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ISSUE209 21 August 2018

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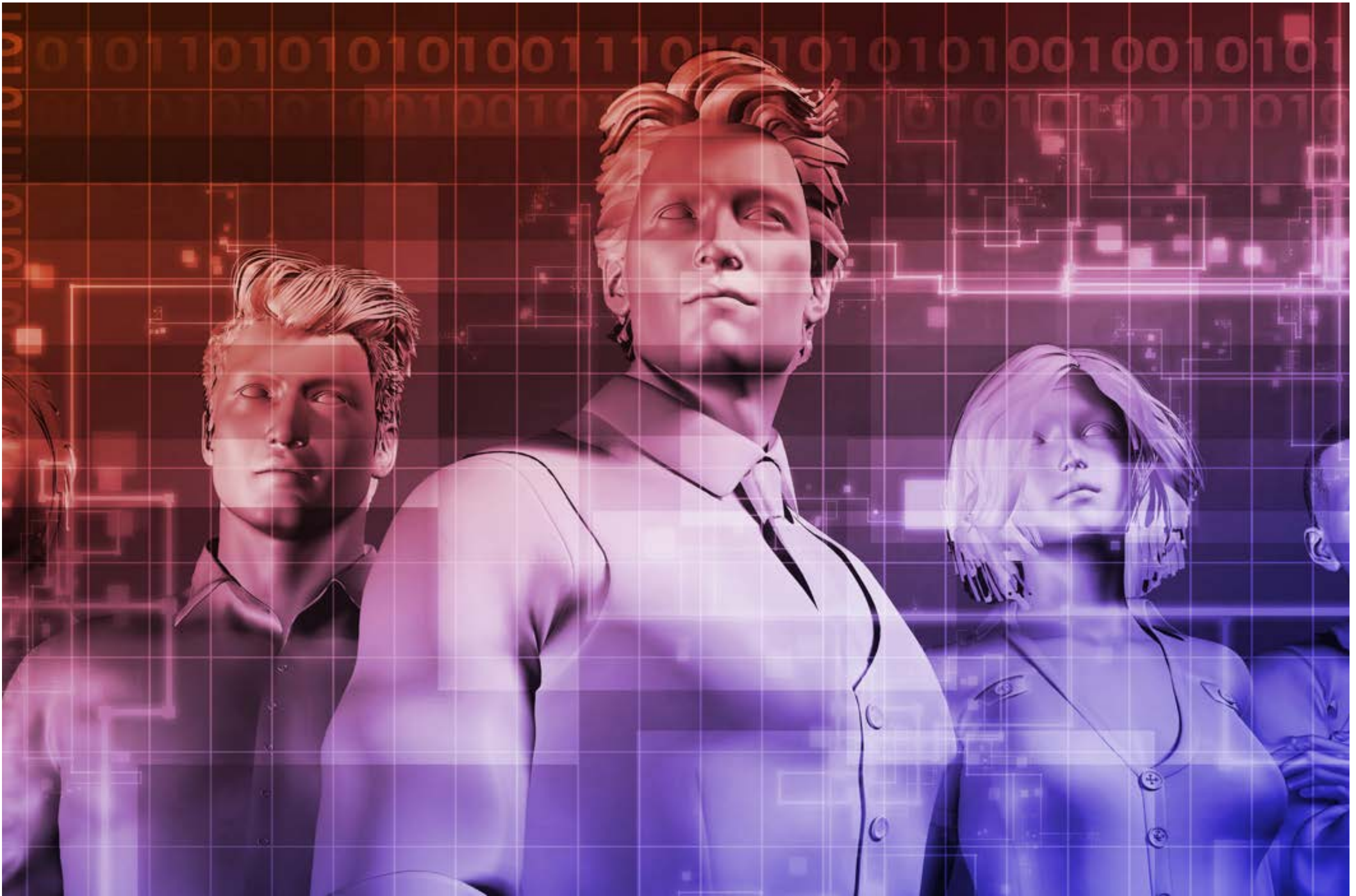

CCPs are becoming increasingly important

Central counterparties (CCPs) are an increasingly important part of the financial system, a study by The Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI), and International Organisation of Securities Commissions (IOSCO) has found.

The study follows the central clearing interdependencies report from July last year and assesses whether those findings have been stable over time.

According to BIS (Bank of International Settlement), the importance of CCPs has increased following the post-crisis reform that mandated central clearing of standardised over-the-counter (OTC) derivatives.

CCPs should be subject to strong regulatory, supervisory, and oversight requirements to fully realise the financial stability benefits they offer, BIS revealed.

The results of the study found that prefunded financial resources are concentrated at a small number of CCPs.

The two largest CCPs account for nearly 40 percent of total prefunded financial resources provided to all CCPs, compared with 32 percent in the report last year.

Additionally, exposures to CCPs are concentrated among a small number of entities. The largest 11 of the 306 clearing members are connected to between 16 and 25 CCPs.

Meanwhile, the study found that the relationships mapped are characterised by a core of highly connected CCPs and entities, and a periphery of less highly connected CCPs and entities.

As well as this, a small number of entities tend to dominate the provision of each of the critical services required by CCPs.

According to the study, this relationship between CCPs and other entities suggests that a failure at one of these central elements of a CCP network would likely have a significant consequence for the rest of the network.

The study also revealed that clearing members and clearing member affiliates are important providers of other critical services required by CCPs, and can maintain several types of relationships with multiple CCPs simultaneously.

