securities lending times

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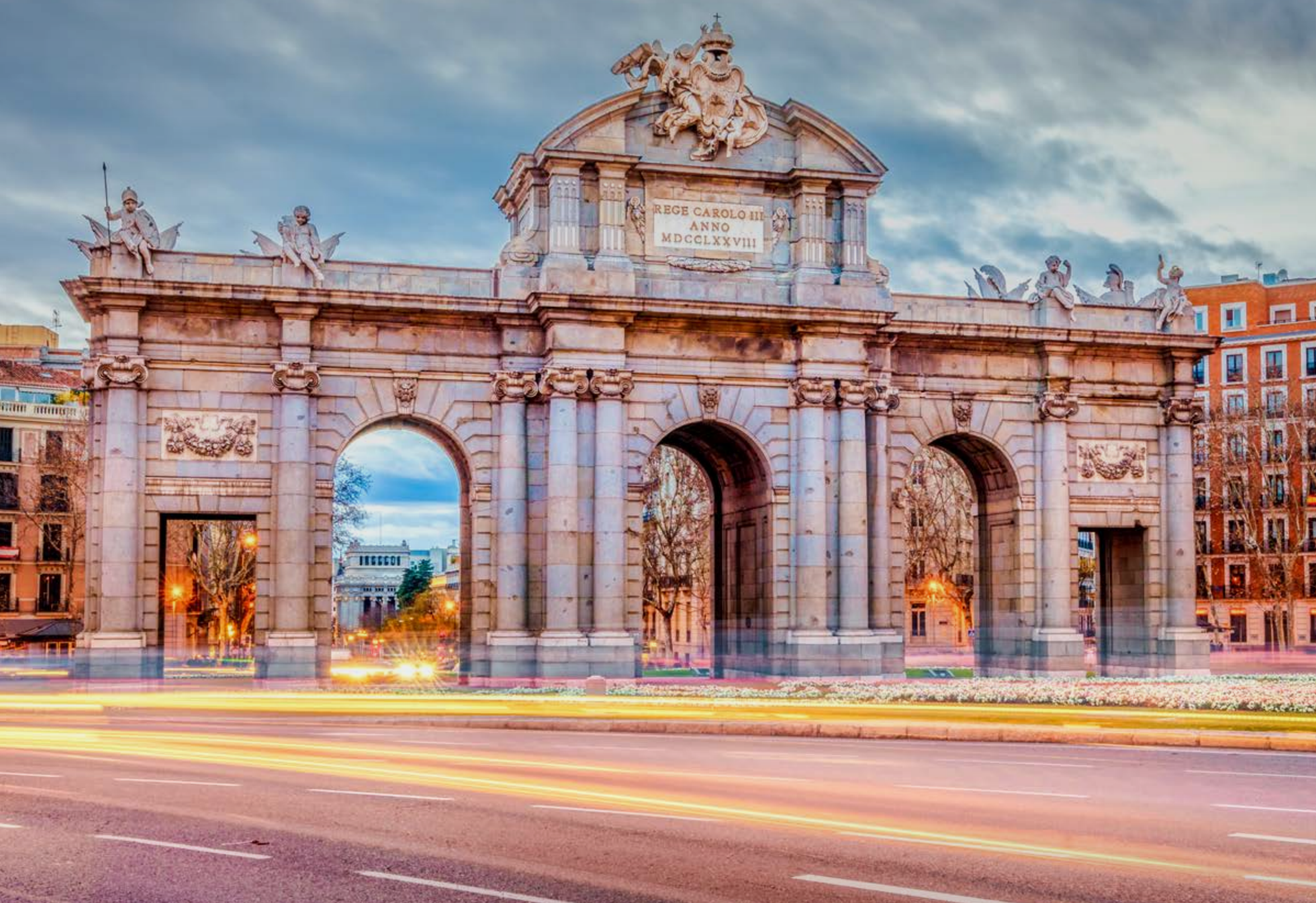
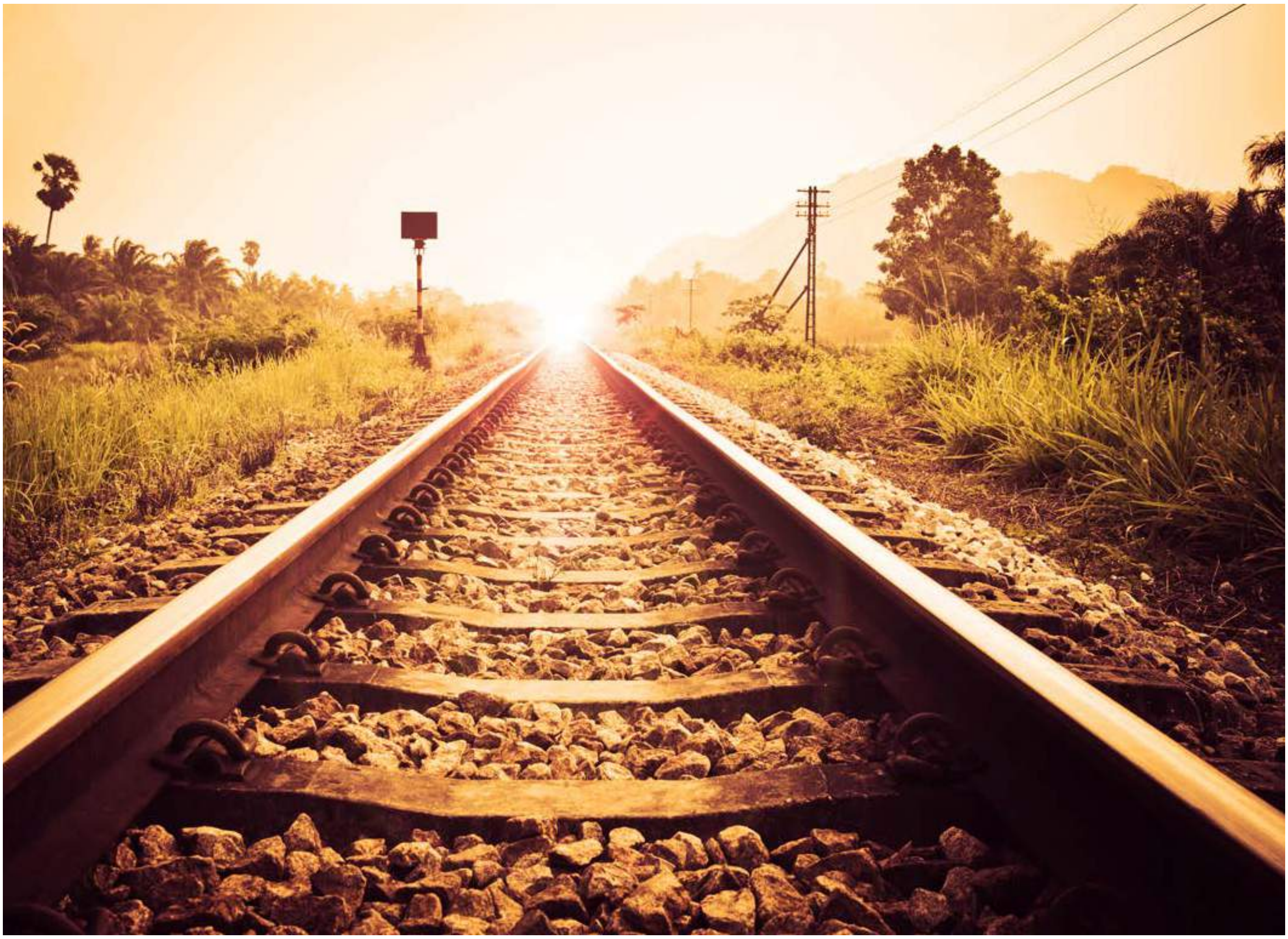
Issue 233 06 August 2019



