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# THE SONG REMAINS THE SAME

While balance sheet efficiency and alternative trade structures remain important to beneficial owners, technology and regulation will also play a big role this year

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# DTCC to provide trade reporting services in Switzerland

The Depository Trust & Clearing Corporation (DTCC) has received regulatory approval from the Swiss Financial Market Supervisory Authority to provide trade reporting services in Switzerland.

DTCC will provide this via their global trade repository service (GTR) in Europe, which has more than 3,500 clients sending over 500 million messages per month, with 46 European regulators accessing its data.

GTR will further expand its services to market participants in support of reporting obligations that fall under the Swiss Financial Markets Infrastructure Act (FMIA), also known as FinfraG.

FinfraG aligns Swiss derivatives trading regulation with international standards and requires that firms with a registered office in Switzerland report their derivatives trades to an authorised or recognised trade repository.

GTR now provides derivatives trade reporting services through its registered trade repositories across several jurisdictions and across all over-the-counter asset classes, including credit, interest rates, equities, foreign exchange and commodities.

DTCC's GTR in Europe will now be able to fully support the European Markets Infrastructure Regulation and Securities Financing Transactions Regulation, subject to regulatory approval, and FinfraG regulations from a single platform.

Valentino Wotton, managing director, product development and strategy, derivatives and collateral management at DTCC, said: "We are pleased to have received regulatory approval to provide trade repository services in Switzerland."

"Market participants continue to seek a single platform that handles trade reporting across multiple jurisdictions and asset classes, and we are proud to extend our capabilities to Swiss market participants and to provide increased value to our clients."


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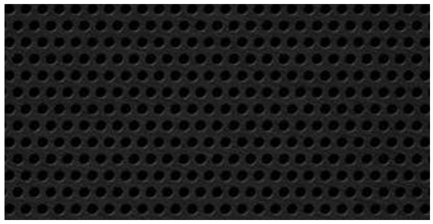



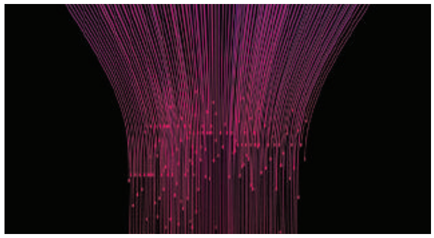



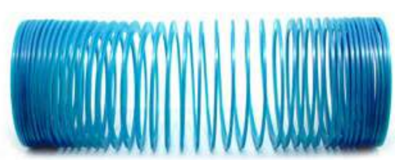

## ESMA issues latest double volume cap data

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 number of new breaches is 53—40 equities for the eight percent cap, applicable to all trading venues, and 13 equities for the four percent cap, which applies to individual trading venues.

Trading under the waivers for all new instruments in breach of the DVC thresholds should be suspended from 14 January 2019 to 13 July 2019.

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

In addition, ESMA highlighted that some trading venues have submitted corrected data that affects past DVC publications.

For two instruments, this means that the previously identified breach of the cap proved to be incorrect and the suspensions of trading under the waivers should be lifted.

As of 9 January, there is a total of 625 instruments suspended.

## EC: No delays to SFTR go-live date

The European Council has informed Securities Lending Times that there will be "no delayed implementation" to the Securities Financing Transactions Regulation (SFTR), after reports of an extension to the current scrutiny period.

On 10 January, a European Council representative stated: "On 8 January, the EU Council decided to extend the one-month objection period for six regulatory technical standards (RTS) related to the securities financing transactions regulation by another month. New deadline: 13 February, no delayed implementation."

The European Council's statement was in response to the International Securities Lending Association's announcement that the period of scrutiny had been extended to six months, with implementation expected "to commence no earlier than July or August 2019".

Seb Malik of Market FinReg contacted the European Commission, Council and Parliament for assurance around the scrutiny extension period.

Malik explained: "We can thus confirm that the period of scrutiny for the EU Parliament is three months; two months for the EU Council and not six months as was incorrectly reported."

He added: "SFTR transaction reporting legislation is set to achieve legal force in April 2019, as we have been advising. Banks and the second

## BearingPoint initiates solution for SFTR reporting

BearingPoint has expanded its ABACUS/Transactions software with a new Securities Financing Transactions Regulation (SFTR) module, which helps institutions comply with the reporting obligations.

Bodo Windmoeller, BearingPoint's chief product officer of regtech, said: "Market actors tend to underestimate the complexity drivers. Myriad regulations make financial services increasingly complex and costly."

"Reporting institutions can rely on the various ABACUS/Transactions modules to reduce the negative effects of the ever-increasing regulatory requirements."

He continued: "Our tried and tested solution already supports various types of transaction-based reports, ranging from European Markets Infrastructure Regulation (EMIR), FMIA/FinfraG, Credit Support Annex and Money Market Statistical Reporting to the second Markets in Financial Instruments Directive/Markets in Financial Instruments Regulation, and now, SFTR. Our clients can make the most use of synergies along the regulatory value chain."

Alexander Becht, product manager for ABACUS/Transactions at BearingPoint, commented: "We have already adopted the established EMIR reporting logic and infrastructure within our SFTR module, enabling the automatic generation and submission of reports to the trade repositories from within the solution."

He added: "ABACUS/Transactions has been in use since 2014 and has become well-established in the market, with renowned clients in seven countries successfully using the software to comply with several transaction-based reporting schemes."

Markets in Financial Instruments Directive firms will file their first reports in April 2020."

According to Malik, the only two scenarios that could change this would be if the EU council or parliament raise an objection or if the parliament extends its scrutiny period. He noted: "We consider both unlikely."

He said: "Our message to firms has been consistent for two years—crack on with implementation and ignore side chatter. SFTR will challenge firms both individually and collectively like no other reporting regime before so it's critical to focus on the task at hand."

The European Commission adopted the delegated regulations comprising SFTR level legislation on 13 December with firms set to go live with SFTR reporting in Q2 2020.

SFTR was published in January 2016 by the European Commission following the Financial Stability Board and the European Systemic Risk Board's recommendation to mitigate the inherent risks in shadow banking and increase transparency in the use of securities lending and repo.

As part of the regulation, firms will be required to report their securities financing transactions to a trade repository registered by the European Securities Market Authority.

### Banks release Q4 results

Citi has reported net income for the Q4 2018 of $4.3 billion on revenues of $17.1 billion.

This is compared to a net loss of $18.9 billion on revenues of $17.5 billion for the Q4 2017.

Q4 2017 included a one-time, non-cash charge of $22.6 billion recorded in the tax line related to the enactment of the Tax Cuts and Jobs Act (Tax Reform).

Excluding the one-time impact of Tax Reform in both the current and the prior-year periods, net income of $4.2 billion increased 14 percent, primarily driven by a reduction in expenses, lower cost of credit and a lower effective tax rate, partially offset by lower revenues.

On this basis, earnings per share of $1.61 increased 26 percent from $1.28 per diluted share in the prior-year period, driven by the growth in net income and an eight percent reduction in average diluted shares outstanding.

For the full year of 2018, Citigroup reported net income of $18.0 billion on revenues of $72.9 billion, compared to a net loss of $6.8 billion on revenues of $72.4 billion for the full year of 2017.

Excluding the one-time impact of Tax Reform, Citigroup net income of $18.0 billion increased 14 percent compared to the prior year.

Meanwhile, JPMorgan Chase reported a record Q4 2018 net income of $7.1 billion and a record full-year 2018 net income of $32.5 billion.

Net income saw an increase of 67 percent. The year prior included a $2.4 billion reduction to net income as a result of the enactment of the Tax Cuts & Jobs Act.

Net revenue was $26.8 billion, up 4 percent, while net interest income was $14.5 billion, up 9 percent, driven by the impact of higher rates as well as loan growth.

This was partially offset by lower markets net interest income. Noninterest revenue was $12.3 billion, down 1 percent, with no notable drivers on a firm-wide basis, the firm revealed.

According to JPMorgan Chase, the provision for credit losses was $1.5 billion, an increase of $240 million from the prior year.

Commenting on the financial results of JPMorgan Chase, Jamie Dimon, chairman and CEO, said: "Last year was another strong year for JPMorgan Chase, with the firm generating record revenue and net income, even without the impact of tax reform."

"Each line of business grew revenue and net income for the year while continuing to make significant investments in products, people and technology, demonstrating the power of the platform. We grew core loans 7 percent, in line with our expectations while maintaining credit discipline and a fortress balance sheet with significant capital and liquidity."

Dimon added: "Credit and debit sales volume, as well as merchant processing volume, were all up double digits. Despite a challenging quarter, we grew markets revenue in the investment bank for the year with a record performance in equities and solid performance in fixed income. Investment banking fees were a record for the year, driven by strength in both CIB and commercial banking."

Dimon concluded: "In 2018, we accelerated investments in products, services and technology to help our employees, customers and communities. In Q4, we opened Chase branches in new states for the first time in nearly a decade. While it is early days, we're seeing terrific results so far, and this is only the start as we continue to open branches in several new markets in the months and years to come."

## eVestment: performance woes spotted

The global hedge fund industry ended a volatile 2018 in the red, making it the industry's fifth consecutive month of negative performance, according to eVestment.

The analytics firm found that aggregate performance for December stood at -2.15 percent and for the year at -4.86 percent. The industry's aggregate negative performance for last year was nearly on par with the industry's second-worst year on record, 2011, when returns came in at -4.99 percent.

The hedge fund industry's worst annual performance on record came in at -15.75 percent back in 2008.

eVestment said: "The 2018 performance is in stark contrast to the industry's strong aggregate performance of 8.93 percent in 2017 and almost universally positive performance among hedge fund markets, strategies and geographies in 2017."

Commenting on the results, Peter Laurelli, eVestment's global head of research, said: "The story in 2018 was very fund-specific, with some funds performing very well, while other funds faltered."

He added: "This highlights the importance of doing deep research and due diligence in the hedge fund selection process."

Despite the aggregate negativity, "there were pockets of good relative returns", eVestment found. Origination and financing hedge funds were the big winners in returns in 2018, with performance of 3.94 percent. Long/short equity and activist strategies were hurt most by year-end market declines.

Activist funds ended 2018 at -13.35 percent, suffering the industry's most significant losses outside of emerging markets. Long/short equity funds ended 2018 at -6.85 percent. India and China-focused products posted the most considerable aggregate losses for the year of all segments, coming in at -17.04 percent and -16.84 percent, respectively.

## EU CCPs post-Brexit plans need further development, says EACH

European central clearing counterparties' (CCPs) post-Brexit plans need to be further developed, according to Rafael Plata, secretary general at European Association of CCP Clearing Houses (EACH).

Plata suggested that for the development, European authorities need to advance the discussions on the European Commission legislative proposals for CCP resolution, which at the moment is on hold.

The global authorities are currently developing their resolution framework. Meanwhile, there is going to be a consultation for the Financial Stability Board on CCPs resolution, with a deadline of 1 February.

According to Plata, it is important to have a good structure of resolution authorities in order to know who is going to take care of what, which is something that the EU legislation would address.

This is why it is also important to have a legislation in place. As part of the EU legislative process, the EU Council and EU Parliament are required to provide their views and combine them and this becomes the framework legislation.

The parliament view was completed at the beginning of last year. Now the council view is on hold because the council gave priority towards other areas.

Plata noted that for the moment, the expectation is that their work will resume in March but this is not yet confirmed.

Explaining why it is important for a resolution, Plata said: "At the moment there is no EU regime for dealing with the resolution of CCPs. This creates legal uncertainty because in a worst case scenario over a CCP resolution, we are really talking about the 'Armageddon scenario'."

"If you think about the financial crisis during Lehman—when Lehman went down—we were far from reaching a resolution. Resolution for me is step number three out of three potential steps to deal with the defaults of members of a CCP."

"Step one is the default management process. This means that it is business as usual (BAU)—the normal default management process of a CCP. It happens on a day-to-day basis. Initially, a member of the CCP—for example, a bank—participate and they can go into default and the CCP will need to apply their BAU tools to deal with that default. All of that is governed by the European Markets Infrastructure Regulation legislation in the EU."