BIS noted that there are some changes that highlight the interdependencies in central clearing. For example, the concentration of client clearing activity has decreased.

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securities lending times

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Published by Black Knight Media Ltd
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OTCX building for the future

OTCX, an independent digital portal for price discovery and negotiation in over-the-counter (OTC) derivatives, has launched what it described as the world's first electronic non-deliverable interest rate swaps in a range of currencies: the Colombian peso, Malaysian ringgit, Chilean peso, Chinese yuan and Taiwan's dollar.

It said this activity in new risk reflects the opportunities available for increased portfolio diversification, and the exponential growth in demand for a digital solution to replace manual processes in OTC derivatives trading.

Nicolas Koechlin, the company's founder and CEO, said: "We're expanding our growing emerging markets capability and pioneering the digitisation of the OTC derivatives market."

"It is essential to overcome the needless obstacles and friction of voice and chat with a solution that offers greater transparency and access to prices across the spectrum of currencies and markets."

"Our goal is to accelerate this process with innovative technology that serves the buy-side, sell-side and end-investor."

OTCX went on to say that so far this year it has also been active in interest rate derivatives for new risk and compression in the currencies of Singapore, Brazil, Czechia Koruna, Israel, Korea, Hungary, Thai Baht, Poland, Mexico, India, Hong Kong and South Africa.

The company said that it is continuously expanding its range of currencies with leading liquidity providers for a fast-growing client base wanting price discovery and digital negotiation in an integrated workflow for the future.

Shorts up at Diebold Nixdorf

The debt-laden US automated teller machine manufacturer, Diebold Nixdorf fell 10 percent yesterday, according to Samuel Pierson of IHS Markit.

Pierson said: "On 1 August Diebold Nixdorf reported a $0.21 per share loss on better than expected revenues, sending shares into a tailspin as analysts had forecast a $0.01 per share profit, per Factset."

"In the week since the report, shares have fallen more than 50 percent, reaching the lowest point since the firm's initial growth phase in the early 1980s."

Pierson added: "Equity shorts have increased their position by 3.4 million shares since 1 August, for a total of 29.3 million shares or 31 percent of free float. In dollar terms, the position has been taken down from a year-to-date high of $352 million on 30 April to $150 million at present, owing to the declining share price."

He continued: "Notably, short demand for the 8.5 percent 2024 bond has also spiked following the earnings report, as the bonds have also been in a free-fall, hitting a new low of 67.13 cents on the dollar on 7 August, after having traded down from 92 cents on 31 July."

"The short position in the 2024s is currently $114 million at par, up from $68 million prior to the earnings report."

European fixed income left largely treading water

European fixed income markets in July were left largely treading water with low levels of realised volatility across the core benchmark products, according to Lee Bartholomew head of fixed income and FX product at Eurex.

In a company newsletter, released on 8 August, Bartholomew said this implied volatility was sold lower as the underlying markets failed to break out in either direction.

This was also reflective of volumes in the over the counter markets, Bartholomew found, where gamma edged lower over the course of the month and sat at historically low points. The 30-day bund volatility has not exceeded 6 percent for any real length of time.

Bartholomew went on: "The only real event for the market was the Bank of England interest rate decision towards the end of the month, but that was priced into the front end and volatility was sold into the event."

Venturing into early August, Eurex saw an increase in realised volatility as the markets sold off, which, according to Bartholomew,

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HKEX adds 25 securities to designated securities list

The Stock Exchange of Hong Kong Limited, a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEX), has added 25 securities that will be eligible for short selling.

The changes in designated securities for short selling will take effect from 10 August.

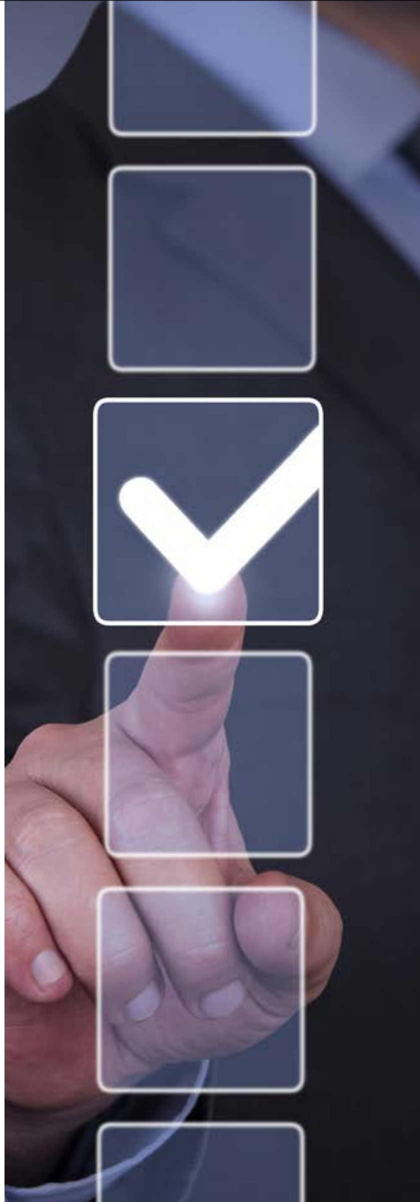
In addition, 48 existing designated securities will be removed from the designated securities list.

The total number of designated securities for short selling will be 946 after the revision.

The news comes after HKEX announced the renewal of the contract of Charles Li Xiaojia, the association's CEO in July.

Li Xiaojia's new contract is to run from October 2018 to October 2021 and is subject to the written approval of the Securities and Futures Commission.

