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A WHOLE NEW PLATFORM

Tammy Phillips discusses her new P2P securities finance financial technology venture

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Repo a potential threat to financial stability

The vulnerability of repos poses potential threats to financial stability, according to a Financial Year 2018 report, released by the Office of Financial Research (OFR).

The report to Congress, released on 15 November, presented the OFR's assessment of the state of the US financial system, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The report stated overall risks to US financial stability remain in a medium range, as it has found for several years.

With regards to repo, the OFR said: "comprehensive and detailed data are scant for about half of the US repo market" and also stated "data gaps persist regarding securities financing transactions, including repos and securities lending".

Concerning this, the OFR issued a proposed rule to collect data regarding transactions in the market for repo and said it is also exploring ways to learn more about uncleared bilateral repos.

The OFR said the repo collection will help to meet the need for a "viable alternative" to the London interbank offered rate (LIBOR).

The OFR said: "The attempted manipulation of LIBOR during the financial crisis and ongoing doubts about LIBOR's reliability, have led to efforts to devise a reliable, widely accepted, and transparent alternative."

It added: "The OFR worked closely with the Federal Reserve to design a set of three interest rate benchmarks based on data on overnight repos, which may form the basis of a future replacement for LIBOR."

The Alternative Reference Rates Committee, an industry group convened by the Federal Reserve Board and Federal Reserve Bank of New York, named the secured overnight financing Rate (SOFR) as its preferred alternative to US dollar LIBOR.

Of this, the OFR said it is "continuing to work closely with the Federal Reserve Bank of New York to oversee the production of the new rates and ensure they accurately represent what they are intended to measure".

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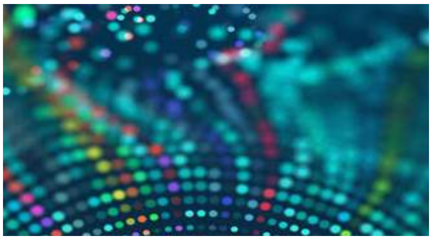

ESMA updates Q&A on short selling

The European Securities and Markets Authority (ESMA) has updated its Q&A on the short selling regulation (SSR).

The Q&A clarifies that the identification of the relevant competent authority, following the entry into application of the second Market in Financial Instruments Directive (MiFID II) and Markets in Financial Instruments Regulation (MiFIR), is no longer made under commission regulation number 1287/2006.

The identification will now be made under commission delegated regulation (EU) 2017/590 for the reporting of transactions to competent authorities.

In the updated version, it is stated: "With the application of MiFID II/MiFIR regime, whereas the formal reference in SSR to Commission Regulation 1287/2006 has not changed, Article 25(3) of MiFID I has been substituted by Article 26 (1) and (2) of MiFIR, supplemented by commission delegated regulation (EU) 2017/590."

"Therefore, the reference to commission regulation 1287/2006 has to be read as referring to commission delegated regulation (EU) 2017/590 for the reporting of transactions to competent authorities."

The Q&A is meant to promote common supervisory approaches and practices in the application of SSR.

Repo a potential threat to financial stability

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It also agreed the successful launch of SOFR laid the groundwork for progress on alternative rates.

It stated: "Building on this progress, cleared futures referencing the SOFR launched in May 2018, and swaps referencing the SOFR launched in July 2018, achieving important steps in the reference rate committee's Paced Transition Plan, ahead of schedule."

Elsewhere, the OFR found that risks from solvency and leverage remain low, for the most part, despite the fact that "some large banks, insurers, and hedge funds could be vulnerable to severe stress".

The OFR said, similarly, funding and liquidity risks are low overall, "thanks to favourable borrowing conditions and high liquidity buffers for most banks".

Based on its research, OFR predicted that if the economy remains healthy, market volatility will "probably stay low" but said it could not rule out a shift to very high volatility, because of financial market indicators that are currently high from a historical standpoint.

OFR stated funding and liquidity conditions are generally good with funding conditions from lenders and markets continuing to support corporate borrowing.

The research firm said: "Given banks' special role in the financial system, we are primarily concerned with monitoring their funding and liquidity risks. For large banks, funding and liquidity risks appear to be low. These banks maintain ample liquidity buffers to survive at least 30 days of stress."

OFR also found total hedge fund borrowing increased from $1.9 trillion at the end of 2015 to more than $2.8 trillion by June 2018.

Data indicated that the total amount of hedge fund borrowing is significant, had grown recently, and is mostly concentrated among a few borrowers. The 10 largest hedge fund borrowers account for nearly 40 percent of all hedge fund borrowing, the OFR found.

According to the OFR, derivatives exposures are still a source of "contagion risk" throughout the financial system "stemming from interconnections among counterparties in financial transactions".

It also stated that cybersecurity risks remain a concern and that although not a concern at this point, "cryptocurrencies are worth monitoring because their use is rapidly growing and evolving".

HKEX adds additional securities eligible for short selling

The Stock Exchange of Hong Kong Limited, a wholly-owned subsidiary of Hong Kong

LCH SwapAgent marks first swaption trade

LCH SwapAgent, a service for the non-cleared derivatives market, has processed its first swaption trade.

Two swaptions trades were completed between Nomura and Deutsche Bank, one denominated in euro and the other in USD.

Swaptions are the latest addition to LCH SwapAgent's product offering for the non-cleared derivatives market, which includes cross-currency basis swaps, interest rate swaps, and inflation swaps.

Aaron Mayor, head of new product development for rates at LCH, said: "We are excited to launch USD and euro swaptions in partnership with the market."

He added that LCH supports "the alignment of swaptions settlement and collateralisation with the cleared swap market and have launched swaptions in SwapAgent with net present value based settlement in both USD and euro".

Martial Collet-Billon, head of euro rates exotics trading at Deutsche Bank, commented: "Deutsche Bank is delighted to be entering the first swaption trade into the SwapAgent service."

"We are continually looking for ways to be more efficient and provide a better service to our clients, and SwapAgent is helping us to achieve that."

Chris Wells, managing director, Europe, Middle East and Africa, head of middle office at Nomura, commented: "The SwapAgent framework enables significant improvements in the processing and settlement of uncleared over-the-counter derivatives".

Exchanges and Clearing Limited (HKEX), has added additional securities, eligible for short selling.

The change was effective from 9 November 2018.

Some 23 additional securities will be eligible for short selling and 40 existing designated securities will be removed from the list.

The total number of designated securities for short selling will be 929 after the revision.

The securities to be added to the list include Jacobson Pharma, Differ Group and Tian Lun Gas.

B3 releases securities lending results

The Brazil Stock Exchange's and its clearinghouse (B3), securities lending revenues totalled Real $30.6 million, a rise of 21.2 percent over Q3 2017.

