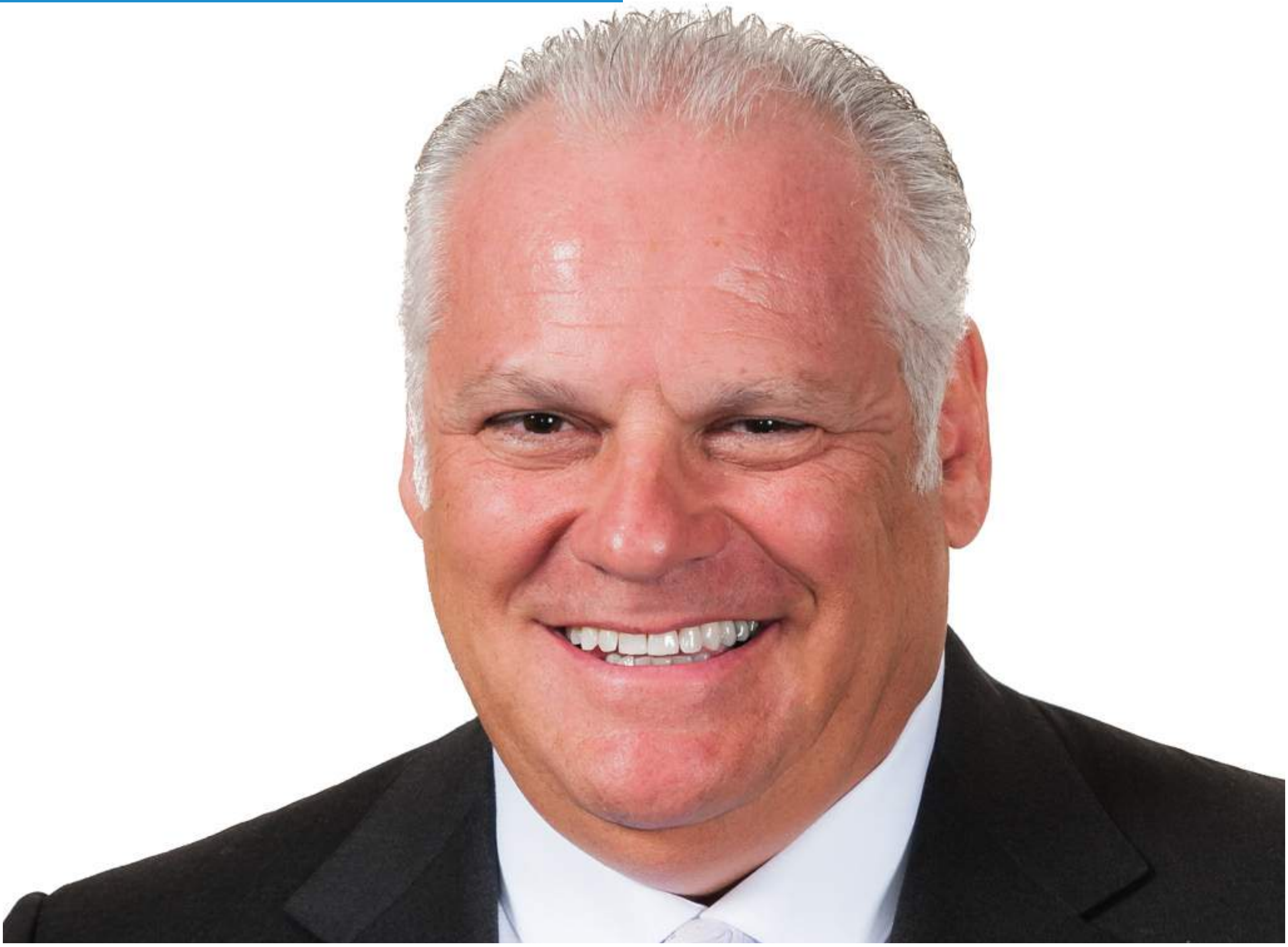
Automated solutions can be introduced with very little technical build, allowing clients to implement rapidly with less cost. However, as not all market participants have yet to embrace automation, ISLA provide standardised data sets in the best practice document to illustrate the minimum levels of information required to transact effectively.

