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ESMA delivers SFTR Level III guidance

The European Securities and Markets Authority (ESMA) has delivered its Securities Financing Transactions Regulation (SFTR) Level III document, which sets out key explanatory details regarding the information to be submitted by trade repositories (TRs) to ESMA.

According to ESMA, such reporting enables the authority to conduct consistent supervision of TRs by aligning content and format of reports to ESMA's supervision and its risk assessment processes.

Reporting of collateral re-use and cash reinvestment has been especially problematic. In section six of the paper, which deals with the tables of fields to be reported under SFTR, ESMA cited: "As highlighted in the regulatory technical standards (RTS), the logic that underpins Table 4 is different from the other tables, and will not be used for reconciliation as this information cannot be linked to individual transactions."

"Instead, non-cash collateral re-use, cash collateral reinvestment and funding sources shall be reported as aggregates at reporting entity level."

Collateral re-use shall be reported using the formula agreed in the Financial Stability Board (FSB) framework and included in the RTS, ESMA notes in the paper. ESMA also clarified that cash reinvestment is reported as-is and not subject to the FSB formula.

ESMA outlined that the reporting obligation only applies to securities financing transactions (SFTs), which means that the collateral securities posted or received from other transactions are out of scope and that entities should not report their own assets.

This also means that the components of the re-use formula should not be reported separately to ESMA, the paper highlighted.

Instead, reporting entities should only provide the estimate that results from the application of the formula at ISIN level.

In terms of scope, this means the collateral received, eligible for re-use captures securities received as collateral in reverse repos and BSB, and securities borrowed in securities borrowing transaction.

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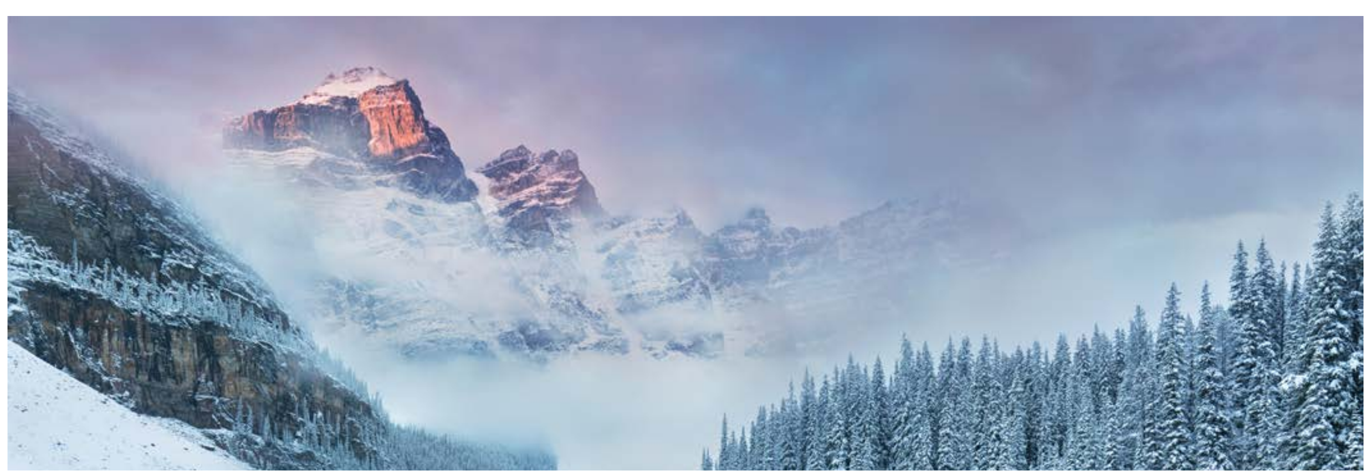

The Great White North
The strength and stability of the country’s securities lending market was reinforced at the Canadian Securities Lending Association’s 9th Annual Conference, and panellists suggested positive change is happening in Canada

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big xyt to provide wider services

Liquidnet Europe has broadened its implementation of big xyt's Liquidity Cockpit analytics platform.

As an independent provider of data analytics solutions, big xyt administers a variety of products and services to Liquidnet, including the cross-check of market volumes and monitoring of market information.

Furthermore, Liquidnet will be able to "capture, normalise, collate, and store" trade data of regulated markets, multilateral trading facilities and systematic internalisers.

The collaboration will also allow Liquidnet to compare quality, liquidity, spreads and costs to ensure maximum efficiency.

Mark Montgomery, head of strategy and business development at big xyt, commented: "We are delighted to be able to provide Liquidnet with the ability to interrogate and assess a consolidated view of their market position."

"Recognising the benefit of outsourced independent, complex data analytics has freed up additional internal resources to concentrate on client focused initiatives."

Barclays, Goldman Sachs and J.P. Morgan sign up for DTCC's GTR

Barclays, Goldman Sachs and J.P. Morgan will use DTCC's global trade repository (GTR) service in order to meet their regulatory obligations under the Securities Financing Transactions Regulation (SFTR).

DTCC's GTR solution supports all product types to be reported under SFTR, including repo and reverse repo, securities and commodities lending and borrowing, sell/buy-back, buy/sell-back and margin lending and borrowing.

DTCC's GTR now supports the European Market Infrastructure Regulation, the Financial Market Infrastructure Act and SFTR regulations from a single global platform through its London-based registered trade repository.

Val Wotton, managing director, product development and strategy, repository and derivatives services and collateral management at DTCC, said: "DTCC is committed to serving clients, and creating opportunities to protect the stability and integrity of the global financial system– such as readying the industry for regulatory mandates, including SFTR."

He added: "Barclays, Goldman Sachs and J.P. Morgan are valued clients, and we're delighted to be working with them in the securities financing arena to achieve the transparency and risk mitigation that the G20 intended."

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Deutsche Börse's regulatory reporting hub to start SFTR service

Deutsche Börse's regulatory reporting hub is adding a new solution for the Securities Financing Transactions Regulation (SFTR) to its suite of regulatory reporting services.

The solution will help clients manage SFTR reporting challenges, improve reporting data quality and reporting efficiency.

The hub's SFTR solution will cover data collection, validation, enrichment, submission report construction and trade repository integration with REGIS-TR.

Clients will be able to report any type of securities financing transactions (SFTs) through the platform.

The hub will ensure SFTR compliance for Eurex Clearing's cleared securities lending and repo business.

The hub also enables Eurex Clearing members to enrich their SFTR reporting with Eurex Repo and Eurex Clearing data (counterparty, transaction and principal collateral, CCP margin). This enrichment service covers all SFTR-reportable transactions that are concluded on Eurex Repo and cleared by Eurex Clearing as CCPs.

This will reduce SFTR implementation costs for clearing participants and increases reporting efficiency by using consistent data.

OCC sees securities lending up in May

OCC's securities lending central counterparty (CCP) activity was up 0.3 percent in new loans from May 2018 with 119,589 transactions last month.

Year-to-date stock loan activity decreased 1.7 percent from 2018 with 567,184 new loan transactions in 2019. The average daily loan value at OCC in May was $73.8 billion.

Total cleared contract volume in May reached 464,971,407 contracts, a 13.1 percent increase compared to last May, and the highest total volume for May in OCC's history.

OCC's year-to-date average daily cleared contract volume is 19,609,615, down 8.0 percent compared to 2018's record-breaking pace.

Futures cleared by OCC reached 9,029,622 contracts in May, up 20.1 percent from May 2018. OCC's year-to-date average daily cleared futures volume is 310,478 contracts, 33.3 percent lower than 2018.

Overall exchange-listed options volume reached 455,941,785 contracts in May, up 12.9 percent from 403.7 million in 2018.

Equity options volume reached a total of 405.8 million contracts, a 10.8 percent increase from May 2018.

This includes cleared exchange traded funds options volume of 175.7 million contracts

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last month, a 16.4 percent increase compared to the May 2018 volume of 150.9 million contracts.

Index options volume was up 33.2 percent with 50 million contracts in May, with a year-to-date average daily volume of 1.9 million contracts.

Arbuthnot Latham moves to Euroclear's investment fund service

Arbuthnot Latham has moved to Euroclear's UK & Ireland's (EUI) CREST investment fund service and will now benefit from full automation of settlement for its UK investment funds.

Arbuthnot Latham, part of the Arbuthnot Banking Group, is a merchant bank offering investment management and wealth planning services to high net worth private individuals and commercial clients.

According to Euroclear, this automation of fund transaction settlement will allow Arbuthnot Latham to offer end-to-end automation for the settlement of fund units and applicable cash movements.

Euroclear noted that from the placing of a funds order to the settlement, transfer, reconciliation and corporate action processing of the asset, the service makes a fund held in the UK as easy to administer as any other EUI-eligible instrument.

Martin Williams, head of investment management operations at Arbuthnot Latham, said: "The move to Euroclear UK and Ireland's investment fund service is another milestone in our drive to reduce operational risk, increase controls and move to automate processes, we are pleased to have worked in partnership with EUI to help achieve these goals."

Stephan Pouyat, global head of capital markets and funds, Euroclear, commented: "We are extremely pleased to welcome Arbuthnot Latham to our service."

He added: "The end to end automation of their fund transactions will result in a reduction of risk and costs as well as provide full line of sight of their settlement obligations which will also improve liquidity."

Investment banking revenues decline

Investment banking revenues have declined in Q1 2019, according to a new report by Coalition.

The trend, indicated in Coalition's Interactive Brokers Index, was mainly driven by the absence of large one-off events, subdued client activity in Fixed Income Clearing Corporation (FICC) and weak issuance activity in the Investment Banking Division.

The report found that in equities, the impact of normalisation in derivatives coupled with lower

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revenues prime services and cash was partially offset by improvement in futures and options.

Equities underperformed due to the absence of one-off results in derivatives and weaker results in prime services and, to a lower degree, cash.

Prime services were negatively impacted by client deleveraging, lower client activity and a decline in trading results.

Cash equities declined on the back of lower volumes and margin compression. Regionally, Asia Pacific (APAC) outperformed relative to Americas and Europe, the Middle East and Africa (EMEA).

The report also indicated that the decline in FICC securitisation was driven by weaker client activity and increased competition.

Cash equities revenues declined due to lower volumes across regions led by EMEA and APAC, while the Americas performed relatively better.

Citco partners with S3 for trade cost analytics

Asset servicing solutions provider Citco Group (Citco) has partnered with S3 Partners to allow its clients to access S3's BLACKLIGHT's financing trade cost analytics tool for trade, margin and collateral exposures and efficiencies.

BLACKLIGHT leverages data analytics along with technology for better outcomes in the investment process, risk management, and counterparty relationships.

The platform will be rolled out via Citco's Æxeo treasury platform.

Bob Sloan, founder of S3 Partners, said: "We are thrilled that Citco has chosen to partner with us and recognises the value of our broker-neutral solutions."

He added: "The Citco-S3 alliance, along with our distribution via Bloomberg, Nasdaq and Reuters, expands the reach of our technology and data to every player type and client segment."

Albert Bauer, managing director at Citco Fund Services (US), commented: "Our focus at Citco has always been to provide our clients with the best technologies and services to make their lives easier."

"This is why we have decided to integrate S3's market-standard BLACKLIGHT suite of data and technology."

He added: "Our clients have asked for nuanced analytics which we can now offer via BLACKLIGHT with single-sign-on access and virtually no operational friction."

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Mixed May results for Eurex

Eurex saw mixed results for May as, despite a decrease in total trading volume, there were increases in repo, equity and equity index derivatives trading.

Eurex repo saw an overall increase of 19 percent in average outstanding volume in the repo markets in comparison to May 2018. The overall number of traded contracts was 173.2 million compared to 184 million in May 2018, a decrease of 6 percent.

Increases of 3 and 8 percent respectively for traded contracts in European equity index derivatives and European equity derivatives contrasted with traded contracts in European interest rates derivatives.

According to Eurex, these stood at 50.6 million, a decline of 25 percent year-on-year (67.4 million in May 2018).

Meanwhile, May saw a number of new monthly records as over 2.79 million VSTOXX futures and options plus more than 343,000 total return futures contracts were traded.

Additionally, more than 900,000 contracts were traded during Asian hours with a new daily record on 31 May of almost 229,000 traded contracts, indicating the success of Eurex's trading hours extension.

NSD CMS treasury repos value grew by nearly five times in a year

The value of federal treasury repos conducted via the collateral management system (CMS) of Russia's National Settlement Depository (NSD) amounted to RUB 5.3 trillion in Q1 2019, 4.9 times more than in Q1 2018.

The average repo maturity increased from three to seven days.

NSD noted this increase was due to floating rates linked to the Bank of Russia.

In Q1 2019, the total volume of Bank of Russia repos reached RUB 192 billion.

The total number of clients connected to the CMS was 160.

In Q1 2019, the number of trades registered with NSD's repository grew to 3.1 million compared with 2.8 million in Q1 2018.

The value of the registered transactions was 20 percent more than in the same period of 2018—RUB 120.8 trillion (RUB 100.6 trillion in Q1 2018).