The result, which accounts for 2.4 percent of the exchange's total Q3 revenue, reflects an increase in the average financial value of outstanding positions in the securities lending platform, the exchange said.

B3 found its depository, custody and back-office revenue totalled R $62.4 million at the end of Q3 2017, 4.9 percent of its total revenue. This was up by 4.7 percent over Q3 2017.

Overall, B3's Q3 total revenues reached R $1.2 million, an 8.7 percent increase over the Q3 2017.

Last year, the Brazilian exchange and clearinghouse moved corporate bonds and equities lending to its new multi-asset clearing platform, as part of a post-trade overhaul.

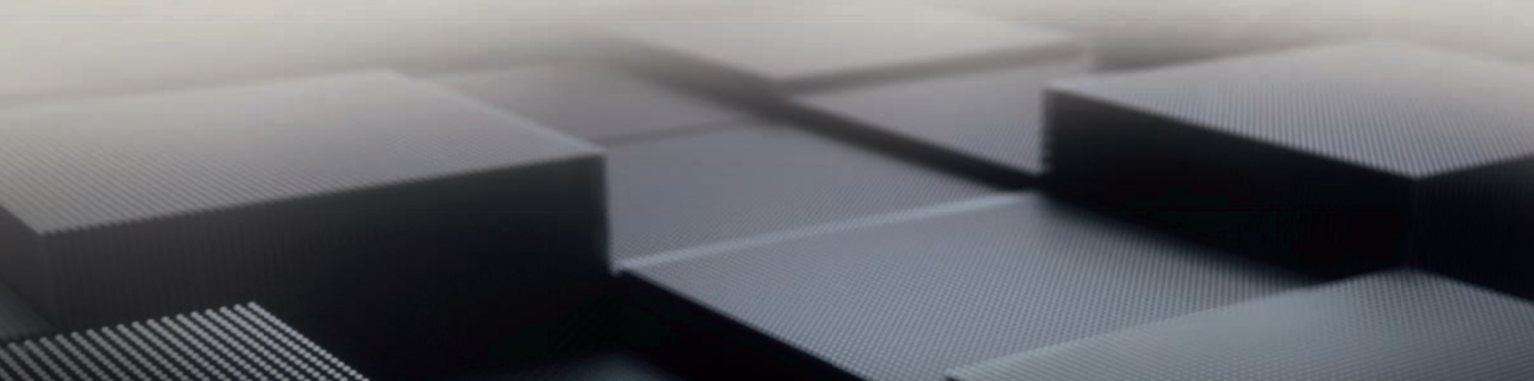
Societe Generale sells Euroclear stake

Societe Generale has sold a stake of 2.05 percent in Euroclear to Société Fédérale de Participations et d'Investissement (SFPI).

After the sale of the stake, Societe Generale will remain a significant minority shareholder in Euroclear.

According to Societe Generale, the disposal is the consequence of the mechanical increase of the group holding included by the successive share buy-backs implemented by Euroclear over the past years.

Meanwhile, all of the authorisations required for the closing of the transaction have already been obtained.



Since the revaluaton of Euroclear securities was initiated in Q3 2018, the positive impact of this sale on the group's core equity tier one will be limited.

America2030 clarifies stock loan agreement allegations

America2030 Capital Limited has released a statement to clarify allegations released by a former client.

According to America2030, two executives from a Singapore public company each executed two loan agreements with them to obtain a loan against their publicly traded securities.

America2030 stated the contracts were executed in early June of 2018 and borrowers did not deposit the securities until the end of October, almost five months after contracts were executed.

It continued: "Three months after the contracts were executed, borrowers attempted to renegotiate terms."

"We accommodated the borrowers and agreed to their new terms and an addendum was executed, thus amending the contract."

"Despite the new terms, the borrowers were still indecisive and continued to renegotiate the contracts and again to seek new terms, despite the existence of executed contracts."

Between the time that the contracts were executed in early June and shortly after the deposit by borrowers of the pledged collateral at end of October, the price of the stock declined by more than 50 percent, according to America2030.

It added: "Borrowers executed the closing statement which required them to deliver additional securities to make-up for loss in value of their shares. Also, according to the loan agreement, borrowers were required to deposit additional collateral to stay within the terms of the loan but failed to do so, instead, again borrowers continued to demand a $6 million loan against collateral worth less than $6 million and to further renegotiate terms."

America2030 said it sought to terminate the contracts after borrowers failed to comply with the terms of the contracts and ignored notifications warning of an imminent default.

The firm said: "Borrowers failed to adhere to the terms of the contracts and repeatedly used every opportunity to renegotiate the terms."

America 2030 Capital has referred the matter to arbitration for resolution and adjudication.

Val Sklarov, CEO of America2030, said: "It's unfortunate that some people do not want to follow terms of contracts because they think that they are special, but would rather resort to distribution of incorrect, defamatory and sensational press releases, and to attempt to litigate a dispute in the public media as opposed to in court or arbitration as required under the contract. We would be pleased to resolve the matter amicably in accordance with the contract, but our calls to do so were ignored."

eVestment: hedge funds go negative in October

Performance challenges in the global hedge fund industry continued in October, according to the latest eVestment hedge fund performance data.

The industry's aggregate performance of -3.10 percent for the month dragged year-to-date (YTD) performance into the red at -2.55 percent and October was the second lowest month in performance since September 2011.

eVestment said: "The search for bright spots in the industry was difficult in October as almost every hedge fund primary market and primary strategy was in the red for the month, although many are still in positive territory YTD."

It added: "October's fund performance and resulting impact on YTD performance are in stark contrast to the largely positive results hedge funds saw in 2017 and 2016."

eVestment found among primary markets, foreign exchange/currency hedge funds returned 1.04 percent in October, with YTD performance at 1.83 percent. Hedge funds focused on Brazil delivered strong performance in October at 12.99 percent, bringing these funds' performance into the green for the year at 0.75 percent.

Funds focused on India, China and Russia, however, continued their negative trajectory in October and YTD.

SF market at-risk from cyber attack

The securities market is one of the most at-risk areas from cyber attacks, according to Swift and BAE Systems in a recent report on how cyber attacks could target the world's financial markets.

The securities market is at risk due to the large number of participants and infrastructures, as well as the complex interactions involved, it was found.

According to the report, weaknesses can be unknowingly introduced by traders, brokers, investors, other stakeholders, and the systems that all of these participants use. The study found that the foreign exchange and trade finance markets are also at risk.

The report advised security participants to embrace the value of checks, communication and data support pre- and post-trade activities and stave off cyber threats.

It noted that securities market infrastructures should collaborate with participants to identify risks in common practices.

Additionally, the report advised banking payments participants to continue to strengthen security controls while building in protection for upstream systems.

The report encouraged trade participants to review and manage areas of inherent trust, which are at risk of cyber exploitation.