He continued: "Step two is the recovery of the system. If somehow step one is not efficient enough then you go to step two; the recovery of the CCP is about using additional tools in addition to the ones used in phase one. This phase is also led by the CCP itself."

"Step three is the resolution. It is operated by the authority and is no longer run by the CCP so it would be the authority that is in control. It is a matter of using resources to ensure the continuation of critical services is provided by the CCP."

Plata highlighted that the industry needs legal certainty for participants that may be under that regime.

He commented: "The other main reason is that in the resolution of our financial institution, the taxpayer's money could potentially be at stake. This is what happened, for example, in the resolution of banks in the past. During the financial crisis, a lot of banks were saved using the taxpayer's money. From a risk management point of view, we are totally against using taxpayers money."

"If you have taxpayers' money at the very end of the process then it could be seen as a safety net by those who need to contribute to avoid reaching that steak. As a risk manager, we don't want to weaken our current risk management system by including a safety net at the very end, which could incentivise participants of the systems not to contribute to the recovery of the CCP."

Plata concluded: "I believe authorities are also against it, however, they like to be pragmatic and realistic and therefore they ensure that in the worst case scenario, taxpayers money could be used. We want to make sure that there are rules around it, which is why resolution legislation is needed to ensure that the taxpayer's money is at discretion."

## Benzinga and Tidal Markets team up on securities lending product

Benzinga and Tidal Markets have formed a partnership to deliver the Securities Lending Volatility Indicator (SLVX).

The new product forecasts market volatility for the broader indices and individual securities. The product will be labelled as 'Benzinga SLVX' and the raw data feed will be available to clients through Benzinga's licensing team.

Additionally, by calculating the spread of rebate rates when borrowing a position to short sell, the indicator can predict movements without relying on the older, more traditional volatility index (VIX), Benzinga revealed.

Before markets get turbulent, the spread in rebate grows and the SLVX anticipates the incoming volatility.

John Bolton, vice president of data operations, Benzinga, said: "The SLVX presents a unique approach to anticipating volatility in stocks, and the simplicity of its output allows it to be utilised in a variety of trading strategies. This exclusive partnership will advantageously position us to provide quality data to a growing market. We're excited to use our skills as a data distributor and media company to deliver the SLVX in a streamlined and engaging way to our clients."

Christopher Sappo, managing principal, Tidal Markets, added: "I'm excited for the opportunity to partner with Benzinga. The ability to utilise a new instrument for detecting volatility, especially in such recent volatile times, demonstrates the value-add the SLVX has to the investment community. For so long, investors have relied on byproducts of the VIX as the sole indicator for detecting volatility—and that's about to change."

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# Regulations to remember

## Seb Malik of Market FinReg discusses key pieces of legislation working their way through the system that will significantly impact the securities lending and wider financial industry

While we rightly plough resources into the well-known Securities Financing Transactions Regulation, Brexit and European Market Infrastructure Regulation projects, the industry should also take note of important regulations making their way through the system. I hope firms will commence analysing these proposals and make representations in order to shape better regulation.

**Counterparty Risk Requirement (CRR) II/ CRD V:** The European Commission is set to finalise a package of Basel III measures with implementation slated in for 2020.

**Bank Recovery and Resolution Directive-II:** Implementation of FSB's Total Loss-Absorbing Capacity (TLAC) into EU law tailored to fit in with the existing minimum requirement for own funds and eligible liabilities. The objective of the TLAC standard is to ensure that global systemically important banks, referred to as global systemically important institutions in the EU framework, have the loss-absorbing and recapitalisation capacity necessary to help ensure that, in and immediately following a resolution, critical functions can be continued without public funds or financial stability being put at risk.

**Recovery and resolution of central counterparties (CCPs) (2016/0365 COD):** The framework for the recovery and resolution of central counterparties legislation is currently working through parliament. CCPs are critical nodes in EU financial markets. This legislation will oblige CCPs to draw up and maintain resolution plans as well as confer powers to competent and resolution authorities to intervene.

**Framework for the development of EU sovereign bond-backed securities (2018/0171 COD):** A private sector entity would assemble an underlying portfolio of sovereign bonds from the market and would subsequently transfer them to a legally separate, self-standing entity, specifically set up for the sole purpose of issuing to investors a series of securities representing claims on the proceeds from this underlying portfolio. The various securities issued would bear any losses from the underlying portfolio in a certain sequence.

**Credit servicers, credit purchasers and the recovery of collateral (2018/0063 COD):** Banks will be required to put aside sufficient resources when new loans become non–performing, creating appropriate incentives to address non-performing loans (NPLs) at an early stage and avoid a too large accumulation of NPLs.

**Minimum loss coverage for non-performing exposures (2018/0060 COD):** Amends CRR to deal with non-performing exposures. The longer exposure has been non-performing, the lower the probability for the recovery of its value. Therefore, the portion of the exposure that should be covered by provisions, other adjustments or deductions should increase with time, following a pre-defined calendar.

**Exposures in the form of covered bonds (2018/0042 COD):** Amends Article 129 of CRR. Defines covered bond. A union legislative framework on covered bonds should expand the capacity of credit institutions to provide financing to the real economy and contribute to the development of covered bonds across the EU, particularly in the member states where no market for them currently exists.

**Issue of covered bonds and covered bond public supervision (2018/0043 COD):** It will establish the structural features of the instrument, a covered bond specific public supervision, rules allowing the use of the 'European covered bonds' label and competent authorities' publication obligations in the field of covered bonds. It also amends UCITS, and Bank Recovery and Resolution Directive.

**The second Markets in Financial Instruments Directive (MiFID II): Crowdfunding service providers (2018/0048(COD)):** Authorised European Crowdfunding service providers should be excluded from the scope of MiFID II.

**European Deposit Insurance Scheme (2015/0270 COD):** In the Banking Union, deposit insurance remains purely national, which leaves national deposit guarantee schemes vulnerable to large local shocks and member states' budgets continue to be exposed to risks in their banking sectors. This act would both reduce the vulnerability of bank depositors to large local shocks and further reduce the link between banks and their home sovereign by establishing the Single Resolution and Deposit Insurance Board and a common system for deposit insurance.

**Cross-border distribution of collective investment funds (2018/0041 COD):** The act will help reduce regulatory barriers to the cross-border distribution of UCITS and alternative investment funds (AIFs) in the EU. These new measures are expected to reduce the cost for fund managers of going cross-border and should support more cross-border marketing of UCITS and AIFs. Increased competition in the EU will help to give investors more choice and better value.

**AML (2018/0105 COD):** Act will help to prevent, detect, and combat money laundering, the associated predicate offences and terrorist financing. It will also provide for direct access to the national centralised bank account registries or data retrieval systems to competent authorities. The competent authorities, to which access is provided for, also include tax authorities and anti-corruption authorities in their capacity to conduct criminal investigations under national law.

We will be keeping abreast of developments and performing interim impact analyses for clients to allow them to stay ahead of the game. **SLT**



**All regulations are referenced from the European Parliament website*

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# Business as usual

## Chris Valentino of Trading Apps explains how the company remains razor-focused on clients and continued growth

At the end of last year, it was announced that BNY Mellon purchased the agency lending securities finance software and associated intellectual property of Trading Apps.

Trading Apps has and will continue to operate as a viable and independent entity, primarily servicing the securities finance community beyond agent lenders.

Now starting a new year, Chris Valentino, sales and client director, Americas at Trading Apps, explains how the company remains razor-focused on clients and continued growth.

With the recent company merger and acquisition news and events in the proverbial rear-view mirror Trading Apps is gearing up for a very exciting and extremely busy 2019. As always, our primary focus continues to be on expanding our partnership with our existing roster of clients and of course adding some new exciting clients or partners to the mix.

In many ways, the themes and bodies of work that hatched themselves in late 2017 and throughout last year will continue to be in our sights and on our radar for 2019. Interoperability, market connectivity, and process automation continue to be popular buzz words for all of our existing clients and prospects and as a result, those conversations have fueled a number of interesting projects for Trading Apps this year.

In terms of interoperability, it is all about connecting to the various outlets or sources of trade liquidity, market data, and settlement and clearing that exist in today's market place. Without naming names for several of our clients, we have already provided dynamic connectivity to the markets leading source for trade liquidity and execution. At the beginning of this year, we look to expand that offering by establishing connectivity to a relatively new trading platform but one that has been a household name for all of our clients for years. We believe that to be just the tip of the iceberg with some new trading venues on the scene, and with Trading Apps willing and able to establish and provide seamless connectivity and integration for all of our clients and prospects.

Connectivity goes beyond just trade execution and we continue to work on a number of interesting projects that will integrate data and establish various central counterparty and triparty connection points to the mix this year.

Automation continues to be a very hot topic and for those that have used or are thinking about Trading Apps, they realise the high level of automation and the seamless and sophisticated workflows that our apps can offer. Many of our clients are leveraging the automation offered by our lending, borrowing, and internalisation applications, and we have a number of projects outlined this year to enhance and expand upon those offerings.

In this age of big data, our clients and prospects continue to push the envelope in terms of their insatiable appetite for all things data related. Our apps continue to deliver high marks in terms of their ability to absorb enormous data sets and provide our user base with a high level of automation or an intuitive and sophisticated workflow. This maximises technical real estate and aggregates all relevant market intelligence at the point of trade for today's securities finance professionals.

We are extremely excited for the year ahead and look forward to working and collaborating with many members of the global securities lending market place.

# Two heads are better than one

## Andrew Kouloumbrides of Xceptor discusses the firms SFTR partnership with DTCC

***Maddie Saghir reports***

### Can you tell me about the partnership between Xceptor and DTCC?

By coming together, our partnership will help address the logistical problems firms face in preparing for the Securities Financing Transactions Reporting regulation (SFTR), which is set to go live in 2020. Any bank with a branch in Europe or trading in Europe will have to comply with it.

SFTR, which requires counterparts to report securities financing transactions to a trade repository, has very extensive requirements with over 153 fields to be completed. There is a fair amount of concern in the marketplace around the extraction and formatting of that data, and this is the key reason why The Depository Trust & Clearing Corporation (DTCC) has partnered with Xceptor.

There will be a huge requirement to upload data from different sources and our offering will enable clients to input that data in any format. DTCC will create the evolving rules and analytics of the SFTR regulations that determine the value of the fields so that Xceptor's intelligent data automation software can capture the data, repair it, enrich it and normalise it before submitting it for reporting. The service also provides a pre-check review for data enrichment and validation that allows firms to make corrections to the data before submitting to a trade repository.

It's a vast improvement on past working methods. In the past, the client had to provide the data in the format that the reporting entity required. Whereas now, the burden of extracting, transforming and analysing that data sits within the service, making the process less onerous for the client.

### How will the platform cope with the influx of data?

The platform is an enterprise-grade platform so it can deal with vast volumes of data flowing through it and, indeed, it does so on a regular basis. Global banks already use it for multiple operations and so there are already vast volumes of data flowing through the platform.

### What were the main challenges in implementing this?

One of the key challenges from my experience is that even published regulations continually evolve. There will always be tweaks that need to be made to them. One of the key factors that we are very aware of in this partnership is to make sure that we are closely aligned to the regulatory bodies so that we can forward-plan for these evolutions.

### How will DTCC utilise Xceptor's software to help with SFTR obligations?

The underlying service for SFTR will be the Xceptor platform. Xceptor will be configured to consume the data fed into it by the end clients and transform it according to the rules and analytics created and maintained by the DTCC. The platform itself will be operated by DTCC so it is a true partnership and the start of a relationship that we hope will evolve to mutual benefit. **SLT**

# The song remains the same

While balance sheet efficiency and alternative trade structures remain important to beneficial owners, technology and regulation will also play a big role this year

**What will be the hot topics for beneficial owners in 2019? And what will be the key market drivers?**

**Vikas Nigam:** Not a surprise but just like last year we believe the song remains the same—balance sheet efficiency. Borrowers and repo/reverse repo providers continue to be extremely protective and conscious of their balance sheets and not just at quarter end. Use of offshore entities, the beneficial owner's risk-weighted asset (RWA) treatment, non-cash collateral eligibility and the provision of documentation to allow netting relief are increasingly factoring into their decisions on which beneficial owners to do business with. We expect this trend to continue, especially as know-your-customer (KYC) procedures become more thorough and frequent.

