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SFTR Insight

John Kernan of REGIS-TR explains what should firms be working on to meet SFTR compliance

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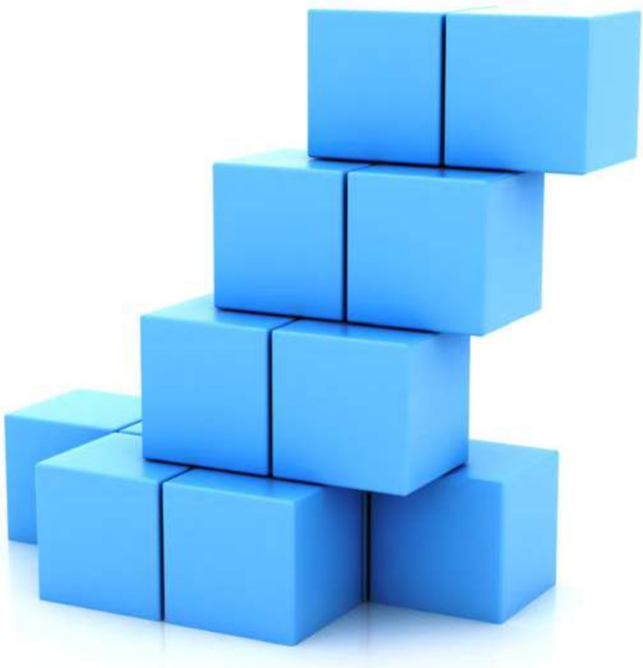

TASE to create blockchain platform

Tel Aviv Stock Exchange (TASE), professional services group Accenture and global financial technology (fintech) innovation centre, The Floor, are to develop a new blockchain securities lending platform powered by Intel.

TASE said this makes it the first global player in the Israeli market to embed this cutting-edge technology into its operating business, utilising it as the technological basis of a new securities lending platform.

There is currently no central securities lending platform in the Israeli market, TASE said. Securities lending is at present executed in the capital market, primarily using inter-bank mechanisms within, and if necessary outside, banking group limits.

As a result, the market has not been fully exploited to satisfy the potential needs of economic agents, TASE added.

TASE said the purpose of this project is to create one central platform that will transform the country's securities lending market by enabling direct lending among all the major financial instruments.

This platform will function as a one-stop-shop for all securities lending activities, permitting access to larger securities volumes within shorter timeframes, even operating in shorter-term positions, it said.

The use of distributed ledger technology (DLT) as the basis of the new trading platform will harness some of the blockchain's primary advantages and features, such as direct peer-to-peer transactions, Smart Contract, and enhanced security through immutability, said TASE. All of these are expected to benefit, including its custodians and their clients by reducing costs, increasing security and enabling the market to exploit its full potential.

The co-operation originated in March last year during an international blockchain hackathon and quickly transitioned to a concrete opportunity, explained TASE. The project is structured with a two-phased approach comprising an initial proof of concept (PoC), which upon its success will be followed by a deployment of the solution in a production environment.

Hyperledger Sawtooth is the infrastructure on which the project is based—an enterprise blockchain platform for building DLT applications. Intel worked with Accenture, TASE and The Floor to deliver a private ledger on Hyperledger Sawtooth that utilises Intel Software Guard Extensions (Intel SGX) technology to encrypt transaction data.

This helps keep data private among transaction participants and provides closed DLT platform members with additional confidentiality capabilities, said TASE.

TASE said that Accenture is leading the initiative by providing project management, systems integration, blockchain and cybersecurity consulting services to support the securities lending platform.

The company will play a key role in the development of the platform's Smart Contracts, one of Hyperledger Sawtooth's main business attributes.

Ittai Ben-Zeev, TASE's CEO, said: "The blockchain technology will present a new level of safety for securities lending and will support growth for transactions based on this new platform."

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ISLA set to respond to Spanish securities lending consultation

The International Securities Lending Association (ISLA) is set to respond to the initiative launched by the Spanish Ministry of Economy regarding securities lending and mutual funds.

The closing date for submissions in response to the ministry's consultation document, launched on 24 April, is 18 May. ISLA said it will be submitting a response on behalf of its members.

The consultation proposes a new regulation designed to create a regulatory framework around the implementation of securities lending activity for mutual funds, and to readdress any competitive disadvantage that Spanish mutual funds suffer compared to other fund domiciles where funds are allowed to lend their assets, explained Mark Hutchings, currently chief operating officer at ISLA.

"We believe the main objective is to allow mutual funds to offer a better profitability to their investors thanks to the securities lending activity while maintaining the protection of their investment on the other end," he said.

In a note, ISLA said: "Over time, we hope to see a broader acceptance of securities lending in this important European market as we look to the development of the Capital Markets Union agenda across Europe."

"Securities lending not only provides important incremental revenue opportunities to investors, but it also provides a foundation supporting effective price discovery and secondary market liquidity."

Plato and Tradeweb team up on European cash equity risk trading

Plato Partnership and Tradeweb Markets have partnered into a strategic partnership to deliver Tradeweb Plato eBlock.

According to the duo, market structure and regulatory changes in European equity markets have created demand for cost-effective solutions to be provided on regulated trading venues to benefit from greater competition, transparency and operational efficiency.

The new platform allows participants to source and aggregate broker principal risk liquidity, addressing buy-side concerns over market fragmentation, providing the buy-side with direct control over their execution, and offering both the buy and sell-side the opportunity to match, negotiate and execute with ease and certainty on a regulated venue.

It has also been designed to leverage innovative 'blotter scraping' technology, providing buy-side traders with the insight required to target suitable organisations based on activity, execution rates and market impact.

Lee Olesky, CEO of Tradeweb Markets, commented: "Our collaboration with Plato Partnership is a significant milestone for Tradeweb. As pioneers of the multilateral electronic RFQ protocol, we have brought greater transparency and efficiency to fixed income, derivatives and ETF markets."

"We are excited to extend this highly successful model to cash equities and to work with Plato to develop new trading mechanisms to more efficiently execute block trades against principal liquidity on a regulated trading venue. We are confident that our innovative and efficient approach to block trade equities execution will offer market participants flexibility of choice and access to robust, cost-effective liquidity."

Mike Bellaro, Plato Partnership co-chair, commented: "We are pleased to partner with Tradeweb to deliver this innovative solution for risk trading of cash equities. eBlock allows buy-side traders to tie the sourcing of risk liquidity into the execution process using intelligent data analytics, giving them the necessary information required to make good decisions about trade execution."

Deutsche Börse and Clearstream to launch Acceleration platform

Deutsche Börse Group and its post-trade services provider, Clearstream, will partner with financial technology (fintech) firms, figo and Finologee to create the Acceleration platform.

The platform is expected to launch in Q4 2018, subject to regulatory approval. First deployments on the platform are currently being evaluated.

According to Deutsche Börse, the new platform will enable established financial industry firms and digital companies to distribute and leverage each other's services resulting in new revenue opportunities.

It will allow access to Deutsche Börse's market and reference data, as well as functional services via web-based application programming interfaces (APIs).

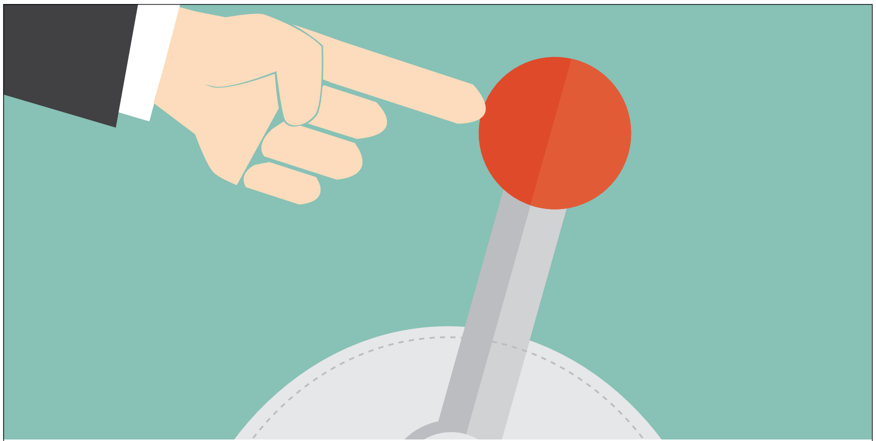
The first services offered by third parties will be an access to account gateway for banks for the second Payment Services Directive (PSD2).