Sanjay Samuel, financial services director at BAE Systems, said: "It's all too easy to be lulled into a false sense of security, and place too much faith in systems which cyber attackers can exploit. While the threat is greatest in the securities market, every part of the global financial services sector needs to be aware that cyber crime is evolving."

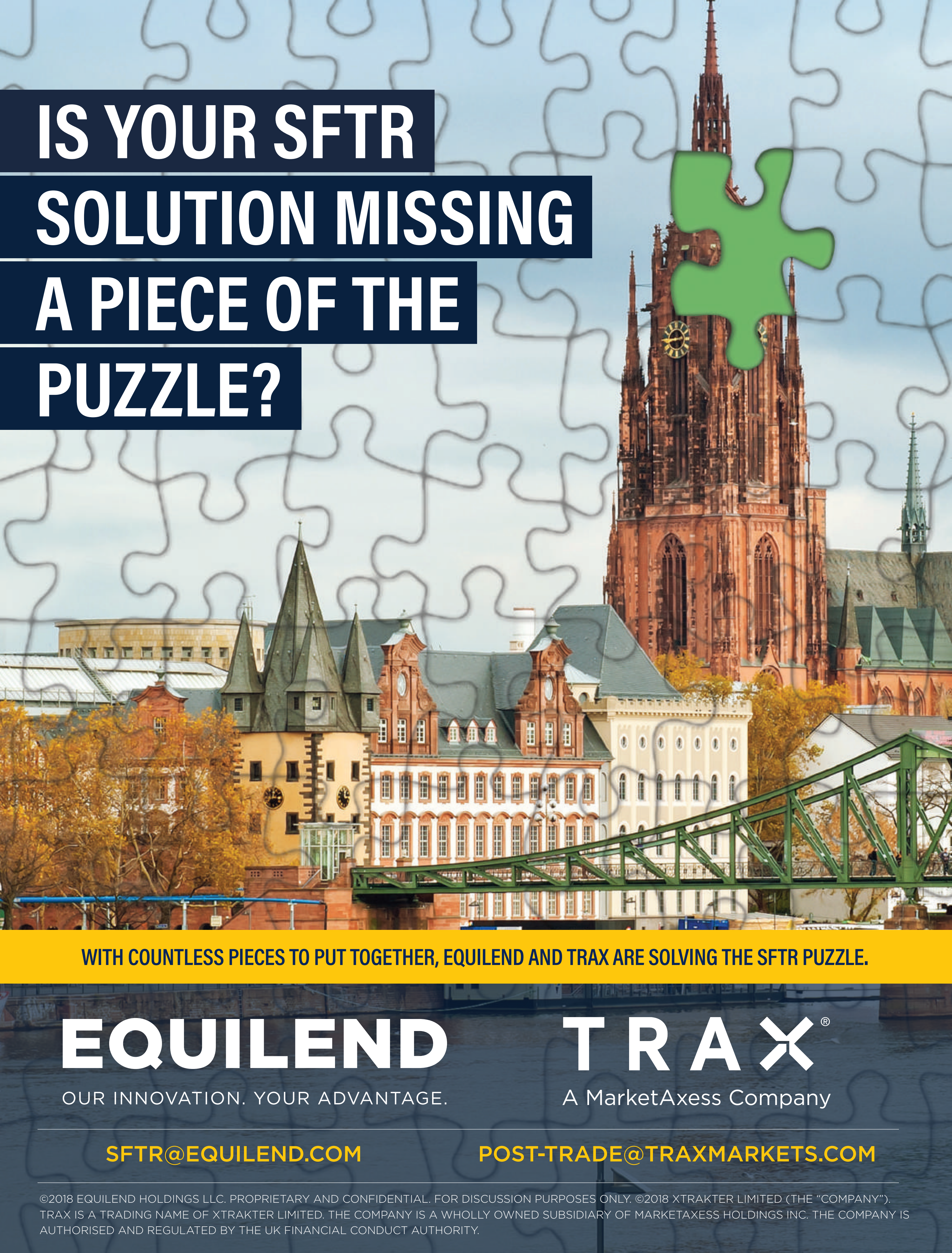
"Threats are becoming more intelligent, and criminals are increasingly focused on generating a return on attack as quickly as possible. There's a wide range of cyber threats out there, and that's why a holistic approach is becoming critical."

"Cyber security is no longer just a technical issue, as attackers are exploiting weaknesses in market operations, people and processes. So security needs to be embedded and coordinated across all levels and sectors of financial services organisations."

Brett Lancaster, managing director, global head of customer security at SWIFT, commented: "Over recent years, SWIFT has made good progress supporting financial institutions in their fight against well-organised cyber attackers—but this report shows that now is not the time to sit back and take this progress for granted."

"As cyber criminals become ever more innovative and agile, we need to continue to work together to build even stronger defences."

He added: "Through our Customer Security Programme, we have been assisting the payments, securities, trade finance and foreign exchange sectors to better protect their immediate surroundings, and have facilitated better information sharing to help equip the industry with the tools it needs to combat cyber crimes. This report is a timely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reminder that we need to go further still to keep ahead of the criminals."

Brexit agreement provides 'sensible period' for UK firms

The UK Government's draft Brexit withdrawal agreements provides a "sensible period" for firms to make necessary changes for operating from the UK as a third country, rather than as an EU member state.

According to Liz Field, CEO of Personal Investment Management and Financial Advice Association (PIMFA), given the significance of the UK's financial services industry, "ensuring stability and maximising the prospects of protecting retail investors are key concerns for the future".

"Very clearly, further detail is needed to ensure that the UK can continue to operate as one of the leading wealth management and financial advice centres in the world", she said.

The government agreed on a withdrawal agreement and political declaration on a future relationship with the EU following Brexit on 14 November, but has already been hit with criticism and concern, with Secretary of State for Exiting the EU, Dominic Raab, resigning on 15 November.

David Lewis, senior director at FIS Global, explained that compared with one month ago, borrowing volume has decreased by 35 percent for the FTSE 100.

Lewis added: "Over the last week we have seen a reduction of some 12 percent and Monday (12 November) to Tuesday (13 November) saw a 19 percent reduction, all suggesting that short sellers had been decreasing their positions as the possibility of a deal edged closer."

He explained that the withdrawal agreement "may show a different course as the government faces key resignations and a tough time in Parliament."

Andy Scott, associate director at JCRA, the independent financial risk management consultancy, said sterling has fallen almost two percentage points against the euro and the US dollar "as markets once again face the heightened uncertainty of not just Brexit, but also the domestic political situation".

Hogan Lovells Brexit Taskforce partner Rachel Kent remarked: "The really good news from today's announcement is that the financial industry will have a transitional period to give them additional, and much needed, time to adapt to new framework post-Brexit."