**George Trapp:** The topics that beneficial owners will discuss this year are a continuation of the themes from the last several years along with some emerging trends. Regulation has been at the top of everyone's agenda for the last several years. Recent developments on Securities Financing Transaction Regulation (SFTR) and resolution stay protocols have provided certainty around details and implementation timeframes. As these regulations are finalised and implemented they will allow the industry to position itself for the future.

Alternative distribution channels and alternative trade structures continue to be a focus for the securities lending industry. Central counterparties continue to gain traction and are working closely with the industry to help provide efficiencies both from a trade matching and balance sheet perspective. Along similar lines, borrowers are looking for different trade structures to meet their specific requirements. These include different collateral and term structures. It will be important for beneficial owners to be flexible in terms of the types of collateral they accept and trade structures they will allow in order to keep pace with the changing securities lending marketplace.

Outside of our control, but likely to influence the market in the coming year, will be interest rates and volatility. The recent volatility in the market has shown that beneficial owners should keep a close eye on how the volatility impacts their securities lending programme.

**Mike Saunders:** Securities financing markets in the year ahead will face similar challenges to those of 2018. Changes to monetary policy throughout the global financial system in the form of higher rates and an end to quantitative easing combined with geopolitical tensions will continue to drive volatility. Historically, elevated levels of volatility benefit participants in a securities lending programme and we believe this trend will continue. As such, beneficial owners should expect a greater demand for specific asset classes and sectors.

The opportunity to monetise holdings of high-quality liquid assets (HQLA) will continue to offer stable and predictable returns. Beneficial owners should be prepared to explore collateral flexibility and longer-dated tenors in their programme as slight enhancements to a lending programme will likely increase utilisation rates on HQLA as well as impact revenue streams.

## PANELLISTS

**George Trapp,** senior vice president, head of North American client service, securities lending, **Northern Trust**

**Mike Saunders,** head of agency lending, Americas, **BNP Paribas**

**George Rennick,** head of agency lending, Americas, **J.P. Morgan**

**Peter Bassler,** managing director, business development, **eSecLending**

**Glenn Horner,** chief regulatory officer, managing director, **State Street Global Markets**

**Matt Wolfe,** vice president of product development, **OCC**

**Vikas Nigam,** director, head of trading, Americas, **Deutsche Bank Agency Securities Lending**

The parabolic growth of the exchange-traded fund (ETF) product also presents a significant opportunity. Demand from counterparties to borrow ETF's linked to politically sensitive regions, specific assets classes and operationally sensitive settlement markets will continue to be in high demand. This demand permits borrowers to have an efficient and broad exposure to a region, sector or market which is otherwise difficult to access.

**Glenn Horner:** Increased market volatility in 2018 magnified dispersion in performance among hedge fund managers. Whether institutional investors react to the 2018 performance with a reallocation among managers, an increased allocation to managers who outperformed, or decide to shift away from hedge funds will impact market demand in 2019.

**George Rennick:** Regulation will remain a hot topic throughout 2019 with a continued focus on Brexit legal entity strategies and documentation, SFTR reporting preparation and the need to spend significant efforts sourcing non-centralised data elements and respond to continued capital rule implications such as G-SIB requirements. The industry felt the impact of the capital rules and potential G-SIB implications during the year-end turn as liquidity tightened and short term funding rates spiked.

One area where regulation is softening for certain beneficial owners is around collateral. Beneficial owners that can take advantage of flexible collateral schedules, term funding trades and a broad list of US and non-US borrowers will be best positioned to take advantage of opportunities.

## How can beneficial owners position themselves for success in 2019?

**Peter Bassler:** The best way to position yourself is to re-evaluate your programme and assess the flexibility needed to capture the greatest opportunity within your risk/return profile. Many beneficial owners do not rethink and re-evaluate this product enough, and we would suggest this become an annual process.

Some questions to consider include: Are my guidelines suitable for today's lending and collateral environment? Has the agent landscape changed? Where is pricing, indemnification? Many of these factors are constantly evolving and it is crucial to have a regular cadence to review your programme from a performance, price, partner and structure perspective.

Some firms have outdated cash collateral guidelines that could be revised to capture additional yield in today's cash markets. Cash yields have improved dramatically and non-cash alternatives can offer a compelling structural alternative to cash and at times for a higher intrinsic lending fee. We suggest a flexible collateral strategy, as not all borrowers have the same preferences.

**Matt Wolfe:** For lenders, it's all about utilisation. Years ago, that meant personal relationships, and they still obviously matter. This year, however, lenders are in a technology arms race. Collecting better data and integrating systems across entities to make inventory easily and cheaply accessible is the new table stakes. More data enables better modelling opportunities for machine learning and artificial intelligence (AI); there's little doubt that such a lucrative business (driving nearly $10 billion in revenues, according to the recent DataLend announcement) is going to attract AI strategies. SFTR is a great catalyst for making technology investments that can drive commercial results as well as regulatory compliance. OCC is also focused on technology that can give our members an advantage at raising their utilisation. We believe that distributed ledger technology has great promise for making inventory easily accessible and cheaply conveyed. We're convinced that investing in technology to improve client outcomes will prove to be wise decisions.

**Rennick:** Beneficial owners should be constantly evaluating their risk/return parameters, working closely with their agent lending partners to evaluate their programme constraints. The business continues to evolve at pace and those lenders who can demonstrate flexibility across the multiple factors, which are considered when lending assets, will be best positioned to take advantage of opportunities.

**Saunders:** Securities lending is proven to offer incremental income on idle assets in a relatively risk-averse fashion under the proper risk management structure. While it is certainly prudent to examine your programme's current lending parameters to increase returns, an element of caution is certainly necessary. The impact of higher and anticipated rising interest rates presents an opportunity to implement several strategies to monetise both the interest rate and basis mismatch affiliated with a lending programme. The continued inflow of securities lending cash collateral into prime money market funds is evidence of this opportunity. However, it is necessary to understand the liquidity element associated with these types of strategies.

> ***Whether institutional investors react to the 2018 performance with a reallocation among managers, an increased allocation to managers who outperformed, or decide to shift away from hedge funds will impact market demand in 2019***
>
> **Glenn Horner**
> Chief regulatory officer
> managing director
> **State Street Global Markets**

Non-cash collateral transactions are an alternative to these strategies as they remove interest rate mismatch and liquidity risk while providing equivalent returns. Implementing a non-cash collateral programme will serve beneficial owners well in 2019. The shift towards non-cash collateral continues to accelerate as a percentage of market share and beneficial owners would be well served to explore not only enhancements to their cash collateral guidelines but to their non-cash collateral guidelines throughout 2019.

**Trapp:** The critical aspects beneficial owners should consider for their securities lending programme are:

- **Collateral:** Review your acceptable collateral and consider whether you can allow alternative types of collateral such as equities
- **Availability:** Maximise the availability of your portfolio by ensuring all of your accounts are approved for lending
- **Restrictions:** Consider whether your programme parameters are appropriate for the current market environment. Review your investment guidelines and any restrictions you have on your programme
- **Performance:** Choose an appropriate industry benchmark and review your performance and ensure it is meeting your expectations
- **Risk:** Review the reporting and set up a framework for regular due diligence on your securities lending programme including a review of borrowers, collateral, cash investment guidelines and the creditworthiness of your lending agent

**Nigam:** Clients that will see the most success in this year are those that are flexible in terms of the collateral types and counterparts that they can deal in and with. New structures and new documentation are being sought by all lending providers and those that are able to accept some of those will see the benefits.

> ***Clients that will see the most success this year are those that are flexible in terms of collateral types and counterparts they can deal in and with***
>
> **Vikas Nigam**
> Director, head of trading, Americas
> **Deutsche Bank Agency Securities Lending**

**In terms of indemnification, regulations and the ensuing capital charges associated with providing it is increasingly changing how it is perceived, offered and priced—how can the industry overcome this challenge?**

**Horner:** The implementation of Basel III and soon to be implemented Single Counterparty Credit Limits (SCCL) have impacted the perception of indemnification due to heightened capital costs for agency lenders and the potential for limitations on balances with large borrowers. The Basel III rules have already been implemented and based on the Collins Amendment in the Dodd-Frank Act US agents must use both the advanced and standardised approaches to calculate risk-weighted assets (RWA). The US banks must then manage their risk-based capital ratios against the higher of the two methods at the bank level. For securities finance, the standardised approach results substantially higher RWA than under the advanced approach, sometimes up to 30 times higher. As a result, indemnified transactions that return a very high rate of return on capital under the advanced approach now have an unattractive rate of return based on the use of the standardised approach.

The good news is that industry efforts have resulted in a new standardised approach for securities finance transactions that we approved by the Basel Committee in December 2017. Once implemented in local jurisdictions, this will result in a conservative but much less punitive measurement of RWA, which will make the return on capital more appealing to agent lenders.

SCCL may limit the amount of indemnified transactions that an agent lender can do with a particular borrower. Under the original proposal, the measurement of exposure for securities finance transactions would be based on the current standardised method for capital purposes. However, based on industry feedback the finalised version in the US allows banks to use an approved method for calculating capital requirements. This means that banks with approved advanced approaches methodologies can use their own VaR estimates of exposures. There is some anticipation that once the new Basel standardised method is adopted for capital purposes in the US it will then be the required method for SCCL. However, both the advanced approach and new standardised calculation will significantly reduce the impact of this limit on current balances.

To date, the industry has done a remarkable job of providing feedback to regulators and ensuring that the long term impact on these regulations will have minimal impact on the balances and the future cost of capital related to indemnified transactions. However, the industry is also looking at structural ways that the impact of the regulations can be managed. A couple of potential ways that industry participants have explored are through the use of collateral pledge structures outside the US and the use of central counterparties (CCPs). Both of these efforts are ongoing, but they are examples of how the industry can continue to redefine itself to meet the requirements of the beneficial owner community.

**Nigam:** It is a provider by provider issue and not necessarily an industry issue. The costs associated with running the business differ from bank to bank and frankly client base to client base. Accurate measurements of resources used and active management of those resources is key to overcoming these challenges.

**Trapp:** Beneficial owners have resoundingly stated that indemnification is important and in some cases a requirement for their participation in a securities lending programme. Beneficial owners should understand who is offering the indemnification, the financial strength of the issuer and the capital base of the securities lending agent. It is important that the lending agent has a strong capital base given their role in the securities lending transaction. Indemnification should complement a sound risk management framework including careful review of borrowers, collateral, margin requirements and operational practices. A lending agent that has expertise in all aspects of the securities lending and collateral management process, along with a strong balance sheet, is in the best position to act as an agent for your securities lending programme.

**Bassler:** Indemnification is here to stay. Period. It is incumbent upon every agent to operate within their own firms to navigate costs, limits and the cost/benefit of various transaction types. However, as an industry, we need to accept that the beneficial owners will continue to demand this risk protection. Every agent has a different internal metric and hurdle that will affect how they lend for their client base. The beneficial owner should be proactive in understanding these nuances as it will likely affect the trading the agent does on their behalf.

Some agents will avoid certain transactions due to their capital allocations. Is that in the best interest of beneficial owner's or just the agent's? Is your agent committed to lending general collateral for you or pursuing a non-cash strategy that you want to employ? It may come down to their capital hit. Asking the questions here is key.