Deutsche Börse Group has been cooperating with figo since 2016, and the new partnership with Finologee is targeted to serve particularly the Luxembourg market with the first end-to-end PSD2-compliant payment solution.

Clearstream will run the APIs marketplace for Deutsche Börse, which the fintech Acceleration platform will be based on.

The platform will be available for use by developers at figo's Bankathon on 27-29 August 2018 in Frankfurt.

Marc Robert-Nicoud, CEO of Clearstream Holding, said: "We believe that this kind of partnership is the way forward in shaping the future of the financial industry. It brings together the know how and innovation capacity of an established market infrastructure with the innovative models and flexibility of strong fintech start-ups.



CME to list USD Eris interest rate swap futures

CME Group and Eris Exchange, a US-based futures exchange group, have entered into a licensing agreement to list USD Eris interest rate swap futures.

Pending regulatory approval, Eris futures will be listed with and subject to the rules and regulations of the platform, CBOT, starting in the fourth quarter of 2018. Existing open interest in the contracts will be transferred to CME Group at that time.

The Eris futures will trade alongside the MAC Swap Futures, though until the migration in late 2018, Eris Swap Futures will remain listed at Eris Exchange and cleared at CME Clearing, where they are subject to margin offsets with CME Group's interest rate futures.

Agha Mirza, global head of interest rate products at CME, said: "Given strong participation and growing demand for greater access to over-the-counter swap markets, making Eris products available to trade on our global, electronic and liquid CME Globex platform will provide market participants with greater capital efficiencies."

He said: "We are committed to offering our customers a choice of products to best meet their evolving hedging needs, and we look forward to working with market participants in the coming months to ensure a smooth transition."

Neal Brady, CEO of Eris Exchange, said: "CME Group is the ideal platform to propel the next phase of growth of US Dollar Eris Swap Futures."

ECB responds to queries about T2S

The European Central Bank has responded to requests for clarification of reports that it would be raising fees for access to its TARGET2Securities (T2S) platform.

A list of publications and extracts reviewing T2S pricing include a reference to the ECB's 2017 T2S annual report, which said: "In March 2012, the T2S Programme Board clarified the platform's pricing policy by emphasising that it did not intend to propose revising the benchmark price of €0.15 per delivery-versus-payment (DVP) settlement instruction before 2019."

This decision was made in order to foster stable volumes in T2S, with the intention of assessing the situation at a later date against certain conditions relating to actual usage and the recovery of development and implementation costs.

The ECB stated in its 2017 report: "With the volumes settled on the T2S platform in 2017 remaining below the projected levels, it will be necessary to review the price of €0.15 per DVP settlement instruction in 2019." This price was set in November 2010 by the ECB's Governing Council and fixed to December 2018.

The Governing Council also made a commitment not to increase T2S fees by more than 10 percent per year between 2019 and the end of the period scheduled for the recovery of the project's cost, September 2022.

The ECB's review of T2S in 2017 included a section noting that in November 2021, the consolidation of TARGET2 and T2S will go live, bringing about the technical and functional consolidation of the Eurosystem's payment and securities settlement services.

The report said that the project will improve the operational efficiency of TARGET Services by enhancing monitoring and increasing the level of automation in operational activities, though consequently, such consolidation will reduce T2S's operational costs.

This symbiosis can contribute immensely to developing new interaction, collaboration and monetisation models."

Raoul Mulheims, co-founder and CEO of Finologee, commented: "I think we found a perfect match here. We aim at building a very powerful service distribution platform and marketplace, serving both the traditional financial industry's and the new generation players' needs."

André Bajorat, CEO of figo, said: "With Clearstream, we use the infrastructure of a trustworthy partner from which our customers, banks and non-banks, benefit."

He added: "Technology, developer community and compliance—the idea of open banking in general—come together in the PSD2, and this is exactly what all three partners make clear at this point. Creating this market place is the logical consequence of what we have done so far."

Top of hot stocks: Shop Apotheke Europe and GOGO Inc

Shop Apotheke Europe (SAEG), a Netherlands-based pharmacy and personal products retailer, made its debut on the FIS Astec Analytics hot stocks list for Europe, the Middle East, and Africa last week (11 May).

SAEG's interest remained relatively low at around 10 percent of supply, until April when it jumped to almost 50 percent, ahead of Q1 results being released.

According to FIS, with 38 percent of the available shares remaining borrowed, there are some short sellers who expect it to fall further.

Following SAEG, was CNH Industrial NV (CNHI), another Netherlands-based firm, which last appeared on the list in March 2018. The firm has been notable for its decreasing short interest volumes over the 12 months to March.

Short interest volume itself, jumped 30 percent last week, though utilisation advanced by less than five percent, suggesting an increase in supply, potentially arising from large institutional funds buying into CNHI.

Top of the Americas hot stocks list, was GOGO, a provider of in-flight connectivity and entertainment for airlines.

Short sellers have held positions exceeding 90 percent of the available supply from GOGO for much of the last 12 months, expanding their positions by volume as soon as new supply becomes available.

Following GOGO, was J C Penney (JCP). The last three weeks has seen 100 percent of JCP shares being borrowed, with the retailer closing the week at 93 percent.

FIS said the fall in utilisation, of around 7 percent, runs contrary to the 8 percent increase in absolute volume of shares borrowed over the last week, suggesting a jump in supply. JCP remain in place holding substantial short positions in anticipation of the final demise of the high-street name, said FIS.

IHS Markit: US gaming stocks soar on US Supreme Court decision

Stocks related to gambling in the US have received a jolt as the US Supreme Court ruled 7-2 to overturn the Professional and Amateur Sports Protection Act of 1992, which banned sports betting in states where it wasn't already legal.

Sam Pierson, director of securities finance at IHS Markit, said in a company commentary, the potential for a dramatic increase in sports betting caused some gaming-related stocks to pop in trading on 14 May.

He said: "While the news was positive for some, the concern that this may actually hurt sports betting in Nevada weighed on the casino stocks, though that impact was certainly more muted than the upside seen elsewhere in the group."

The likelihood of an increase in legal sports gambling means that even if Nevada loses shares it may be coming from a much larger pie, he calculated.

The ruling was not great news for short sellers, especially those targeting Scientific Games Corp, Pierson said.

Short sellers added 1.7 million shares to short positions over the last month, an increase of nearly 30 percent.

Pierson added: "With the price up more than 11 percent on 14 May, it's likely that some of the recent short sellers have headed for the exit, at least for the time being, but the higher price may induce some short sellers to add or enter a new position."

Short sellers covered 13 percent of their position in Boyd Gaming Corp in the month prior to the new ruling, as shares rallied off the year-to-date low on 2 April, Pierson observed.

That may have served to limit the reaction in the price today, which was up less than comparable stocks, though the price did advance more than 3 percent and are now back above where they started 2018.

Pierson also found short demand is down 25 percent since the start of the year.

"It remains to be seen how states will react to their newfound freedom, though this certainly opens the door to a large scale expansion of sports betting", Pierson said.

Other likely beneficiaries identified by Pierson include the state of New Jersey, which had lobbied in support of legalised sports betting since Jon Corzine took up the cause as governor in 2009.