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Euroclear 2018: Stimulating dialogue and collaboration

Hot topics at this year's Euroclear conference included regulation, repo and leverage, collateral trading, and technology

Maddie Saghir reports

This year, delegates gathered in Brussels for Euroclear's 17th annual collateral conference. The vast majority of delegates hailed from client services and senior management practices from a variety of industry segments.

During the event, panellists discussed a range of topics, including collateral trading, new marketplaces and technology. In one session, many panellists agreed that artificial intelligence (AI) has endless use cases, while other panels created mixed debate, particularly around the subject of SFTR, which some panellists saw as a 'blessing in disguise'.

In the opening remarks on the first day of the conference, Olivier Grimonpon, global head of collateral management and securities lending, Euroclear and CEO of DTCC-Euroclear global collateral, reinforced this, stating that "our focus every year is about stimulating the industry dialogue and driving market collaboration. And those discussions help us to adapt our services and to remain relevant whilst the industry evolves".

This year marked the event's 17th anniversary and Grimonpon noted that many things have changed since its beginning. He said: "The most notable difference is that this is no longer just a collateral conference, this is about so much more. This conference now focuses on strategic decisions that we all face or will face. It is about regulation, cyber, blockchain, micro and macroeconomics, politics, geopolitics, and the list goes on. All of which have a direct or indirect impact on the business of collateral."

He continued: "The scope of topics that we address every year continues to expand and this ensures that we, as an industry, continue to have a forum in which we can discuss anything and everything that impacts our business."

During the course of the two-day event, delegates gathered to partake in panels on collateral trading, repo and leverage, and technology transformation. In a panel on collateral trading, speakers explained that recent regulation has dramatically changed the global collateral management landscape.

Under this wave of regulation, the market has demonstrated its agility and responsiveness by adapting to take advantage of the resulting opportunities.

Panellists explained that moving away from balance sheet intensive trades to new forms of collateral trading such as collateral swaps, and the integration of previously siloed asset classes are two examples of this agility.

Panellists also said there were “two main pressure forces” that were particularly prominent in the past: one, regulatory pressure, and the other, the withdrawal of financial resources from the sell side, which has affected the buy sides’ ability to access the market.

One panellist said they “don’t see that pressure coming back any time soon”, but said it was too early to write anything off completely.

In terms of trends, panellists agreed that there was a big trend around efficiencies. One panellist said: “In a world where margins are becoming more compressed, there is a big trend that we are seeing around product efficiencies. I expect that trend to continue. The new thing is the relationship with the client.”

“The burden that is going onto our clients is enormous, and this does not get enough attention. We are equipped to handle these things but clients are tearing their hair out trying to keep up with this,” one speaker said.

The speaker added: “The sell side is being constrained for various reasons. Unless a sweep of solutions is made available for clients, I think this is going to be a serious problem.”

Additionally, the panellist drew upon the idea that ‘clients are being de-marketed’ and said as the pressure on financial resources increases, this will continue to be an ongoing issue.

This panel was followed by a Euroclear update, where Brexit was a hot topic. Naming it the elephant in the room, one speaker remarked: “We have no choice but to prepare for the worst case scenario.”

“Specifically for collateral management this could mean a migration of up to 2,500 contracts pairs in up to 20 UK entities. In order to be ready for those kinds of volumes, I urge you to engage with us and confirm with your clients as soon as possible before the deadline so we can all work together on a viable plan.”

In the following session, panellists discussed repo and leverage. One said leverage as a financial system includes not only the banks leverage but the systems leverage.

The speaker added: “The databases that people use do not pick up leverage completely. One of the topics of today is leverage and it is not being picked up via download. The other headline topic is repo, and repo is not the only flaw of collateral, there are other flaws of collateral if you are talking about securities finance transactions and these are significantly from the hedge fund prime brokerage.”

The second panellist summarised: “Leverage, the topic and the rhetoric is not accurately identified and regarding repo, you cannot get the full picture of repo through collateral.”

The first panellist added: “Where we are concerned about leverage is in collateral transactions. In a crisis time, if a chain is corrupted then experience shows the problem gets multiplied.”

He said: “We have to weigh the short term with the social losses if things go wrong. Therefore, I would say let’s be careful. I agree that we do not see all leverage but at least with the one we can see and can limit, I would say that in this space we should be careful in posting collaterals unless you have enough buffer.”

The other speaker explained: “Liquidity has done a fantastic job, but we need leverage ratio because of the capital side. We have tried to look at these numbers for 10 years now and there is something fundamental here. Some collateral will remain good and some will lose value.”

Another panellist added: “Leverage ratio is not perfect but there is not much point tinkering with it. Repo is not the only issue in leverage and we make the mistake of focusing on it too much—but don’t forget about it.”

Meanwhile, in a panel on technology, one panellist said that AI produces immediate gains, potential in the value of its services, potential revenue and doesn’t require any industry-wide collaboration.

The panel looked at some of the developments that showcase the future uses of technology in the industry, with one speaker noting that over the past few years technology has been affecting lives like never before.

One panellist questioned the reasonable timeframe for execution of technology and in response, another speaker said: “Nobody has a crystal ball. It is really hard to generalise, so you cannot say that all institutions have the same technology programme, there is a diversity out there and the crystal ball doesn’t give one answer for the whole group.”

Panellists explained that technology has been subject to a lot of hype over recent years, and one said that technology at the moment is not fully stabilised yet. The panellist said: “Adoption will take time, it requires collaboration across the industry and this will take time. There will be a lot of initiatives, there will also be a lot of scrutinies.”

Discussing data, a panellist commented: “You need data for AI because without it and without the transparency of logic, you will get flaws and biases as a result. On top of that, you need a robust set of application interfaces, in order to survive in the market, you need to move from a pipeline to something more platform-like.”

In terms of challenges, one speaker observed: “There is a lot of resistance and questions which need to be addressed. The cost of migration is huge. Cost-effectiveness and user friendlies are good but the most important is security.”

“A lot of regulators have access to a bulk of data, for example, the passport member of everyone trading UK security, which leaves a cyber risk of that data there.The problem with cloud and regulators is the cloud providers. The regulators want audit rights and the cloud providers won’t give them that yet. I don’t think new regulations should be made for fintech. Regulators need to cooperate a lot more globally to get a reduction in risk.” **SLT**

All about that data

Andrew Kouloumbrides of Xceptor discusses SFTR and how the industry is responding to the growing abundance of data

Maddie Saghir reports

What projects has Xceptor been working on recently?

We have 60 active projects at the moment—there is quite a lot of activity going on!