Technology can be a catalyst to accelerated decision making whilst providing a scalable controlled solution to inefficiencies. Increased automation will be a significant step to improving market efficiency allowing straight-through, exception-based processes and in turn enabling effective deployment of resource to more value additive functions.

Recommended next steps

- Review the ISLA best practice paper
- Speak with your counterparties to discuss efficiency and process optimisation
- Review service providers to determine opportunities leverage existing solutions to achieve greater connectivity and higher levels of automation
- If you are not connected to a market vendor ask them how automation can help you

Join the debate with market practitioners to increase effectiveness of how we all interact in the industry. **SLT**



Walking through history

Jeff Kidwell of AVM discusses his career in the securities lending industry and how the market has evolved since he started 35 years ago

With over three decades in securities lending and repo tell us a little about your career and how the industry has changed?

I celebrated 35 years in the repo and securities lending industry in December. I was hired during the Drysdale crisis in May 1982 and have witnessed a lot of history, including the savings and loan crisis, Orange County, and long-term capital. I saw the rapid expansion of the industry in the 1980s and 1990s, followed by the failures and consolidation of 2007 to 2009, and the hyper-regulated environment that we work in now. I began in IT, moved on to overnight repo trading, then to term repo trading, risk management, and sales/trading management, for broker-dealers and their repo-matched book operations in the US, Canada, and Europe. Currently, I deal on a global basis, but as an introducing broker for institutional clients and broker-dealers. I've seen it when there were 47 primary dealers, some running repo matched books with over $1 trillion in balance sheets and then seen those primary dealers dwindle down to 21 and their balance sheets shrink by 60 percent or more. That led to smaller boutique broker-dealer startups and the movement of business to international banks.

When I started, repo and securities lending was traded through a broker-dealer, typically a primary dealer. Clients on both sides of the market dealt with a repo-matched book at a broker-dealer or had third parties, such as securities lending agents deal with those repo-matched books on behalf of them. The broker-dealer repo-matched books were managing the interest rate risks, documentation risks, settlement risks, default risks, and counterparty credit risks themselves. Therefore, clients on either side of those huge repo-matched books had no idea who the clients were on the other side, how they might impact each broker-dealer or that client. Things have changed enormously since I started and now, I am introducing those clients to each other, and they are assuming those risks themselves rather than putting blind faith in someone doing it for them, especially since the financial crisis.

You were brought in to create a repo desk for broker-dealer AVM, how did this come about?

A repo desk already existed at AVM and handled financing for some of their clients, as an introducing broker. I left Wall Street at the end of 2007 and was visiting clients around the country to keep in touch, and I happened to visit my client AVM in Boca Raton. They recognised the value I could bring from my long history on Wall Street and thousands of client relationships to bolster their repo desk. I was intrigued because it would be a new side of the business for me, it would allow me to help many of my clients, who were suffering from lack of liquidity during the financial crisis.

How has your role developed since then?

It turned out that the financial crisis crippled the repo and securities lending industry, causing firms to fail, forcing mergers, spurring layoffs, and drastically reducing liquidity for certain classes of securities and overall drastically reducing balance sheets. The US repo market shrunk from about $7.2 trillion in 2007 to about $3.2 trillion. The repo markets in Europe, Asia, and Canada shrunk similarly. In my conversations with clients, it wasn't that the cash providers still didn't have the cash to invest, or the collateral providers still didn't have the collateral to finance, or the securities lending beneficial owners didn't have the securities they would like to lend and then reinvest the cash, they just couldn't get it all to function through the traditional broker-dealer pipeline anymore. And that became a more permanent challenge, when regulations were proposed and enacted while dealing with the systemic risks that the financial crisis had laid bare. The market needed other pathways to liquidity, besides the traditional broker-dealer pipeline, and I had access to those clients on both sides. So, it seemed logical to me, within weeks of starting at AVM that I should introduce those clients to each other so they could establish their own 'direct' pipelines, I coined the term direct repo for that connection. Of course, to change client behaviour that had developed over decades in the repo industry, I had to re-educate the market, brand our trademarked Direct Repo, extensively market the product, tweak the product for different clients' needs, attempt to streamline the processing of credit and documentation, and eventually publish rates and push for trade executions. The education and branding process took a long time, and many of the folks in the industry saw me speaking at many conferences and writing many articles for a few years.