ITG: Introduction of DVC has seen an emergence of different venue profiles

Dark caps created "a more fragmented, and likely more challenging liquidity landscape for

capped securities compared with non-capped ones”, according to an April report by ITG, a financial technology firm.

The research showed that since the Markets in Financial Instruments Directive (MIFID II) went live on 3 January, and since the later introduction by The European European Securities and Markets Authority of double volume caps (DVC), there has been an “emergence of notably different venue profiles for DVC and non-DVC stocks”.

ITG found that across the overall equities marketplace in Europe, trading on dark venues (as percent of total market volume) has started to decrease while lit venues recaptured the bulk of the trading volume thus far in 2018, with a 90 percent increase.

The research by ITG found that talk since MiFID II’s 3 January go-live date might have shifted in focus but by no means has decreased.

ITG said: “The changing market structure dynamics in Europe continue to be in the front of our clients minds, in Europe and globally. With a full quarter of trading activity since MiFID II took effect, we are providing an update on the significant changes in equities markets.”

“This data set provides an exclusive view into how firms are adapting their execution venue choices as a result of the new regulation, including the impact of DVCs for activity after 12 March.”

ITG concluded: “We found that use of both bank-sponsored and systematic internalisers has increased so far in 2018, while broker crossing network flow disappeared.”

“All of this confirms our expectations of how MiFID II would affect the overall market structure in Europe. We believe these trends will strengthen through the rest of 2018 as algorithmic trading providers optimise use of the new and existing venue types.”

Firms need to plan early for reg landscape transition, says Ferrise

Firms need to plan early for changing in the changing regulatory landscape the industry is currently seeing, according to Andrea Ferrise, regulatory compliance officer at UnaVista, who was speaking at the Finadium Investors of Securities Lending Conference.

During the presentation, Ferrise discussed topics including the rationale for Securities Financing Transaction Regulation (SFTR) and the second Markets in Financial Instruments Directive (MiFID II), as well as what the regulator has in mind when drafting the regulation.

He opened the session by posing the question: “Is it time for the financial system to slim down?”

He also advised to reform compensation practices to support financial stability, introduce new reporting requirements to get more data granularity and improve OTC derivatives market.

Ferrise said: "The regulation wave started after the financial crisis in 2008 when due to lack of data, the field for regulators and supervisors grew to detect potential cases of market abuse, it had been decided to intervene and regulate those markets."

According to Ferrise, since 2014, the industry has seen so many different regulations before finally seeing SFTR.

"As you know," Ferrise said, "reconciliation is one of the challenges, both legs of the trade should be reconciled".

He continued: "What I consider to be the most important approach today, is that different approaches will bring different results. The Markets in Financial Instruments Regulation is a great success because most of the market participants were advanced."

IHS Markit: Pot stocks rally on Trump commitment and Canada vote

US marijuana stocks have shown a rally on Trump's legislation commitment, according to Samuel Pierson, director of securities finance at IHS Markit.

Pierson, who released an analysis and commentary on the subject on 22 May, also stated that the upcoming Canadian Senate's vote, which could make the recreational use of marijuana legal throughout the country, could also see a rally on such stocks.

The analysis found marijuana related market cap was down $2 billion year-to-date, despite a $3.4 billion quarter-to-date advance.

Pierson said: "A key development for the US marijuana industry came on 13 April, when President Trump confirmed he had promised Colorado Senator Cory Gardner that US Attorney General (AG), Jeff Sessions revocation of the Cole memo will not affect the state's legal marijuana industry."

He added: "That was a very timely update, with the combined market cap for marijuana related stocks hitting a 2018 low on 9 April. Since then, the market cap of those stocks has risen by $3.4 billion, a 13 percent increase."

Pierson found that in terms of short balances, short sellers "have not backed down", increasing the combined short position in marijuana related stocks to nearly $2 billion, a level just below the all-time high on 24 January.

He commented: "Since that last high point in short positions, the total market cap has fallen by $5.5 billion, or 15 percent. Short

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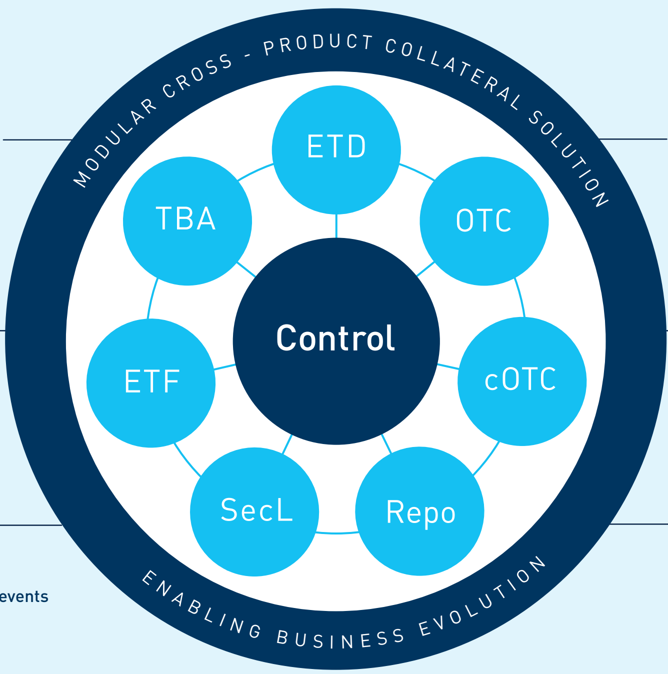

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sellers have generally increased positions on a lag to advances in share prices, but have kept up the overall pace with the total market cap increasing by 92 percent since the start of Q4 2017, while short balances have increased by 102 percent."

Pierson also found a correlation in terms of shorted stocks and the largest market caps. He said: "A list of the most shorted marijuana stocks is also a list of those with the largest market caps, a reflection of the capacity challenges for short sellers, which have contributed to elevated borrow costs, particularly at the start of the year."

The Canada Senate's vote is due to go ahead on 7 June — a legislation which would make regulated recreational marijuana use similar to the laws on tobacco.

Though, as Pierson explained, Sessions waded in on the issue, sending a letter to US attorneys back in March, which proposed greater use of the death penalty in large scale drug prosecutions", of which Pierson stated "some viewed as an extension of his dim views on recreational marijuana."

Sessions also decided to rescind the Cole memo in January. The Cole memo was an Obama era direction from the deputy AG Robert Cole stating that the Justice Department would not expend resources enforcing federal marijuana laws in states which had some form of legalisation.

Pierson commented Session's revocation of the Cole memo, "may have actually aided in the pro-legalisation effort, causing congressman and governors from states which currently have legalised medical and/or recreational usage to dig in, ultimately eliciting the promise from Trump mentioned at the outset".

He predicted: "With the legislative path in the US and Canada looking increasingly clear, and with a near term catalyst in the 7 June vote, there may be further room to the upside for the group."

Pierson concluded: "Marijuana related stocks remain highly shorted on valuation, ahead of what appear to be green pastures from a regulatory perspective."

"The shares are in many cases priced to perfection; though from a short seller's perspective those prices may be rational after a consideration of borrow costs."

"A known catalyst on 07 June may prove a further tailwind as these stocks continue to rally off the lows, however, short sellers have shown little fear of a further breakout, with total short balances nearly back to the January high over $2 billion."

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Prepare ahead of time

John Kernan, head of product management and business development of REGIS-TR, explains what firms should do to prepare for SFTR implementation

Maddie Saghir reports

What should firms be doing right now to prepare for the implementation of the Securities Financing Transactions Regulation (SFTR)?

Firms should have a project team in place and be towards the end of the process of reviewing the data required to be reported and, in particular, understanding how much of that data the firm has within its own systems and where it is located. Almost certainly, no one will have all of the data and so they then need to work out how to get the 'delta', and the best way to consolidate all of this information, format into XML ISO 20022 and get to their trade repository all by T+1.