One of the most prominent recently is DerivHack, an event sponsored by Barclays in partnership with International Swaps and Derivatives Association (ISDA), in London and New York. They were looking to see how they could improve the whole process around derivatives documentation and the possibility of using blockchain. A number of teams spent two days working on a pre-packaged bunch of data, the ISDA common domain model and the blockchain of their choice. Interestingly, in London everyone chose R3, one of the companies that we were partnering with. We were the only software provider in the hackathon and our team ended up winning the prize for the most complete solution.

The key thing for us at Xceptor is the end-to-end integration, it needs to be able to integrate into the end-to-end service layer of a post-trade but an ecosystem of different technologies is needed. This is because ‘bank A’ may use one platform, ‘bank B’ may use two or three platforms, and ‘bank C’ may use even more platforms. They all have to co-exist on a common domain model, representation of data, and common blockchain layer. The challenge that has always been inherent in these kinds of initiatives is coming up with a common representation of data and a common service layer that everyone can participate in, but you are relying upon everyone changing their technology to fit in with that and to be able to interoperate with that, and that is always a massive struggle.

Therefore, where our platform is the strongest, is in its ability to transform data, and fit and sit between the different layers of technology and trends and form that data, as well as our applications being able to take a trade from one end of the lifecycle to another. Not only did we have that application end-to-end, we also had our generic data transformation engine being able to allow others to interact with that service layer.

What are the disadvantages of derivatives trades documentation processes?

The conflict that we see in a lot of our clients is where they are driving automation initiatives. They are trying to automate in the face of increasing regulation and complexity in trade documentation, which is typically caused by the regulation. It has driven more volume and retained the complex paper-based documentation; there is a limit as to what those banks have been able to do around automating that aspect. If you haven't been able to automate anything then it exponentially increases the workload, the operational overhead, and the risk that is inherent in it, so that is a disadvantage for the banks.

Where we come from, we look at how we can deliver that automation in what I would call that completely unstructured world, so you can take this documentation and you can automate the consumption of those contracts in trade documentation, you can automate picking up the data, validating it, comparing the changes that are made by multiple parties who inherently pardon the ecosystem that the banks need to work with. And so if you can automate as much as possible, and with the new technologies that are native to our platform around natural language processing, artificial intelligence (AI), and machine learning, these are far more attuned to be able to process those documents. Then you can actually start to meet the increasing complexity and the regulation but also be able to meet the increasing workload as well.

What opportunities are you seeing for technological innovation in securities finance?

Securities Financing Transaction Regulation (SFTR) is the next big thing coming down the line. Currently, we are in the final stages of negotiating a partnership where we will provide an SFTR data capture transformation reporting service.

With SFTR, 153 fields need to be extracted and nobody has a pure database for those 153 fields to be able to put that into an analytics engine which would derive the necessary reporting. A number of banks that I have spoken to have said that even if they went across their whole organisation, they do not believe that they hold all 153 items of data.

They may be held in some form of documentation, for example, spreadsheets, faxes, PDFs. The ability to extract that data and be able to present it in a way that allows those regulators to connect is what we do.

Every initiative is all around the ability to consume data from multiple different sources in multiple different formats, whether it's structured, semi or unstructured, to be able to actually consume it, repair it, fill in the gaps, transform it and do something with it. This is where the innovation is coming from, particularly in the regulatory space.

How is the industry responding to the abundance of data? Are there any opportunities to be had here?

I think that there are countless opportunities to be had. I read recently that over 50 percent of data coming into financial institution requires intervention. It comes in in a way that you can't fully consume, it is incomplete, incorrect and needs repair. That is significant, if we take client onboarding, which is a massive issue for our clients at the moment, it impacts the ease of doing business and the speed of onboarding clients, as well as client satisfaction.

We have got personal experience of this as we have tried to set up bank accounts in different parts of the world as our business has expanded. It is completely frustrating with incessant form filling and constant requests for information.

But with all of that data, how can firms actually streamline it? You capture it in one place, and you actually have availability of data sources that you can put in and get all of your know your customer, anti-money laundering data automatically fed into that process so that you're not going back to the end client and asking them to provide you with data that has already been provided somewhere else.

As far as we are concerned, data sits at the heart of everything that we do and those 60 projects that we talked about are all data centric, from client onboarding to servicing a trade, to migrating, to looking at evaluation of assets and how you pull that evaluation together whether that is a private equity valuation statement on a website or taking on board fund pricing information coming on an email or a spreadsheet—there is a raft of innovation that is now happening that make it faster, quicker, cheaper, and reduces risk.

Looking to the future, how do you see technology improving the securities finance industry?

There are two schools of thought, the first, which I have heard a number of institutions talk about is: 'We are going to replace the enterprise platform, it doesn't do what we want, it is a legacy system, we are going to rip it out and put a new AI-driven one in.' Typically, around three months later the reality hits where institutions say: "This isn't feasible, there is so much value and intellectual property rights in the data in these legacy platforms, and actually we cannot replace these platforms, so how can we deliver the transformation but in the context of retaining the value of some of the legacy that is there?" We believe that you don't have to retain it all or chuck it all out, you can selectively retain.

Platforms, like Xceptor, drive innovation by being part of the ecosystem of automation technologies. The word ecosystem is frequently used; innovation is currently like a jigsaw puzzle where organisations have lots of jigsaw pieces but with some gaps.

Client onboarding can leave big gaps because when the onboarding data is provided on forms or spreadsheets, someone has manually typed that into a system.

Someone then manually sends an email to another part of the bank because they have to open an account in one area, and somebody else will then send an email to another part of the bank opening an account in another area, and then someone fills in forms to inform the recipient where everything is because there is no overview of what is going on. As a result, you are left with lots of gaps where manual activity or spreadsheets are happening. The innovation is about how to plug those gaps while retaining some of the value of the legacy existing enterprise software. This should be done in a way that allows it all to work seamlessly so that you get the efficiencies of the transformation without having to go through the upheaval of people ripping up lots of existing technology.

Are you seeing people in the industry embrace new technologies or are they choosing to stick with legacy systems?

Most organisations that we deal with will have an innovation/transformation/automation group either centrally or across their major lines of business. I don't think that any of the financial institutions that we deal with have got the luxury of standing still, they are all looking to innovate.

Spreadsheets and manual processing exist because technology couldn't easily or cost-effectively fix the problem but now the new set of technologies can. AI and natural language processing are starting to address those hard problems that nobody has been able to fix before.

Interestingly at Sibos this year, presentations on AI or blockchain tended to attract large crowds. Those two themes are the technological innovations that organisations are seeing as being the game changer in allowing them to transform. From our point of view that is great. I talked about the DerivHack around blockchain distributed ledger, which will bring the industry together and make it far more efficient in terms of how it interacts. AI is a major transformation that is an inherent part of our platform, which allows us to play our part and consume any data in any format. Fraudulent payments, for example, is an area of where machine learning is being used.