**Wolfe:** Prudent risk management is crucial to the success of any lending programme. The risk to lenders stemming from a counterparty's default has been mitigated primarily through three components: credit evaluation, excess collateral, and indemnification. Credit evaluation is an important step to ensure that any new counterparties are creditworthy, and this assessment should be reaffirmed on a frequent basis. Excess collateral, (for example, 102 percent for cash collateral) is the primary tool that helps avoid losses should the lender need to buy-in the loaned securities in the event of a borrower's default. Indemnification is a back-stop if the collateral is insufficient. OCC has a similar three-tier approach for mitigating risk. The first tier is through careful assessment of new members and ongoing monitoring. The second tier is margin collateral, which is based upon econometric models of future stock prices and the amount of collateral is recalculated daily to cover losses at a 99 percent confidence interval. The third tier is a guarantee fund which is only drawn upon if the margin collateral was insufficient to cover the obligations of a defaulted member.

Essentially indemnification is an insurance policy and like insurance, the premium is related to the likelihood of drawing upon the insurance policy. The securities lending industry could consider counterparty credit evaluation and setting of collateral rates as ways to lower the probability of drawing upon indemnification. If the counterparty risk evaluation is effective and the collateralisation rate is more certain to cover the replacement cost of lent securities, then the conversation about indemnification may change. The guarantee provided by central clearing is another alternative that would help reduce the likelihood of drawing upon indemnification.

**Saunders:** Regulation and the ensuing cost of indemnification will continue to be a pain point for agent lenders and clients. The industry, for the most part, has been repriced to reflect the capital cost associated with indemnification through tiered splits, third-party providers of indemnification, minimum spreads or various other commercial elements. The crux of the conversation remains the same—the attractiveness of the pool of lendable assets for each client. Clients with optimal assets for lending or specific risk profiles will benefit throughout this process and each lending agent views these relationships differently. Therefore, it is the notion of client selectivity which becomes the main issue when discussing indemnification with lending agents determining how the capital will be deployed across their lending programme clients.

**Rennick:** Indemnification has become somewhat standard and expected as part of the core offering. At the same time, capital is a finite resource and as capital charges continue to increase, certain securities lending activity may become prohibitive for an agent lender and a borrower. Similar to conversations in other parts of the financial industry, for example, between prime brokers and hedge funds, we are starting to have discussions with our lending clients about what is additive or detractive to a bank or broker dealer's balance sheet.

***Regulation and the ensuing cost of indemnification will continue to be a pain point for agent lenders and clients***

**Mike Saunders**
Head of agency lending, Americas
**BNP Paribas**

That education is critical as capital is a binding constraint for both the agent lender and borrower. One outcome may be one price for indemnified business and a different price for the non-indemnified business. Solutions to reduce capital footprints remain a priority and alternatives such as central clearing or accepting collateral via pledge will gather momentum as they benefit asset owners, lenders and borrowers.

### After two years of Donald Trump's presidency in the US, how have beneficial owners adapted to the new landscape?

**Nigam:** Beneficial owners adapt to market conditions, which are obviously influenced by political administrations. It behoves them to watch the trends in the market when making decisions, rather than reacting to the issue of the day in Washington.

**Trapp:** Beneficial owners have felt the impact of the market volatility in Q4, 2018 on their investment portfolios and on their securities lending earnings. It's hard to attribute what happened in the securities lending market back to the Donald Trump presidency, but certainly, the volatility has been felt across the markets. In terms of the regulatory landscape, there has been progress over the last several years as the industry looks to implement several new regulations. The current administration's stance towards reducing regulation is favourable, however, and will likely slow the pace of new regulations over the coming year.

**Saunders:** Regardless of political views, the landscape has proven beneficial owners and lending agents who maintain an active dialogue to discuss, implement and monetise opportunities are well positioned. Market volatility will remain and likely increase throughout 2019 and those nimble enough to have the framework in place to handle the volatility will likely outperform.

**Bassler:** The new landscape during most of the last two years had been one of low volatility and upward stock markets. That changed in Q4 2018 with market dislocation and higher volatility. This market climate may be here to stay given global political and macro factors, and it could lead to more short conviction and a better demand environment for beneficial owners. We anticipated higher volatility with the Trump presidency, but only recently have we seen it come to fruition. Staying engaged with your agent and other peers and market participants is critical to remaining relevant as a lender, and then reacting to an evolving market in order to capture opportunity that the financing markets offer.

> ***The new landscape during most of the last two years had been one of low volatility and upward stock markets. That changed in Q4 2018 with market dislocation and higher volatility***
>
> **Peter Bassler**
> Managing director, business development
> **eSecLending**

### How are beneficial owners approaching SFTR? What are the main challenges they are facing?

**Saunders:** The implementation of SFTR has consumed tremendous resources within the firms participating in securities lending as well as those providing securities financing services. The general sentiment from a servicing perspective continues to focus on the successful implementation of the solution. These challenges have been eased with the assistance of third party vendors. However, challenges remain on automating the data submission component and the sharing of costs to comply with SFTR. It remains an open question as to how agent lenders will handle the commercial elements of SFTR. Several agent lenders have absorbed this cost as a matter of sound business practice. As SFTR progresses, certainly beneficial owners will require bespoke reporting solutions which will add additional levels of complexity both in terms of costs and data sharing.

Despite these challenges, there is an opportunity as a lender to synthesise the data to increase lending performance. The compilation of market data is simply another data point which can be utilised to benchmark the performance of a programme.

**Nigam:** It has been our experience that beneficial owners are relying heavily on their providers for guidance and solutions with SFTR.

**Rennick:** SFTR remains at the forefront of discussions with some beneficial owners more prepared than others, but all share concerns around the need to supply an approximate 150 data elements, particularly since many of those elements lack consistency and a centralised source. Market participants will remain active in meeting the specific transaction reporting requirements, but asset owners that delay focus may risk being left behind. We continue to articulate the extra-territorial impact this EU regulation is going to have to the US and the Asia Pacific clients.

**Trapp:** We are working closely with the industry to ensure that the requirements for the SFTR are understood for our clients by the 2020 deadline.

## In terms of technology, what developments do you expect to see in 2019? And how are they benefitting beneficial owners?

**Wolfe:** I expect we will see two technology changes in the future that will benefit beneficial owners: machine learning and distributed ledger technology. SFTR is requiring that many more data points be captured and made available in electronic form for European regulators. Firms and vendors have been investing in new technologies to support these requirements. Improved access to this more robust dataset could enable participants to apply machine learning in order to discover surprising and valuable insights. Similarly, distributed ledger technology has the potential to not only improve the transparency for beneficial owners but also to potentially enable beneficial owners to take a more active role in their lending programmes. I'm not confident either of these will come to fruition this year, but I do believe we will see experimentation and innovation over the coming year in both of these emerging technologies.

**Rennick:** At J.P. Morgan, we continue to make significant investments in our securities lending platform as technology remains a differentiator and true value add to the beneficial owner community. Clients have access to vital lending data and consolidated reporting, while our advanced proprietary trading platform consolidates data repositories, trading parameters and the trade lifecycle with advanced risk management and analytics as we draw from the firm's quantitative research capabilities. Data consumption and comparison will most likely be a key theme for beneficial owners over the next few years as big data and AI will help drive decisions and opportunities.

**Trapp:** The increasing use of technology and automation continues to bring benefits to beneficial owners. There is continued focus on pre-trade, trade and post-trade automation to increase efficiencies for the securities lending industry. In 2018, the expanded use of the NGT platform added significant straight-through processing capabilities, bringing increased levels of transparency and efficiency to the industry. Northern Trust has built out our capability to take full advantage of the improved distribution and pricing offered by the platform. This year, our focus will be on the use of emerging technologies such as AI, robotics and machine learning to further optimise pricing and distribution of client portfolios.

**Saunders:** Participants in securities financing transactions are at various stages of harnessing technology to offer a more compelling product. Each participant has a different focus as to how they are spending their technology budgets. At BNP Paribas, we have opted to focus on efficiency and transparency. We are utilising AI and simplistic forms of robotics to remove many of the daily, manual processes associated with a lending transaction. These developments automate many of the low margin, high volume transactions and enable more of a focus on bespoke trading strategies to extract value from a clients' lending portfolio. The common denominator remains to generate more revenue for beneficial owners while offering higher levels of transparency. In a relatively low margin, high volume type of business, efficiency is a critical component and leveraging the tools of technology are assisting the industry in their efforts to monetise opportunities in a cost-effective and risk-controlled manner.

**Nigam:** With SFTR and the unparalleled level of data that will come as a result, we expect to see vendors pitching new views on the industry and how it pertains to the beneficial owners. Additionally, we also expect to see a more concerted push for central counterparties to take on and counteract some of the balance sheet inefficiencies that currently plague the industry.

## Over the next 12 months, how do you expect to see the securities lending landscape develop/change?

**Bassler:** We expect to see greater beneficial owner engagement and focus as securities lending continues to see more attention across the investor segment. Beneficial owners are under pressure to show value to their underlying shareholders and beneficiaries, and securities lending is a pure shareholder value product. This means existing lenders will be looking for new opportunities in new markets, new collateral structures and potentially new peer to peer transaction opportunities. Agents and providers will continue to have to keep up with the demands of the beneficial owners from education, technology and overall innovation perspective. The market will remain competitive as clients demand more, and focus on transparency, best execution and a partner that is truly looking around every corner for opportunities or risks that are not necessarily obvious.

**Nigam:** We expect to see a continued shift away from cash as collateral. The spike in treasury repo rates over year-end illustrated the

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>
> **George Rennick**
> Head of agency lending, Americas
> **J.P. Morgan**

> ***I expect the use of non-cash collateral will continue to grow, and hopefully there will be continued dialogue with the US Securities and Exchange Commission regarding the use of equities as collateral***
>
> **Matt Wolfe**
> Vice president of product development
> **OCC**

need to be prepared and have an alternative plan, be it shifting more balances to non-cash or signing up new counterparties that are not a balance sheet driven.

**Saunders:** At BNP Paribas, we expect this year to be a pivotal year as we realise the significant investment in several initiatives, which will substantially benefit our clients. There will remain a continued focus on extracting value, implementing technology and looking for cost-effective strategies to grow business. We will continue to leverage the multitude of technology offerings which exist as well as continue with the development of propriety systems all with the focus on delivering value to our clients and shareholders. Ultimately, client selectivity and higher levels of engagement will become the forefront of our programme as we seek to deliver the benefits of securities lending to our clients.

> ***Continuing to improve the distribution channels through the use of CCP's and fintech tools will have a large impact on the future of the lending business***
>
> **George Trapp**
> Senior vice president, head of North American client service, securities lending
> **Northern Trust**

**Trapp:** Technology and automation are the primary focus of the industry. Continuing to improve the distribution channels through the use of CCP's and fintech tools will have a large impact on the future of the lending business. Beneficial owners can put themselves in a position to benefit from these developments by reviewing their collateral guidelines and ensuring they are aligned with the trend toward non-cash collateral.

Emerging markets will also provide opportunities for clients given the need for borrowers to source supply in less liquid markets or securities. As a custodian and fund manager, Northern Trust has experience working in both developed and emerging markets to provide access for our securities lending clients.

Despite the trend towards non-cash collateral, cash collateral investment can generate incremental returns for beneficial owners. A favourable investment spread can have a significant impact on earnings. Beneficial owners should review their cash investment guidelines to make sure they are aligned for changes in short term interest rates.

**Rennick:** The biggest changes will continue to be driven by regulation, especially SFTR and potentially Brexit, G-SIB charges, the Central Securities Depositories Regulation and changes to collateral rules. SFTR will offer unprecedented transparency, but will also challenge firms to first comply and then data mine for trends and opportunities. Outside of regulation, you are seeing beneficial owners return to lending after a long pause post the financial crisis. You also see new entrants, with lending portfolios seeking to increase challenged returns or possibly to offset fee pressures in the asset management client segment, for example. Evolution is constant and the firms that can adapt quickly and remain flexible are the ones that will maximise opportunities.

**Horner:** We expect beneficial owners to adopt peer-to-peer solutions that will allow them to potentially increase utilisation/returns while maintaining indemnification and operational/trade support from their agent lender.