At the end of 2018, NSD implemented integration with Moscow Exchange's over-the-counter system and in March 2019, the NSD became the first central securities depository to sign up for SWIFT's gpi service.

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AMF to improve European rulebook with new proposals

The French financial markets regulator, Autorité des marchés financiers (AMF), is making concrete proposals to improve the quality of the European rulebook and its ability to evolve.

AMF will contribute to the 2020-2024 agenda following the European elections and Parliament and the European Commission's new term of office.

It has proposed a series of adjustments to existing texts to make them easier to read, simplify and, if necessary, correct provisions that prove inadequate.

Additionally, AMF suggested that the architecture of asset management regulation be rethought.

During the review of the Alternative Investment Fund Managers Directive, the drafting of a legislation defining a clearer and more harmonised common set of rules for asset managers could be considered.

AMF also affirms its support for simplifying the Packaged Retail and Insurance-based Investment Products regulation to better inform investors.

As well as this, AMF supports a targeted review of the second Markets in Financial Instruments Directive.

This is to adjust certain provisions in the light of experience and to take into account the effects of the UK's exit from the EU.

The regulator also calls for a review of reporting requirements to avoid duplication and inconsistencies.

AMF commented: "The AMF puts forward pragmatic proposals to promote greater convergence in the supervision of actors and developing a framework for day-to-day relations between supervisors in a European landscape that will be profoundly transformed by the UK exit from the union and the coexistence of several financial centres."

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ESMA provides SFTR guidance

On 27 May, the European Securities and Markets Authority (ESMA) delivered its keenly-awaited guidance on SFTR transaction reporting in the form of a consultation paper. The so-called level III guidance comprises a melange of ESMA's opinions and questions to the industry. This document is the first substantive new information concerning the Securities Financing Transactions Regulation (SFTR) since ESMA delivered its final report more than two years ago in March 2017. We at Market FinReg sacrificed our bank holiday Monday to analyse the document and the associated Excel sheet of validation rules and produced a briefing note for the industry by next morning. I would like to share with you the salient points from the new guidance.

Collateral re-use

Confusion reigned on how to report cash and collateral reuse. The Financial Stability Board (FSB) formula seemed unfit for purpose to report cash collateral reinvestment:

$$collateral_{ij}^{reused} = \left(\frac{collateral_{ij}^{received.eligible_for_reuse}}{collateral_{ij}^{received.eligible_for_reuse} + assets_{ij}^{own}} \right) \times \left(collateral_{ij}^{posted} \right)$$

Concerning the highlighted assets element—for cash, this would imply adding the bank/entity's entire cash holdings thereby producing a meaningless number. During a trip to Frankfurt, an individual from a German industry group told me that they had informed their regulator (BaFin) that, absent guidance, they would be reporting 100 percent on all occasions. Guidance now states that the above formula is only for securities and not cash. For cash, one merely reports the amount of cash and the rate at which it was reinvested. Specifically, counterparty A reports its own cash reinvestment of €100,000 at 1.5 percent rate in the repo market by completing: Field 4.11 (Reinvestment rate): 1.5; Field 4.12 (Type of re-invested cash investment): real estate and private markets; and 100000 for re-invested cash amount in field 4.13. Regarding securities collateral reuse, the formula applies and, unfortunately, the highlighted problematic assets own element remains, which would imply a bank/entity would need to track its entire inventory of that particular International Securities Identification Number (ISIN). Market FinReg will be highlighting this problem in our response to ESMA's consultation.

Buy-sell back

ESMA responded to industry feedback concerning buy-sell backs (BSB). ESMA appears to have fundamentally misunderstood the product, and hence field validation changes have been introduced to make amends, notwithstanding continuing issues.

Backloading

Recall, to capture pre-existing systemic risk, SFTR requires reporting pre-existing SFTs that (i) the remaining maturity of those SFTs on that date exceeds 180 days; or (ii) those SFTs have an open maturity and remain outstanding 180 days after that date. These must be reported by 190 days. Given the phased-in start date, this posed challenges concerning unique transaction identifier (UTI) generation and dissemination with counterparties—especially those who only report later. Industry bodies were at one point gravitating to ignoring the aforementioned legislation and just reporting backloaded SFTs on the go-live date. I had consistently cautioned against this, and ESMA has confirmed our view that the legislation must be adhered to concerning timing, but that the previous lifecycle events can be ignored.

Phased-in reporting

ESMA states that non-banking entities (that are only due to report three-plus months after initial go-live) are free to report in advance of their go-live date: 'should the non-banking counterparties find it easier.' Central counterparties were already intending to do so—donning my legal cap, there is a strong argument that ESMA has no authority to overrule legislation in this way, but such a view would risk lapsing into pedantry.

General or specific collateral

Following questions on how to consider the two, ESMA engages by proposing two approaches. In summary, approach A is to default repos and BSBs to general collateral (GC) and for securities lending specific collateral. Approach B is to restrict GC to GC automated trading systems. ESMA solicits industry opinion.

Amendments

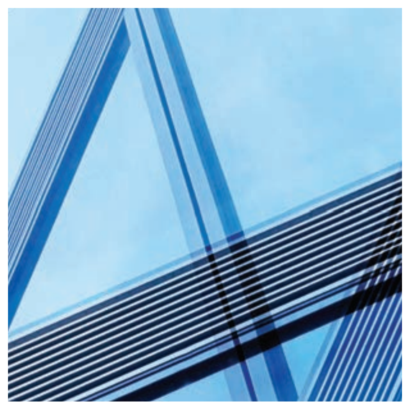
ESMA consults on whether amendment reports should contain all fields afresh, or merely the updated field(s)—the latter option would reduce payload.

Other issues

ESMA provides guidance on the identification of the central securities depository (CSD) participant is provided including that, "counterparties should not report the legal entity identifier (LEI) of the CSD in which they are either direct or indirect participants". What constitutes an SFT being concluded in the course of operation of a branch is clarified; ESMA acknowledges problems of fungibility of repos in order to avail compressed position reporting as well as obtaining LEIs for the jurisdiction of the issuer.

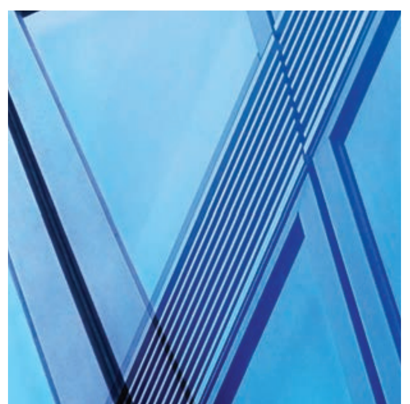
It is impossible to provide detailed comment on a 179-page document here. For those interested in our fuller views, do visit our blog: https://www.marketfinreg.com/blog/

I encourage all industry participants to respond to ESMA's consultation.

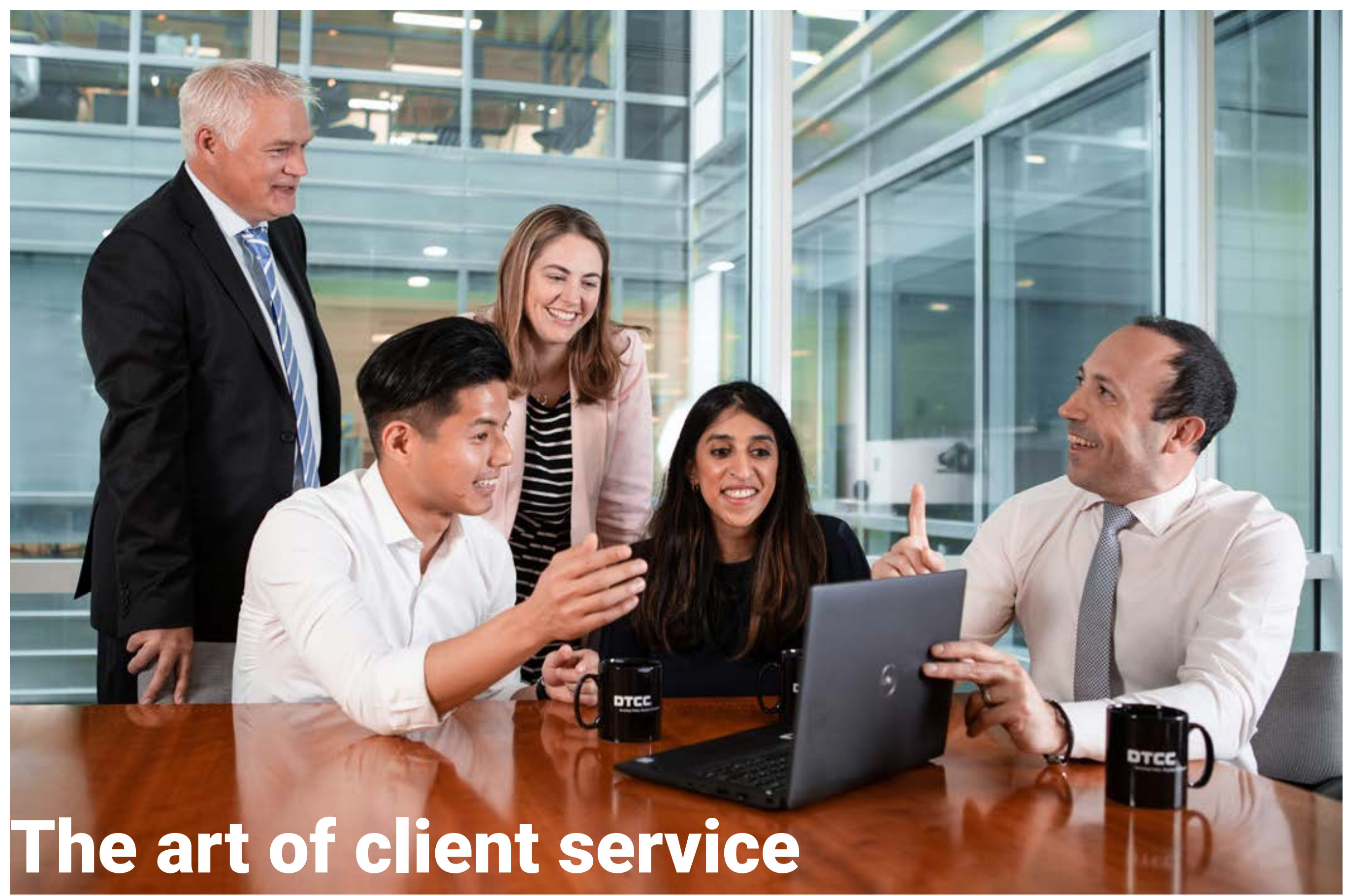


We clear the path

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.



The art of client service

Industry experts at DTCC discuss the expansion of its GTR functionality to accommodate the reporting of SFT as required by Europe's SFTR and how it will support clients who are gearing up to comply with the regulation

Market participants doing business in the EU face an additional regulatory regime starting in 2020, one that will challenge their operational capacity to report large volumes of securities financing transactions (SFT) to trade repositories (TRs). While many of these firms are experienced in reporting over-the-counter (OTC) derivatives trades to trade repositories (TRs) under the European Market Infrastructure Regulation (EMIR) regime, the EU's Securities Financing Transactions Regulation (SFTR) will place additional pressure on standard operating procedures and impose new compliance burdens in a business area previously untouched by such mandates.

DTCC's Global Trade Repository service (GTR) is the premier transaction reporting and disclosure solution for clients and regulators worldwide. Launched in 2012 in response to the G20 recommendations for risk mitigation in the OTC derivatives market following the 2008 global financial crisis, GTR is the largest trade repository for OTC derivatives, processing some 40 million open positions a week and more than 11 billion messages for 5,250 clients in multiple jurisdictions around the world.

In response to SFTR, GTR is offering an end-to-end client service programme that includes all the features of its standard global client support system along with new enhancements and specific testing tools designed for SFT reporting.

GTR's partnership model

Over the years GTR, in partnership with its user community has amassed unparalleled expertise working with a wide array of market participants. This experience allowed GTR to build out its functionality to accommodate SFT, making GTR a one-stop shop for clients' transaction reporting needs. GTR's multi-channel client service operation provides comprehensive support throughout clients' trade reporting lifecycle, from onboarding and connectivity through to testing, go-live and post-reporting data analysis. Enabled by its global footprint, GTR provides follow-the-sun support servicing clients in Europe, Asia, North America and Canada. Its email and call centres connect to a case management system to create a feedback loop with clients, relationship managers and client service staff.

Over the years GTR, in partnership with its user community, has amassed unparalleled expertise working with a wide array of market participants

SFTR's unique challenges

Compliance with SFTR, as with any new mandate, is generating anxiety among firms that will be required to comply with it. Not only does SFTR cover a broader swath of market participants than EMIR's derivatives rules, but the securities finance industry also has a heavier lift in preparing for SFTR compliance, particularly in the areas of data availability and daily workflows. For instance, SFTR requires up to 153 fields for data reporting, compared to 129 fields under EMIR.