Li Xiaojia joined HKEX in 2009 and became the CEO and an executive director in January 2010.



was triggered by the Japanese Government Bond market and stronger-than-forecasted US ADP National Employment Report data.

Tradeweb sees strong volumes in July

Tradeweb has continued to see strong volumes in July, a Tradeweb Markets monthly activity report revealed.

The report found that July trading volumes on Tradeweb Markets reached $518 billion average daily volume, which was a 41 percent increase from July last year.

As summer trading has taken hold, volumes were down from June's record of $590 billion average daily volume.

Meanwhile, the report also found that derivatives trading continued to see significant growth this year.

All three derivative product lines including rates, credit, and equities, saw volumes more than double in 2017 year-to-date.

Additionally, fixed income bond trading continued to remain strong, with US treasury trading exceeding $65 billion per day, up 34 percent versus July last year.

There was similar year-to-year growth in other cash products, including European government bonds (29 percent), US high-grade (32 percent), US high-yield (48 percent), and European corporate bonds (23 percent).

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According to Tradeweb, the success of the bilateral dealer-to-client repo platform continues to drive growth in the money market business.

Tradeweb also found that total repo activity exceeded $20 trillion year-to-date, on track for its best year since at least 2010.

Elsewhere, exchange-traded funds (ETFs) were up 29 percent during the month, compared to July last year, and European ETFs were up more than 36 percent compared to July last year.

ESMA updates DVC data

The European Securities and Markets Authority (ESMA) has updated its public register with the latest set of double volume cap (DVC) data under the second Markets in Financial Instruments Directive (MiFID II).

The updates include DVC data and calculations for the period of 1 July 2017 to 30 June 2018, as well as updates to already published DVC periods.

The number of new breaches is 308. Some 246 equities for the 8 percent cap, are applicable to all trading venues, and 62 equities for the 4 percent cap, apply to individual trading venues.

ESMA stated trading under the waivers for all new instruments in breach of the DVC thresholds should be suspended from 10 August 2018 to 9 February 2019.

The instruments for which caps already existed from previous periods will continue to be suspended.

In addition, ESMA highlights that some trading venues in the meantime have submitted corrected data that affects past DVC publications.

For a total number of 54 instruments, this means that previously identified breaches of the 8 percent and 4 percent caps prove to be incorrect.

For these instruments, the suspensions of trading under the waivers should be lifted. As of 7 August, there is a total of 1,275 instruments suspended.

MiFID II introduced the DVC to limit the amount of dark trading in equities allowed under the reference price waiver and the negotiated transaction waiver.

The DVC is calculated per instrument based on the rolling average of trading in that instrument over the last 12 months.

Ex-Neuberger Berman Consultant launches boutique consultancy

Former Neuberger Berman consultant Sanjeev Rai has launched his own consultancy firm named Five Rivers Fund Consulting Ltd.
According to Five Rivers, clients can benefit from a complete end-to-end turnkey delivery in which Five Rivers will produce Packaged Retail and Insurance-based Investment Products (PRIIPs) and the second Markets in Financial Instruments Directive (MiFID II) documents and disseminate to a network of banks, data vendors and distributors through its newly formed partnership with PRIIPsHUB.

Anthony Miranti, head of business Development of PRIIPsHub, commented: “We are excited to partner with Five Rivers. The partnership will allow Five Rivers to focus on their core strength in EPT, EMT and KID production whilst leveraging of our infrastructure with a full-blown dissemination to over 230 distributors, data vendors and platforms across Europe.”

The firm has also entered into a strategic partnership with an analytics firm based in Zurich, to offer Solvency II and VAG reporting and is in current partnership discussions with a leading TCA firm to offer a “true arrival price” calculation for its transaction cost offering.

Other services offered by Five Rivers includes an independent non-executive director offering for small to mid-sized asset managers.

Rai was previously an external consultant to Neuberger Berman leading on the European MiFID II Template framework, PRIIPs implementation and transaction costs calculation.

Commenting on the launch of his new consultancy, Rai said: “The establishment of Five Rivers Fund Consulting was a natural progression in our mission to serve small to mid-sized asset managers.”

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He added: "We saw the regulatory burden and complexities surrounding the MiFID II and PRIIPs implementation, in particular for the product governance departments where such firms either lacked appropriate representation or technical knowledge in the context of the regulations."

"Unlike other financial service providers, we spearhead on defining the target markets, product governance and investment objectives. Five Rivers is a specialised outsourced product governance for smaller asset managers, allowing our clients more time to focus on raising and investing capital."

FSB consults on OTC central clearing incentives

The Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commission, (IOSCO) have published a consultative document on incentives to centrally clear over-the-counter (OTC) derivatives.

The central clearing of standardised OTC derivatives is a pillar of the G20 Leaders' commitment to reform OTC derivatives markets in response to the global financial crisis. A number of post-crisis reforms are, directly or indirectly, relevant to incentives to centrally clear.

The FSB said the consultative document evaluates how these reforms interact and how they could affect incentives.

It added that the evaluation will inform relevant standard-setting bodies, and if warranted, could provide a basis for fine-tuning post-crisis reforms, bearing in mind the original objectives of the reforms.

This does not imply a scaling back of those reforms or an undermining of members' commitment to implement them, said the FSB.

The evaluation is the second under the FSB framework for the post-implementation evaluation of the effects of G20 financial regulatory reforms.

The document stated that the changes observed in OTC derivatives markets are consistent with the G20 Leaders' objective of promoting central clearing as part of mitigating systemic risk and making derivatives markets safer.