**Wolfe:** I expect the use of non-cash collateral will continue to grow, and hopefully there will be continued dialogue with the US Securities and Exchange Commission regarding the use of equities as collateral. OCC is working closely with the custody banks and industry participants to develop a cleared programme for non-cash lending. CCPs and peer-to-peer are exciting initiatives that have the potential to increase utilisation, improve revenues, and lower costs. Finally, I believe that the decreasing cost and increasing access to big data and advanced data analytics and potentially new network paradigms will introduce exciting developments. **SLT**

# A fresh look

## As the securities lending market continues to grow, Sam Pierson of IHS Markit explains how the firm is taking a fresh look at the measurement of securities lending returns and how they are reported to beneficial owners

Securities lending revenues for 2018 were the highest since 2008 as demand for equities, credits and government bonds have all trended higher. The challenge for beneficial owners has been that lendable inventory has increased at a faster pace than demand, which has spread the returns over a larger base. The total lendable assets reported to IHS Markit crossed $20 trillion for the first time in 2018, an increase of 110 percent since 2009, while loans out of that inventory have only grown by 23 percent.

As the securities lending market continues to grow, strategies for realising the optimal mix of reward and risk exposure have also evolved. Accordingly, we are taking a fresh look at the measurement of securities lending returns and how they are reported to beneficial owners. There is a lack of clarity on what a peer group contains, along with a necessary look at return drivers, which standard peer group filters lack the flexibility to capture.

**Lendable inventory by asset class**


Source: IHS Markit Securities Finance © 2019 IHS Markit

In 2003, IHS Markit securities finance, then known as Data Explorers, pioneered the concept and paved the way for transparency in the securities finance industry. Since then the use of data within the industry has greatly increased and is now used not only for performance measurement, but is also embedded in the trading process from automated programmes to the management of re-rates and intraday spot-rate checks. Securities finance data also powers income estimates and projections, highlights liquidity and depth of market—particularly for fixed income securities—and aids in the estimation of short interest.

While there has been an increasing use of the dataset across the industry, there is more ground to cover with regard to the analysis of securities lending returns. There have been developments and new functionality, but in the decade following the global financial crisis, this has not necessarily kept pace with the substantial change to the industry and the structure of programmes. Even the term benchmark, with respect to securities finance, may be somewhat misleading and, given the focus and reforms across financial market benchmarks, a more fitting description which we will use henceforth is securities lending performance measurement (SLPM).

As the level of divergence and customisation in lending programmes has dramatically increased, focus has been on adapting to regulatory change, optimal revenue generation on specials and maintaining income. From a pure mathematical perspective, when using average returns as the benchmark, there should be an equal proportion of under and over performance. However, feedback from beneficial owners typically yields some variation of the "everyone beats the benchmark" refrain.

Sixteen years on from those early beginnings, the time is right for an industry wide focus on the issues that drive these outcomes to establish a global standard so that the industry as a whole—its observers and its participants—can have the confidence that there is one global agreed upon methodology.

### Data consistency

There are different views across the industry regarding inventory and lendable assets, which can lead to distorting performance measurement outcomes when calculating returns as return to lendable. This could mean that two identical funds, both generating the exact same securities lending income, could have differing return to lendable outputs, simply driven by differing views of lendable inventory. Common areas of difference are: restricted markets, restricted assets, regulatory lending limits, programme-imposed buffers, foreign ownership limits on a company, client mandated hold-backs and buffers. More detailed consideration of these factors is required when considering returns relative to lendable inventory.

There is an inherent challenge in the way that the reference rate for SLPM is calculated. In no other part of financial markets is a reference rate calculated where a considerable majority of the input has a zero fee. At the end of 2018, according to IHS Markit, global utilisation was 9.24 percent—lendable $19.1 trillion; on-loan $2.3 trillion—meaning that 90.76 percent of the lendable input had zero fee. The classification of lendable inventory into fee ranges will allow for greater specification of returns, for example, return on specials inventory.

Securities lending performance measurement generally weights the assets across the industry to the same size and form as those belonging to the fund being reviewed. This can create some distortion, due to different programme structures and assets not actively lent, which leads to a higher proportion of funds outperforming. While the implementation by IHS Markit of a new preferred benchmark is aimed at starting to address this, further work is required. Due consideration must also be given to alternative SLPM metrics, specifically the inclusion of current SLPM rate and a new active only SLPM rate, which focus on returns on loans made rather than scaling returns by inventory.

Part of the explanation for the "everyone beats their peer group" narrative is the post-crisis emergence of different lending strategies, specifically participation in general collateral versus specials lending, where traditional peer group designations bely a potential range of strategies. The key to delivering meaningful benchmark reports going forward will be the combination of peer group clarity as well as consideration of style-based peer group filters.

## Optional trades

A fund's investment objectives will greatly influence how optional trades such as scrips and cash/stock options are approached. A fund that invests for income and a passive fund will usually take the cash option while a longer-term investor may elect for the additional stock if their mandate allows it. At the portfolio level, the latter will usually have the most value (as the stock is often provided at a discount rate), but those forced to take cash effectively recover some of this discount via securities lending trade. Such securities lending transactions usually have exponentially high income, and that can disproportionately distort overall SLPM. This is especially true when a portion of the universe does not need to engage in such transactions as they are already better off from selecting the stock option.

## Collateral details

We view the process of performance measurement as a complement to the increase in regulatory reporting requirements. SFTR has mandated the reporting of some lending transaction details, which had previously been challenging for market participants to produce in real-time. Looking at collateral details, the demand for more clarity from the industry has been significant and consistent, as has been the challenges in reporting for market participants. We anticipate that will finally change in 2019.

While we work with clients on the provision of additional collateral metrics, we are also working on restructuring the collateral flexibility buckets which define collateral usage for the current performance measurement process. Of particular note is the isolation of equity collateral.

## Accuracy versus complexity

With so many variables that can materially impact SLPM, one possibility is to have significant flexibility that allows greater customisation in order that there is an exact match between a fund and the peer group. However, such customisation is harder to manage, can become too time consuming and lead to comparisons to a peer group of one. What then is the right balance? We've taken one step in the direction of a self-selecting peer group based on fund characteristics and size, which was made available in Q4. The removal of funds with limited activity can be thought of as one of the first style-based peer group designations.

## Disclosure

When a peer group has been selected for analysis it is important to review the total peer group inventory and returns profile in addition to the returns weighted to the client portfolio. Tracking the returns to the total pool for relevant asset classes supports understanding of the context for returns to the client portfolio and weighted benchmark. One advantage for multi-agent beneficial owners is the ability to generate reports which show top level performance as well as agent specific breakouts, which can be run against a consistent peer group. The disclosure of peer group inputs must be simple enough to understand and easy to replicate.

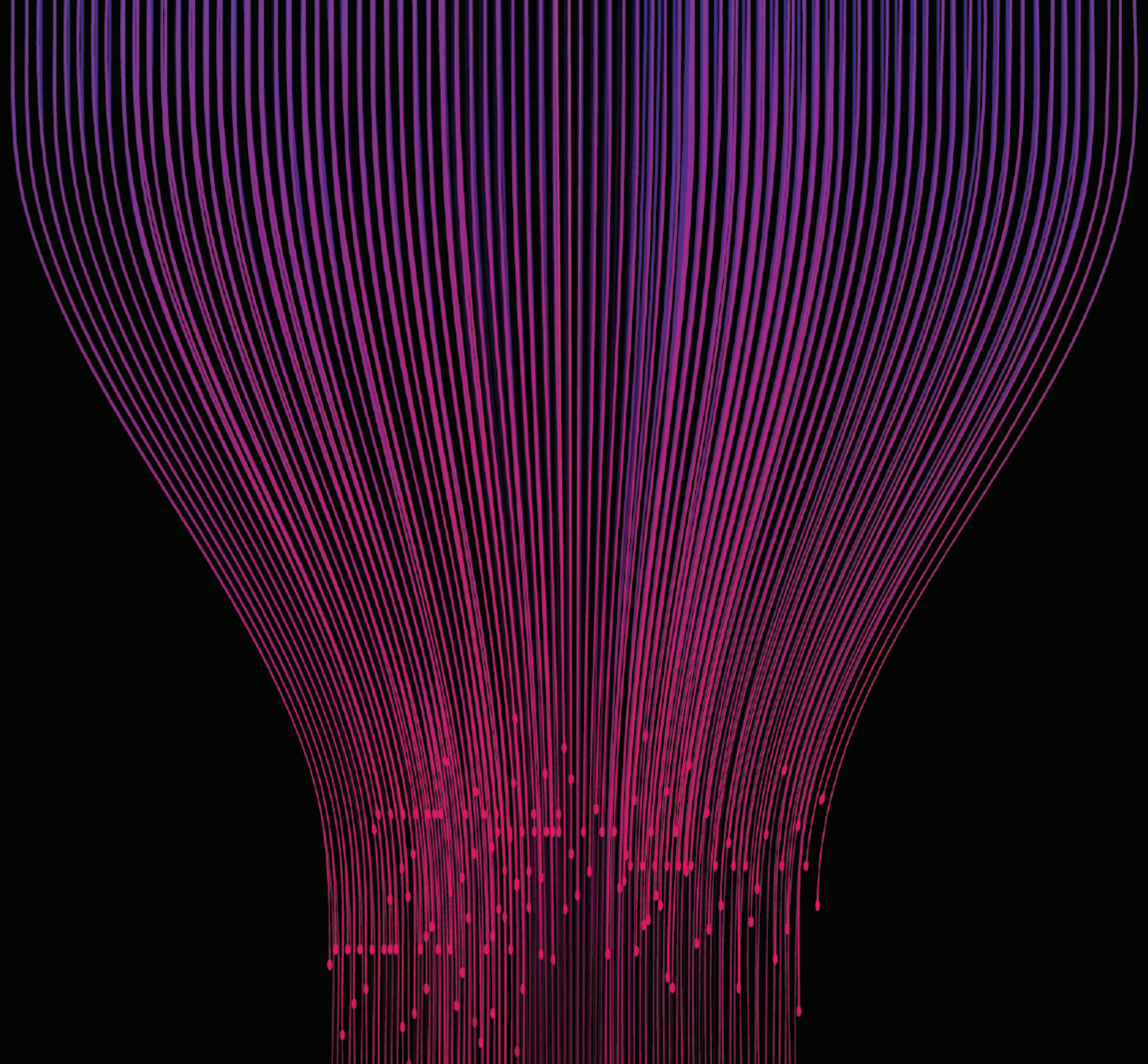
## Wrap up

There are a few key threads here which we are focused on as we further develop the framework for securities finance performance measurement:

- Clarity of inputs and size of peer group
- Additional dimensions for specifying programme preferences
- Updated collateral specification

We are encouraged by the feedback we have received from our clients both within agency lending as well as the beneficial owner community for the next generation of securities finance performance management tools. We are committed to delivering a solution for beneficial owners which clarifies the trade-offs in programme specification and provides a meaningful performance measurement framework. Progress toward that goal is underway and we're excited about the roadmap ahead. **SLT**

**Sam Pierson**
Director of securities finance
IHS Markit



# Synthetic financing trends

## Robert Levy of Hanweck explores the use of a new metric for looking at broad aggregates of securities over the last two years

Hanweck launched borrow intensity indicators in March last year to provide intraday transparency into US stock borrow/loan rates and inform people of trading and lending opportunities. The model is based on the concept of constant maturity synthetic lending terms rates from 30 to 360 days. Borrow intensity is expressed in the format of lending rebate rates and can be readily incorporated into a company's valuation framework. On a day-to-day basis, most users naturally focus on single securities that are exhibiting significant changes in term levels or are persistently hard to borrow (high intrinsic). The focus here with the close of last year, is to explore the use of a new metric for looking at broad aggregates of securities over the last two years and to see if there are discernible patterns.

## Analytic approach

In previous research, we have examined trends of borrow intensity levels, counts of hard-to-borrow (HTB) securities of different ranges of intrinsic value and also categories of general collateral. Data is generated from the exchange-traded options markets and incorporates predictive analytics, rather than based on bilateral transactions.