Maria Dwyer, managing director of solutions client services and business operations at DTCC, said: "Firms under the SFTR mandate are asking questions such as, 'do we have the right systems in place for organising our trade data and transmitting it to a TR efficiently? How do we know if our trade data is robust enough to meet the standards of the new rules?'"

Dwyer explained: "GTR has responded to these concerns by developing an end-to-end support service that starts by helping these firms understand the regulation and their obligations, then gets them connected to our platform and provides value-add with analytical resources that can enhance the quality of their data."

She added: "GTR's success is driven by our collaborative relationships with clients, regulators and industry partners. We're committed to minimising the client build-out effort and facilitating SFTR implementation to the greatest extent possible."

New support tools and practices

As the demands of GTR's user base continue growing in response to the ongoing release of new and revised technical standards by regulators, GTR keeps improving its client support model.

Luca Cappelletti, global head of client service for DTCC's repository and derivatives services group, explained that the "increasing volume of messages we process and number of clients we support has generated a large number of user inquiries over time, which funnel into GTR's client support teams."

Cappelletti said: "Since 2012 we have evolved from a reactive helpdesk to deliver a more proactive user experience. Having our client community represented on our board and steering committees drives the voice of the client right to the heart of our business both in terms of product delivery and continuous improvements to our support services."

GTR has also invested heavily in new client service tools over the last three years, "putting a variety of knowledge, testing and training modules at clients' fingertips," Cappelletti said.

These new tools will be easily accessible thanks to a redesigned user portal GTR began rolling out in 2017 to improve the client experience. Users now have direct electronic access to the data stored in the repository maximising user control over the content, number, and frequency of reports generated.

Dwyer explained: "The portal redesign grew out of lessons we learned from the go-live of EMIR derivatives reporting in Europe several years ago. With EMIR we could see patterns of repeated inquiries, so we built into our new platform hands-on learning resources that guide users to the answers of common questions."

Besides its self-service capabilities, the new portal offers a simplified, more-intuitive interface along with features that can smoothly integrate other DTCC solutions into clients' trade life cycle-management workflow.

"Our UAT environment will be live from August 2019, which along with this structured approach to testing, will help avoid a last-minute free-for-all"

Features include an advanced dashboard that provides a snapshot of submission, trade and reconciliation data; analytical tools that enable performance benchmarking by country; and a feature-rich search interface that expedites data queries and customisation options to filter and sort query results. The portal's enhanced landing page shows a summary of user data from the previous reporting day.

Dwyer said: "Clients coming on board for SFTR reporting will realise all these benefits. I'd also encourage existing GTR clients who haven't yet switched to the new portal."

From onboarding to testing

Onboarding to a new service is often cumbersome for clients, Cappelletti noted, but GTR's SFTR offering delivers a "slick, web-based, digital onboarding process. New self-service features will streamline onboarding and eliminate a lot of the headaches that typically characterise this process".

Once onboarded, firms will need to test their internal builds and identify where their data quality requires improvement, to ensure operational conformance with SFTR. To give clients a long lead time to prepare for the new mandate, which will be phased in by type of entity starting in April 2020, GTR worked with users and vendors to develop an innovative pre-user acceptance testing (UAT) simulator. Available now and at no additional cost, the simulator allows clients to submit test messages and determine whether they will be "acknowledged" or "negative acknowledged" by GTR's trade message validation process. For negative acknowledged messages, the simulator flags why the message has not been acknowledged so firms can adjust their messaging specifications accordingly—and proceed to UAT later this year with confidence.

For SFTR, GTR has structured its UAT phases in order to support both vendor and client testing. It will be making downloadable testing scripts available to clients.

Cappelletti explained: "Furthermore, our UAT environment will be live from August 2019, which along with this structured approach to testing will help avoid a last-minute free-for-all that can occur with new regulations as go-live approaches."

Continuous improvement

"Besides our platform, testing tools and training modules, something else sets GTR apart from the competition: we continuously adapt our client support to respond to the needs users bring to our door," Dwyer said.

She added: "We assimilate best practices by participating in the Consortium for Service Innovation and the incremental investments we've been making across support are reaching an apex to coincide with our SFTR launch."

Among the improvements is the move to knowledge-centred support, with solutions to commonly asked client questions organised by topic to help GTR respond quickly and resolve issues consistently.

What's more, GTR is integrating the Agile methodology into its client support system.

Cappelletti said: "Our software developers in the Asia-Pacific region employed Agile in building out our new portal there. Now we're extending Agile's squad-based collaborative practices beyond IT applications to the delivery of client service. It's a groundbreaking use of Agile that will laser-focus us on streamlining our responsiveness at every step of our client interactions."

Clients are taking note of GTR's client support performance. In DTCC's latest Brand Equity Survey, conducted in December and January, the company's brand attribute ratings registered the largest increase in Europe, thanks to positive feedback from GTR users. Furthermore, GTR clients overall reported significantly increased engagement with the business and showed greatly improved perceptions over the past five years in areas like proactivity, reliability, expertise and client focus.

Dwyer commented: "We're extremely proud of the level of support we offer our clients. This enhanced client support model, along with DTCC's ongoing commitment to mitigate risk, automate processing, enhance transparency and drive down costs in transaction reporting enable us to deliver a compelling SFT offering to clients in Europe and beyond over the coming years."

Increasingly complex landscape

ISLA's Andy Dyson says over the last 12 months, the demands and expectations of association members have changed considerably

Maddie Saghir reports

What is ISLA working on at the moment?

Since we gathered as an industry in Lisbon last year, the demands and expectations being placed upon our members and various stakeholders have changed considerably. This has led to a notable investment in both people and infrastructure to support the industry across a number of different disciplines. Not unexpectedly, the Securities Financing Transaction Regulation (SFTR) figures prominently in much of what we do, and we now have a dedicated team that is working through the broad array of implementation issues with our members between now and Q2 2020 when the first reports are due. While SFTR does dominate much of our technical work, we are also looking at the implications of Central Securities Depositories Regulation (CSDR) and how the arrival of fines for failed settlements and mandatory buy-in regimes will force us to change our behaviours, particularly in the post-trade world. Notwithstanding the very real focus on the imminent arrival of these important pieces of regulation, we are also thinking more broadly about the future of our industry, including the development of greater and more efficient settlement and communications protocols through common domain models (CDM). In many ways, CDM's are the immediate manifestation of the future in our world today. While we recognise the importance of developing robust and scalable reporting and trading infrastructures, we are also looking at how we can develop access to new markets and different ways of unlocking securities lending liquidity. In particular, we have begun looking at how we may add to the debate around the development of securities lending capabilities in the Middle East. The arrival of Saudi Arabia with global indices such as MSCI and FTSE will drive expectations from global investors who will want to trade efficiently in and out of these markets.

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What trends are you seeing in the securities lending space?

In the post-crisis world, securities lending has become an increasingly complex business that is driven by many binding constraints on both sides of the transaction that can change over time. While this complexity creates challenges, it also offers opportunities to those that understand this changing landscape as well as those who can capitalise on them. One of the clear messages we have seen from talking to market participants from all elements of the value chain is that creativity and flexibility are key drivers for success in the industry today.

What are you expecting to be the big talking points at the ISLA conference in Madrid?

We have a varied and diverse agenda in Madrid this year, with many new speakers and topics not normally associated with this event. In addition to our normal mix of technical updates and interactive panel sessions, I would highlight the elements of the agenda that are devoted to the changing role of technology, and in particular the tokenisation of assets and the development of smart contracts. We are also very fortunate to have Steven Maijoor, the chair of the European Securities and Markets Authority, with us again this year. His perspectives on where we are today as an industry and what we might expect to see next will be a 'must see' for all delegates.

Is the industry becoming more collaborative as a result of SFTR?

This is a very interesting question. We all live in a world where most, if not all, of our member's firms compete with each other. Having said that, there is also a growing recognition and appreciation that associations such as ISLA can do certain things on a collaborative basis. Much of our work in the legal space has for many years allowed member firms to leverage the ability that ISLA has to obtain netting enforceability opinions at a single price point, thereby reducing unit costs and providing legal certainty. More recently, SFTR has brought with it many common issues and problems where a common collaborative approach has allowed many minds and experiences to identify specific issues. As many firms essentially have the same set of problems around SFTR and to an extent CSDR, it also makes economic sense to pool resources and share costs. Much of the work ISLA is currently doing around SFTR is driven by those combined objectives of knowledge sharing and the mutualisation of development and implementation costs.

You recently said that SFTR is forcing the industry to shine a light on often long forgotten elements of its trading and settlement infrastructures, could you explain this further?

There is no doubt that many of the systems and market practices in securities lending have been with us in some form for many years, and there is always a propensity to put off today what you can leave until tomorrow, particularly if it requires capital investment in the business. Rightly or wrongly, the business around the legacy Agent Lender Disclosure (ALD) process is seen by many as being out of step with the current regulatory landscape especially in respect of trading transparency and new client approvals. SFTR is driving institutions to review many aspects of their business including how the current ALD process will sit alongside or even instead of SFTR data flows.

Over time, I would expect most firms to want to dispense with the legacy ALD trading information as SFTR data flows will be more timely and accurate through the adoption of broad industry standards such as legal entity identifiers.

What will ISLA be working on in the next 12 months?

As we look out 12 months, there are some clear elements of what we are doing today that will still be with us this time next year. SFTR has a feeling of inevitability about it, although I would hope to see the first reports produced by this time next year. As we get closer to go live with SFTR, CSDR will feature more prominently as firms think about how they minimise the more extreme elements of this regime.

ISLA has a key role to play around CSDR and working to define better more efficient post-trade operating standards. I would also like to think that the work we are doing today to better understand how CDM's can be applied to our markets, will have begun to change the way we look at future technology and settlement infrastructures.

I also anticipate that we will be increasingly more active in looking to unlock assets in jurisdictions including the Middle East, where I expect to see greater momentum behind the development of a more broadly based capital markets ecosystem that will attract international institutional investors.

Finally, we should not forget that we still have to be ready for the UK leaving the EU at some point and the arrival of a very different parliamentary structure in Brussels later this year. **SLT**

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Adapting to change

Panel participants

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Mark Jones
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Simon Nottage
Head of product development, EMEA
State Street Securities Finance

Simon Tomlinson
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Leading market participants discuss how the European securities finance market is adapting and adjusting to the current changing environment

How is the European securities finance market currently faring and what trends are you seeing?

Simon Tomlinson: It's certainly been a mixed start to the year and follows on from a slower Q4 2018, with revenues down year-on-year.

The European securities finance space is feeling the effects of the political stalemate over Brexit and while there was a hope we might see a second-half jump in demand after a March exit from the EU for the UK, the delay until late October has in all likelihood pushed that back into 2020. This is further compounded by the US and China trade tensions and the potential knock-on effects that will be felt in Europe.

Negative interest rates, general spread compression, lack of specials, a short sale ban in Wirecard, de-leveraging and political tension do not make for good reading and these are all playing their part in the current market conditions.

Mark Jones: It's been a challenging start to the year following strong performance from multiple asset classes last year. Continued focus on regulatory capital with borrowers maintaining investigations into methods which encourage efficiencies. Borrowers are seeking access to capital efficient beneficial owners, or those with less challenging netting opinions, so-called 'segregated lending' or 'smart buckets'.

The recent addition of pledge, as opposed to the traditional title transfer, also highlights the strong desire of our counterparts to seek capital efficiencies. Specifically, collateral switches continue to be sought in fixed income markets as banks look to satisfy liquidity ratios, though a narrower basis swap has led to a reduction in returns more recently. In equity markets, we have seen a further shift in demand from hedge funds with a quant bias. These strategies typically employee low latency execution and require the highest level of trade automation. Northern Trust has benefitted in this respect given our commitment to automated trading.

Ben Challice: Last year was a watermark year in many respects, but the European securities finance market in 2019 remains robust. On the demand side, trends include a further drive towards efficient borrowing—borrower defined lending, 'smart bucketing'—along with greater levels of borrower internalisation. This is translating into demand from borrowers for more tailored trade structures and increasingly automated solutions, resulting in more efficient borrowing. We see little sign of this abating.

While pledge has been an industry hot topic and key ask from borrowers for several years, uptake to date has been somewhat muted. Several factors could be contributing to this, starting with the current business cycle where the absolute binding constraint seems to be revenues rather than balance sheet or capital. Other contributors are greater levels of internalisation, use of synthetic structures and even central counterparties (CCPs). Despite limited use, pledge remains a core part of our offering and we expect to see balances increase steadily through 2019 and into 2020.

Following the inclusion of Saudi Arabia in the MSCI, we're seeing an increase in borrowing enquiries. We welcome the work that the International Securities Lending Association (ISLA) cross-industry working group is doing to help open this potential new lending market.

On the supply side, we have seen more assets come into lending programmes across beneficial owner sectors/types and a diverse ange of counterparty types. This increase in supply, against a relatively flat borrower demand, poses a challenge for agent lender on two fronts: seeking the right type of assets to bring into lending pools (along with the right type of collateral flexibility), and developing solutions to ensure their client base remains relevant and attractive to borrowers.