It also suggested that the relevant post-crisis reforms, in particular, the capital, margin and clearing reforms, taken together, appear to create an overall incentive, at least for dealers and larger and more active clients, to centrally clear OTC derivatives.

Also, non-regulatory factors, such as market liquidity, counterparty credit risk management and netting efficiencies, are important and can interact with regulatory factors to affect incentives to centrally clear, while some categories of clients have less strong incentives to use central clearing, and may have a lower degree of access to central clearing.

The decision noted that the provision of client clearing services is concentrated in a relatively small number of bank-affiliated clearing firms.

Some aspects of regulatory reform may not incentivise provision of client clearing services, said the FSB, adding that the analysis suggests that, overall, the reforms are achieving their goals of promoting central clearing, especially for the most systemic market participants.

This is consistent with the goal of reducing complexity and improving transparency and standardisation in the OTC derivatives markets, it said.

Beyond the systemic core of the derivatives network of central counterparties (CCPs), dealers/clearing service providers and larger, more active clients, the incentives are less strong.

The FSB noted that analysis of quantitative and qualitative survey data and market outreach suggests that the treatment of initial margin in the leverage ratio can be a disincentive for banks to offer or expand client clearing services.

Bearing in mind the original objectives of the reform, additional analysis would be useful to further assess these effects, it added.

The FSB said that the four principal entities involved in the consultation welcome responses to the questions set out in this

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consultative document by Friday 7 September 2018. Responses will be published on the FSB website. The final report will be published at around the time of the G20 Summit at end-November 2018, the FSB concluded.

LSEG reveals 'strong set of results' for H1

The London Stock Exchange Group (LSEG) has delivered another strong set of results, with growth across all business areas, according to David Warren, LSEG's financial officer.

Commenting on its first half of the year results, Warren said: "The LSEG is well positioned as a global financial infrastructure business, providing critical services to clients around the world, based on a strategy with open access and customer partnership at its centre."

"During the period, we have continued to invest for growth as we launch new products and drive further efficiencies across our businesses."

Capital markets performed well, with good growth in the period in primary markets, where issuance was strong, and in secondary markets, with increased equities, derivatives and repo trading.

In capital markets, the first half saw an increase in the number of new issues, with 87 companies joining the group's markets.

On a reported basis, total income increased 12 percent, while operating expenses (before depreciation and amortisation) rose by 2 percent, with adjusted operating profit rising 21 percent to £480 million, and adjusted earnings per share (EPS) increasing 25 percent to 88.7 pence per share.

Underpinning the income growth were strong performances at FTSE Russell and at LCH, with both businesses achieving the targeted double-digit revenue growth rates.

LCH delivered record notional cleared volume at the SwapClear service, up 23 percent to $576 trillion, and compression activity increased 24 percent at $388 trillion.

The ForexClear service also saw record clearing levels with $8.7 trillion cleared and 1.26 million trades, up by 79 percent and 87 percent, respectively.

LSEG increased its stake in LCH Group to 68 percent, acquiring an additional 2 percent following a sale by a minority shareholder. In addition, LSEG acquired around a 16 percent stake in AcadiaSoft; LCH SwapAgent and AcadiaSoft signed heads of terms agreement. LCH SwapClear continues to expand its spread of currencies from 18 to 21, clearing its first non-deliverable interest rate swaps denominated in Chinese yuan, Korean won and Indian rupee; and, in June, gained

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approval to clear for counterparties domiciled in Mexico. LCH SwapClear launched Secured Overnight Financing Rate clearing, while LCH ForexClear launched clearing of FX options in early July.

LSEG announced plans to expand the global footprint of the group's shared services company, BSL, with the establishment of a new business services centre in Romania.

David Warren added: "In line with the group's stated progressive dividend policy, we have increased the interim dividend by 19 percent, to 17.2 pence per share."

David Schwimmer, LSEG's new CEO, said: "My immediate focus is to meet with colleagues, customers, shareholders and other stakeholders, and to ensure we continue our focus on driving operational excellence across LSEG as I work with the executive team to develop the group's many opportunities ahead."

NEX issues July volume figures

NEX Group's trading volume information for July showed that July was a slower volume month across many of the markets, and a volatility measure in the US Treasury market indicated the lowest levels since 1973.

Volume information includes US treasury benchmarks and agencies. Off-the-run securities, including T-Bills, are provided through an agreement with ICAP Securities USA LLC. The results showed that the midweek 4 July holiday also contributed to a fragmented volume month.

The yield curve remained relatively flat, which contributed to less of an opportunity from a relative value trade, and tariff talk did little to move the markets. It was a similar case with US Federal Reserve chairman Jerome Powell's testimony this month, noted NEX.

All of these factors contributed to lower volumes and only a couple of days with benchmarks total over $150 billion.

The end of the month volumes saw a slight increase off the anticipation of a series of rate decisions by the Federal Reserve, Bank of England and finally the Bank of Japan, whose decision on 31 July indicated the inclination to keep rates low for the long term. The month's last session produced a print of over $170 billion.

US repo trading activity was impacted by a shortage of specials, low volatility and trader vacations, said NEX. Volume at Fixed Income Clearing Corporation (FICC) is down $100 billion (per day) from the highs registered last February.

In the absence of specials, the composition of the repo market shifted from trading "as the issue" to trading as general collateral/ general collateral financing trades (GCF).