Direct Repo was set to challenge the standard process in the market, how has this worked out?

Direct Repo is a 'challenge' to the standard process, a disruption if you will, but it has not been met with a negative reaction from the broker-dealers. If anything, several broker-dealers welcomed it because it took the burden off of them to get their clients who had bought securities from them financed away from them. In fact, we've worked closely with several broker-dealers who no longer had the distribution to finance positions or source collateral. The challenge with the customer is that it is 'different' than what they are used to doing, but it isn't. It's still repo or securities lending, still governed by the same documents (sometimes with even better terms than the ones they had with broker-dealers), still done with another principal, maybe more fitting for their tenor needs (rather than all long-term to fulfill broker-dealer liquidity coverage ratio requirements), at a mid-market rate, which is a significant benefit to the client, possibly at better margin percentage—another benefit to the client—and probably stickier supply.

The real difference is that their credit department may have been used to looking at an elephant (broker-dealer) at the watering hole (market) and now would also be looking at a giraffe (non-broker-dealer) or a lion (another non-broker-dealer). So, they are still mammals, but different species. And that's not to say an elephant is better than a giraffe, or vice versa. However, at least in this scenario, the client gets to choose what species it can trade repo with, and the counterparties don't all have to be elephants. I am biased, but I think it's worked well. As I see the Federal Reserve doing its reverse repo programme, central counterparties (CCPs) are popping up and doing all-to-all trading, electronic trading platforms popping up and doing peer-to-peer or all-to-all financing, and the Treasury's Office of Financial Research (OFR) is publishing data about Money Funds doing repo with non-broker-dealers in peer-to-peer financing, I think how much the concept has been 'accepted as self-evident.'

Where is Direct Repo at right now and where is it going?

Direct Repo is growing, and large clients have recently joined, which will likely lead to greater volume. Segments of the market that have been slower to change, like municipalities, money market funds, and central banks/sovereign wealth funds then, are suddenly changing their investment policies to open up their restrictions on repo counterparties and take advantage of extra liquidity, extra diversification, and extra savings. Some segments, like pension funds, have now realised that they know a lot more about hedge funds than they thought, and are now in dialogues about lending to the hedge funds directly. Now money funds have gone through waves of regulatory reforms; they finally have the time to focus on adding alternative repo clients and grabbing back yield and liquidity in government securities, which have suffered in liquidity during the broker-dealer balance sheet shrinkage.

What do you predict this year will hold for the securities lending market?

Each of the pathways that are being developed, and probably some we haven't seen yet, will continue to be implemented and grow. Some may not survive, some may have to consolidate, but I believe, in the end, that the market will accept several pathways and that there isn't one pathway that will solve all clients' needs. **SLT**

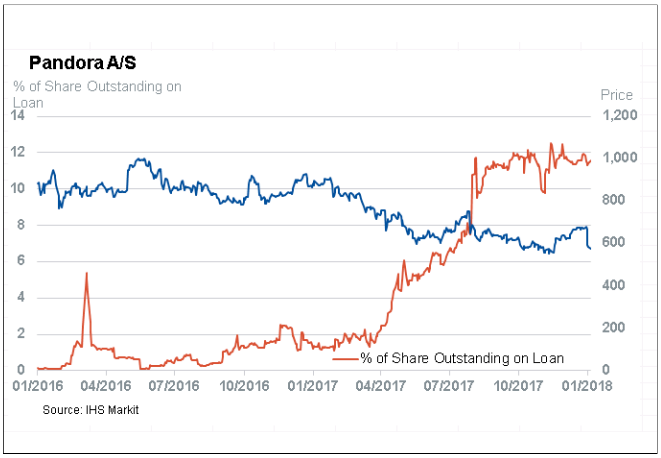
Pandora glitters gold for short sellers

Samuel Pierson of IHS Markit explains how short sellers target jewellers as the so-called global retail apocalypse continues to play out