Finally, while environmental, social and governance (ESG)-focused investing has been on beneficial owners' agendas for some time, we are seeing renewed interest especially across recalls for voting and demand for wider ESG-compliant collateral sets. We expect ESG to increase in prominence and are working with our clients and the wider industry to provide ESG-enabled solutions.

Simon Nottage: The landscape is changing as a response to increased regulation and developments in technology. Trends including the adoption of technology, combined with increased levels of transparency, have resulted in higher levels of engagement across market participants looking for integrated financing solutions. Overall, there has been a reduction in yield enhancement trading, which when combined with tightening spreads, has ultimately led to increased volumes and activity. The move to non cash collateral and collateral optimisation has continued to develop and will remain a core component of the securities finance ecosystem.

Ross Bowman: Although often viewed as slow to adopt change, the securities lending industry has demonstrated its resilience to all manner of events over the years and continues to deliver strong returns. Last year was a good revenue year for the market, with double-digit revenue percentage increases over 2017.

Against a backdrop of low capital market volatility, as seen through the CBOE VIX Index, lendable and on loan balance inventories remained stable across Q1 2018/19, seeing only a marginal 4 percent drop in average utilisation across all asset classes.

However, the return to lendable (RTL) over the same period fell by 12 percent as traditional European equity seasonal trading volumes reduced and spreads on high-quality liquid assets (HQLA) government bonds fell, impacted by the reduction in demand to finance bank balance sheet assets and the termination of the ECB PSPP in December 2018.

This picture was echoed in the hedge fund industry as, although alpha generation on the whole has been positive in Q1 2019, long biased fund strategies have been the success story as global equity indices have continued to climb.

With the Brexit and US/China trade negotiations still in play and the potential for broader market volatility and financing costs to increase, it is likely that there will be a positive knock-on impact on securities lending revenues.

Are you seeing increased automation in Europe's securities lending market?

Challice: Yes, absolutely. When we talk about automation in securities lending, it's important to think how creating and harnessing automation in and across pre-trade and post-trade enables a more seamless end-to-end transaction flow and better client experience.

The use of tools such as next-generation trading (NGT) has allowed far greater connectivity and automation over the last few years. The need for this connectivity is evident: at an industry level, there are ~$2.2 to $2.3 trillion of on loan balances at any one time, of which 80 percent are classified as general collateral (GC), typically below 20 basis points. This volume simply can't be processed manually, and NGT offers an elegant solution. We have approximately 70 percent of all agency trade flows already automated with further growth expected, driven by fixed income borrowing (particularly government bonds).

Automation significantly reduces operational costs and risks, and also allows trading teams to focus on more high-value revenue opportunities and the overall client experience, where technology and data are vital enablers. The ability to aggregate and analyse large data sets support better-informed trading decisions, the identification of new revenue opportunities aligned with each beneficial owner's investment mandate, and enhanced performance information.

Nottage: The environment is developing along with two key themes; automating pre- and post-trade processing and the adoption of new technologies. Participants are developing and integrating automation. Part of the securities finance strategy is to adopt and leverage platforms to improve the pre- and post-trade efficiencies. The adoption of new technologies, such as artificial intelligence (AI) and distributed ledger technologies (DLT), is happening as part of a wider transformational change at group levels which will feed into securities finance. This combined approach is necessary to maintain market position and deliver innovative client solutions.

Jones: The levels of automated trading deployment continue at a pace but there is still some way to go. Northern Trust has invested heavily to position ourselves as a market leader and benefits greatly from frictionless trading. The aforementioned growth in quantitative-based trading strategies is emphasising this all the more. Borrowers are increasingly focused on executing and pricing securities lending transactions with lenders in as frictionless a way as possible, as they seek to reduce execution latency and reduce human touch in the trade lifecycle.

EquiLend's NGT is viewed as an important tool to leverage in this regard, as the industry looks at ways to increase efficiencies across global trading desks. Northern Trust's significant capital investment in the integration of NGT within its proprietary trading platform is allowing us to continue to be recognised as a market leader in this increasingly important part of an agent lenders product offering.

The role of new technology such as AI and robotics undoubtedly have a role to play in the future evolution of the industry. At Northern Trust, we are actively working with these new technologies in order to identify ways to enrich everything from trading strategies and data analytics to operational efficiencies.

We also believe that blockchain (or DLT) can have a transformative impact on the industry, as has been discussed over recent years. We believe this technology has multiple applications and can help deliver significant benefits, including increased transparency, enhanced risk management, and operating efficiency. What is interesting is the increase in the practical application of the technology in various markets that are now occurring, there's a new story on this almost

The European securities finance space is feeling the effects of the political stalemate over Brexit

Simon Tomlinson
Head of trading agency securities finance, EMEA and Americas
BNY Mellon Markets

every day. Northern Trust already has a track record of integrating this technology into other areas of its business, and we remain focused on exploring opportunities to deploy it across our capital markets business.

Bowman: Yes. However, due to the over-the-counter (OTC) and un-commoditised nature of the securities lending market, automation has largely been confined to back-office reconciliation processes through the application of technologies offered by companies such as Pirum and DataLend to drive operational efficiency. Triggered, at least initially, by the broad-based adoption of trading technologies such as DataLend, NGT, and more recently spurred on by the enhanced connectivity that will be required under the Securities Financing Transactions Regulation (SFTR), there is a palpable sense that true innovation within the industry lies just around the corner. More than at any other time in the history of the industry, we have seen an explosion in technology start-ups right across banking and capital markets businesses, all looking for opportunities to disintermediate the historic chains that have been synonymous within the securities lending industry, particularly: beneficial owner—agent— borrower—hedge fund. With the overwhelming drive by banks to efficiently manage collateral inventory across their businesses, technologies that help firms reduce the significant capital costs of doing business and generate enhanced automation across all aspects of the product life-cycle will help drive down fixed costs. Businesses that are service providers within these participant chains will need to be more nimble than ever, adopting change through a combination of in-house and externally-sourced solutions.

Tomlinson: Yes, automation is key to any successful participant in this business. This ranges from the basic straight-through processing (STP) trading of the low margin, high volume business via a platform like Equilend or directly via our own trading platform up to the use of AI and machine learning to improve pricing and the way we look to distribute our client's assets.

At BNY Mellon, we have made a major commitment to our securities finance business in terms of technology and infrastructure. For example, in December we purchased the securities lending intellectual property from Trading Apps. After a successful multi-year relationship and the accelerated pace of change taking place in the industry, we felt it advantageous to firmly take control of the direction of the product positioning us to lead change, quickly being able to adapt the programme and position us to deliver increased opportunities to our clients.

We are excited by the potential ahead of us.

Ultimately, we are all being asked to do more with less and there is only one real way you can do that which is by automating manual processes, improving connectivity and creating smart solutions for both clients and counterparties.

How can technology be leveraged in the collateral space?

Nottage: Technology is a key driver in providing collateral management and optimisation solutions. The new transparency regimes will make data more readily available and force increased automation to improve settlement levels. The application of prudential regulations (Basel III) has led to an increase in the use of non-cash collateral and structures to manage the risk-weighted asset (RWA) usage, such as English law pledge. It is anticipated that the improved market-wide data and digitisation of the operating environments will allow further developments in collateral management with portfolios to be actively managed across different limits. This will also allow increased correlation and new structures to be added.

Tomlinson: Technology already plays a huge part in the collateral space, as lenders and borrowers would not be able to manage the complexity of their collateral requirements without it.

In the near term, the digitisation of collateral schedules and the workflow around their agreements will reduce the time to market. With the mobilisation and optimisation of collateral a key factor for any borrower, the ability to do that easily across multiple collateral boxes becomes a huge differentiator for any tri-party service provider. BNY Mellon's tri-party offering has these capabilities either live or due

"Northern Trust has invested heavily to position ourselves as a market leader and benefits greatly from frictionless trading"

Mark Jones
Head of securities lending, EMEA
Northern Trust

imminently, and during the course of this year we will see wider use of our online collateral schedule platform, RULE, which simplifies the schedule set up and maintenance, and ECPO, which provides continuous portfolio optimisation across borrowers; various collateral holdings.

Beyond these important developments, the discussion around tokenisation continues and it will be interesting to see how that progresses.

Bowman: Technology will continue to play an increasing role in supporting securities lending players' crucial needs for efficient management of their collateral pool. The integration between Tri-party collateral agents and trading or matching platforms is now offering a full STP post-trade chain for collateral management and a solution to meet SFTR requirements.

Technology should now be leveraged to facilitate the negotiation and the day-to-day management of eligibility schedules. But where technology will also need to play a key role is around anticipation and optimisation of collateral allocation across activities. Simulation engines should enable a consolidated view of collateral activity with associated eligibility terms and selection criteria to be built. This should serve to better anticipate needs and make the best use of the collateral to be allocated across all trading relationships.

New ways to exchange collateral and improve settlement using technology such as blockchain will definitely drive us towards new capacities, more flexibility and opportunities.

Challice: While technology has been an increasing differentiator for collateral management for many years, the speed and demand for change is increasing and is multi-faceted. As the collateral ecosystem looks to build increasingly automated and sophisticated tools, all actors within the end-to-end collateral flow have different challenges to solve for. This demands a collaborative approach as one participant cannot create a solution in isolation, and there's an opportunity for a solution that targets one problem to have much broader application.

As one example, the drive for increasingly sophisticated optimisation by collateral providers cannot be tackled by developing a best-in-class optimiser as a standalone solution: you need to approach the problem holistically. Without up-to-date eligibility schedules, exposure calculations and available inventory, even the best optimiser will be ineffective. To be effective, optimisation needs eligibility schedules to be digitised in order that they can be automatically consumed. When schedules are digitised, the end-to-end workflow to update them can then be industrialised through user interfaces and application interfaces.

Another example would be asset mobilisation. Industry players and technology need to combine to reduce friction in the movement of assets in order to increase efficiency in liquidity and optimisation. As an enabler, a unified global collateral management platform can help to quickly mobilise and optimise collateral across regions and legal entities. More broadly, tokenisation is widely discussed as a possible technological solution that would foster liquidity, asset mobility and velocity along with other, as-yet-unknown, benefits.

How is regulation impacting the industry in Europe?

Bowman: In recent years, conversation in the industry has been dominated by regulation and its impacts. Regulation focused on investor protection such as the second Markets in Financial Instruments Directive (MiFID II) and the European Securities and Markets Authority (ESMA) has driven changes in market practices and financial conduct, while Basel III regulation has placed additional requirements on banks to maintain higher levels of capital and liquidity.

SFTR and the Central Securities Depositories Regulation (CSDR) are challenging market infrastructure and practices. The real test for the industry will be how the market copes with the reporting obligations under SFTR next year.

Nottage: The new regulatory regimes, such as CSDR and SFTR, are a central focus for market participants and require a significant amount of allocation of both personnel and budget resources. All indications from local regulators seem to suggest that the implementation of a

> *Automation significantly reduces operational costs and risks, and also allows trading teams to focus on more high-value revenue opportunities*

Ben Challice
Global head of Trading Services
J.P. Morgan

firm's regulatory solution will be closely scrutinised and penalties will be applied for insufficient adherence. The increasing cost of providing securities lending may lead to possible market consolidation where smaller participants may exit due to the cost of compliance, while the new market level transparency is encouraging new asset owners to look at participating in a securities finance programme.

Jones: SFTR and CSDR dominate the regulatory agenda at present. We've talked about SFTR for a number of years now, and with the deadline now set, efforts across the industry is intensifying.

CSDR presents a different set of challenges but could be potentially just as impactful. The settlement discipline regime that comes into force later in 2020 will demand that the industry becomes as efficient as possible in terms of trade matching and settlement if we are to avoid the fines and mandatory buy-ins that are being introduced.

As a lender, we will need to consider the things we can do to ensure our instructions are timely and that any issues are resolved quickly.

Frequent buy-ins as a result of failing returns would be detrimental to the beneficial owner client base and risk of reduced supply exists if we get this wrong as an industry. The work ISLA are doing around the best practice is going to be helpful, and it's interesting that the end goal of efficient trade booking and settlement practices will also have overlapping benefits for SFTR.

Tomlinson: Regulation is not new and has been an ongoing theme since 2008. However, it does feel as though 2020 will finally see the end of the larger development initiatives such as SFTR and CSDR.

Right now you may argue that a significant amount of tech spend and resource has been focused on meeting these regulatory demands, and this has limited the discretionary level of spending on developing solutions to enhance productivity and revenues.

However, you only have to look at how the market has evolved and continues to develop to know that is not the case. Regulation, while in most cases costly to implement, has also brought about a significant opportunity for those able to quickly adapt.

For example, in June 2018 we printed our first pledge transaction and saw steady growth in balances which will continue as more lenders sign up. In H1 2019 we will be looking to clear our first European SFT via Eurex and this again will be something that will gain traction as regulators are keen for this to become more widely utilised. These developments have come about because of the challenges new regulation has placed on businesses and the need to become efficient in the use of financial resources.