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The ratio of GCF to the entire FICC market hit a 12-month high in July. General collateral trading is up to an even greater extent, according to NEX. Beginning in the month of August, the Treasury will begin raising more cash to the tune of about $350 billion in new supply through September.

This could further exacerbate the macro shift in elevated funding rates that began in April. Summer holiday trading kicked in and the BrokerTec average daily volume for July was €250 billion versus €269 billion in June, said NEX.

The first two trading days of the month, 2 to 3 July, each registered €265 billion and from the 4 July the US onwards it did not break above €259 billion.

The European Central Bank was the only major central bank to hold a monetary policy meeting in July. On the 26 July, it left rates unchanged and re-confirmed that it is on track to cease quantitative easing in December. This was widely expected by the market and did not create any market volatility.

Month end passed quietly with zero stress and a minimal uptick in short-term rates across all countries due to ample liquidity and efficient planning by the investment banks on BrokerTec.

Saxo Bank sees positive H1 results

Saxo Bank Group reported a positive net profit of DKK (Danish krone) 150 million for H1 2018.

Some of the results from the report found that operating income for the Group reached DKK 1.5 billion, which highlighted a decrease of 0.3 percent compared to H1 2017. Meanwhile, client collateral deposits continued to rise to DKK 110.4 billion, which represented an increase of 7 percent compared to the same period last year.

Saxo Bank Group continued to strengthen its capital position with the total capital ratio for the Group reaching 27.6 percent as of 30 June this year, which compared to 22.7 percent at the end of last year.

Operating income reached DKK 1,506.4 million compared to DKK 1,557.6 million for H1 last year.

Additionally, profit before tax reached DKK 209.4 million for H1 last year compared to 312.2 million for the same period last year.

Saxo Bank Group also reported that clients' collateral deposits reached DKK 110.4 billion this year, which highlighted an increase as last year the Group saw DKK 103.6 billion for H1.

Commenting on the results, Kim Fournais, CEO and co-founder of Saxo Bank, said: "The results reflect the low levels of volatility across financial markets that have marked the first half of the year." **SLT**

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Troubling times at Tesla

After suffering an extremely volatile year, Tesla's troubles are not over yet. Maddie Saghir explains more

Maddie Saghir reports

Tesla, the electric vehicle and renewable energy corporation, has experienced extreme volatility this year, particularly from May through to 7 August. The company's first week in May saw shares end the week flat despite earnings volatility. In July, Tesla saw the cost of insuring Tesla debt against default rise, and in August, Tesla's equity short position was above $13 billion for the first time.

IHS Markit evaluated data found that the 5.3 percent coupon issue maturing in 2025 saw short demand trend up last autumn. As 2017 came to a close, some short covering coincided with the bonds tracking back up to 96 cents on the dollar. Then, in March this year, IHS Markit found the mid-close price hit 92.5, which was the lowest level following issuance of the bond in August of last year.

Tesla has lost a lot of gains; last year it topped out in September at $385 but in late January and early February, stocks closed at $353, $354, and $357, respectively. In June, shares dipped below $300.

In addition, Tesla saw shares end flat for the first week in May. Samuel Pierson, director of IHS Markit, said that the much-discussed Tesla earnings report and conference call certainly added to the volatility, though the net impact was fairly muted, with shares ending the week with little change from the start.

Commenting on the flat shares, Pierson said: "Short sellers have continued to increase bets against the firm, which currently total more than $12.6 billion."

He explained: "The short balance in dollar terms has increased 45 percent since the year-to-date low price, observed 2 April, resulting from both share price appreciation (16 percent) and an increase in shares shorted (24 percent). The borrow cost has continued to trend up, with substantial spikes around proxy record dates."

"Earnings season can be a minefield for short sellers, with the known catalysts providing immediate feedback to a short thesis. Witness Frontier shares have appreciated more than 40 percent since their earnings report on 1 May."

In terms of numbers, Pierson stated there were 27 million shares short (for Witness Frontier), representing a 6 million share decline from the 2018 high on 3 April.

He added: "It's worth noting that some portion of the short demand is used to hedge long positions elsewhere in the capital structure, including the convertible preferred shares. Following the report, short sellers added 6.3 million shares to the position, putting the total short back over 33 million shares."

For the following month in June, equity shorts reduced their position size by eight million shares in the first three weeks of June, while the share price increased by more than 20 percent.

Meanwhile, in July, Pierson announced that the cost of insuring Tesla debt against default was on the rise.

IHS Markit found that there had been increased interest in trading credit default swap (CDS) on Tesla since late June, at which point the five-year CDS was offered around 18 points upfront.

The upfront points on the offer widened during the second week of July, and peaked above 23 points on 12 July following reports that former employee Martin Tripp, had filed a whistleblower complaint with the US Securities and Exchange Commission.

Credit shorts were active in the 5.3 percent 2025 bond from the initial issuance in August last year, borrowing 8 percent of the total issue size within the first week following the offering, or $140 million at par.

The short position in the 2025 bonds, implied by borrowing demand, had increased to $264 million at present, or 14 percent of the issue size.

Pierson said: "While that suggests there's another 86 percent of the issue to go, that isn't really the case, as owners of the bonds have only put 14 percent of the issue into lending programmes where they can be readily borrowed by short sellers or market makers."

He added: "The utilisation of that lendable supply has not been lower than 95 percent in 2018, despite the size of the pool increasing by $40 million."

Earlier in August this year, Tesla's equity short position was above $13 billion for the first time, which compares to the previous peak being $12.8 billion in June. This comes after Saudi Arabia's sovereign wealth fund took a $2 billion stake in Tesla shares.