- Pandora jewellers most shorted European consumer durables stock
- Short sellers have increased bets against Pandora tenfold in last 12 months
- Other retail jewellers selectively targeted by short sellers

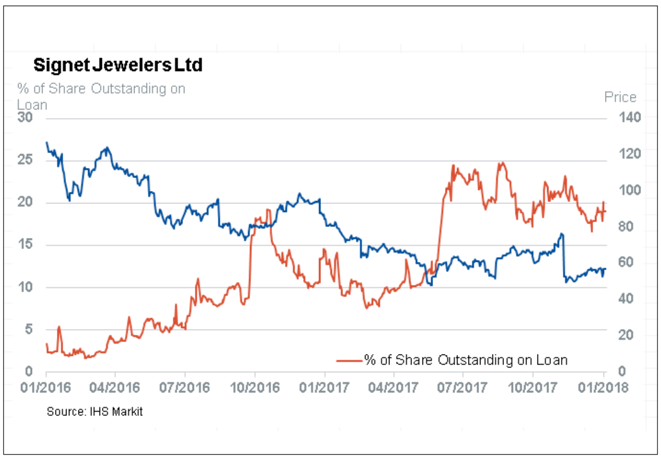
It has been a wild start to 2018 for shareholders of Danish jeweller Pandora. The share price declined more than 15 percent between 9 January and 15 January–the result short sellers have been waiting for since they started increasing bets against the firm in early 2017. Since then, shares have recovered more than half the decline, as the CEO has soothed some investor concerns, however, the short demand for Pandora is unchanged.

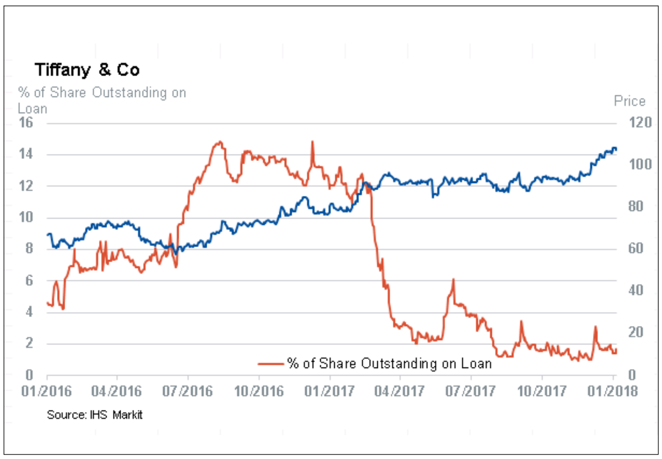
Since the start of 2017, short sellers have increased their positions in Pandora dramatically, and more than 11 percent of outstanding shares are now out on loan. The trade worked perfectly to start, with the double-digit price declines in Q1 and Q2 2017. Short sellers continued to press in Q3 – undeterred by a rally of more than 20 percent in August – and were rewarded when shares appeared to resume the downtrend, setting a 52 week low of DKK 560.5 (USD 92.07) on 24 November. Meanwhile, it's interesting to note that the demand for shares from short sellers has been flat since the start of September.