What challenges are firms finding while preparing for SFTR compliance?

Over and above the sheer volume of data and the fragmented nature of it already discussed, one of the other things that firms need to do is to work out how securities financing transactions (SFT) reporting—and compliance—will run in business as usual (BAU). If the reporting has been delegated, somewhere within the organisation then they will need to have a robust process in place to monitor the quality of what has been reported on their behalf. Even if it hasn't been delegated, there will be exception management in terms of trades, which do not pass the trade repository (TR) validations, or those which do, but cannot be matched due to data discrepancies with the counterparty. Wherever this sits within your organisation, you will need internal audit and compliance to help you establish the appropriate control framework. It's not just a question of executing an implementation project, SFTR compliance requires ongoing and dedicated resourcing.

If preparations and compliance is done correctly, what benefits can SFTR provide?

An organisation, which effectively builds their own internal data repository, can benefit from increased transparency across a number of areas, whether it be for trade monitoring purposes or for things like identifying opportunities for operational efficiencies, more effective use of collateral and so on.

In addition to this, one of the by-products of the implementation of the regulation is greater standardisation across the surrounding process flows. This, in itself, should improve accuracy and efficiency.

What would you recommend firms do to ensure a smooth implementation?

Engage with the trade associations to help build a consensus on best booking and reporting practice. Also, identify whether it makes sense to report directly or use the services of an intermediary—there are many good ones out there with considerable expertise in this space. Go through a proper selection process, both with your intermediary—if you chose to report this way, but also with your TR. The quality of engagement and responses to request for information will likely be a good indication of future performance for implementation. Once you have made your selections, test as much as you can as early as you can.

Will market participants be expected to report perfectly from day one?

Theoretically, it is incumbent on market participants to report correctly from day one. Although the regulators will probably not publicly say it, I think that there is a tacit understanding that for something as complex as SFTR it is a process of learning by doing, and that there will be unforeseen issues that arise in production. To my mind, the most important thing is to be able to demonstrate that you have the appropriate control framework in place to quickly identify exceptions and anomalies and to take remedial action as soon as possible. Of course, you also need a highly responsive TR to assist you with this.

Why should market participants choose REGIS-TR as their trade repository for SFTR?

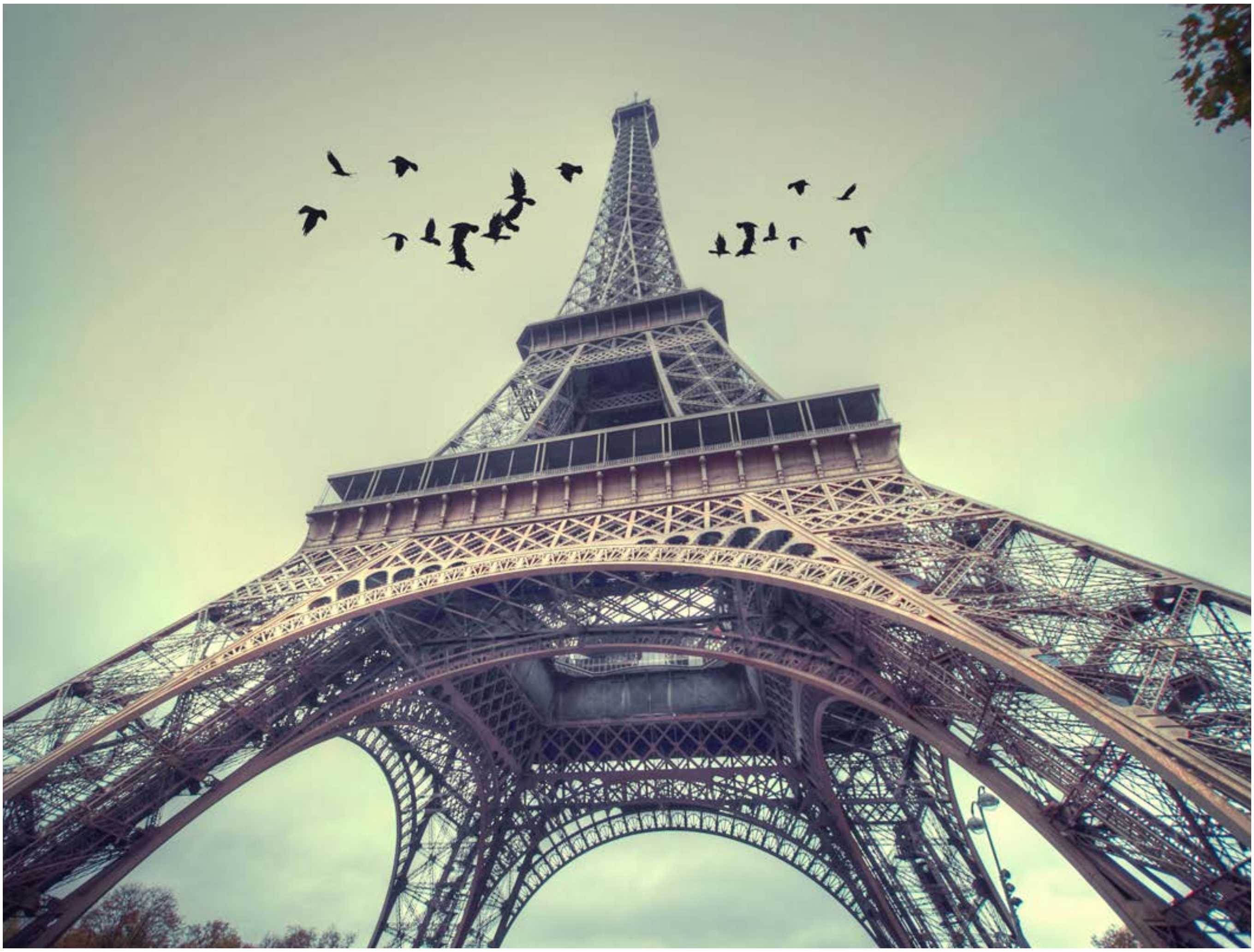
SFTR is complex and niche. REGIS-TR is a sister company of Clearstream and Eurex and so we are the only TR, which truly combines regulatory reporting expertise with securities lending, repo and collateral management expertise. We will also service significant 'own' reporting flow from these sister companies.

> ***One of the by-products of the implementation of the regulation is greater standardisation across the surrounding process flows***

In addition to this, where we really differentiate ourselves is through service support. As already discussed, there will be exception management. We have seen with European Market Infrastructure Regulation (EMIR) that implementation of regulatory reporting is iterative. You need a TR who is going to assist you through all of this. If you are using another TR, you need to ask yourself the question "When we need support with this change, am I able to speak to the head of IT, the head of product or the head of functional design?" At REGIS-TR, we stay very close to our customers to help them through the entire lifecycle of regulatory reporting.

What other trends are you seeing in the trade repository sector?

I think that the TR landscape is becoming more competitive. We have seen an additional two TRs authorised under the European Market Infrastructure Regulation (EMIR) regime. Although we probably won't see as many TRs applying for SFTR, one trend we are definitely seeing is a move away from automatically consolidating all of your reporting through a single TR. Market participants are looking at SFTR on its own merits and selecting the TR, which has the most expertise in this area. They are also using this as a point of inflection regarding the performance and pricing of their incumbent EMIR TR. We are seeing lots of request for proposals from new prospects. In a similar vein, the European Securities and Markets Authority published EMIR portability guidelines last year with the aim of increasing healthy competition between TRs. **SLT**



An Eiffel lot to juggle

With SFTR just around the corner and President Macron's suspected revision of the FTT, what does the future look like for France's securities lending?