The short interest equated to 20.7 percent of outstanding shares, down from the year-to-date (YTD) peak of 23 percent observed in June. Commenting on this, Pierson stated: "The short interest in Tesla hasn't changed a ton over the last week since they reported earnings."

Pierson added: "We've seen a 700,000 reduction in shares short, leaving the total at just over 35 million shares, well above the 31.5 million shares observed the last time the share price was in the $370s in mid-June."

He also outlined that the short value was higher than any Standard and Poor 500 stock. Only Under Armour has a higher percentage of outstanding shares short with 24 percent.

Pierson stated: "There's a lot of debt, around $9 billion, which short sellers are betting against via outright shorts in the underlying bonds and credit default swap contracts. The firm doesn't need to go bankrupt in order for these trades to be profitable."

While Musk is no stranger to backlash on Twitter, his recent tweets on the privatisation of Tesla resulted in a lawsuit calling the firm's operations into question.

In the Tweet, Musk claimed that he would make Tesla private and that the funding for doing so had been "secured". Shareholders responded by saying that this was an attempt to manipulate Tesla's stock price and ruin plans for short-sellers.

Following this, shareholders filed a class action lawsuit, claiming Musk's tweet was false and misleading information. As a result of the tweet, Tesla's stock rose to $387.46, $45.47 over the previous day's closing price (as 10 August).

Investors remain "sceptical" regarding Musk's suggestion about making the firm private. Pierson concluded that part of this reason is that at yield in the 6 to 7 percent range could be a challenge for a firm, which continues to report losses to fund interest payments on an addition of many billions in debt.

According to Pierson, there has been no reduction in short positions in the bonds, currently over $300 million short the bonds (at par), compared with $12 billion-plus in the equity. **SLT**

Getting SFTR ready

SFTR is the next big challenge in regulatory reporting. What are the timelines for implementation and what should firms be doing to prepare? Jonathan Lee of Kaizen Reporting explains more

Becky Butcher reports

You recently joined Kaizen Reporting. What does your new role entail?

I joined Kaizen to lead development and implementation of our suite of quality assurance and regulatory testing products for the Securities Finance Transaction Regulation (SFTR). Pre- and post-SFTR Article 4 reporting go-live, we will offer accuracy testing, advanced reconciliation, reference data testing and a tailor-made full governance framework of controls across all financial services reporting parties and their delegates.

Kaizen is a highly specialised firm with an unrivalled focus solely on quality assurance and regulatory testing in the key G20 financial services reporting regimes SFTR, the second of Markets in Financial Instruments Directive (MiFID II) and European Market Infrastructure Regulation (EMIR).

What's your background?

I spent nine years at Barclay Capital as an interest rate strategist before joining J.P. Morgan in 2007 to implement MiFID reporting for fixed income. I ran Europe, the Middle East and Africa fixed income regulatory reporting team through the financial crisis working closely with the Bank of England (subsequently PRA) in establishing the liquidity reporting regime for fixed income in 2009.

As chair of what became the International Capital Market Association, European Repo and Collateral Council (ERCC) and SFTR Taskforce, I advised on the Financial Stability Board working group, culminating in their publication Standards and Processes for Global Securities Financing Data Collection and Aggregation in 2015.

Also during 2015 and 2016, I advised the European Central Bank on their SFT Datastore project. More recently, I was closely involved with European Securities and Markets Authority (ESMA) consultations on the RTS for SFTR as well as in implementing MiFID II for the bond market businesses.

What are the latest developments when it comes to SFTR?

The European Commission has now stated they plan to endorse, with amendments, the draft regulatory technical standards (RTS) and implementing technical standards (ITS). These amendments and the six weeks for ESMA to respond will introduce some additional delay to SFTR Article 4 reporting go-live. However, I anticipate that the RTS will be published in the Official Journal of the European Union at the end of 2018 or early 2019 and that reporting will go-live for banks and investment firms in Q1 2020 with market infrastructures, fund managers and non-financial counterparties to follow at three-month subsequent intervals.

Are the commission's amendments significant?

The changes are minor but extensive. There are a large number of changes in semantics, providing further clarity through simpler language.

The material changes relate to concerns that legal entity identifiers for branches and standards around unique transaction identifiers may not be ready in time for go-live.

They have also incorporated industry feedback on two reportable fields—the first, that agent lenders should be permitted to use repo trades and the second, the termination optionality needs a non-applicable tag for repo and securities lending trades.

SFTR is going to be even more complex than MiFID or EMIR. What are the key highlights?

Participants in European securities financing markets will be required to provide daily reporting to a trade repository of not only every new trade, amendment, correction, error and cancellation but also the majority of lifecycle events, collateral valuations and legal entity-wide collateral re-use statistics.

It's a herculean reporting task that will hand a legal obligation to all but the smallest non-financial counterparties to report between 61 to 128 fields (product dependent) across four reporting tables.

Reporting parties will be tasked with ensuring that between 36 to 48 of these fields can be matched between reporting parties (intra and inter-trade repository) for ESMA to be able to interpret the data and the European System of Central Banks Datastore to be able to create the Europe-wide data aggregations.

Handling trade repository reconciliation queries on SFTR is set to become a significant and complex operational task post-go-live.

Why are regulators now turning their focus to securities?

Securities financing markets are very large in scale and seen as a contributor to the financial crisis of 2007 to 2011.