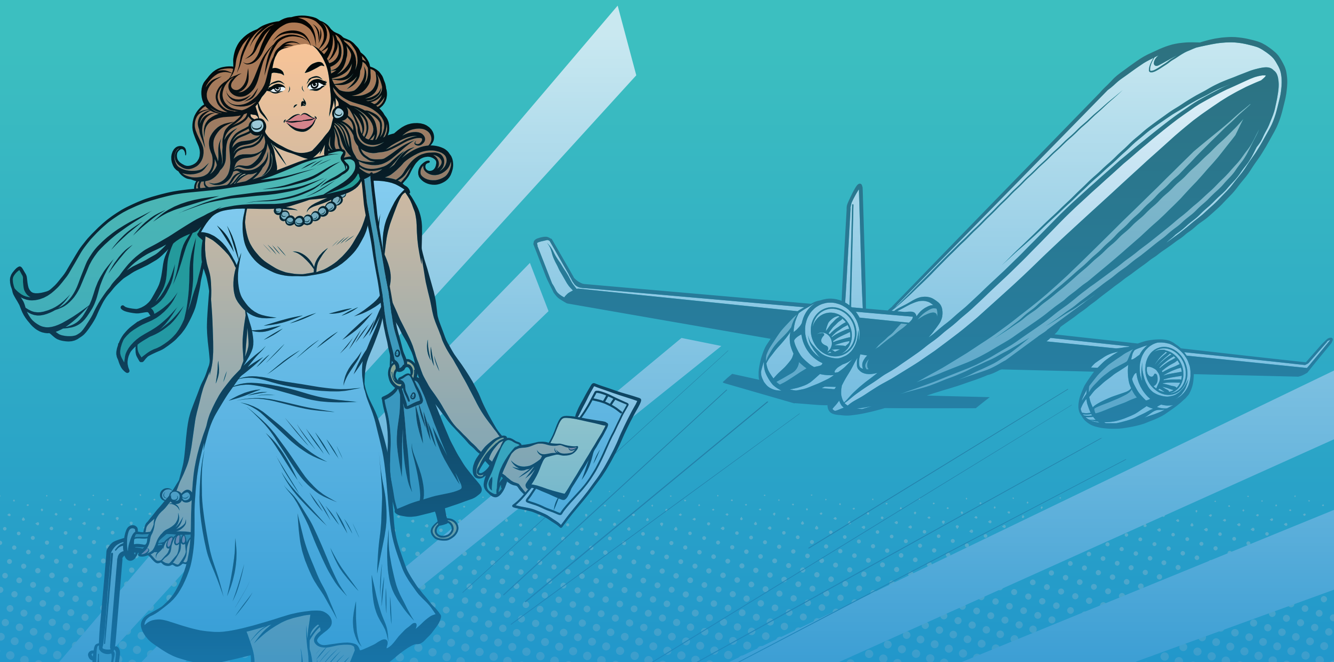


Short sellers are hoping that Pandora will follow Signet Jewelers, whose shares have declined in value by more than 60 percent since the all-time high in October 2015. Throughout the decline, short sellers increased their bets, reaching a peak of 24 percent of outstanding shares in September. On 21 November, Signet shares plunged 30 percent in a single day after the firm reported disappointing sales numbers. This was a sweet relief for short sellers who got in late, as shares rallied nearly 50 percent from their 52-week low in the preceding three months. While volatility has been elevated recently, no clear trend has emerged and, like Pandora, the share price is currently higher than it was at the end of Q2.

Short sellers are not indiscriminately betting against retail jewellers and have in fact covered significant positions in the sector over the last year. Tiffany's attracted significant short activity in late 2016, but its share price rallied by 20 percent in Q1 2017, and short sellers took down positions. After treading water for the subsequent six months, shares rallied a further 16 percent in Q4, suggesting short sellers were wise to stay away. A similar narrative emerged in Swatch Group, which saw short interest decline by more than 50 percent in the last year while the share price has increased 17 percent. **SLT**







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Comings and goings at Broadridge, Eurex and DTCC

The Depository Trust & Clearing Corporation (DTCC) has appointed Timothy Lind as managing director of data services.

Lind will be responsible for guiding data businesses, including services that leverage data derived from DTCC's global processing platforms, as well as monitoring all risk management and regulatory requirements.

Lind has experience in global capital markets infrastructure and the deployment of technology for operational efficiency, data governance, transaction automation, regulatory compliance and risk management.

Prior to DTCC, Lind was global head of financial regulatory solutions at Thomson Reuters where he was responsible for developing and overseeing the growth of solutions to meet regulatory compliance data challenges.

He was also a consultant at RTech Advisors and worked at Omgeo, now a part of DTCC, as its chief strategy officer.