Jenna Lomax reports

In the midst of the Securities Financing Transactions Regulation (SFTR) implementation date in 2019, Macron's revision of the Financial Transaction Tax (FTT), and the challenges Brexit could bring for the Capital Markets Union (CMU), it would seem like a challenging time for France's financial industry, and indeed it's securities lending infrastructure.

In Q1 2018, BNP Paribas securities services's revenue reached €505 million, an increase of 5.7 percent compared to Q1 last year and the number of transactions rose by 5.1 percent compared to the same quarter the previous year.

In addition, (as of 11 May 2018) EquiLend reported on the whole, France's average daily on loan balance thus far for 2018 stands at an impressive $130.70 billion per day, while average daily lendable balance thus far for this year is $733.8 billion.

Furthermore, average utilisation for the French market has been close to 18 percent so far in 2018—from 15.2 percent in early January up to 23.4 percent in May.

But despite the growth, there are concerns elsewhere. Fresh fear is lurking in the global financial markets, according to Tom Elliott, international investment strategist at deVere Group.

He cites Syrian chemical weapons installations causing growing tensions between France, the US, UK, and Russia as just one reason.

In addition, back in March last year, when Clearstream warned the industry that Brexit posed a threat to the harmonisation effect of the CMU, nerves seemed frayed.

Though, looking more towards the future, Paris could in fact inadvertently benefit from Brexit—capitalising headquarters in Paris, with The European Securities and Markets Authority (ESMA) already having its headquarters there. But how likely is this to actually happen? Will Paris take over from London as the world's central financial hub?

SFTR: The big issue

Under the European Markets and Infrastructure Regulation (EMIR) rules, over-the-counter derivatives required more collateral, and therefore were usually more expensive. Many thought this could lead to derivatives businesses borrowing additional securities to cover the new costs, could this also happen under the framework of SFTR?

Historically, while the regulatory landscape has been volatile across Europe and has probably affected all financial services markets, it can be difficult to judge the knock-on effect that individual changes will have, particularly in France.

SFTR is at "a very pivotal point", according to Andy Dyson, CEO of the International Securities Lending Association (ISLA), in a video message released on the association's website last month.

Dyson said: "We are currently waiting for the [European] Commission to start the formal adoption of the technical standards that were published by ESMA in March 2017."

The FTT? We'll have to see...

The French president Emmanuel Macron wants to put the FTT back on the European agenda. FTT requires taxes to be collected for regular cash market transactions in France and Italy and is charged only on the specific transactions that are designated as taxable.

Given that most clearing firms and instant payment systems transact, on average, thousands of transactions a day, securities lending could be affected.

This is because in January this year, the rate of interest increased from 0.2 percent interest to the rate of 0.3 percent.

Recently, a panellist at the Association of the Luxembourg Fund Industry European Asset Management Conference said: "The FTT issue needs to be resolved." But will this harmonisation be possible in the midst of Brexit?

La grande question of ESMA and Brexit

Strained political relations in the EU has put the harmonisation efforts of Europe's financial markets under "severe stress", according to a statement from Clearstream released in March, last year.

In a note to clients, the Deutsche Börse subsidiary said: "Against the current political backdrop, it is key for policy makers and stakeholders to focus on the execution of capital markets union objectives."

However, Northern Trust's Clive Bellows, head of global fund services for Europe, the Middle East and Africa, seems adamant that location wise, nothing much will change.

He says: "Northern Trust has an established network of offices across the UK, Ireland and continental Europe and remains well placed to continue to service our clients regardless of the outcome of the Brexit negotiations."

He adds: "Our London office remains our regional headquarters for our business in Europe, Middle East and Africa."

A report from professional services firm PwC, stated disruptions to the level of market access in financial services as a result of Brexit will leave "no winners".

PwC's report, which focuses on the impact of the loss of mutual market access in financial services across the EU27 and the UK, projected that disruptions would be "economically costly".

For remaining EU members, like France, the economic impact "incorporates both gains and losses", according to the report.

The report showed while Frankfurt has emerged as the likely recipient of the largest amount of relocated activity, a number of other cities have also been selected, including Paris. **SLT**

Top five hottest securities by revenue so far in 2018 include:

- Total SA
- Vallourec SA
- LVMH Moët Hennessy Louis Vuitton SE
- Vinci
- L'oreal

(Data as of 11 May: Christopher Gohlke, EquiLend)

Just BEAT it

The BEAT element of the recent US Tax Reform has attracted much attention, industry participants discuss how it will affect the securities lending

Brian Bollen reports

The base erosion anti-abuse tax (BEAT) element of recent US tax reform has attracted much attention in specialist outlets popular with accountants and lawyers. Both sets of professionals can normally be relied upon to produce extended reports of new accounting and law measures, and they have not disappointed here. Indeed, we are indebted to them for making available their detailed thoughts for educational use.

The underlying dryness of the subject matter and its arcane complexity cause the eyes of normal mortals to glaze over, at some speed. To the untrained longstanding market observer, it has elements that sound very much like a 21st-century attempt at reducing the impact of over- or under-invoicing between different members of an international group operating in different legal and tax jurisdictions.

BEAT could have some impact on securities lending, suggests Fran Garritt, director of securities lending at the Risk Management Association. He states that the essence of BEAT has to do with intercompany payments where the US administration is trying to stop firms from using such payments to reduce or avoid US taxes.

This impacts brokers more than any other individual subset in the international financial services industry, he says. They could be forced to source offshore, that is, away from US markets and US tax authorities.

He cites an utterly fictitious example: "A borrower hits its limit for inter-company transfers under BEAT, and a London branch needs to source 100 shares of IBM."

"Let's say the US parent in New York has those 100 shares. Then the cheapest and most efficient borrow (especially for capital purposes) would be from the New York parent. The branch may be forced to source those 100 shares from somewhere else as the inter-company transfer would be subject to the BEAT. Without the tax, the cheapest supply would be internal; with the tax, the best source may be from an agent in Europe."

"As a general statement, interest rates are expected to rise over the upcoming one- to two-year horizon. Embedded within the rebate of a securities lending transaction is a benchmark rate (for example, overnight bank funding rate (OBFR). All else being equal, if interest rates rise, the intercompany loan could become more expensive. As a result, a firm could encroach on its tax threshold more quickly."

In expressing such opinions, he is ahead of the pack. A surprising number of very senior figures in the industry have readily professed that they do not even know what it is. A spokesperson for a large financial institution that could have been expected to contribute, explained: "I'm afraid we don't have anyone confident enough on the topic to speak."

Another major custodian replied: "Nobody in our group, including myself, has heard of BEAT so we don't have an expert on the securities lending side that can give you any information."

Amanda Varma and Brigid Kelly, partner and associate, respectively, at Washington-based law firm Steptoe & Johnson LLP, suggest, in a blog post, that BEAT has to be seen in the broader context in which it sits, the new US tax law (P.L. 115-97), often referred to as the Tax Cuts and Jobs Act of 2017.

One of the most striking elements of the act is the reduction it mandates in the headline corporation tax rate to a flat 21 percent, compared with a previous notional 35 percent.

It has dramatically modified the US international tax provisions, impacting both US and non-US headquartered companies, Varma and Kelly say.

The duo adds: "Amongst other things, the act creates a base erosion minimum tax (informally referred to as BEAT), generally designed to curtail excessive base erosion payments, namely, deductible payments to foreign affiliates."

These rules ensure that a US corporation pays at least a 10 percent tax (5 percent in 2018 and 12.5 percent beginning in 2026) on its taxable income after adding back these base erosion payments. Payments included in the cost of goods sold or otherwise treated as reductions to gross receipts are generally not base erosion payments.