A decision in sight

Current restrictions in Spain prevent locally domiciled funds from fully engaging in securities lending, but is that about to change?

Fintech regulation | The effect of LIBOR on banks | Data analysis from IHS Markit | Latest people moves



Negotiations are 'on track' for Deutsche Bank

Negotiations are on track for the sale of Deutsche Bank's prime finance and electronic equities platform to BNP Paribas, Christian Sewing, Deutsche Bank CEO, revealed.

The announcement of this negotiation with BNP Paribas comes after Deutsche Bank said it is to exit its equities sales and trading business, while retaining a focused equity capital markets operation, as part of a radical transformation.

As part of its Q2 results, Deutsche Bank reported over 900 employees have either been given notice or informed that their role will be eliminated since the announcement of the transformation strategy.

Deutsche Bank reported that its net loss—as of end Q2—was €3.1 billion after strategic transformation charges cost €3.4 billion euros. Excluding these charges, Deutsche Bank said net income would have been €231 million versus €401 million in the prior-year period.

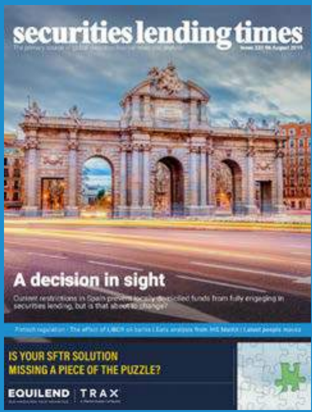
Overall, revenues were essentially flat or growing in more stable businesses, including global transaction banking, private and commercial bank and asset management, which made up 65 percent of revenues in the quarter.

Assets under management were up €88 billion, this included net inflows of €9 billion.