So while regulation has, without doubt, had a significant impact on the industry, it has also brought opportunity in the form of new trade structures and routes to market, with more focus on the efficient use of limited resources.

Challice: SFTR is the single biggest shift in the industry on the horizon and, given its scale, could drive consolidation in the securities financing industry. If that consolidation is combined with effective solutions and offers, it could present a significant opportunity to create a more efficient market. SFTR, along with CSDR, will also affect the collateral space. As significant undertakings for the industry as a whole, the hope and expectation is that implementing these regulations might drive further industry collaboration, data standardisation and technology solutions. Uncleared margin rules segregated initial margin rules are quickly coming into scope for the buy side in September 2020. Although primarily a derivatives conversation, providing an end-to-end solution brings together a number of core competencies offered by securities services providers: custodians providing control accounts, collateral managers agreeing and exchanging initial margin and securities financing transforming available securities into eligible collateral. While none of these services is new, served collectively they create a solution that is greater than the sum of the parts for institutions adapting to regulatory driven change.

Across the board, regulation continues to dominate in terms of how both borrowers and lenders manage to binding constraints—driving the need to find solutions that optimise collateral structures, such

The increasing cost of providing securities lending may lead to possible market consolidation

Simon Nottage
Head of product development, EMEA
State Street Securities Finance

as pledge, CCP, collateral allocation methodologies and inter-entity structures.

How is your firm preparing for SFTR?

Challice: We are working closely with all affected parties to prepare for SFTR. On the industry side, we've engaged with both ISLA and ICMA to ensure that we are in line with industry best practices for reporting under SFTR as we work through the roadmap, and are working with ISLA to respond to the consultation on guidelines for reporting under articles 4 and 12 of SFTR released by ESMA on 27 May 2019.

We are partnering with our clients to make sure they are aware of SFTR and the service we will provide to them for reporting, and working with borrower counterparties to ensure they are aware of how we aim to share data with them to support their SFTR reporting obligations. The key technology components are in an advanced development phase and we expect to begin testing with vendor partners and counterparties later this year in order to have sufficient time to identify and address any issues. We are also beginning to formulate the target operating model that will support the SFTR reporting service.

Tomlinson: BNY Mellon began its SFTR project around two years ago, and over that time we have been an important contributor in the refining of the regulation, both with the regulator directly and via the excellent work of the industry associations.

As one of the first agent lenders to sign to a vendor solution in the third quarter of 2017, BNY Mellon is leveraging existing post-trade data feeds to provide near real-time, legal entity identifier-level transaction and collateral data, as well as UTI allocation.

As a result, we are already in the early stages of data provision and have the ability to reconcile with similarly connected counterparties. Despite having no direct obligation under SFTR, we fully understand the importance of the role that agent lenders will have to play in the provision of assisted/delegated reporting solutions for their clients and, as importantly, the provision of data to in-scope counterparties. This is also why a partnership with a vendor solution was chosen since the connectivity for both reconciliation and the dispersal of data would have been difficult to achieve in isolation.

In preparation for the April 2020 'go live', we intend to continue to dedicate resource to the industry associations in the defining of reporting 'best practice', the ongoing collation and refining of loan and collateral data, and look to begin testing as soon as possible as the best way to ensure the accuracy of our data and that of our in-scope borrowers.

Jones: We are in the midst of our preparation for SFTR with multiple workstreams active. We are working closely with our vendor and technology teams on the core system build we need to produce the data in the right way, and at the same time analysing our processes across front office and operations to ensure that the data we are producing is as accurate and complete as possible before it leaves our organisation.

Through this process, we are definitely seeing that a lot of firms we speak to are more comfortable with the mechanics of the requirement, and are switching focus to less obvious impacts such as how their own long-established practices fit in with the regulation and what they might need to change to get their reporting right. Overall, the industry will benefit from this exercise and we'll come out of it understanding the way our counterparts manage their processes better than ever before. This can only be a good thing for market efficiency, standardisation, and automation.

We've also stepped up our client communication programme to ensure the lenders on whose behalf we will be reporting are well informed and have the information they need to be comfortable with the progress and end result of the implementation.

Bowman: SFTR and MiFID II have driven the shift in demand across the securities lending market, where financial regulation has materially impacted the level of balance sheet capital banks and broker-dealers can allocate to borrowing securities. Such regulation has reduced demand as the cost to borrow through a securities lending transaction has increased and alternative financial instruments including the use of synthetics and swaps have emerged to provide banks with a similar level of desired market exposure but at a reduced balance sheet cost.

> ***SFTR and MiFID II have driven the shift in demand across the securities lending market***

Ross Bowman
Senior relationship manager, securities lending
BNP Paribas

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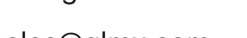 sales@glmx.com

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At BNP Paribas, we are addressing the needs of our clients who are required to report under SFTR. Under a dedicated bank-wide transversal project, we have partnered with IHS Markit and Pirum, collating all the requirements now known under the final operating model. We are fully committed to providing our clients with the necessary reporting to fulfil their requirements under the regulation, whether this is through providing reporting to our clients or reporting directly on their behalf.

Nottage: State Street is fully engaged and working collaboratively with different parties across the securities finance ecosystem in building a scalable operating model that will support current and future business volumes to provide the data, governance and reporting to meet the regulatory requirements. State Street has engaged with vendor platforms to support the operational matching and reconciliation of trading and the management of collateral to develop the required reporting solutions for the trade repositories. There is an open dialogue with both borrowers and lenders to socialise the State Street solution and our response to these regulations.

What are the biggest challenges that the industry faces?

Bowman: Aside from macro-economic and market factors that impact our industry, enhanced regulation in the form of SFTR and CSDR remain a primary focus of attention for market participants. Although an incredible amount of time and resource is being consumed across the market in readiness for these regulations, they are not the only challenge on the horizon.

Borrower demand and behaviour should also be a key area of focus as the increasing cost of balance sheet capital for a securities lending transaction has reduced borrower demand and pushed banks and broker-dealers towards synthetics and swaps as alternative instruments for financing. The consideration of pledge collateral over title transfer has gained much traction in the last 12 months and it is widely expected that the adoption of Pledge will become increasingly important for the industry's longevity going forward.

Nottage: Regulations, and how they are implemented globally, are a central challenge. The new regulatory regimes will disrupt current operating and technology models and necessitate a change in the workforce to be able to respond to these changes. The ability of participants to react and adapt quickly to these changes will be a key challenge.

Tomlinson: In the short term, the regulation still remains the biggest challenge for the industry. A number of the post-crisis rules have come into force already and some of them are due to go live in 2020 and onwards, all bringing with them significant change.

The industry will be focusing on SFTR and CSDR, as they are on the horizon now, the former brings about a reporting regime like nothing we have ever seen before, and the scale and cost of development to meet this requirement is as significant as the amount of information that will be flowing to the regulator.

CSDR will change the way we lend, the buffers that are held, and may reduce liquidity as lenders ensure they do not create unwanted fail activity. This will require significant attention and effort, necessitating both technology and process change.

Jones: Borrowers are increasingly discerning around the clients they wish to transact with. The type and jurisdiction of the underlying beneficial owner have increasingly become a deciding trading factor as country risk classifications drive appetite and RWA usage. This may negatively impact client performance and revenue if remedial measures are not established. This will likely be in the form of pledge, CCPs, collateral expansion, and stability guarantees, for example.

In addition, regulation continues to prompt a greater focus on technology. Firms who have not taken a good look at their systems architecture and made efforts to move with the evolution of available technology will likely struggle to remain relevant in this fast-moving marketplace.

Challice: The challenges we need to address with the highest priority would be compliance with the three upcoming regulations which will have a specific impact on securities finance. Whilst SFTR and CSDR may be European in origin, they will have an extraterritorial impact and are likely to change trading behaviour. For these, we'd like to see better industry consensus in terms of operating models; the fact that ISLA continues to have open questions on 50 fields demonstrates the level of uncertainty around how SFTR will be implemented.

There a number of other challenges/inefficiencies related to the industry, many of which are not new but are increasingly in the spotlight as their impact on financial resources becomes more evident. Unfortunately, it's impossible for one organisation to fix these in isolation and the market participants mostly seem focused on the implementation of their own regulatory solutions.

How is the securities finance industry in Europe dealing with Brexit uncertainty?

Challice: There has been an active dialogue with our clients and counterparties with respect to their and our plans to deal with each potential outcome of Brexit. We feel confident, that given our footprint across the UK and Europe, that there will be no disruption of business whatever the outcome.

Jones: From a trading perspective, the Brexit impact has thankfully been relatively light so far. We have witnessed some borrowers open European entities which have led to some contract repapering and new agreements in some instances—the same for some beneficial owner clients as well. In terms of market specifics, while demand for UK gilts has declined in recent years, this is largely following the trend of other highly-rated sovereign issuers, thus Brexit cannot be fully blamed. In equity markets, there remain pockets of demand for Brexit-related stocks, such as home builders, autos and financial services. However, the full impact will not be known while the political uncertainty remains.

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Tomlinson: Looking at the first three quarters of 2018, one would have said Brexit was having little or no impact outside of discussions on operating models post-Brexit, as well as the potential need to set up documentation with new entities that were being considered.

However, in the first quarter, the wider political tensions—of which Brexit was a part—took hold. Leverage was reduced and has not come back. Like BNY Mellon, most firms worked diligently towards the 29 March initial deadline and had everything set up prior to that, so all the extension has done is prolonged the already muted demand to borrow.

Nottage: Many participants have implemented Brexit plans and strategies to support their business in Europe and the UK with the key goal of ensuring that impacted clients continue to have a seamless service and are unaffected by possible political changes in the future.

Looking to the future, what opportunities do you see on the horizon for Europe's securities finance industry?

Tomlinson: Despite the slow start this year, I remain confident the future is bright for the industry. The influx of new assets to lending programmes and new routes to market will continue as additional revenue streams are sought; technology will continue to play a huge part in connecting the buy and sell side; regulatory compliance will drive demand for HQLA. This will only increase as phase 4 and 5 of the uncleared margin rules come into force.

Interestingly, these markets seem to be able to shrug off bad news and political tension much more easily than in the past but at some point, volatility will be back providing an opportunity for the market.

Nottage: The ability to offer securities finance solutions through different channels; for example, State Street is developing a new product offering Direct Access. This new product introduces the concept of peer-to-peer lending, bespoke structures and new collateral arrangements, to ensure businesses can run efficiently and profitably in line with the new regulatory regimes. Being able to retain and attract key talent is essential to remaining competitive and developing integrated client-driven solutions. This is where deep client relationships will require a combination of strong business understanding with technology and possible solutions.

Jones: The use of automated processes, algorithms, and self-learning programmes, largely encompassed under 'machine learning', offers an exciting opportunity for the industry.

Additionally, beneficial owners who have flexibility within their programme parameters will be well positioned to take advantage of future opportunities. This may be in the form of non-standard collateral acceptance, or via new trading structures or routes to market.

The ongoing expansion of the industry's global footprint continues to represent an exciting opportunity. While opportunities in Europe are more limited, the neighbouring Middle East represents an exciting new prospect. As this region looks to diversify their economy away from their reliance on hydrocarbons, governments are seeking to encourage greater foreign investment.

The implementation of securities lending and covered short-selling programmes will be key as they look to develop their capital markets capabilities. In Saudi Arabia, the authorities have already implemented a series of new regulations to help facilitate securities lending and covered short selling, the first for a Gulf state. More work is required to deliver a workable operating model, however, this represents an exciting development in a region that offers significant long-term potential.

Another noticeable change will come from the increasing demands of our clients to offer a suite of products. The days of securities lending as a standalone offering are in the past. Clients are increasingly looking to their asset servicers and agent lenders to provide the infrastructure they need to run their business as efficiently as possible. This may be as simple as mobilising collateral for margin purposes or deploying/raising capital, through to more structured initiatives in order to satisfy regulatory requirements.

Challice: Putting a positive spin on my previous comment, if the industry gets this right we will all have better, timelier data in standardised syntax which will then allow both pre- and post-trade inefficiencies to be addressed.

Before that, though, the settlement discipline which CSDR requires will create new demands to borrow securities (to facilitate timely settlement), as will the third of the three regulations we mentioned—Phases 4 and 5 of the uncleared margin rules. While this isn't directly related to securities finance, the need for a joined-up solution to let clients mobilise their assets in the most efficient way--alpha generation from lending versus cheapest-to- deliver to meet their margin obligations—calls for a joined-up approach between custody, collateral management and agency securities lending. We believe this to be a large opportunity for organisations who can provide a connected outsourced solution to clients to achieve that goal, and is a key priority for us.