Varma and Kelly explain that the base erosion minimum tax amount is the excess of 10 percent (or other applicable rate) of the taxpayer's "modified taxable income" (generally, taxable income adding back base erosion payments and certain other amounts) for the taxable year over an amount equal to the taxpayer's regular tax liability, reduced by credits other than the research credit and an amount not exceeding 80 percent of "applicable section 38 credits".

The applicable section 38 credits include the low-income housing credit and certain energy credits. The special treatment of the section 38 credits appear responsive to concerns that the minimum tax could have negatively impacted the renewable energy and low-cost housing markets. However, such special treatment is eliminated beginning in 2026.

The minimum tax applies to US corporations, other than regulated investment companies, real estate investment trusts, or S corporations, with average annual gross receipts for the three preceding years of at least $500 million. The tax does not apply, however, unless the foreign-related party deductible payments made by a US corporation are 3 percent or more of the corporation's total deductible payments.

The minimum tax contains several special rules for banks and registered securities dealers. They are subject to a one percentage point higher rate: 6 percent for 2018, 11 percent for 2019-2025, and 13.5 percent thereafter. In addition, the 3 percent threshold for foreign-related party deductible payments mentioned above is reduced to 2 percent.

Further, add Varma and Kelly, there is an exception from the definition of base erosion payments for "qualified derivative payments" for taxpayers that annually recognise ordinary gain or loss on such instruments.

If the devil is in the detail, he is to be found on the subject if one is determined to do so. Melissa Geiger, a partner and head of international tax at KPMG in the UK, explains the BEAT feature as a clawback provision, which effectively applies a 10 percent minimum tax for taxable income adjusted for base erosion payments.

In a thought piece on the KPMG website, Geiger notes that as the tax only affects businesses where US gross receipts are in excess of $500 million (aggregated on a global group basis) it has limited application for multinational groups without a significant US presence.

In addition, echoing Varma and Kelly, she notes that costs of goods sold (COGS) are generally excluded from the definition of base erosion payments.

For its part, Deloitte tackles the topic in an 84-page US Tax Reform Report. A base erosion payment generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortisation in lieu of depreciation).

A base erosion payment also includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid to or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, but only if such person became a surrogate foreign corporation after 9 November last year, and (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2) of the act, it adds.

The road to understanding the provisions of the law will not be an easy one, according to Mike Urse, PwC's international tax services leader, in a recent blog entry on the topic. Companies are facing a whole host of complexities in order to comply with the new law, let alone change their businesses because of it. What's clear for everyone at the forefront is that there is a lot of work that must be done, he explains.

Some might find the detail difficult to digest, but certain universal principles persist. Where there are attempts to impose new rules and regulations, long experience has shown, there are opportunities to be identified and exploited by sophisticated market practitioners.

When new laws are introduced, which create possible arbitrage manoeuvres that did not previously exist, who can blame the bright and the ambitious from attempting to exploit them?

The law of unintended consequences always seems to operate most effectively when the government, any government, of any political shade and nuance imaginable, tries to stop ordinary people from doing things, especially, when there is a profit motive involved.

In such a climate, it is possible to identify and focus upon one undoubted certainty. Uncertainty will be rampant until a sufficient body of experience and expertise has been built that will allow market participants to see more clearly the direction they ought best to follow.

If one thing is sure, it is that the outlook is unclear—very unclear. That is encapsulated in this closing comment from Mati Greenspan, senior market analyst at social trading platform, eToro.

Greenspan notes: "Both elements of this story, the US tax reform and securities lending, border on the impossible for most people to understand."

"Even securities lending industry officials are professing utter ignorance of the BEAT factor in the equation and conceding that they have thus not been able to think about its potential impact. It will be fascinating to observe how this unfolds, one way or the other." **SLT**

Ocado: Do short sellers always get it right?

Short selling performs a vital function in the financial markets, according to David Lewis of FIS Global, but are they always right? He explains more

Timing is everything and knowledge is power. Many people's experiences of life contain a multitude of "if only I had just…" moments. Whether those reflections are related to personal events or choices, or investment decisions, the impact is the same—a brief sojourn into the world as it would have been if only you had taken that alternative option. The internet is awash with stories of people, probably mostly fictional, who sold their Apple shares for $10, or bought apart pizza with a whole bitcoin. If only they had done the other thing, their lives would be so much better now. This week has, allegedly, seen the day that will go down as the "if only I had closed my short positions in Ocado" moment. But is that really the case, or does the answer just depend on which positions you had taken, as well as when?

A favourite investment quote was attributed to Baron Rothschild, who, in explaining the strategy behind the family's accumulation of wealth, claimed that he "never bought at the bottom and always got out too soon." He was referring, somewhat irreverently, to those who often claim to buy when shares are at the absolute bottom, and miraculously sell moments before the shares crash to the ground. Several articles in this week's press have feasted on the possibility that hedge funds and short sellers in general, both terms applied to the bogey men of the investment world, may have lost their shirts as Ocado shares leapt by 45 percent on the news of what may well be a game-changing deal for the online shopping logistics technology company.

Ocado PLC, the UK-based online retailer that really considers itself a technology company, has seen its shares falter from the July 2010 initial public offering (IPO). Unable to get the shares away at the initial guide price of £2 to £2.75, the company launched at £1.80 a share. By the end of the following year, they had hit an all-time low of just £0.56, down 69 percent from the already depressed IPO. Short sellers had piled into the IPO, and, as is common with IPO stocks, the utilisation levels were kept high, even as new supply came to the market. As shown on figure one, there were high levels of variance in utilisation during the first few months following the IPO, reaching well over 90 percent at times. Those holding short positions from the IPO until the end of 2011, made a potential profit of around £1.20 a share. At the end of 2011, almost 29 million shares of Ocado, representing 69 percent of the market supply, were being borrowed.

In May 2012, as the shares were trading around the £1.20 mark, the market behaviour appeared to change, bringing utilisation and volume more into a correlated behaviour. As figure one shows, the utilisation and volume lines broadly match each other in profile from May 2012 to date. Lendable supply, for the most part, comes from the custody bank-managed investments of larger, institutional funds, those being the funds with the size to make lending their shares practical and profitable. With volume and utilisation correlated, supply must be relatively stable, suggesting that institutional investors had seen the issues facing Ocado as short-term problems, buying into the longer-term value of the proposition.

Ocado certainly spent a great deal of time promising the next big deal, even while relations with Waitrose, it's only real client, soured somewhat and, more recently, the online giant, Amazon, muscled its way into the increasingly crowded market. Short interest waned significantly through 2013 and early 2014 as the share price advanced, peaking around £6 apiece in early 2014, with short sellers returning in the second half of that year as the price began to fall once more, down as low as £2.20 in the last quarter. Contrary to this week's reports in the press, while some that remained in position would indeed have lost their shirts, short sellers began closing off their positions following an all-time peak volume around March 2016. Since then, borrowing volume, taken here as a proxy for short interest, has decreased by 69 percent. With utilisation standing at about 30 percent last week, as the news of the deal with the third largest retailer in the US, Kroger Company, broke, most short positions had already been closed out.

Such significant shifts in sentiment cannot be ignored as an input into investment decision-making. Certainly, there is some mileage in the story for the popular press when the short sellers make a loss, but, since the Ocado IPO, most appear to have called the price changes accurately. It is, of course, less than a year since the Carillion debacle led to what the market described as a shock profits warning, wiping billions of pounds from their share value and, in due course, leading to the failure of the construction giant. What many may not have realised was that 70 percent of the Carillion shares that were available on the market had already been borrowed, likely to support short selling positions, before the market announcement.