Concerns were raised over shadow banking, the lack of transparency in securities financing transactions, the potential for a build-up of leverage, interconnectedness and the pro-cyclical nature of SFT markets.

G20 regulatory authorities working through the FSB, concluded in 2015 that there needed to be regional SFT reporting, with global aggregation of these reports to identify any systemically significant issues.

What advice would you give to firms for preparing for SFTR reporting?

Start now if you have not done so already. This is a complex regime and securities financing markets have not been subject to reporting requirements until now.

There is less precedent, less market convention and less infrastructure in place than for other markets. In terms of next steps, we would recommend the following:

- Secure appropriate project governance and planning—even if you plan to delegate your reporting
- Assign business analysts to identify internal data sources (and where you need to go external), data gaps and timing issues
- Ensure open dialogue and engagement with the business and traders. SFTR will have a material impact on how firms do business
- If you are planning to complete or partial reporting solutions in-house, you need to provide technology teams with clear and comprehensive business requirements and functional specifications
- Build controls and management information requirements into the project plan. Adequate reconciliation and quality assurance should not be a 'day two' delivery

Why is data quality such a big issue when it comes to reporting?

Regulators are turning their focus to the quality of regulatory reporting data. We have seen that with EMIR and now MiFID II. SFTR will be no different.

Effective identification, monitoring and surveillance of the activities of SFT markets and the build-up of counterparty and collateral risk are entirely dependent on high-quality reporting.

If the data is full of inaccuracies and inconsistencies, then it is likely to be challenging to process and interpret and ultimately misleading.

From a firm's perspective, ensuring accurate and complete reporting from the get-go will mean less risk of regulatory censure, reputational risk or costly back-reporting.

What is the 'valid but wrong' problem?

This is something that we at Kaizen address. Just because regulatory reports have been validated by an approved reporting mechanism or trade repository, doesn't mean that the data in the reports is correct.

Our quality assurance service ReportShield checks the data inside the reports for accuracy and completeness. It will do the same for SFTR—it will test the quality of a firm's implementation of SFTR, ensure that the reporting firm is on a path to continual improvement in data quality, that the controls and testing environment become embedded in business as usual, and that senior managers are kept abreast of the ongoing level of regulatory compliance. **SLT**

> "Regulators are turning their focus to the quality of regulatory reporting data. We have seen that with EMIR and now MiFID II. SFTR will be no different"

Jonathan Lee, senior regulatory reporting specialist at Kaizen Reporting

Preparing for the future

Is the securities lending industry gearing up for the widespread adoption of blockchain as the default mechanism for the issuance and transacting of securities?

Brian Bollen reports

Lendingblock, a digital asset lending exchange platform for fully collateralised cryptocurrency, claims to be the first company to bring cross-blockchain lending to the crypto world.

The company aims to build on the existing securities lending platform to create a "simpler, and more transparent version of securities lending than the one that currently exists", according to its co-founder, Steve Swain.

Swain says that, in simple terms, the company is a securities lending platform for digital assets such as bitcoin, but he also sees it as a "once-in-a-lifetime opportunity to build something from scratch on a blank sheet of paper".

"Our team is largely from a conventional financial services background, and we saw the opportunity to create a critical foundation stone of an emerging and exciting new financial services ecosystem."

Asked if the company represents a logical progression of blockchain into the securities lending industry, Swain replies: "In some ways, but more the opposite; it's the move of securities lending into the blockchain-based financial industry."

While it will have nothing to do with the lending/borrowing of traditional securities, Swain and his colleagues believe that two key developments are inevitable: firstly, that many existing digital assets will be regulated as securities, and secondly, that there will be a widespread adoption of blockchain as the default mechanism for issuance and transacting of securities.

"It's this future that we are preparing for," he says, "we believe that securities lending plays a critical role in the functioning of an efficient capital market and many, though not all, of the same benefits for borrowers and lenders exist. We do think, however, that the market we are creating can be much leaner and more efficient than the existing securities lending market."

"You don't have to be a zealot to see the potential of digital assets," he explained.

"The vast majority of transactions in conventional financial systems are purely digital with no physical settlement. What we are doing is genuinely innovative, and we are pushing the limits or limitations of existing technology, law, and financial markets."

He describes the market reaction to Lendingblock's arrival on the scene as overwhelmingly positive.

"The number one question we have been asked by prospective clients is 'how soon can you be live?', which is obviously encouraging," he said.

But is blockchain just an overhyped buzzword? Or could it revolutionise the broader securities lending business and indeed much of human activity?

Answering these questions, Swain says: "We recognise many of the problems in the broader securities lending business, but our focus is not to try to fix them."

"As a team, we are focused on building a better version in the belief that the future is digital."

"Blockchain is helping to make systems across practically all sectors more efficient already, including traditional banking and the transfer of humanitarian aid, so it's not just a buzzword without application or function, but rather something that will shortly see mass market applications."

In a previous interview, M Damian Billy, the founder and CEO of Illinois-based Econophy Group, raised a number of issues, including a question on how, with Bitcoin approaching a decline of 70 percent in value, would Lendingblock intend to maintain any collateral relationship.

Responding, Swain explains: "Correlation between digital assets is relatively speaking very high, and given our model is crypto loans secured by crypto collateral, the level of collateralisation required is significantly less than if loans were collateralised against fiat currencies."

Billy also asked: "Since there are two transactions involved (lending and borrowing), are there two fees involved? If someone is going to lend their tokens, they would expect some return on investment. If someone is the conduit for borrowing, they are going to charge a fee for the transaction."