Bowman: Charles Darwin said that "the species that survives is the one that is able to adapt and adjust best to the changing environment in which it finds itself". Our industry is no different. Revenue opportunities continue for lenders of specials, general collateral and collateral swap/high-quality liquid assets transactions. However, the extent of these opportunities is a fundamental question. Annual lending returns fluctuate as a result of underlying market volatility and macro-economic and political events. A successful lending industry will, therefore, need to continue to adapt to change. Pledge, CCPs, regulation, adoption of environmental, social, and governance criteria, amongst others, will play an increasingly important role in the development of the industry over the coming years, to maintain revenue stability and growth. **SLT**

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Eye of the tiger

While many investors are incorporating ESG into securities lending programmes, it's not on everybody's agenda, so the industry must keep the risks of inaction in sharp focus

Maddie Saghir reports

Environmental, social and governance (ESG) has become a hot topic in the financial services industry but ESG investing should not be looked at as the 'latest trend' because, according to industry experts, it is here to stay. Currently, the planet's oceans are being disrupted, the forests are being destroyed, and devastating changes are happening to the climate. We're also facing a global poaching crisis but WWF found that wild tiger numbers are on the up for the first time in conservation history, and China has committed to banning all trade in ivory. This offers a gleam of hope—we still have time to act.

Christian Nolting, CIO of Deutsche Bank Wealth Management, points out in his 'CIO Insights Reflections,' that the risks of inaction are substantial. Inaction has negative consequences for the world we live in and comes with concrete economic and social costs.

Nolting noted: "Environmental negligence can destroy our living space, without attention to social matters we sacrifice human capital

and hence productivity, and, finallsy, lack of governance creates wrong incentives. It's no secret that wrong incentives tend to have a negative impact on the environment, but what all too often goes unnoticed is that they can have a deleterious impact on long-term financial performance as well."

Andy Dyson, CEO of the International Securities Lending Association, explains that ESG investing refers to a class of investing that is also known as 'sustainable investing'.

He cited: "This is an umbrella term for investments that seek positive returns and long-term impact on society, environment and the performance of the business. Sustainable finance includes a strong green finance component that aims to support economic growth, whilst reducing pressures on the environment, addressing greenhouse gas emissions, tackling pollution, minimising waste and improving efficiency in the use of natural resources. In light of the growing political and social focus on issues associated with climate change more broadly, investors are increasingly looking to align their investment strategies with these greener credentials."

A natural step in the securities lending landscape

Recently, NN Investment Partners (NN IP) analysed every aspect of securities lending and ESG, and discovered the areas that overlap. Xavier Bouthors, senior portfolio manager, securities lending, NN IP, explained: "We adapted these areas to be compatible with our ambition to be a leader in responsible investing. We see this as a natural step in the evolution of the securities lending landscape."

Also from NN IP, Martin Aasly, senior portfolio manager, commented: "The first thing to highlight is that our responsible investing team cannot engage with companies if the voting rights have been passed on to someone else. So, every security needs to be available for voting, which may sound simple and obvious, but it requires a solid process of monitoring record dates and issuing recalls when necessary."

Bouthors affirmed: "Another area that we see impacted by ESG in recent times is the exclusion of securities that do not fit our ESG requirements for investment. These also need to apply to collateral received under securities lending. These 'exclusion lists' were once tricky to incorporate but are now adopted by tri-party collateral agents as part of a push from beneficial owners."

He continued: "Asset managers have also had to evaluate their approach to the potential issues arising from differences in fiscal status between assets and fund domiciles. Asset managers should conduct their securities lending activity in a way that complies with local tax rules, and seek to avoid entering into securities lending transactions for the purpose of improving their tax position. At NN IP we have measures in place to prevent the facilitation of such trades."

Aasly added: "Finally, a common perception of securities lending is that it facilitates shorting and that shorting is bad because it undermines the value of long-only portfolios. However, the notion that securities lending is incompatible with ESG because it facilitates short selling is a misconception. We believe in efficient markets in which short selling plays a crucial role. This is well established and documented."

Dyson highlighted that in keeping with a responsible investing approach, institutions are able to tailor their lending programmes to adhere to specific stewardship codes of conduct, as well as the Shareholders Rights Directive and the Principles for Responsible Investment.

He said: "We are also seeing some institutions screening their counterparties to ensure that they also comply with broad ESG criteria. At a more granular level, individual ESG funds may not be able to lend currently as they are only able to accept collateral which complies with the parameters of the fund. This may not always be readily available."

"Institutional investors or shareholders, although one step removed from the day to day governance of a company, do have a responsibility to scrutinise the activities of the management of the company around this and other related ESG factors. Exercise of that responsibility can come through ensuring that they vote at important shareholder meetings, etc. In the context of securities lending, it is important that any investor has a clear policy around governance and in particular recalling securities to vote at Annual General Meetings (AGM) and Extraordinary General Meetings."

Dyson also noted that through the development of best practice and operating protocols, it is possible for an institutional investor to still discharge its governance obligations while capturing securities lending revenues as appropriate.

Easing the path to a solution

Discussing potential cost barriers, Dyson argued that the mobilisation of so-called ESG assets within lending programmes should not necessarily attract additional costs. However, Dyson attained that the absence of any meaningful non-cash collateral, ESG compliant collateral buckets is a clear barrier at the moment.

He added: "While recognising that this is not necessarily a simple fix to a complicated problem, we are keen to explore market-wide solutions around establishing best practice and industry standards which may ease the path to a solution here."

Ross Bowman, client management, BNP Paribas Securities Services, observed: "Both data and costs of technology were the top two barriers to ESG integration cited under the 2018 BNP Paribas Global ESG survey of 347 respondents from 16 countries within the global investment community."

"As a result, there is a growing opportunity for global banking groups to provide data and technology solutions to investors that utilise the

vast array of available data while leveraging technology platforms to benefit from economies of scale."

Faryda Lindeman, senior responsible investment specialist, NN IP, stated that ESG integration represents an opportunity to modernise the investment management industry but is a process with hindrances as well as, "a lack of standards for measuring ESG performance; lack of ESG performance data reported by companies; concerns about the underperformance of ESG investments; lack of ESG data from other sources; and costs associated with ESG integration".

Lindeman remarked: "We contest that there is a lack of ESG data from sources other than the companies. This may have been an issue in the earlier days of responsible investing, but nowadays there is a proliferation of ESG data, both in the 'traditional' as well as in the alternative data domain."

"The challenge is more to focus on those data points that are relevant for the business model and financial value creation. There may be concerns around the cost associated with ESG integration, particularly if investment managers feel they need to have access to a multitude of ESG data providers and the extra people to analyse / interpret that, but NN IP analysis shows that responsible investing does not have to cost returns. It may even improve financial returns."

Incorporating ESG

Incorporating ESG into securities lending programmes won't be smooth sailing. Bouthors commented: "There are substantial challenges involved in adapting a securities lending programme to ESG parameters, and it requires both knowledge and expertise in both lending and sustainable finance."

Aasly explained that NN IP monitors the record dates and annual general meetings so that securities are back well in time to vote. He advised that lenders should seek to automate this as much as possible.

Bouthors stated that a key step in incorporating ESG factors is the protection of voting rights. He explained: "So we maintain the right to recall and restrict our securities at any time to engage in shareholder meetings. This is embedded in the securities lending process where our Responsible Investing team, who oversees governance responsibilities, monitors securities for voting."

"We then recall the securities and restrict them from lending until voting is concluded. This ensures NN IP can always exercise its voting rights and prevents 'empty voting'."

Aasly noted that just as their approach to responsible investing excludes certain types of business activities for investments, the same principles apply to collateral received. He commented: "NN IP applies dynamically adjusted exclusion-lists of both equity and fixed income securities with triparty collateral agents to ensure only eligible securities are used in any trade with NN IP."

Bowman added: "Ensuring strong programme governance, providing a high degree of flexibility on what securities are accepted as collateral, tailoring cash collateral investments and providing lenders with an 'ESG related score' to facilitate the benchmarking of borrowers from a sustainability perspective, are tenets that are fast becoming key focus areas for lenders."

Increasingly important

While ESG is becoming increasingly important for investors, the demand for further education in this area has heightened. Recently, Chartered Financial Analyst UK launched a new qualification in ESG investing, which will be available to investment professionals later this year. The Certificate will be the first formal qualification on ESG investing available sector-wide investment professionals in the UK.

This increasing interest to engage and educate investment professionals on ESG investing stirs some cause for optimism.

Bowman suggested that institutional investors are making investment decisions based on the long-term sustainability of a company, and not just its financial performance. He added that such decisions, reflect on the values of that investing company.

He added: "Lenders are beginning to reshape their securities lending programmes in line with the ESG tenets they are adopting more broadly across their business and investment practices."

Meanwhile, highlighting further cause for optimism, at NN IP, Lindeman observed the opportunities of ESG and found a strong link between the longer-term positive impact of ESG integration and improved risk-adjusted returns, in addition to its effects on the well-being of both society and the environment.

She outlined: "Aside from that, we are convinced of the benefits of integrating ESG information into the investment process for our equity, fixed income and multi-asset strategies. ESG is relevant because it relates to both corporate competitiveness and the strategic choices companies make."

"Focusing on ESG factors enables our analysts to unlock potential value by identifying the associated opportunities and/or risks, which fund managers then use as the basis for their investment decisions. Focusing on ESG also ensures that we live up to our values, and demonstrate good corporate citizenship. It helps us better align our core business with the broader expectations of society."

Going forward with a sense of optimism, the risks of inaction must be kept in sharp focus. As Sir David Attenborough recently pointed out: "It may sound frightening, but the scientific evidence is that if we have not taken dramatic action within the next decade, we could face irreversible damage to the natural world and the collapse of our societies." **SLT**

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Building from the base

David Lewis of FIS explains that before moving onto AI and machine learning, the industry needs to strengthen its foundations first

Maddie Saghir reports

What types of behaviours are the likes of SFTR, CSDR, and UMR driving in the securities finance industry?

The Securities Financing Transactions Regulation (SFTR) is a trade reporting requirement and in many ways, it shouldn't be over-thought—it is what we do, and it is how we work. Other parts of the financial markets have been through this already with the European Market Infrastructure Regulation (EMIR), for example.

Driven by SFTR, lots of people will have to look at the nuts and bolts of their trading systems and behaviours, potentially needing to change the way they're booking things to make sure they're getting it right. In addition, we as an industry, will need to fix some of the fundamental structural issues we are facing.

In a data panel at the Securities Finance Technology Symposium, it was discussed that firms need to have the right foundations. It can be tedious to some, and we'd perhaps rather talk about artificial intelligence (AI), machine learning and all of the other shiny bells and whistles, but you need to get the base technology and data right first.

SFTR will drive the industry to be much clearer about data because it is a regulatory imperative. There are lots of things we would love to do but regulatory drivers mean that you have got to comply with regulation otherwise your business is over. SFTR is all about getting that data martialed at the right place and at the right level. For example, legal entity identifiers (LEIs) need a reference to every single entity. LEI's are just one of a multitude of changes that can make our industry so much better in terms of efficiency and technology. SFTR is going to do a lot to make us change behaviours and, in the long run, adopt some much needed best practice approaches.

Central Securities Depository Regulation (CSDR) is one regulation that is creeping up behind us, and it is all about settlement certainty. If we don't get some of these settlement behaviours right, then there will be fines. One of the unintended and not necessarily positive consequences of CSDR is around the periphery of market participants. Some market participants will not take the risk of lending a security, particularly if it is illiquid. People want settlement certainty and the illiquid stocks, by definition, can be harder to settle and thus carry more risk. This could lead to a reduction in the lendable supply of harder to settle assets, raising the risk of settlement failures, not reducing it.

Uncleared Margin Requirements (UMR) is another interesting topic. You've got the steady reduction of the thresholds in which you are required to post margin. We've gone from the seven biggest firms to the next 35 becoming eligible this September. The next charge, in September 2020, will affect just under 900 more firms because the next threshold drops dramatically. Suddenly, you've got lots of other firms that weren't involved before who have now got to post margin that was never required before. From the securities finance industry's point of view, it could be a great demand driver.

It is also something that we have to structurally think about because while a sudden uptick in demand is great, we've got to be able to manage it and make sure our systems are prepared. A lot of the topics discussed at symposium were about efficiency and automation; meeting these demands effectively is all part of that.

How will UMR affect the trading of non-centrally cleared OTCs and the future of collateral management?

I could argue that the trading of non-centrally cleared over-the-counter (OTC) transactions will start to become centrally cleared. When you think about what some of these regulations—such as SFTR—are trying to do, they are nudging the industry towards exchanges. The regulators love exchanges because they are transparent, efficient, and arguably more secure. There are lots of mechanisms there that regulators like, so, reading between the lines of SFTR, it is encouraging the use of central counterparties and exchanges. With UMR, it is uncleared OTC derivatives that are being targeted.

A recent study showed that few firms are fully compliant for the UMR due to be implemented September this year, why is this? What advice would you give to firms who are not yet compliant?

People are somewhat behind the curve; part of this is due to people's one-by-one approach. If an organisation is not willing to put their money into investing what is required, then the regulators will no doubt take a dim view of their approach.

When EMIR went live, those who didn't have an LEI could not trade, it was as simple as that. The regulators are strict. If you are not going to post margin on derivatives in line with the regulations, then don't trade derivatives.

What challenges will CSDR present the industry with?