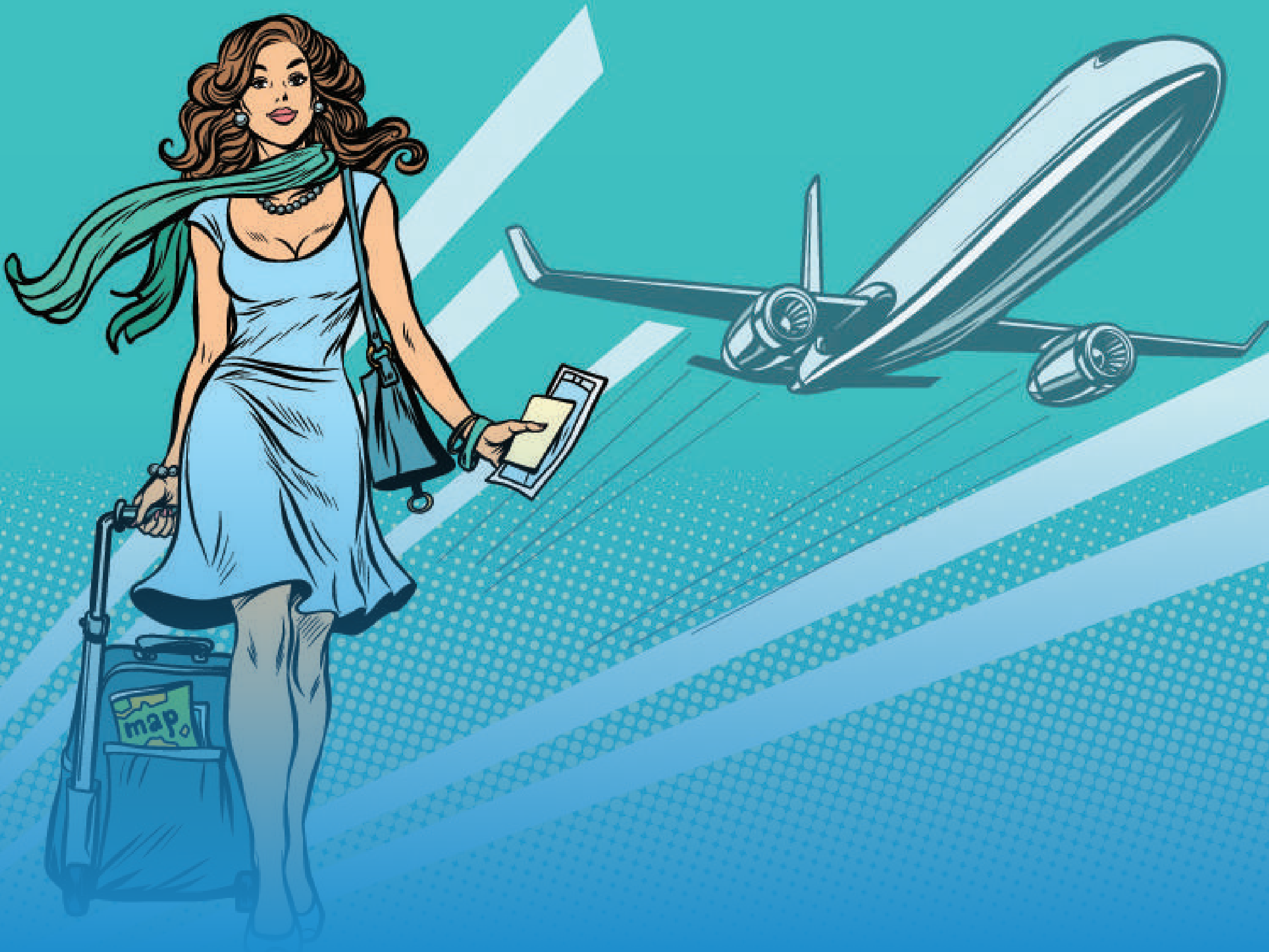
Figure one: Loan volume, utilisation and closing price for Ocado PLC (Indexed to July 2010)

Source: FIS' Astec Analytics

No investors, whether operating under a long or short strategy, get it right every time, but with a higher risk should they get it wrong, investment actions from short sellers should arguably carry more weight. Irrespective of its treatment in the press, short selling performs a vital function in the financial markets, ensuring price bubbles do not form and ensuring that inefficient companies do not absorb capital that is better employed elsewhere. Securities lending, another industry often seen as sitting alongside short sellers on the shadow banking naughty step, is also a vital component of a vibrant and efficient market place and, together, they can provide important sentiment data for investors, both long and short. Armed with that information, they just have to get their timing right. **SLT**

> ***No investors, whether operating under a long or short strategy, get it right every time, but with a higher risk should they get it wrong, investment actions from short sellers should arguably carry more weight***

David Lewis
Senior vice president
FIS



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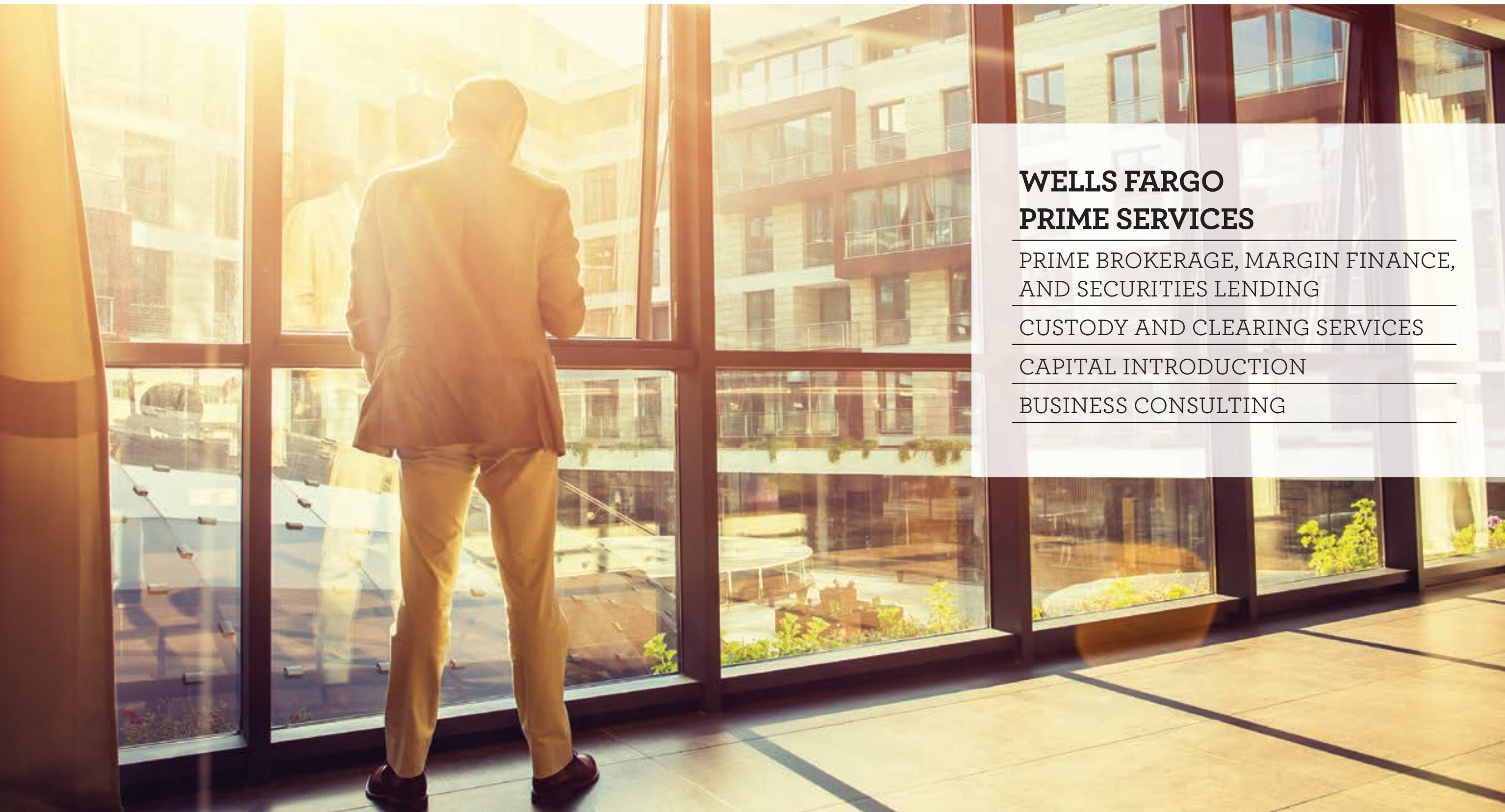

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Comings and goings at Crédit Suisse, J.P. Morgan, Societe Generale and more

Crédit Suisse has confirmed that a number of appointments have been made at its prime services team in the Asia Pacific (APAC) region.