A relative measure is possible, with the help of underlying historical data in the option and equity markets. We used the data shown in table one to construct a synthetic fee measure for a given maturity of borrow intensity, in this case, 45 days. We then calculated a metric of dollar/day at the 45-day rate, across the universe of HTB securities that ranged from mild to high intrinsic value, and further breaking this group into quintiles, with the first quintile holding extremely HTB securities.

This synthetic fee measure gives a fairer and more representative view of trends in aggregates of securities across time rather than merely looking at rates. Unlike an average rate view, the fees are not thrown off by illiquid low volume securities that are extremely HTB. Conversely, milder HTB securities that trade in high volume can contribute significantly to the total.

The calculation of synthetic fee dollars is described below:

### Data for synthetic fee-dollar index

Daily data aggregated from intraday measures across entire US equity option universe (Hanweck Historical Option Analytic data):

- Option expires that bracket target maturity
- Trading volume of nearest-to-the-money strikes for each observation
- Interpolated OIS rates as a term risk-free rate
- Hanweck Borrow Intensity data

## Summary of analysis 2017 to 2018

The following results were generated from the data described in table one above. The series is volatile on a daily basis, and so are presented herein monthly or annual rollups to make any trends more visible.

We initially expected the results to be similar to fee trends in the overnight securities lending market since the behaviour of rebate rates and the distribution of overnight lending rates and term borrow intensity levels are similar.

The process of bringing in options volumes, however, appears to introduce a new dynamic beyond simply a basis for weighting contributions upon liquidity. There is no side-effect from put-call ratios because both are treated equally for volume weighting. But the overall measure becomes sensitive to the correlation of option volumes and synthetic lending rates. This causes spikiness in higher frequency data and has visible effects on the monthly series as well. It's a phenomenon that bears further investigation.

## Break-out by quintiles

Fees from the first quintile strongly dominate the overall fee distribution. Note that the break between first and second quintiles occurs roughly at a borrow intensity of -3 percent. Figure one below shows the total fees by year for the quintiles, and figure two shows the behaviour of the individual series over two years. The first quintile peaks in January of 2018 where both its level and spread to other quintiles is widest. By year-end of 2018, both the fee levels and spreads declined.

## Monthly fee trends

The synthetic fee measure is not intended as a value to be considered on an absolute basis. That is, it cannot directly be compared to lending fees reported in the physical market. It is a comparative measure of option market-based fee trends, as it overstates the volume for options selected by using the entire traded volume, and then understates by omitting other series that are nearly comparable (for example, a nearby weekly) but not included. The goal is to account for both liquidity and lending fee spreads and objectively base that liquidity on the options that would most likely be used in an actual conversion trade.

**Figure one: SEQ Figure * ARABIC 1 - Fee Quintiles**

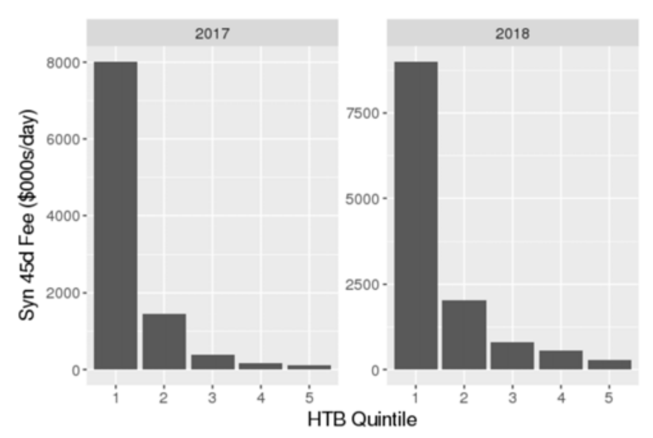



**Figure two: Fees by HTB borrow intensity quintiles 2017 to 2018**

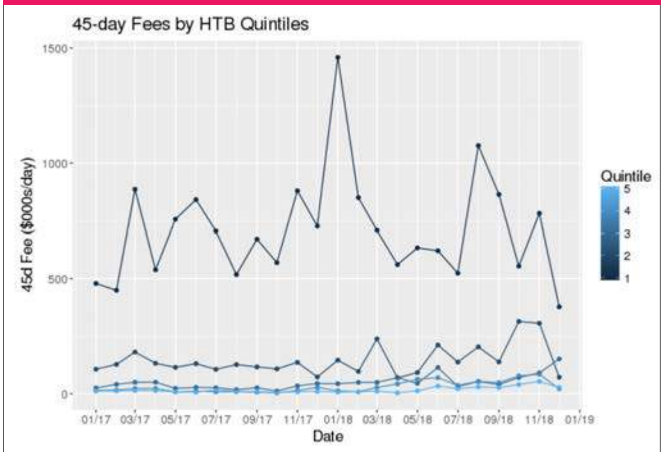
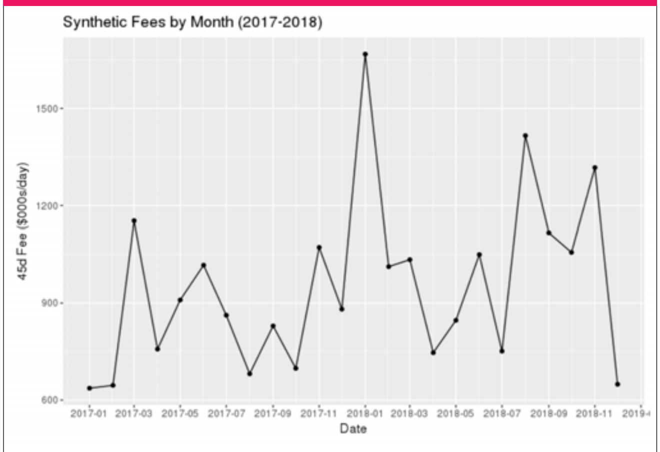


Figure three shows a plot of synthetic fees aggregated across the full range of HTB securities based upon 45-day borrow intensity.

Last year appears more volatile with peaks that exceed 2017 levels. Additionally daily fee dollars exceed 2017 by about 20 percent in 2018. The measure here is sensitive to option volumes as well as implied rates, and these two factors both increase in January, August, and November of last year to generate peaks in fees.

This contrasts with modestly lower security lending fees in the US lending market for 2018 versus 2017. These are different segments also, with lending fees mostly based upon the overnight lending market, and this analysis strictly focused on a term segment.

**Figure three: Synthetic fees by month**




## Periods preceding and during major market declines

Interestingly, January and November activity both preceded months of major equity market declines and increases, which implied volatility. January synthetic fee activity in particular spiked prior to the February volatility spike and liquidity distress.

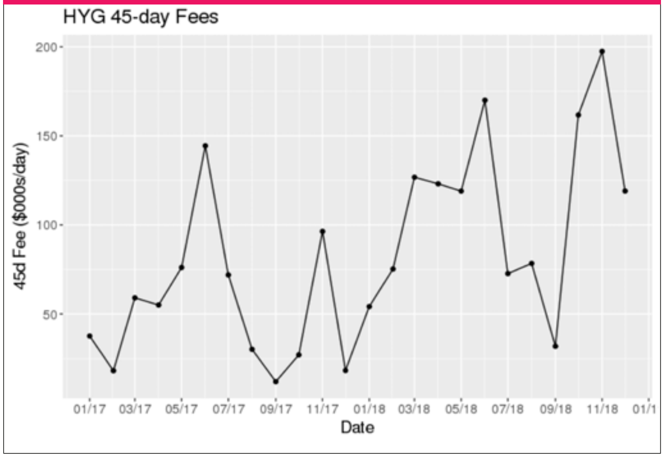
Much of the year-over-year increase in 2018 fees were due to these three periods. It's also notable that fees in months where there was a major sell-off including February, October, and December all showed fairly significant drops from prior months.

Volume changes are not consistent with this, so it appears that real selling that occurred in these periods brought additional collateral into the market, reducing lending spreads.

As an aside, this pattern in December was visible with single securities also including some exchange-traded funds (ETFs). For example, the ETF HYG as seen in figure three, shows a drop in fees during the December 2018 period where it experienced the most precipitous price decline of 2018.

Fees were actually at the highest level in November 2018, a period where the price decline in HYG had just started to gain momentum.

**Figure four: Synthetic fees HYG (iShares HY ETF) 2017 to 2018**

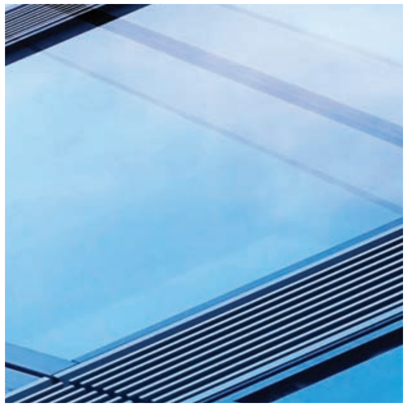


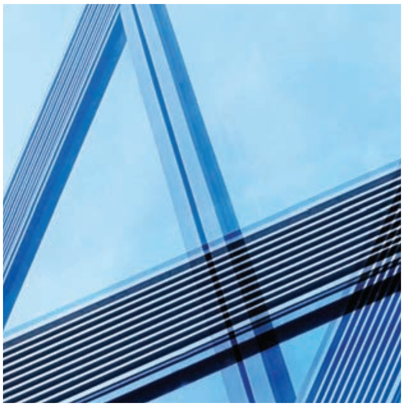

## Perspective from borrow intensity and additional option-based data

Borrow intensity indicators are created from tick-level data in the Hanweck option analytics framework. In this note, we explored a new indicators created from combining borrow intensity with filtered options trading data from Hanweck historical data. Synthetic fee dollars add the dimensions of liquidity and volume. The most frequent applications of borrow intensity indicators are two-fold: inform overnight lending rates and provide signals for equity strategies.

In this article, we explored the behaviour of the set of equity names that had at least minor intrinsic value to the most extreme of hard-to-borrow—excluding general collateral. Last year, fee dollars demonstrated more volatility than 2017 and modestly higher levels overall, and particularly noteworthy: time periods of major spikes in synthetic fees preceded periods of higher volatility and broad market sell-offs, including price declines in February and December of last year. It's exciting to find new ways to relate information across the derivatives and cash markets, and Hanweck will look to publish periodic synthetic fees statistics in the future. **SLT**

**Robert Levy**
Head of business development
Hanweck





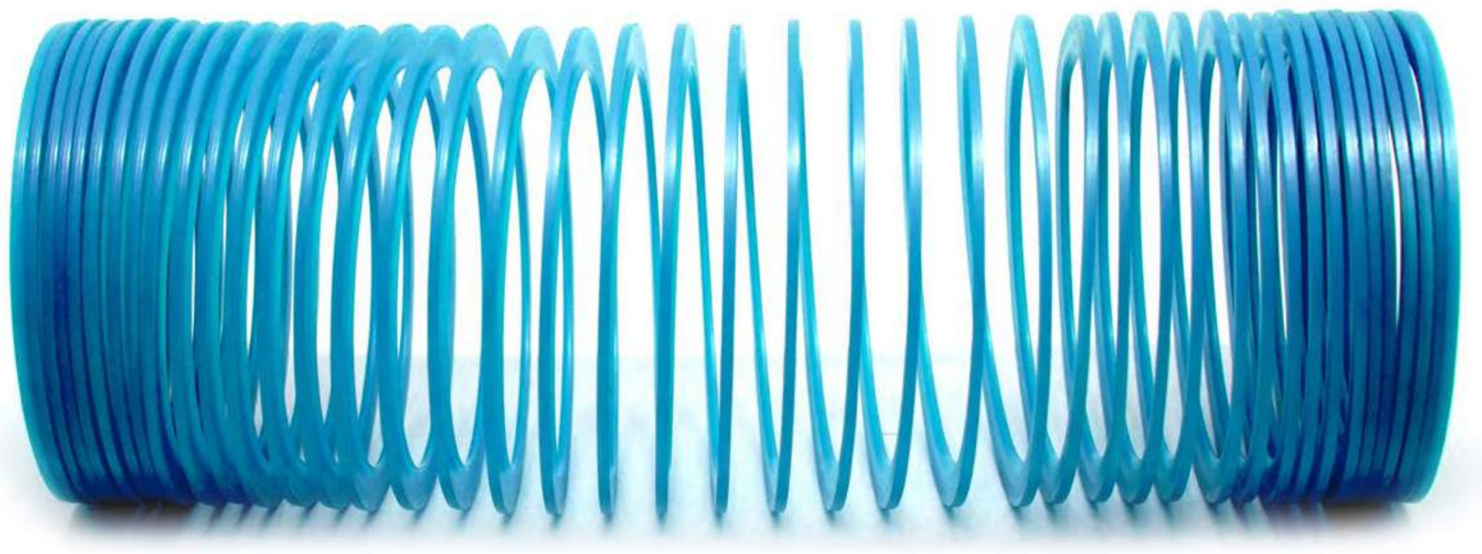
# We clear the path

OCC has the largest centrally-cleared stock loan offering in the world with approximately $80 billion in cleared loan balances. Over the last 25 years, OCC has built an innovative and unique U.S. program for securities lending transactions where OCC steps in as the counterparty (with a two percent risk weight) and guarantees the return of stock or collateral. We continue to enhance and expand access to our stock loan program in order to offer clearing solutions and capital efficiencies for our members and the entire securities finance industry.