Swain confirmed that Lendingblock takes a fee from both borrower and lender. On an annualised basis this is 1.5 percent, split 2:1 borrower:lender. For example, if a loan is made at 10 percent, the borrower pays 11 percent and the lender receives 9.5 percent, he explained.

Billy asked that if the pledged token loses value, is there a margin call by the lender? Swain answers: "We actively margin call borrowers on a 24/7 basis."

Billy noted that many of the blockchain-related concepts and technologies are yet to be proven at best. He said: "As some are nascent, how do you establish a hierarchy of what tokens can be pledged? Or is it all based on a good faith basis that the entire initial coin offering (ICO) complex does not go to hell in a handbasket?"

Swain says: "For collateral, we will only initially accept the 'blue chip' assets, specifically the top five by market cap and trading volume. Over time we will carefully consider extending this where we can do so in a way that doesn't compromise the protection to lenders."

Billy asked that with some institutional interest coming into the market, would Lendingblock be supportive or be counterproductive to stabilise any lending versus borrowing activity?

Steve Swain replies: "We see strong institutional loan supply and demand, and also think that there will be an active market in identifying inefficiencies and inconsistencies, which should have a steadying effect."

Billy said that as criminal activity is rampant, where or what are the risk-management controls? Who decides? Is there any regulatory oversight?

Swain explains: "We are strongly focused on working with regulators, as we believe in the importance of trustworthy markets and market participants. Only through regulation are we going to reach the level of trust that is needed for the development of our sector."

Billy said: "From what I have read, there are a handful of individuals that control upwards of 70 percent of the Bitcoin market and other ICOs, how do you defend a transaction that cannot be controlled internally?"

Swain replies simply: "I don't believe this is true."

Billy asked: "Will it be a one to one transaction relationship between the lender and borrower or will a skewed equity relationship exist between the two sides of the transaction? Are there more lenders than borrowers or vice versa?"

Swain replies: "Our loans can be syndicated across multiple lenders. For example, one borrower may have its loan request filled by more than one lender based on best offers in our order book.

This transparent "best execution" model is a significant improvement on existing opaque securities lending processes."

"If the token loses 10 percent, 20 percent or 30 percent of value, where and who has the liability for paying off the loan?" asked Billy, "is the borrower required to add more tokens as collateral?"

Swain says that all loans are over-collateralised, based purely on the principal/collateral correlation. If the collateral value drops below the defined collateral floor, the borrower is required to provide more collateral.

"If they do not do so, their collateral position is liquidated to cover their obligation to the lender," he adds.

"Can the loan be called due to a market price drop?" asked Billy.

Swain says the answer is no, though the collateral management process described above applies.

"Is there ever a point in the lender versus borrower relationship where the market environment would just negate it?"
asked Billy.

Swain replies that if the borrower does not meet any obligations they enter into default. Given that there is an enforceable legal contract in place, this would have serious repercussions, he says.

For his last salvo, Billy said: "Everything is fine when things are positive, what happens when neither side controls market movement and the token pricing collapses? Does the lender just seize the borrower's collateral?"

Swain explains: "Lendingblock acts as an agent for the lenders, and is empowered to liquidate collateral to purchase the principal obligation from borrower to lender." **SLT**

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Comings and goings at Lago Kapital, EquiLend, State Street and more

Lago Kapital has appointed Jussi Siukonen as head of operations.

Based in the Helsinki office, Siukonen will report to CEO Jarkko Järvitalo and will be responsible for back-office operations.

Prior to Lago Kapital, Siukonen worked at United Bankers for more than 20 years.

EquiLend has hired Mark Bowers as a product specialist.

Bowers will be based in EquiLend's London office.

Prior to EquiLend, Bowers was part of the business control, regulatory delivery and product management team at Deutsche Bank.

At Deutsche Bank, Bowers covered the Securities Financing Transactions Regulation and Markets in Financial Instruments Directive, as well as other regulations, from 2016 to 2018.

Before Deutsche Bank, Bowers was director of equity finance at RBS global banking and markets from 2002 to 2016.

State Street Corporation has appointed Andrew Allright as CEO of InfraHedge, the firm's managed account business.

Allright has been with InfraHedge since March 2011, serving as head of client solutions.

Allright will work alongside Ravi Raman, COO, as well as new hires, including Robert Vanderpool, president of InfraHedge North America, and Lizzy Buss, head of Europe, the Middle East and Africa, as well as Asia Pacific business development.

InfraHedge has more than $30 billion of client assets and designs, builds and operates customised platforms for institutional investors to manage their third-party investment programmes.

Commenting on Allright's new role, George Sullivan, global head of State Street's Alternative Investment Solutions business, said: "The InfraHedge business has shown tremendous growth over the last few years."

He added: "I look forward to Andrew Allright and his team driving it through the next stage of its development by taking advantage of the attractive market environment."

"Managed accounts are increasingly becoming the preferred choice for institutional investors, and we have great confidence in the attractiveness of our platform business, which has been designed since inception to focus entirely on the needs of investors in order to help generate the best possible outcomes."

Alex Jeffcoate is leaving MUFG and will be joining HSBC, effective 20 August.

Jeffcoate served as senior associate, securities lending at MUFG for six years.

At HSBC, Jeffcoate will take on the role of securities lending trader.

He will serve on the agency lending side of the business and report to Reshad Mullboccus, global head of trading strategy at HSBC.

Do you have a industry appointment that we should cover?

Get in contact with us at:
beckybutcher@blackknightmedialtd.com