It is all about settlement certainty. However, people are not convinced that settlement efficiency is that bad. Some argue that it is a little bit of a sledgehammer to crack a nut.

A large part of the securities finance industry is about ensuring settlement certainty and that is where it started many years ago. It was a back-office operation undertaken to raise settlement certainty, for example to reduce failure rates through the borrowing of assets.

When we think about the fact that the regulators are now trying to codify that and say "you must do that and if you don't then you're going to pay a fine", in some ways it is over-egging the situation as nobody wants to fail, and many take stringent measures to avoid it already.

Failure rates are lower than we think; the very industry that is trying to stop them—and makes its living, partly at least, out of stopping them—is potentially going to be impacted by this. It might be the lower liquidity end of smaller organisations, the lower liquidity stocks, the very things you really want to be available in an emergency because something is failing. It might be the ones who say "no, I won't lend you that for fear of a fine". So, we potentially have a negative impact.

Will it really improve behaviours? I'm not sure that behaviour is bad. People don't go out of their way to fail on purpose.

Do you think firms will fully utilise technology to help overcome challenges associated with SFTR?

Yes, I do. If you don't apply heavyweight technology to SFTR then you will fail. When we think about some of our largest clients at FIS, they might have half a million outstanding positions that can generate more than a million life cycles per day, all of which are reportable to the European Securities and Markets Authority (ESMA). Those lifecycle events have up to 80 matchable fields in them. Having a number of employees trying to solve that in any sense manually will simply fail. Think of the enigma code and how they had to break it over a 24-hour period, and once that 24-hour period had gone, all work on it was gone too. The daily reporting of transactions under SFTR will be a lot like that. If you are going to be reporting 1,000,000 life cycles a day, when the cut-off ends for that day, you're starting again. If you have made one error on one matching field in 10 percent of those trade messages, which is very conservative, it is actually 100,000 breaks that you're building up every day. If you don't fix them then by the end of the week it is 500,000 breaks. You have to apply heavyweight technology to cope with that. As I said earlier, the right approach would be to avoid these breaks in the first place by focusing on the foundation data and accurate processing. Getting the basic stuff right will pay significant dividends in the end.

Your technology has to be in a position where you're able to send every lifecycle event to ESMA. ESMA wants to be able to audit from start to termination every single transaction. In order to do that, they need every life cycle event because if they jump one then the front is not going to meet the back. The importance of technology, and applying that technology thoughtfully, is an absolute prerequisite to success with SFTR. The industry is being driven into the dark corners that we didn't really worry about before and we have to get that stuff right. We need technology to meet the complexity of requirements that ESMA is asking for.

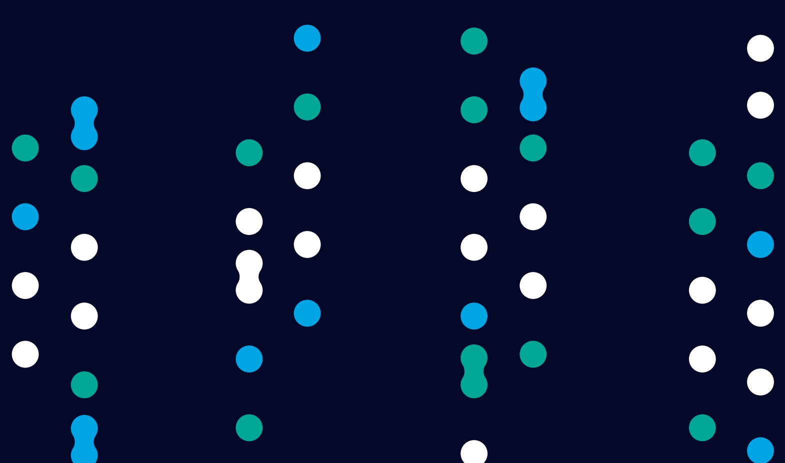
In a panel at the Symposium, the moderator asked panellists if they thought ESMA knows what is coming in terms of the tsunami of data. And, I'm not sure they do. We're talking about a million life cycle events per day from just one of our many clients. The quantities of data are absolutely enormous. It is going to be interesting and a little bit worrying at the same time. The International Securities Lending Association and the International Capital Market Association are trying to help ESMA understand what they're in for. There is so much data to sift through that I do not envisage any meaningful analysis or response from ESMA until some time after SFTR goes live.

How prepared are firms for SFTR? Do you think there will be a large number of firms who will not meet the deadline in Q2 2020?

There is a very wide range of readiness. There are some organisations who have had people and budgets in place for some time. They are coming to us and saying: "give us another version of the software, what have you built so far, we're ready to test, we're building our own internal mechanisms". There are some organisations who are absolutely on it and there are some who have only recently said that they've come to the decision that they want our system, and they have less than 12 months until go-live.

Now that a date is known, people can put a project plan in place. For some organisations, up until that point, the people who hold the budgets and hold the priority lists have said until they know when they have to comply they are not going to do anything. Therefore, there are different states of readiness. I would suggest very few are not going to make it. They have to. It is a date you have to meet. If you don't you're breaching your regulatory responsibilities, and if you do that, then you are not trading.

I think an interesting variation of the question would be, "how many people are going to make a mess of it?". They may be live and they are putting data over the wall to the trade repository, but is it correct? Much of the assessment each nationally competent authority will make, will probably include how much effort and commitment the reporting firm has expanded on SFTR. Firms that can demonstrate effective preparation and testing, for example, will likely be in a better position than those that cannot. SLT



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View from the CCP

As Eurex Clearing's CCP service continues to establish itself, Deutsche Börse Group's Mathias Graulich discusses the outlook for the Lending CCP

Topics shaping the securities lending market globally are concentrated on the crucial areas of legislation and regulation as well as infrastructure and technology. More precisely, meeting the continued demand for collateral optimisation, the legal challenges surrounding Brexit, the implementation of Central Securities Depositories Regulation (CSDR) and Securities Financing Transactions Regulation (SFTR) and the drive for the enhanced use of technology solutions across the entire securities lending process.

Ongoing developments have driven market participants to analyse the impact on their securities lending businesses. Regulatory changes introduced under European Markets Infrastructure Regulation in Europe and the Dodd-Frank Act in the US were put into place to reduce systemic counterparty and operational risk and imposed the requirement for financial counterparties to centrally clear eligible over-the-counter (OTC) derivative trades and to post initial margin and variation margin against non-cleared derivatives transactions.

As a result, there is an increasing shortage of high-quality collateral in the market. The scarcity of high-quality liquid collateral is stimulating the demand for collateral transformation using securities lending as a key mechanism.

Creating and maintaining cost and capital efficient trading strategies

Market participants strive to implement beneficial capital cost-efficient methods of trading via electronic platforms and utilising central clearing as a form of safeguard. Central clearing will continue its onward march and become even more important to the market as it leads to greater safety and integrity in the financial markets. The driving factor is to continue the transformation of the securities lending market from a non-standard, bilateral OTC model to a more progressive and sustainable operating model.

We believe that our clients and key market players are fundamental to drive the growth and transformation of central clearing for the securities lending market

Service features

Eurex Clearing's Lending CCP covers loans in European equities, Exchange Traded Funds as well as international fixed income assets. Direct CCP access for beneficial owners via a specific lender license, provides significant benefits to market participants. It preserves the relationship-driven business structure and at the same time delivers the capital efficiency and safety associated with central clearing. The Lending CCP reduces counterparty risk exposure and eliminates the need for multiple credit evaluations. As part of Deutsche Börse, Eurex Clearing is the only infrastructure provider with an integrated clearing offering across derivatives, equities, securities lending and repo transactions.

Challenges and opportunities

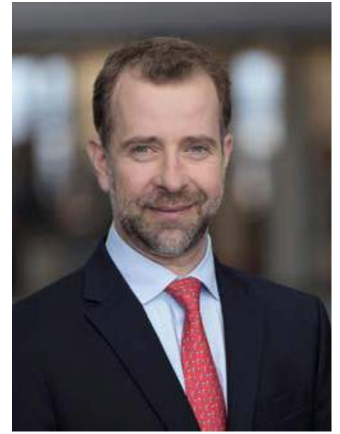
The challenge for Eurex Clearing is to continue to engage and bring committed participants together to identify and form the next steps towards transforming the securities lending market. Eurex Clearing is uniquely positioned to encourage dialogue on strategy and initiatives that drive the delivery of a new phase of market access for securities lending with the aim of shaping the growth of CCP utilisation for the securities lending market. A key focus is to continue our collaboration with clients to bring innovation to the market. At Eurex Clearing, we believe that our clients and key market players are fundamental to drive the growth and transformation of central clearing for the securities lending market.

At the end of last year, we hosted a 'CCP Think Tank' meeting with the objective to bring committed participants together to identify and form the next steps towards 'building a market'. As a result, the Lending CCP Strategic Committee was formalised and a number of primary work streams were identified. The Lending CCP Strategic Committee consists of BNY Mellon, BlackRock, Citi, EquiLend, J.P.Morgan, Morgan Stanley, Natixis and Pirum, has met monthly in 2019 to achieve a committed and streamlined approach for the development of the Lending CCP service.

Outlook

As far as the Lending CCP is concerned, Eurex Clearing looks forward to maintaining its role as a leading market infrastructure provider and partner to our clients. As safety and integrity are also objectives that buy-side and sell-side market participants have in common, Eurex Clearing anticipates further demand for its innovative Lending CCP service. The Lending CCP has major buy-side clients and agent lenders operative on its service and continues to extend the range of clients, markets, and assets into our offering. As a result, we expect the daily average on-loan volume to steadily increase for both equity and fixed income segments.

Mathias Graulich
Member of the executive board, Eurex Clearing AG, global head of fixed income, funding and financing strategy and development
Deutsche Börse Group



Opportunities emerge for UK equity lenders

Sam Pierson of IHS Markit discusses the state of equity lending revenues so far in 2019

- Average fees for 'specials' on the rise
- Increased willingness to pay for hard to borrow shares
- Q2 UK equity VWAF highest since 2017

Year-to-date UK equity lending revenues through May 2019 are 16 percent below the same period of 2018. This lackluster start to 2019 is only slightly better than total EU equity lending revenues, which are down 22 percent year on year. Despite the backdrop of lower revenues, utilisation and return to lendable, there is some cause for optimism on the part of UK equity lenders. Namely, an increase in the average fees for 'specials', or stocks with exceptional borrow fees, relative to the first half of 2018.

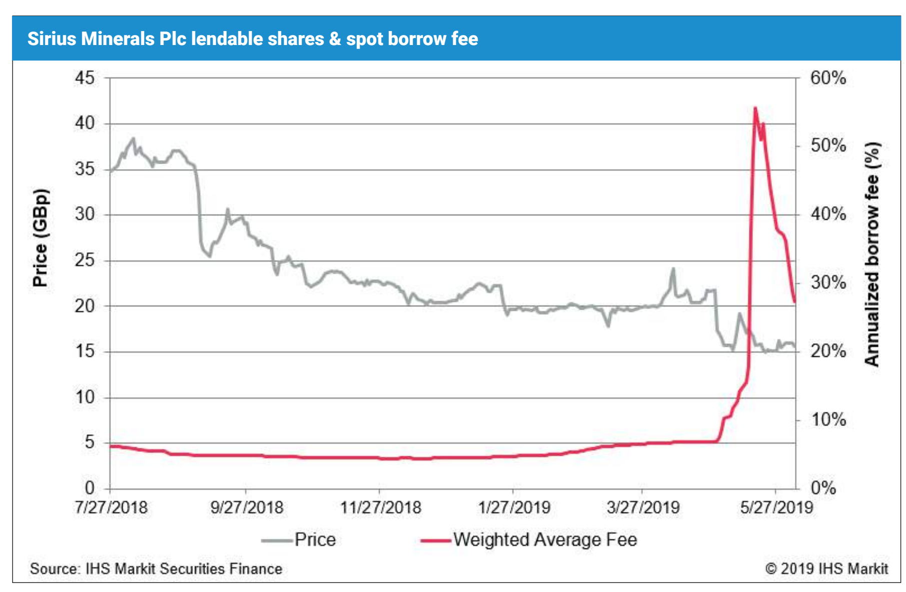
Filtering UK equities to those with average fee greater than 200 basis points, there has been a notable increase in the average fees, suggesting a greater willingness to pay for the most in-demand shares. One standout is semiconductor firm IQE, whose weighted average fee has been greater than 10 percent since October last year. The increasing fees and loan balances were sufficient to make IQE the most revenue generating UK equity in Q4 2018 and Q1 2019. While fees have trended down on the margin year-to-date, IQE is still the third most expensive to borrow UK equity with more than $100 million in balances.

Metro Bank has the second highest fee for a UK equity with significant loan balances. The lender's share price has declined more than 50 percent year-to-date amid concerns regarding classification of commercial loans (which resulted in the bank holding lower reserves). Shares on loan have surged as short sellers seek to maintain a position above $100 million while the share price declines. The increased borrowing demand has pushed the utilisation of lendable shares above 90 percent, which has coincided with the increased fees.