As the world's largest equity derivatives clearinghouse, OCC is committed to providing market participants with high quality and efficient clearing, settlement and risk management services. As a Systemically Important Financial Market Utility, we work to enhance our resiliency in order to reduce systemic risk, increase market transparency, and provide capital and collateral efficiencies for the U.S. capital markets.

OCC

**THE FOUNDATION FOR SECURE MARKETS**



# Flexible structures

Don D'Eramo, global head of securities lending at RBC Investor & Treasury Services, discusses market trends and the top opportunities for beneficial owners this year

**What trends are you currently seeing in the securities lending space from a North American perspective?**

In North America, we continue to see shifts in the behaviour of borrowers towards increased demand for automation, a continued emphasis on balance sheet optimisation and collateral management as well as an overall shift towards further non-cash collateral.

Levels of automation continue to increase as both borrowers and agent lenders look to streamline flows. There have been ongoing efforts to utilise the latest auto-borrowing technology to actively manage inventory to borrowers thereby minimising the back and forth communication on both sides.

At RBC I&TS, over 75 percent of our connectivity with counterparts is automated allowing a greater focus on optimising high-value lending by our global desks. Secondly, the demand to borrow high-quality liquid assets (HQLA) continues to be significant in North America.

Global financial institutions continue to optimise balance sheet requirements as the focus on regulatory driven liquidity coverage remains a significant mandatory necessity in a post-financial crisis environment.

Additionally, collateral optimisation in itself is increasingly important as the cost of financing remains top-of-mind. These two drivers of demand persistently shape the changing demand landscape towards increasing fixed income on loan balances and especially towards term lending trades.

Lastly, a common trend in the North American space this year, which is expected to continue, is an increasing shift to non-cash collateral. Borrowers are constantly looking for lenders to expand their non-cash collateral offerings to include the acceptance of exchange-traded funds (ETFs), American depositary receipts, additional equity indices and non-investment grade corps.

It is imperative that agent lenders engage with beneficial owners and continue the education on collateral flexibility, trends and expansion.

## And more specifically, what trends are you seeing in the Canadian market?

The hot topic here in Canada for most of last year was the federal legalisation of cannabis, which went into effect on 17 October. In the Canadian lending market, cannabis names truly dominated the specials space for H1 2018.

However, as greater supply entered the market through share issuances, lending rates began to see the effects of downward pressure stepping into H2. Recently, we have begun to see some renewed interest in directional demand following the legalisation date in October as the market evaluates supply and demand dynamics as well as investor expectations of valuations.

Outside of the specials environment, the market in Canada is gearing up for some exciting changes in 2019 when it comes to the retail sector, as regulatory changes to national instrument guidelines have expanded mutual funds to allow alternative investment strategies within their retail funds. It is still early days but increased demand to borrow is expected as new funds are expected to launch in the new year.

## As of 29 June last year, there were circa €950 billion of equity securities on-loan from an available lendable supply of just over €12 trillion. From your perspective, did you experience a strong H2?

From a notional balance perspective, equity balances do remain a significant component of the global lending market, both from a general loan balance and revenue perspective. However, recent downward trends in the market and a general softening of specials made for a more challenging H2 2018.

It is actually now in the fixed income space where we continue to see strong demand driven by high-quality liquid assets (HQLA) and even in the corporate bond sector. Going into H2 2018 the demand for HQLA continues to rise and specifically on a structured term basis presenting greater opportunities for asset optimisation.

## This year, what do you think the top opportunities for beneficial owners will be in the next 12 months?

Appetite for HQLA was a significant demand driver last year with the expectation of continued interest this year. Beneficial owners of HQLA (such as Canadian sovereign and provincial assets), who are flexible with their collateral acceptance, stand to benefit the most through structured term lending opportunities—which we continue to see increasing demand for.

The opportunity to capture premium lending fees for the ability to lock in defined periods for lower grade collateral will be one of the top opportunities for lenders this year.

Additionally, the ongoing focus applied to monetary policy on both sides of the border can be a key driver this year. As the interest rate environment continues to change additional rate hikes can often translate to an increased demand for specific issues, but also a general rise in yields can potentially lead to increased demand for HQLA.

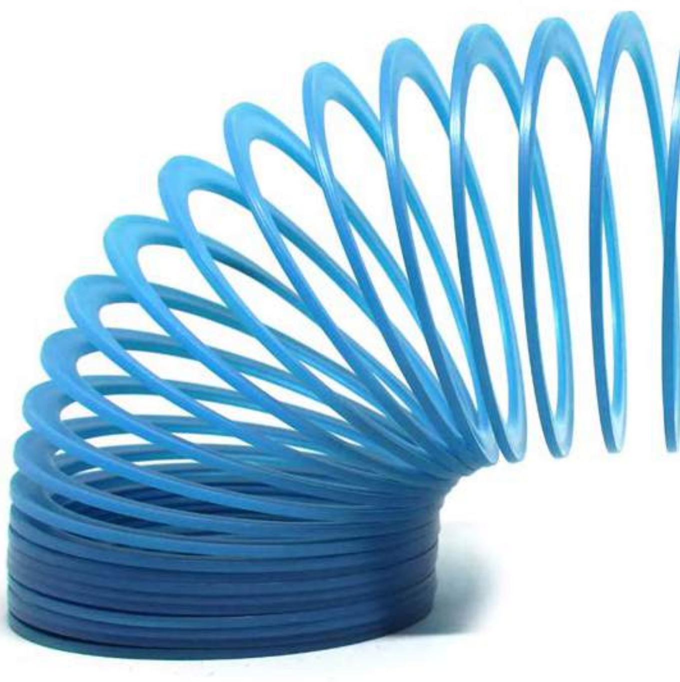
With the ongoing change in the demand sentiment within the lending industry, collateral flexibility by beneficial owners should be considered a significant opportunity to further optimise lending performance this year.

A well-known fact is that wider collateral acceptance can lead to greater overall lending performance, especially in an increasingly non-cash collateral market. Such flexibility is key in structured HQLA opportunities and striking the right balance between risk appetite and collateral acceptance is key to optimising any beneficial owner's lending programme.

## What challenges or opportunities will other areas of the industry face?

Upcoming regulatory changes will continue to be a focus for the industry; a major focal point centres around Securities Financing Transactions Regulation (SFTR).

The transaction reporting phase of SFTR presents a challenge for the industry to find a solution for all key stakeholders (beneficial owners, agent lenders, securities borrowers, custodians and so on) as this will touch the basic core infrastructure of the industry. **SLT**



# What comes next?

With SFTR to take legal force in early April, Seb Malik of Market FinReg and Fabian Klar of Regis-TR discuss what's next for the regulation

The Securities Financing Transactions Regulation (SFTR) obliges an approximately 10,000 firms to transaction report at a day-one cost of an estimated €150 million to €200 million. It affects firms as small as non-financial counterparties right up to multi-national investment banks and reinsurance firms.

SFTR requires a huge amount of data, much of it will not be held internally and it must be reported by the next working day with multiple daily trade lifecycle updates for the same transaction until expiration for many transactions.

SFTR transaction reporting is due to achieve legal force on or around 3 April this year, short of an objection being raised by the EU Council or EU Parliament during their three-month scrutiny period.

After the Promethean torture of having to endure a one-and-a-half-year delay, the EU Commission finally adopted the long-awaited level II legislation in December last year. These 10 delegated acts comprise the details. A lot of them are specific to trade repositories while the two that specify the details and formats of transaction reports have general application.

As a leading trade repository, we at Regis-TR have been poring over all texts ensuring we pick up any differences between the Commission's adopted texts and the original the European Securities and Markets Authority (ESMA) drafts that were published in March 2017.

During meetings with clients, we are often asked 'what happens next'? Did the Commission change anything in the adopted texts? When will we have to file the first transaction report? How will Brexit affect SFTR? What should we be doing? How can Regis-TR and Market FinReg help? For the benefit of the wider community, I'd like to share my views.

## What happens next?

The delegated acts were adopted by the EU Commission on various dates in December. While the EU Council adopted a scrutiny period of one-month which they extended once to two months in total, the EU Parliament chose a three-month scrutiny period. This means that as long as neither institutions raise objections, SFTR will enter the Official Journal on or around 13 March, achieving legal force 20 days later—making 3 April the target date.

The first firms to transaction report are the second Market in Financial Instruments Directive (MiFID II) firms and banks, 12 months later—April 2020. This much is confirmed.

Should the parliament vote to extend its scrutiny period then this would push these dates out by three months but this is not our expectation for two reasons. Firstly, European elections are in May and secondly, as we shall discuss, the commission has only made minor changes to the March 2017 drafts.

So, in summary, April 2020 is the date when the first transaction reports must be delivered to trade repositories.

## Did the EU Commission change anything?

Yes and no. The adopted texts are almost identical to the ESMA's drafts. The headline change is the number of fields to be reported has increased from 153 to 155. Table four now comprises 18 fields compared to 16 in ESMA's draft. The two extra fields are simple currency fields to specify the currency of the reused collateral (new field 10) and the currency of the funding source (new field 17).

The other changes are minor tweaks to validation rules including the textual description which has benefited from a helpful clean-up.

## When will we have to file the first transaction report?

As discussed, April 2020 is the start date, with the minor caveats already cited. MiFID II investment firms and the Capital Requirements Directive IV (CRD IV) firms—essentially banks—will be the first to report. Thereafter European Market Infrastructure Regulation central counterparties (CCPs) and central securities depositories (CSDs) will report from July 2020; UCITS and Alternative Investment Fund Managers (AIFMs) as well as insurance companies in October 2020 and non-financial counterparties January 2021—note the January 2021 date is after the proposed Brexit two-year transition period that ends on 31 December 2020, the significance of this we'll discuss below.

What does this mean in practical terms? During the phase-in period, matching will prove complicated because reports that are, in essence, two-sided will remain one-sided due to the other side not yet having been phased in. Regis-TR is aware of this quirk of nature and is taking mitigating steps to reduce the number of non-matches.

## Data, data, data

The word 'data' occurs 1,109 times in ESMA's SFTR draft legislation final report. And if we were to single out the most challenging aspect to transaction reporting, it would be sourcing the required data. The required data is often siloed and so new systems and processes must be created to cut horizontally across verticals. A lot of data will not be available in-house and so will have to be sourced externally.

Regis-TR is interoperable across all the major data vendors. We have forged partnerships with leading vendors who will be providing vital data enrichment services for onward reporting to us. Our comprehensive system will be accepting transaction reports directly from clients, via delegated reporting or via a third-party data vendor including Equilend/Trax and IHS Markit/Pirum. Taking Equilend's multilateral trading facility (MTF) as an example, it processes 90,000 plus new trades per day and 60 plus percent of their NGT platform's trade flow are SFTR reportable transactions. This flow can seamlessly be reported on to our trade repository.