All of the faster payments for the banks come through our platform, and we do the floor checking for them. For example, "this payment is on an account and we have been notified that it has been compromised or the debit card has been stolen."

Fraud comes up quite a lot in terms of interesting rules around trends of transactions, regarding mostly how fraud is detected these days. Dynamic rules, the provisioning of those rules but also the monitoring of some trends around payments history and being able to dynamically analyse payments against trends is really key. We are using AI modules to be able to track and analyse trends and look at slight variations but that are very noticeable in terms of fraudulent activity.

Another area that is becoming prevalent is reconciliation, people should be aware that the financial industry is most probably solely focused on reconciling between parties, transactions, and end of day/start of day, and so on. We have been working with the banks to look at all of the breaks of reconciliation to determine and understand why the break is happening and how we would repair that break, and whether or not we can auto-repair it. If we know what the analysis of it is, as we are also feeding into the front end of that reconciliation, the solution can self-learn so we can undertake some data normalisation and transform it before the data goes into the reconciliation itself.

It is about learning from the break and then auto adjusting the transformed data going into the reconciliation.

This is really interesting because there are a lot of processes that have significant financial impact, which aren't agreed between two parties, and being able to prepare that and auto correct that is key. **SLT**

> ***AI is a major transformation that is an inherent part of our platform, which allows us to play our part and consume any data in any format***

Andrew Kouloumbrides
CEO
Xceptor

Act now

Valentino Wotton of DTCC suggests the industry act now on SFTR to ensure readiness for the implementation

How will SFTR affect the securities lending industry? What changes can we expect?

The Securities Financing Transactions Regulation (SFTR) will have significant implications for the industry. First of all, the regulation requires that any transaction where securities are used to borrow cash, or vice versa, must be reported to a European Securities and Markets Authority (ESMA)-authorised trade repository. The new reporting requirement applies to a wide range of securities transactions, including repos, sell-buy back and buy-sell back activities; securities and commodities lending and borrowing, as well as margin lending and borrowing.

While SFTR is a European regulation, its impact will be felt beyond Europe's borders.

The SFTR requirements will apply to both financial and non-financial entities which are established in the EU, including all branches irrespective of location, as well as all entities that are established in a third country if they conclude a securities transaction within one of their EU branches.

How will the new regulation affect current processes in securities lending? Do you think there needs to be an increase in automated processes?

Our recent research has shown that transaction reporting for securities financing trades may create five times as many reports as trades when SFTR takes effect, which is likely to significantly impact trade booking models. The regulation may also affect 60 percent of current processes resulting in the need to develop new processing capabilities.

It is evident that firms will need to reassess their current workflows so that they can understand the data they process, ascertain how that data will be obtained and—for that data which is not available—determine how it can be sourced. Also required, is a validation of messages when accepting and storing them to ensure message completeness, as well as the accuracy of data formats, including reference data validation, legal entity identifiers, international securities identification numbers and International Organization for Standardisation country codes.

With this in mind, firms will need robust control frameworks in place to manage the data effectively in case of any possible breaks and to oversee the accuracy of data reported by a third-party on a firm's behalf. This should lead to processes that ensure the reporting of securities lending trades in an accurate and timely manner, as this is critical to the success of SFTR implementation.

In what ways will it change current reporting once the regulation takes effect?

SFTR shares many similarities with the European Market Infrastructure Regulation (EMIR) from a trade reporting perspective, however, there are also significant differences. Looking specifically at the differences, the securities finance industry has much more work to do in comparison to the derivatives industry when it first faced trade reporting regulation, especially regarding data availability and the workflows that currently sit at the core of the securities finance industry. Repo and stock lending businesses are traditionally more siloed than those of derivatives; therefore it will likely take longer to implement processes to comply with SFTR reporting than it took for EMIR.

What other challenges will the securities lending industry face?

A key challenge for the securities lending industry will be around the development of a unique transaction identifier (UTI) creation and sharing process for transactions. The UTI is one of four key fields used to pair trades within the Trade Repository reconciliation (alongside reporting counterparty, other counterparty and master agreement type—where applicable). The issue of developing a process to create and share UTIs is currently being worked upon by the trade associations, however, requires focus from the entire industry to agree and then implement.

And how will the regulation benefit the securities lending industry? What opportunities will it bring?

SFTR is the latest piece in the regulatory efforts to tackle systemic risk issues exposed by the global financial crisis. If SFTR preparations and compliance are approached correctly, SFTR will deliver some clear benefits such as data transparency which, in turn, will result in more accurate pricing, as well as contributing to the creation of greater transparency in the global financial system overall and the mitigation of systemic risk.

If you could give one piece of advice to the industry on preparation for SFTR, what would it be?

SFTR will be adopted via a phased-in approach, likely beginning in early 2020. Given the complexity of the SFTR reporting requirements and the volume of data that will need to be reported, it is vital that firms act now to ensure readiness for the implementation.

What is more, given the interconnectedness of financial markets and the fact that a large amount of securities financing activity takes place across borders, it is essential that the regulation is seen as a multi-jurisdictional initiative aimed at reducing systemic risk on a global scale. **SLT**

> ***It is evident that firms will need to reassess their current workflows so that they can understand the data they process***

Valentino Wotton
Managing director
DTCC

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A whole new platform

Former SBL Networks CEO Tammy Phillips discusses her new P2P securities finance technology venture Asterisk Networks

Jenna Lomax reports

Can you tell us about Asterisk Networks?

We established Asterisk Networks because we could see a growing frustration in the securities lending marketplace. It is over complicated, opaque, and has been largely unchanged for many years. The current wholesale marketplace, operating from beneficial owners through agent lenders to investment banks and borrowers, has outstanding loans in excess of $2 trillion generating more than $4 billion in fees annually. Some 90 percent of these loans are in highly liquid general collateral-type securities. The current bank dominated model has been overwhelmed by regulatory costs and reporting which in turn has impacted revenue for both the buy-side and intermediaries.

Our platform provides a solution and enables the removal of many of these impediments. Securities finance transactions can be negotiated with complete transparency, with the participants—borrowers and lenders—meeting electronically in a secure, scalable and efficient way.

What does Asterisk Networks provide to participants?

Our participants have a common theme, they want an alternative route to market that allows both beneficial owners and hedge funds direct access to each other in a bilateral relationship. However, they want to do this with the efficiencies achieved in the wholesale marketplace such as electronic execution, post trade reconciliation, documentation, secure settlement, collateral management and reporting.

Our platform delivers a standardised framework for peer-to-peer (P2P) securities lending providing electronic negotiation, market standard documentation, incorporating Euroclear's infrastructure for settlement, triparty collateral management and reporting. In addition, the Asterisk platform enables participants to manage the full life-cycle of events associated with stock loans such as rate changes, returns, recall, corporate actions, together with access to a real-time anonymised transaction ticker providing data such as security identifier, quantity and fee on every transaction executed across the platform.