James Scully will join as managing director, head of prime product sales, APAC, Robert Cheeseman will serve as head of prime derivatives services, APAC and Kieran Murphy has been appointed director, head of prime consulting, APAC.

Scully brings 22 years of experience in the financial services industry, including 10 years in the prime business. Most recently, he served at BNP Paribas, where he started out as head of securities lending and synthetic sales trading in Asia in 2012.

Cheeseman brings more than 15 years of experience in listed derivatives sales and trading in APAC. Before working at Morgan Stanley, he spent almost ten years at Goldman Sachs in listed derivatives sales trading in Hong Kong and London.

He will begin his new role at the end of May.

Both Scully and Cheeseman will report to Ken Hon, head of prime products and trading, APAC.

Murphy joins from Bank of America Merrill Lynch, where his primary responsibility was to provide detailed consulting to established and emerging hedge funds in the region.

Starting in July, Murphy will report to both Simon Chow, who leads the prime brokerage sales function, and Raza Jafree, who heads the prime services for private banking sales team in APAC.

In a statement, Crédit Suisse said: "We are pleased to announce several key appointments in Prime Services in APAC to further strengthen and enhance our product capabilities and the delivery of solutions to our clients."

Crédit Suisse also announced two new hires last week with Advanced Execution Services (AES) in Australia.

The new hires, Eugene Budovsky and Melissa Cooper, in the AES team form part of its continued effort to strengthen our electronic trading franchise in Asia Pacific, which is rated highly in the market.

John Shellard and Matthew Sarson are leaving J.P. Morgan.

Shellard, who joined the bank in 1998, will be leaving his role as global head of trading, agent lending.

Sarson, who started working at J.P. Morgan in 2004, will be departing as global head of agent lending, asset management.

J.P. Morgan declined to comment.

Brown Brothers Harriman (BBH) has appointed Carla Jane Findlay-Dons as chief global regulatory and market strategist.

Based in London, Findlay-Dons will lead the global regulatory and market strategy group, and develop BBH's point of view on market and regulatory events.

According to BBH, under Findlay-Dons leadership, the group will ensure a global voice on regulation, and develop solutions that help clients respond to a quickly changing regulatory landscape.

Findley-Dons joins BBH from Goldman Sachs Asset Management (GSAM) where she was an executive director for regulatory management with a particular focus on Europe, the Middle East and Africa regulation.

Prior to that, Findlay-Dons led GSAM's client services fixed-income team for the Americas.

Findlay-Dons also serves as a member of BBH's European Diversity and Inclusion Council.

BBH said: "Carla Jane Findlay-Dons brings a wealth of experience and insight to the BBH team from her diverse background in asset management, law and the arts."

It added: "Findlay-Dons is an accomplished public speaker and passionate commentator

on the importance of creating a diverse workforce and the benefits that diversity of thought can bring to business."

Deutsche Börse AG have increased the number of members on its supervisory board from 12 to 16.

The new members, Martin Jetter, Barbara Lambert and Joachim Nagel were elected for three leaving members of the shareholder representatives. Jetter has held various senior roles at IBM and is currently senior vice-president for Global Technology Services.

As a member of IBM Corporation's Management Board, Jetter has global responsibility for IBM Group's Infrastructure Services.

Barbara Lambert has held senior roles at WestLB, Arthur Andersen, Ernst & Young and Banque Pictet & Cie.

At Ernst & Young, Switzerland, Lambert was head of financial sector audit activities.

Lambert was also a member of the executive board and group chief risk officer at Banque Pictet & Cie until March 2018, and was appointed to the bank's board of directors with effect from April 2018.

Between 1999 and 2016, Joachim Nagel held several senior positions at Deutsche Bundesbank, including membership of its executive board between 2010 and 2016.

Nagel is also a member of the executive board of KfW Group.

Societe Generale has appointed Gildas Le Treut as managing director of coverage.

Previously, Le Treut served as global director of prime clearing at Netherlands-based ABN Amro from 2014 to 2018.

Prior to that, Le Treut was head of product and network management at ABN Amro from 2010 to 2014. He has also held roles at Fortis Bank Global Clearing.

Ryan Aufrichtig is leaving his role as head of prime finance South Africa at HSBC.

Aufrichtig has been head of prime finance for the region for over 16 years after starting his role in 2001.

Before HSBC, Aufrichtig served as head of securities lending at Metropolitan Asset Managers from 1999 to 2001.

Mark Hutchings is due to leave the International Securities Lending Association (ISLA).

Hutchings has been COO at ISLA since September 2016.

He was responsible for the day-to-day administration of ISLA's work.

Prior to ISLA, Hutchings served at AIG from December 1997 to January 2015. He worked in various roles including managing director of global securities lending, managing director of client services, and managing director and head of shared services.

Jonathan Lombardo, ISLA's chair, said: "Mark Hutchings tenure at ISLA enabled fundamental improvements to our operating model. Hutchings' efforts in streamlining core processes and tackling critical industry initiatives have proven invaluable."

He added: "These foundations that Hutchings has established will enable ISLA to concentrate on the key drivers pertinent to our membership going forward."

Ted Eliopoulos is due to leave The California Public Employees' Retirement System (CalPERS) to relocate to New York with his family.

Eliopoulos, chief investment officer (CIO) at CalPERS, will remain in his role until a replacement is found, assisting in the transition through the end of 2018. His replacement has not yet been announced.

Eliopoulos has been at CIO for nearly four years.Joining CalPERS in 2007, Eliopoulos was initially senior investment officer for the real estate division and the real assets unit.

Following the financial crisis, he led the effort to restructure the asset class, refocusing on core investments in real estate and infrastructure.

He continued this work across all asset classes when he was appointed interim CIO in June 2013 and later as the permanent CIO in September 2014.

Under Eliopoulos's leadership, CalPERS established its first emerging manager plan in 2012 and the investment office's first diversity and inclusion committee in 2016.

He also established CalPERS's first governance and sustainability plan and the opportunistic credit programme in 2016.

The news comes after it was announced Curtis Ishii, the firm's managing investment director of fixed income, will retire from CalPERS, after a 40-year tenure with the agency.

Ishii will continue as managing investment director of fixed income and a portfolio official in charge of the firm's fixed income programme until July this year.

Commenting on his departure, Eliopoulos said: "It's been extremely rewarding to have helped steward an investment institution that serves so many hardworking and deserving California families."

He added: "I am confident the transition to a new CIO will be seamless as I leave the office in the hands of some of the most skilled investment professionals in the industry."

Marcie Frost, CEO at CalPERS, commented: "Under Eliopoulos' leadership, the investment office has greatly reduced the cost and complexity of the investment portfolio and increased transparency around fees."

She added: "Because every dollar we save goes back into the fund, our members will directly benefit from those cost savings for years to come.

Eliopoulos has always been guided by our fiduciary obligation to our members and the fund." **SLT**

Do you have a people move we should cover?

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