Electronification and SFT trade flow is shifting to MTFs as a direct result of SFTR's matching regime. With 96 fields (albeit 32 after 24 months) being required to match to zero or very low tolerance thresholds, having both sides' data in one consolidated place such as a trading platform makes the task of both sides accurately reporting the same details immeasurably simpler.

Our EMIR trade repository regularly processes more than 30 million new trades per week for over 2,000 individual clients accounts.

## Product expertise and training

With our parent company, Clearstream, an active participant in the securities financing markets, REGIS-TR already has unrivalled in-house expertise in these markets and will capture a high proportion of SFT reports across the UK and mainland Europe. We are also in the process of establishing a separate UK entity for our TR for UK clients to Brexit-proof our operations.

We have also partnered with Market FinReg, a leading consultancy. Together we are providing cutting-edge SFTR training to empower your in-house operations, project managers and business analysts to perform vital project work. The training is available in person in London, Luxembourg, Frankfurt and Madrid or online with material

***Market FinReg is helping firms to conduct gap analyses to identify deficiencies in both data and processes and subsequently design appropriate solutions***

**Seb Malik**
Head of financial law
Market FinReg

posted out. We consider it essential to get key personnel trained immediately to allow SFTR projects to proceed immediately in an efficient manner.

Now that the legal texts have been adopted, Market FinReg is helping firms to conduct gap analyses to identify deficiencies in both data and processes and subsequently design appropriate solutions.

A quick and immediate project that should be undertaken is to identify all of the following entities that you interact with and to ensure they have valid legal entity identifiers (LEIs): counterparties, submitting entities, branches, other counterparties, beneficiaries, tri-party agents, brokers, clearing members, CSDs, agent lenders, CCPs and security and issuers.

## Brexit

No piece would be complete without mentioning the six-letter word. The worst-case scenario is a no-deal (perhaps more accurately described as a minimalistic-deal) Brexit. Regis-TR has mitigated against the worst-case scenario by establishing a UK entity. We have a long and established presence in London via our parent company Clearstream and are building out our UK TR.

While Market FinReg has been briefing clients with the lengthy minutiae, in summary, Brexit affects SFTR as follows: the UK is 'onshoring' SFTR, meaning that the UK is copying and pasting the EU SFTR and putting it onto the UK's own law register.

The UK Treasury explains that it would "create a dual reporting burden on firms as an inevitable consequence of the UK leaving the EU without a deal". In other words, firms would have to report twice: once to the UK TR and once to the EU TR. The treasury continues: "Evidence indicates that this additional burden is not expected to be significant as firms would be reporting the same data, using the same templates, to both TRs."

A further complication arises in that the level II legislation, that we discussed at the beginning of this piece, which has not yet entered the EU's Official Journal will not be onshored in time. We are left with a vague "the government is acting to explore alternative means to ensure that SFTR is able to function in the UK as intended in all exit scenarios".

A bill is currently passing through parliament that empowers the treasury to pass regulations for up to two years after Brexit. This would solve the problem. In any case, I am confident the entire suite of SFTR transaction reporting legislation will be onshored to the UK in due course.

SFTR is a beast, but with our help, it can be tamed. As discussed, Market FinReg and Regis-TR are offering cutting-edge training; it is a great way to learn the granular details from experts. **SLT**

***I am confident the entire suite of SFTR transaction reporting legislation will be onshored to the UK in due course***

**Fabian Klar**
Vice president, business development management
Regis-TR

# Luxury losses

In recent months, much has been written about the struggles of mainstream retailers and their falling share prices, however, David Lewis of FIS explains why elite stores are no different

When considering the purchase of high-end luxury goods, including jewellery, cars, boats and even houses, if you have to ask the price, then you probably can't afford it. This maxim is there to suggest that those buying luxury goods are rather more immune to economic factors that affect people on lower incomes who might consider interest rates and the cost of their mortgage or rent when considering significant purchases. Logically, then, the share price of purveyors of such luxury items should be relatively immune to most economic factors, or at least those factors that affect the majority of consumers. But is that really the case?

It might be natural to assume that small changes in interest rates, for example, won't affect high earners' spending patterns, but bigger macroeconomic and even social issues may well be a cause for concern for high-end marques. One such influence is the Chinese economy and its slowing rate of growth. Only this week, Jaguar Land Rover announced a £2.5 billion cost-saving programme and, while they would not confirm this included job losses, it is hard to imagine achieving those kinds of savings without up to 5,000 jobs going. This is particularly likely when some manufacturing plants are already on short time or have experienced periodic shutdown to "balance production levels". The slowdown in China has been cited as a primary cause, with Chinese nationals thinking harder about committing to big-ticket items.

Economic reliance on the future growth of the Chinese economy appears to be ever more acute, perhaps even eclipsing that of the US economy as the world "pivots to Asia," to quote the analysis of

**Figure one: Short interest volume two years to January 2019 | Source: FIS' Astec Analytics**


the former US President back in 2016. Other luxury goods reliant on the growth of high-end consumer brands in China include watches. Switzerland's biggest export market for timepieces is Hong Kong, gateway to mainland China sales. Hong Kong and greater China account for 25 percent of sales for Richemont (Compagnie Financiere Richemont SA, CRF), owner of Cartier, but including sales to Chinese nationals abroad, this rises to 44 percent. While this is a significant level of concentration of one, albeit large, geographical segment, both Swatch (The Swatch Group AG, UHR) and Salvatore Ferragamo (Salvatore Ferragamo SPA, SFER) rely on China for even higher proportions of their annual sales.

Social issues can also affect financial performance, but these are significantly harder for analysts to predict. France has seen significant amounts of civil unrest in the last months of 2018, some of which has spilt over, although with less intensity, into 2019. Known as the "Yellow Vest Movement," their prime aim was to address issues affecting low-paid workers in France through protest and direct action, but they have also had a direct effect on the economy, including the high-cost brands such as Richemont, LVMH, Moncler and Hermes. Richemont is least exposed, with France representing just 1 percent of the company's annual sales, but with 14 percent and 10 percent, respectively, Hermes and LVMH have suffered more from the pre-Christmas shutdown across their Paris flagship stores.

Short sellers have been quick to capitalise on some of these economic and social pressures, but not in a uniform pattern. Richemont and Salvatore stand out from the pack, with Richemont seeing a significant climb in short interest volume beginning in the fourth quarter of last year, up by over 190 percent from 1 October. Richemont shares saw a 12-month trading low of CHF 60.44 just after Christmas, representing a 39 percent drop from the 12-month peak of CHF 99.02 seen in May. The shares have recovered a little in January, reaching over CHF 67 by January 10. Salvatore followed a remarkably similar pattern, reaching a peak of €25.50 in May and hitting a 12-month low of €17.17 in the first week of January, a loss of some 33 percent. Again, the shares have recovered a little, closing at €17.83 on 10 January. Figure one shows the short interest volume for both Richemont and Salvatore over the last 24 months, identifying a reducing trend through 2018 for Salvatore, matched by the levels of utilisation, suggesting a constant level of supply as large investors kept hold of their investments. Richemont saw much greater volatility in short interest volume, rising sharply in February and staying high through to October, before bouncing back through November and December. Utilisation levels, by contrast, stayed within much narrower bands, suggesting significant changes in ownership between large funds that lend and those that do not participate in the lending market. At 10 times the market capital of Salvatore, Richemont is likely to see larger flows in and out as investors adapt their strategies, but the differences in volatility between volume and utilisation are marked.

While not all economic influences that affect share prices can be identified or predicted, such as social unrest or extreme weather events, some, such as the relative health of significant economies like China, can be more easily related to share price fluctuations. The impact on the luxury brands discussed here illustrates that the position a brand occupies in the market, with regard to price point and the relative wealth of their clients is no protection from the economic headwinds blowing some economies off course. Much has been written about the struggles of the more mainstream retailers, from Sears to Debenhams, but the falling share prices among the elite stores go to show that they are really no different to their lower-grade cousins in the end. **SLT**

**David Lewis**
Senior director
FIS

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London

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22-24

# Comings and goings at BNY Mellon, HQLAx, BMO and more

**Robert Chiuch has departed BNY Mellon as managing director, global head of equity and fixed income finance.**

Based in New York, Chiuch has served in the role since May 2014. He has also served at BNY Mellon as managing director, global head of equity finance and US head of corporate bond finance and managing director, head of North American equity and corporate securities lending.

Previously, he also served as president and co-founder of the Canadian Securities Lending Association between June 2009 and June 2012. He also worked as co-head of global securities lending at CIBC Mellon from 1993 to 2011.

**Nick Short has been appointed as COO of HQLAx and will report to Guido Stroemer, founding partner at HQLAx.**

In this role, Short will oversee the build-out of the operating model from a technical and legal perspective as well as ensuring that the operating model meets the requirements of the HQLAx customers.

Based in London, Short has been in this role for over a year in an acting capacity.

Short served at R3 for almost two and a half years but while at R3 he spent most of his time working with HQLAx helping to build out the HQLAx operating model, which uses R3's Corda blockchain technology.

Prior to R3, Short spent 17 years at Goldman Sachs building out collateral management technology solutions for various funding related departments including treasury, repo desks, and operations.

Commenting on his appointment, Short said: "I am very excited to be joining the firm. While at R3, I spent most of my time working with HQLAx and the HQLAx idea went through the R3 innovation lab and I was involved with that from the get-go."

Stroemer commented: "I am extremely excited for Nick Short to be joining HQLAx. He has played an instrumental role in shaping our operating model during the R3 incubation and acceleration projects, and I am very much looking forward to him helping to lead HQLAx into live production later this year."

**Mary Jane Schuessler has joined BMO Capital Markets as director of global equity finance, effective today.**

Schuessler will be focused on covering, utilising, and optimising its prime brokerage and retail positions while improving their overall client experience especially when it comes to servicing their custodians, asset managers, pension and hedge funds.

Based in Toronto, Schuessler will report to John Loynd, managing director at BMO Capital Markets.

Prior to BMO, Schuessler was a director and desk head-North America of securities lending at RBC Investor & Treasury Services (RBC I&TS).

In her position, she managed the global front office team who work to optimise lending revenue on behalf of RBC I&TS' custodial clients.

Additionally, Schuessler worked closely with business management and sales teams globally to develop growth strategies and deliver on the strategic direction of the securities lending programme.

Schuessler has 13 years of experience in the securities finance industry in Canada, spending two years working on the lending desk at RBC I&TS' office in Sydney.

BMO Capital Markets believe that Schuessler will be integral to the continued expansion of its equity finance platform globally.

**Neil Atkinson will join HSBC Securities Services as global head of client management for banks and broker-dealers, effective early March, according to industry sources.**

Based in London, Atkinson will report to Alexis Meissner, global head of banks and broker-dealers.

Currently, Atkinson serves as managing director, head of global strategic initiatives, depositary receipts at BNY Mellon.

He has served in various roles at BNY Mellon over a 12-year period. Prior to this, Atkinson has also held roles at Euroclear, BNP Paribas and Ivory and Sime.

**Matt Culek has been appointed as managing director, COO at Citadel Securities.**

Culek will work closely with CEO Peng Zhao on strategy and management, establishing overall resource priorities and launching new businesses across the firm globally.

He will also oversee the business level COOs who drive the day-to-day operations of the firm.

Culek served as managing director, global head of business management, office of the CEO at Citadel Securities.

Culek first joined Citadel Securities in 2012 as COO of Citadel Execution Services. Prior to joining the firm, he served as an associate principal at McKinsey & Company and as a capital markets associate at Lehman Brothers.

**Pierre-Nicolas Bissonnet has left his role as a member of the Europe, the Middle East and Africa (EMEA) sales for fixed income and buy-side team at Deutsche Bank.**

Bissonnet held the role from March 2018 to January 2019. He has worked at Deutsche Bank since 2012, where he started as part of the Euronext sales, investor services team.

Prior to Deutsche Bank, Bissonnet served at PwC and Ernst and Young. **SLT**