Commenting on the appointment, Tim Keady, managing director and head of DTCC Solutions, said: "Tim Lind brings to DTCC more than 25 years of domestic and international experience in the capital markets, including a rich background in data offerings."

"We look forward to Lind's contributions, working with our community to continue advancing our data strategy with an emphasis on reducing risk, enhancing data transparency and maximising value for our clients."

Lind added: "I'm excited to partner with my colleagues and the industry to identify innovative ways to increase the value of DTCC's data offerings to enable compliance with regulatory requirements, optimise capital use and more effectively manage risk."


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Broadridge has appointed Tom Carey to head up the firm's new international business Broadridge International, in an attempt to expand in Europe, the Middle East and Africa (EMEA), as well as Asia Pacific markets.

Carey will also serve on Broadridge's executive committee.

Previously, Carey headed up the firm's technology and operations solutions business in EMEA and Asia Pacific.

In the newly created role, Carey will work closely with the firm's governance and communication product groups led by Patricia Rosch outside of North America.

Rosch, who works as international head of Broadridge investor communication solutions, said: "Working closely with Tom Carey and his team will enable us to take our current and next generation of products directly to market in EMEA and Asia Pacific in the most effective manner to meet clients' growing needs."

Carey added: "I am excited to lead our international efforts outside of North America, redoubling our focus and commitment to helping our clients support their business needs through the global scale and local relevance of our solutions and services, to meet today's challenges and capitalise on what's coming next."

New York-based law firm Bressler Amery & Ross has promoted hedge fund lawyer David Hantman to partner.

Hantman joined Bressler as associate in 2007 and was promoted to counsel in January 2017.

In his previous role he focused on securities litigation and arbitration, and dealt with expungement practice and defending funds against investor claims as misrepresentation, fraud and unsuitability.

Prior to Bressler, Hantman served as a risk mitigation consultant, as well as a consultant in the hedge fund industry.

AxiomSL has hired Harry Chopra as chief client officer with immediate effect.

Chopra will oversee the firm's global business development efforts, implement market strategies and build client-driven growth.

He brings with him 30 years of experience in global sales and financial services. Most recently, he served as chief commercial officer at Credit Benchmark.

Alex Tsigutkin, founder and CEO of AxiomSL, said: "Harry Chopra comes with a remarkable financial services background and will oversee an important client-facing role globally. Along with his proven leadership skills and track record of financial success, [he] will play a fundamental role in achieving our growth targets and implementing AxiomSL's go-to- market strategies."

Chopra added: "I'm delighted to join the AxiomSL leadership team. One of my goals is to continue the immense growth AxiomSL has experienced, by driving demand generation and sales. I've spent the majority of my career in the financial sector and have followed AxiomSL with great interest."

Eurex Clearing has hired Adam Husted as co-head of global partner banks relationship management.

In his new role, Husted is responsible for working closely with Eurex Clearing's partner banks to develop liquidity and client services in the exchange's over-the-counter interest rate swaps products.

Eurex Clearing developed a partnership programme designed to accelerate the development of a liquid, EU based alternative for the clearing of interest rate swaps. The program has been launched in October 2017.

Based in London, Husted reports to Philip Simons, global head of fixed income derivatives sales and business development at Deutsche Boerse.

Prior to Eurex, Husted worked at CloudMargin as head of sales for the Europe, the Middle East and Africa from October 2016.

Before CloudMargin, Husted briefly oversaw new business development at Lombard Risk.

Simons said: "We are glad to have Adam Husted on board for our partnership programme. Since its launch in October last year, the programme has already gained broad market support: more than 25 market participants from the US, the UK and Continental Europe are taking part so far."

"With Adam joining our team, we expect to further grow our products, services and market share in OTC IRS."

Former securities lending associate Thomas Fiorentino has stepped down from his role at eSecLending to become a client support specialist at Intercontinental Exchange (ICE).

He will continue to be based in Bedford, Massachusetts.

Fiorentino was at eSecLending for more than two years and was responsible for processing trade settlements and monitoring securities transactions.

Prior to eSecLending, Fiorentino briefly worked at State Street as part of its global operations team. **SLT**