Who can join the platform?

Any eligible counterparty can participate in the platform. Participants sign documentation for platform connectivity that binds them to standardised protocols around execution, market standard documentation, and collateral management. Once a participant has onboarded with Asterisk Networks, they then approve other participants as active counterparties for bilateral transactions.

So, any counterparties operating in the current market can use the network? Not just beneficial owners and hedge funds?

That's correct. Our marketing will focus initially on beneficial owners and asset managers such as insurance companies, pension funds, sovereign wealth funds, mutual funds, UCITs funds, along with hedge funds as you would expect in a P2P environment. This remains our primary target today. However, through working with some visionary early adopters we are developing an even broader strategy for our platform amongst banks. The banks connecting with our platform are taking the innovative approach of restructuring their service offering to better fit this current regulatory environment, adopting our vision for the efficient use of financial resources in the form of agency prime.

At its core, Asterisk simply facilitates lenders and borrowers negotiating directly for transparency and price discovery. With the future of best execution on the horizon, this is likely to be a focus for all participants in this marketplace. For both borrowers and lenders, the Asterisk Platform provides the opportunity for an alternative route to market that increases price discovery, revenue, flexibility and control. Additionally, lenders can directly influence increased utilisation, borrowers can bid for stock, and intermediaries can carve a new role in an evolving market allowing them to create more efficient returns on their financial assets under the agent prime structure.

What barriers to entry have you experienced?

We are working hard to deliver a route to market with Asterisk Networks that utilises as many standard features from the current marketplace as possible. Market standard documentation, triparty services and no massive deviations from standard processes. Once the decision to utilise Asterisk Networks has been made, documentation is swift. The next, and very important decision for participants to make, is who to add to their approved participant list.

You have had a very close association with the P2P marketplace over the past 18 months. Is Asterisk Networks linked to your former employer SBL Network?

No, there are no corporate links between Asterisk Networks and SBL Network Limited. There is certainly a shared philosophical mindset that the market place could be improved. With market circumstances being favourable towards such innovation, Asterisk is committed to delivering a service that offers benefits to lenders, borrowers and intermediaries who embrace change.

It was recently reported that SBL Network went into liquidation, can you tell us what went wrong at SBL Network and how can you avoid that again?

There was a strong primary concept at SBL Network Limited to provide a standardised framework for P2P securities lending transactions providing price discovery, transparency and efficiency in a secure environment to increase revenue for its participants. However, there was not a consensus amongst shareholders on the future business strategy. With diminishing financial resources and no ability to raise additional capital for a singular fully-supported business strategy, the board and shareholders had no option but to place the company into a creditors' voluntary liquidation as previously reported.

Do you have the same team at Asterisk Networks?

No. While I have offered roles to both former employees and contractors that provided business services to SBL Network, there are some that will join us, some will provide advisory roles within the business and some have decided to explore opportunities in new and very different sectors of financial services.

What has reaction to Asterisk been like? Are you getting strong support?

We are at the chrysalis stage and, so far, we have had overwhelming support. This has come from likely participants, a range of stakeholders, new investors, service providers that form part of the infrastructure of the platform like Euroclear and mentors.

I would like to say thank you to everyone for their support, you know who you are.

Their understanding and counsel in recent months and during my brief interlude has been really appreciated.

You must have had a very busy month. When do you expect the Asterisk Networks butterfly to emerge?

Yes, it has been very busy and there's still plenty to do but the team is up to the challenge. The plan is to launch in Q1 2019. I'll keep you on top of the developments. **SLT**

Good news is good news

Samuel Pierson of IHS Markit discusses the continued growth in ETF lending, which shows no signs of stopping

The increasing presence of exchange-traded funds (ETFs) in the capital markets has extended to many classes of investors, with retail investors seeking low fee passive vehicles, while operational ease of use has drawn many institutional investors. The total assets under management (AUM) for global ETFs reached $5 trillion this year, an increase of $280 billion compared with the end of 2017. The increasing use by institutional investors is reflected by the growth in lendable assets in securities lending, which also reached a new high this year, though like total AUM, has declined with markets in Q4. Since 2014, global ETF lendable assets have doubled to $280 billion, reflecting the increased institutional use of the products beyond the gains in the global markets during that time.

The revenues associated with lending those portfolios have also been trending higher, with the $342 million in year-to-date revenues poised to best the 2017 total of $345 million before the end of November. The $52 billion in average balances quarter-to-date is the highest on record for any quarter, despite the sell-off in global assets. The good news for ETF holders is that utilisation of lendable supply has also trended up this year, from 9.1 percent in Q1 to 11.3 percent in Q4.

The key driver of borrow demand: exchange traded products are popular with short sellers, as they allow for the efficient expression of a view on a wide range of asset classes. That allows hedge funds to gain short exposure to a given sector, or asset class, both as a directional view or as a hedge to a specific long. At the top of the list of most revenue generated funds year-to-date is the USD high-yield index tracking funds, HYG and JNK, though, equity funds drive the bulk of total revenue (75 percent quarter-to-date, up from 70 percent in Q3). The $52 billion in borrowed ETFs equates to roughly a third of short positions reported to exchanges. The other two thirds are largely created from borrowed fund constituents which are exchanged for units of the ETFs. The ability to "create to lend" often keeps a lid on the lending fees for holders of the ETFs, however, the products, which are more challenging to create, can still command non-general collateral rates (for example, JNK and HYG currently have fees greater than 200 basis points).

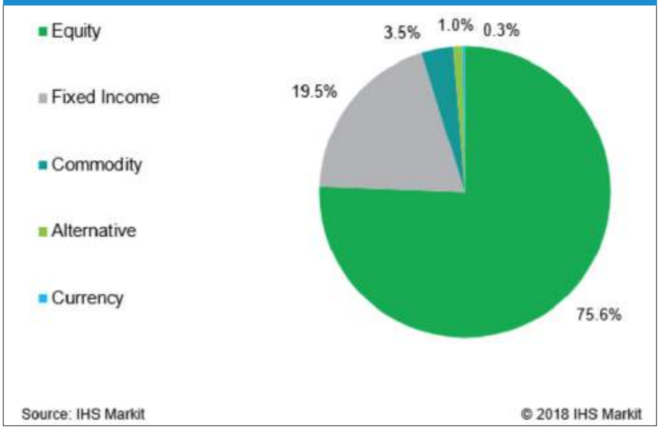
Not all ETFs can be created out of borrowed securities, in particular those with exposure to illiquid asset classes. One such example is the Invesco Senior Loan ETF, BKLN, which consists of a basket of leveraged loans. The fund has seen increased demand from short sellers in Q4, with over $800 million in current loan balances. Only a small handful of the underlying loans have any availability in securities lending, so borrowing shares from long holders of the ETF is essentially the only means of sourcing the borrow. Lenders have attempted to pass through increased rates, though the increased fees in late October and early November saw an immediate response of returned shares, driving fees lower. Once the borrow fee declined the balances picked up and fees have started to move up again. It's worth noting that BKLN has a 67 basis points expense ratio, which means that if short sellers can borrow for less than that rate, there is an arbitrage assuming no movement in the underlying asset class.