The materials industry group contains some of the most revenue generating UK equities. The significant balances in Anglo American made it the second most revenue generating UK equity in Q1, despite having a low average fee. Sirius Minerals is an emerging special in the sector, with hedging activity relating to the firm's convertible bonds driving a portion of the borrow demand, however the timeline to profitability for the firm's potash mine may also be attracting directional short bets. The spike in borrow fees in May made Sirius the most revenue generating UK materials stock this quarter to date, pushing past Anglo American. While the fees for new loans of Sirius shares declined over the last two weeks of May, they still have the highest average fee for a UK equity with at least $100 millon in balances.

Other UK equities leading the increase in special balances include Blue Prism Group, Amigo Holdings & Victoria Plc. While the balances are quite low, Purplebricks Group deserves a mention for being the only UK equity whose weighted average fee is greater than 100 percent annualised. The weighted average fee for UK 'specials' increased from 600bps to 800bps over the twelve months ending 30 May.

Despite the rally from the Q4 lows, the broader UK equity market is still more than 10 percent below where it started 2018. The lower share values have reduced lendable assets by 6 percent over the first 5 months of 2019 relative to the same period in the prior year. Frustrating the potential for higher utilisation, loan balances have declined by even more (15 percent). The decline in balances has put pressure on lending revenues and returns to lendable, despite the lower lendable base. The increase in fees for specials are helping to establish greater value for lending programmes, despite the overall drop in balances. The higher fees for specials are pushing up on overall fees, with Q2 weighted average fees for all UK equities on pace to exceed 50 basis points for the first time since Q4 2017.



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In your best interest

The Great White North

The strength and stability of the country's securities lending market was reinforced at the Canadian Securities Lending Association's 9th Annual Conference, and panellists suggested positive change is happening in Canada

Maddie Saghir reports

The Canadian securities lending market's reputation for strength and stability was once again reinforced at this year's Canadian Securities Lending Association (CASLA) Conference in Toronto.

Panellists at the conference discussed some of the foundations of Canada's reputation: its experienced market participants, proven infrastructure and a prudential regulatory regime that works in collaboration with market participants, and the country's interaction with the rest of the world.

The conference kicked off with a global economic update presentation by Benjamin Tal, managing director and deputy chief economist, CIBC, who indicated that the global economy is currently in a fog of uncertainty. Tal observed that 2017 saw a peak for the global economy, but it has dipped since then. This was partly down to political concerns, but the speaker said in 2017 there was "a rush" for "cheap money".

Despite the global economic slowdown, the US pushed against this trend. Tal said this was a "short-term gain", but could result in "long-term pain" for the US.

Elaborating on this, he added: "Usually, governments stimulate their economy when it's down—not up—but Trump provided an extra lift that it did not need when it was high."

Meanwhile, in a panel on regulation and funding, speakers suggested that positive change is happening in Canada after the Canadian government revealed it was to make changes to a variety of federal tax laws earlier this year. Discussing the tax laws, Christopher Steeves, Fasken Martineau DuMoulin LLP, said that "withholding tax rules applicable to certain cross-border share lending arrangements were amended in response to perceived withholding tax avoidance".

He commented: "Canadian non-resident withholding tax generally only applies where certain payments (including dividends interest) are made by a resident to a non-resident of Canada. Domestic rate of withholding tax is 25 percent. Rates may be reduced or payments may be exempt under an applicable tax treaty."

The panel also pointed out that under the Canada-US tax treaty, Article XXI exempts US pension funds from Canadian withholding tax on interest and dividends. According to a speaker, interest and dividends may also be an example of where the beneficial owner is entitled to claim sovereign immunity.

For securities lending arrangements completed prior to 19 March, Steeves explained that compensation payments in respect of loaned corporate shares paid by a Canadian resident borrower to a non-resident lender were characterised as interest for withholding tax purposes unless the loan was fully collateralised.

Steeves noted that fully collateralised means, that throughout the term of the securities lending arrangement, the borrower provided collateral with a value not less than 95 percent of the value of the loaned shares.

He stated: "Securities lending arrangements completed prior to 19 March, where a loan was fully collateralised, compensation payments in respect of loan corporate shares paid by a Canadian resident borrower to a non-resident lender, were characterised as dividends. Dividends would be subject to Canadian withholding tax. The new characterisation rule applies to compensation payments on or after 19 March unless the payments are pursuant to a written arrangement entered into before 19 March."

In that case, the new rule will apply to compensation payments beginning in October 2019, Steeves added.

The moderator asked panellists if the supply-side is sufficient right now. Speakers confirmed that a number of firms have indicated that there is a significant amount of supply and it could have a significant impact on pricing.

One speaker predicted that there is a big plumbing change coming to the industry. The speaker explained that the changes involve the futures having a liquid market, making sure that the swap conventions are consistent as well.

Meanwhile, during a panel that had a regulatory focus, panellists discussed the European Securities and Markets Authority's (ESMA) Securities Financing Transactions Regulation (SFTR) Level III consultation paper and warned that this could present the last opportunity to make changes.

Following ESMA's deliverance of its Level III guidance on 27 May, Tamela Merriweather, senior vice president, assistant general counsel,

Northern Trust, said: "SFTR is coming and this consultation paper probably presents the last opportunity to make changes, if any. The consultation paper asks for comment on a number of things and seeks feedback. It also clarifies what is in scope and out of scope for SFTR."

Merriweather noted that one of the hurdles for non-EU participants will be the need to obtain a legal entity identifier (LEI).

She continued: "ESMA expects to see reporting on all securities financial transactions whether or not they're settled, and it was disappointing to see they took this broad view of the scope of transactions to be reported."

"In terms of key risks, I would say that it will be interesting to see what sort of access non-EU beneficial owners will want to have or continue to have to the EU markets. For so many years we have been on a path toward globalisation, will we now see trends toward domestic portfolios or will beneficial owners accept the increased regulatory demands of cross-border activity?"

Glenn Horner, managing director, State Street, cited: "Different regulators go down different paths in terms of getting the information they want. The US thought the European regulators were going well overboard. We also have the other issue with Brexit. I'm not sure SFTR is going to offer any stability to the market. And it's a huge financial resource for the technology to deal with it."

Later in the panel, the moderator asked panellists if they thought SFTR is driving technology opportunities.

In response, Michael Norwood, associate director, EquiLend, said: "The industry has to become more efficient and precise. Operational processes and reconciliations have to be done in a more timely manner because of the upcoming SFTR and Central Securities Depositories Regulation rules."

"As a result, you have to take advantage of tools today, whether it be automation or reconciliation tools. The more you take advantage of the technology, the easier it is going to be to comply with the regulatory regime that is coming."

Technology, challenges, and opportunities became topics of discussion during one panel entitled 'Industry leaders—the current and future state of securities lending', and Robert Goobie of Healthcare of Ontario Pension Plans, explained that challenges "encourage us to think differently, and to think differently means coming up with new solutions".

Goobie cited: "Solutions such as changes to the legal doc combining master repurchase agreement (MRA) and global MRA since all these functions are been centralised. We should consider other forms of credit rating not the standard S&P etc."

Some of the challenges the panel discussed included trading in different time zones. To help overcome this challenge, one panellist stated that they leverage operational groups and technology, understanding the trading rules for each market, and communicating trading requirements is very important.

On the topic of technology, France Boisjoli, head of securities finance, equity market, Caisse de dépôt et placement du Québec, stated: "Two major elements that helped support growth is technology and engagement of our support teams. Technology is an essential factor in achieving efficiency."

Boisjoli continued: "Automation has always been an integral part of our business, and I believe that if something can be automated then it should be."

The panel agreed that the industry has come a long way since the financial crisis, and Boisjoli explained: "Securities lending used to be more of a 'back office' business and was done with no regard for the optimisation of the collateral and its composition, cross-asset trades, liquidity as well as balance sheet optimisation, legal and tax regulations, and the risk profiles of counterparties."

She added: "However, the 2008 financial crisis and the regulations that came after have changed the landscape of securities lending forever. This was complex and while it posed a lot of challenges it also poses a lot of opportunities. We have changed significantly over the years and thus developed our businesses as a result."

During the panel that gave a buy-side perspective on securities lending, one speaker suggested that shorting is more of an art than a science. The speaker suggested that shorting is more of a thesis. They said: "Your initial thesis might be blown, and so re-evaluating your thesis is very important."

The moderator asked: "When I think about shorting, it is incredibly difficult and there are lots of challenges to it, how do you establish a thesis around it and how do you execute it?"

One speaker replied: "We look for red flags—for example, bank statements—and we take these and look deeper into them. A big part of what we look for on the short side is high yields."

The moderator then asked panellists if they had spoken to a management team with the preconceived notion that you want to short them.

One panellist replied: "Interviewing the management teams is a key part of our process. Questions, for example, include 'if you could only sell through one product what would it be?'."

They explained: "Questions like this help to probe thinking better. You don't become a CEO unless you're an excellent sales person, people will tell you the most optimistic perspective on it. It is about getting them to tell the full story, such as a series of interviews." **SLT**

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4 Tables
6 Reports
10 Action Types
Reports vs Action Types

Field by field analysis of ESMA's validation file
Table 1
Table 2
Table 3
Table 4

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New September dates

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Moves at GLMX, Elixium, DeltaOne and more

GLMX has appointed Andy Wiblin as chief product officer.

Wiblin previously held a senior position at ION Trading, where he was responsible for business development in repo, securities lending and collateral management products and services.

Phil Buck, managing director of GLMX Europe, previously worked with Wiblin at ION Trading.

Since June last year, Wiblin has been working as an independent financial markets consultant.

Gareth Mitchell has departed Elixium as global head of client relations, sources have confirmed.

According to sources, Mitchell's contract came to the end of its term and was not renewed.

Mitchell started his role at Elixium in November last year and was based in London, reporting to CEO Nick McCall.

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

He served at Citi for more than 18 years.

Mitchell's departure follows Roberto Verrillo's, who left Elixium in May this year.

Femi Orangun has departed DeltaOne Solutions, part of IHS Markit, where he spent more than 15 years as a primary architect of benchmark feed platforms.

During his years as a primary architect, Orangun was intrinsic in the design of the Markit XML feed and the DeltaOne SOLA application.

Orangun has now joined the ULTUMUS team as a solutions architect, to assist in the development of its data platform.

He will also assist in the production of advanced tooling in conjunction with the recent alliance between ULTUMUS and Velox Financial Technology.

Bernie Thurston, CEO, ULTUMUS, commented: "Femi Orangun joining ULTUMUS is a key hire for the business and a firm commitment to bring the most experienced people on-board for further developing our index and exchange-traded fund data, meaning that we are the 'go to' company for anybody who needs timely or accurate benchmark data."

Clear Street has hired Salvatore Cangialosi and Antonio Maneri to work in its expanding securities lending team.

Jack Nicosia has also joined Clear Street as director after leaving his role as managing director at ETC.

Cangialosi joins as managing director, having previously held director and managing director positions in securities lending at Credit Suisse and TD Prime Services, respectively.

Maneri joins Clear Street from his role as executive director at Morgan Stanley, where he developed expertise in securities lending and prime brokerage services across more than 20 years.

The appointments come as part of the firm's efforts to improve the sourcing, locating, clearing and settlement of products and transactions.

Chris Pento, co-founder and CEO of Clear Street, commented: "At Clear Street, we are improving access to financial markets. Funds of all sizes—from startups to multi-billion dollar funds—will use our technology platform to clear and settle transactions."

"Securities lending will be an important part of that platform. Effectively sourcing and locating hard-to-borrow financial products will give our clients the flexibility they need to implement their trading strategies."

He added: "We are bringing together a team of outstanding professionals, each with decades of experience in securities lending and prime services, to lead the development of our securities lending business."

IHS Markit has appointed Stewart Cowan as head of Asia Pacific (APAC) securities finance product, effective from 3 June.

Based in Sydney, Cowen will report to Paul Wilson, managing director and global head of securities finance at IHS Markit.

Cowen will oversee all regional activities with a focus on business development and strategy execution, identifying growth markets and synergistic data sources, and introducing new services and solutions for beneficial owners.

Cowen joins IHS Markit from fintech firm Digital Asset Holdings, where he served as a senior product manager for distributed ledger technology and smart contract solutions.

Prior to this, Cowen served at J.P. Morgan as the APAC head of trading services, responsible for regional business growth and client management in the agent lending segment. Cowen has also held senior roles at State Street and Perpetual Trustees.

Wilson said: "I am delighted that Stewart Cowen is joining IHS Markit to lead the growth of our securities finance product in APAC."

He added: "Cowen has a wealth of knowledge across all our client segments, including borrowers, banks, agents, asset managers, hedge funds and beneficial owners."

"Most importantly, his leading-edge insight on the region's securities finance sector will help us capitalise on significant opportunities to expand our presence there."

Roberto Verrillo has left Elixium where he served as COO, based in London.

Prior to this, Verrillo worked at Nomura Global.

Commenting on his departure, a spokesperson from Elixium said: "Elixium would like to thank Roberto Verrillo for his work and wishes him well in the future."

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