Additionally, the year-to-date increase in overnight bank funding rate means that short selling any easy-to-borrow asset will result in a positive rebate to cash proceeds. Generally speaking, hedge funds would prefer to be short ETFs with higher expense ratios, as that is a direct drain on the fund's performance. However, most funds will achieve securities lending revenues which partially offset the fund expenses, making this analysis less precise for funds which lend.

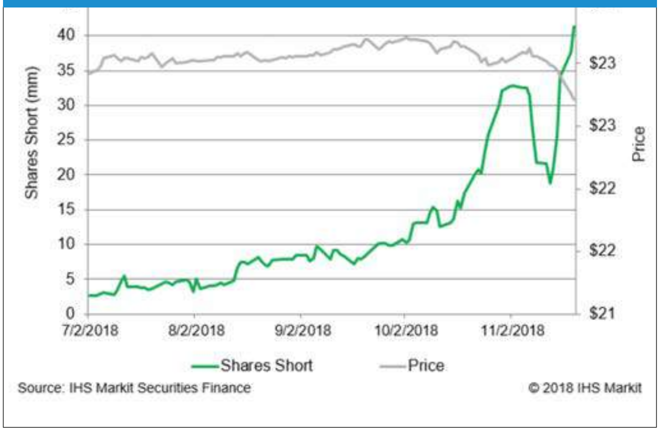
The continued proliferation of exchange-traded products shows no sign of stopping, both in terms of AUM and product count. The Q4 sell-off has only reduced AUM to the level observed in Q2 and is still 5 percent above Q4 2017. As far as product count, there are now over eight thousand exchange traded products, with more than a thousand new entrants over the last 12 months.

Holders of these products continue to see increasing total revenues and the increasing utilisation means that returns to portfolios in lending programmes are also increasing as a percentage of assets. **SLT**

Q4 ETF lending revenue by asset class



Invesco Senior Loan Etf equity short demand & share price



> ***The continued proliferation of exchange-traded products shows no sign of stopping, both in terms of AUM and product count***

Sam Pierson
Director of securities finance
IHS Markit

Comings and goings at ISLA, Elixium, the SEC and more

The International Securities Lending Association (ISLA) has appointed Adrian Dale as director of regulatory policy and market practice.

Dale will begin his new role at ISLA in January 2019. He has worked in the securities lending industry for more than 25 years across operations, trading, technology, and product development roles.

Most recently, Dale served at IHS Markit as product manager from September 2017 to November 2018 and recently took part in a Securities Lending Times roundtable on the Securities Financing Transactions Regulation (SFTR).

Before IHS, Dale served as a product manager at BNP Paribas Securities Services from December 2011 to August 2017.

Andy Dyson, CEO of ISLA, said: "The industry is looking to us for guidance and support around a number of existing and emerging themes including settlement, sustainability and technology. Adrian Dale has the requisite skills and experience to really allow us to take this agenda forward."

Commenting on his new role, Dale said: "I am delighted to be joining ISLA and taking up a role that will draw on my 25 years of experience within the securities lending market."

"It is a particularly exciting time in the evolution of securities lending as the markets are undergoing a regulatory-driven seismic change."

He added: "ISLA is a critical focal point for these changes and I very much look forward to working with its members on the many resulting issues."

Pierre Khemdoudi, managing director and global co-head of equities, data and analytics at IHS Markit, commented: "Adrian Dale has been instrumental in guiding the IHS Markit SFTR client experience teams, and our design partners over the last 18 months."

He added: "We thank him for his contributions and remain certain that ISLA and the securities lending industry will benefit from his hands-on regulatory experience and subject matter expertise."

"We wish him all the best and look forward to working with him in his new role."

Gareth Mitchell has joined Elixium as global head of client relations.

Based in London, Mitchell will report to CEO Nick McCall

Mitchell left his role as managing director at Citi in June.

At Citi, Mitchell served as global head of securities finance equity trading, for Europe, the Middle East and Africa and Asia head of securities finance.

He worked at Citi for just over 18 years.

Mitchell also worked at Deutsche Bank as director from 1998 to 2000.

Anthony Kelly, co-chief of the enforcement division's asset management unit at The Securities and Exchange Commission (SEC) will be leaving the agency this November after more than 18 years of service.

Co-chief C. Dabney O'Riordan will continue to lead the unit following Kelly's departure.

The asset management unit is the division's largest specialised unit and focuses on misconduct by investment advisers and service providers to mutual funds, exchange-traded funds, retail client accounts, hedge funds, and private equity funds.

Kelly joined the division of enforcement in 2004 and joined the asset management unit at its inception in 2010.

He was promoted to assistant director in the asset management unit in August 2012, and to co-chief in March 2016. As co-head of the unit for the past two and a half years, Kelly led a nationwide staff of attorneys, industry experts, and other professionals responsible for conducting investigations across the asset management industry.

He also coordinated with senior leadership in other SEC divisions and offices on priorities, emerging risks, and rulemakings.

Stephanie Avakian, co-director of the SEC's division of enforcement, commented: "Anthony Kelly has shown himself to be a consummate leader and mentor within the division. Through his thoughtfulness and fairness on matters within the fund industry, he exemplifies the best of the division. We will truly miss him."

Steven Peikin, co-director of the SEC's division of enforcement, said: "As co-chief of the division's asset management unit, Anthony Kelly has spearheaded significant initiatives that protected investors and impacted the behaviour of asset managers and investment advisers."

Lynden Howie has joined Cantor Prime as managing director, head of European equity finance.

Howie will be responsible for European equity financing and swaps business reporting to Jon Yalmokas, head of Cantor Prime Services, globally and to Angelo Sofocleous, CEO of Cantor Fitzgerald Europe, locally, in Europe.

Howie will play a key role in expanding Cantor Prime's swap product offering globally, first in Europe, then into Asia Pacific.

Howie brings 20 years of trading and product management experience in international equity financing, swaps and prime brokerage.

Before Cantor Prime, Howie served at State Street Global, where he was head of prime brokerage and enhanced custody in Europe.

Before that, he spent 15 years at UBS, where he built and managed both the European and Asian swap product as part of the prime brokerage platform. SLT