In the first six months of 2019, assets under management increased by €88 billion with cumulative net inflows of €20 billion.

Christian Sewing, CEO of Deutsche Bank, said: "We have already taken significant steps to implement our strategy to transform Deutsche Bank. These are reflected in our results. A substantial part of our restructuring costs is already digested in the second quarter. Excluding transformation charges, the bank would be profitable and in our more stable businesses revenues were flat or growing. This, combined with our solid capital and liquidity position, gives us a firm foundation for growth."

He added: "We're not just at the beginning of our transformation of Deutsche Bank—after two weeks, we're already right in the middle of it. And I'm incredibly optimistic when I think about what I've seen at our bank in that short time."



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Published by Black Knight Media Ltd

ASIC consults on agent lenders role in securities lending

The Australian Securities and Investments Commission (ASIC) is consulting on the role played by agent lenders in securities lending and the market's view of any exemption from substantial holding disclosure.

This follows the ASIC's publication of "Consultation Paper CP 319" on securities lending by agents and subsequent disclosure of a substantial holding in a listed entity.

Meanwhile, the ASIC seeks feedback on proposed legislative relief that aims to improve substantial holding disclosure by these intermediaries, while also reducing red tape.

Danielle Press, ASIC commissioner, commented: "Our focus is on ensuring the market has adequate information on substantial holdings in listed entities, including substantial holdings that are derived from securities lending transactions."

AgentLenderPLUS to launch securities lending portal

AgentLenderPLUS, a Goldman Landow Capital company, is launching a securities lending portal for beneficial owners of US treasury securities.

Lewis Goldman, president and founder of Goldman Landow Capital, will serve as CEO of AgentLendersPLUS.

He commented: "Our US Treasury Alpha PLUS strategy proved within a SEC Rule 2a-7, stable NAV $1, AAA-rated US Treasury Money Market Fund that our strategy is transferable to beneficial owners who engage in securities lending."

Goldman continued: "We are currently in the process of adding relationship managers as we build our distribution effort, while also exploring strategic partners."

Northern Trust enhances global options trading capabilities

Northern Trust has enhanced its global options trading capabilities by establishing a dedicated options trading desk within its institutional brokerages business.

The Chicago-based options desk provides institutional clients globally with options trading and streamlined reporting for prime brokerage.

Options trading at Northern Trust is offered through an agency model with no principal trading operation in order to drive alignment with client interest and best execution practices.

Guy Gibson, global head of institutional brokerage, commented: "As sophisticated investors navigate fluctuating markets, Northern Trust continues to broaden our capabilities to increase speed, provide transparency and manage the market impact, all of which can contribute to investment performance results."

"This new options trading desk demonstrates our commitment to meet the evolving needs of the asset manager and asset owner clients who seek tailored solutions to manage risk and portfolio exposures efficiently across global markets."

Jon Cherry, global head of options, Northern Trust Capital Markets, cited: "From 2015 through 2018, Northern Trust recorded triple-digit annual growth within our options business, with client volume approaching nearly 3 percent of total OCC daily volume, on any given trading session."

Cherry added: "By setting up a standalone options team with dedicated sales, trading and support staff, we are committed to helping investors achieve their goals and objectives."

CACEIS makes public offer for all securities in KAS BANK

CACEIS has made a recommended public offer in cash for all the securities in KAS BANK, which is presented at a price of €12.75 per share, valuing KAS BANK at €187 million.

The offer period started on 29 July at 9:00 hours CET and ends on 23 September 2019 at 17:40 hours CET, unless extended.

Meanwhile, the management board and supervisory board of KAS BANK unanimously recommend the offer.

Completion of the offer is expected in H2 2019 and is subject to fulfilment of the conditions laid out in the offer—including approvals from Dutch and European Central Banks—available from KAS BANK and CACEIS.

Jean-François Abadie, CEO of CACEIS, commented: "We are delighted to be taking these steps towards strengthening our market share in the Netherlands, Germany and the UK."

"This deal is an excellent opportunity to bring significant pension fund servicing expertise into the CACEIS group, together with the professional staff who know the servicing needs of their institutional investor clients. With CACEIS's extensive

geographical footprint and broad scope of services, clients stand to benefit from being part of one of Europe's largest asset servicing groups."

Abadie added: "At every step in the process, clients are our number one priority. Leveraging our extensive migration experience, we will ensure uninterrupted client service and a smooth business migration once regulatory approvals are received."

Wematch expands offering

Wematch has added a Euro Interest Rate Swaps (IRS) matching and negotiation platform for banks in addition to its securities finances and equity derivatives offerings.

The expansion has seen J.P. Morgan, RBC, HSBC and Societe Generale all join the new fintech platform.

Wematch IRS is a web-based, dealer to dealer platform which gives sell-side human traders enhanced tools and workflow to match and negotiate trends.

Additionally, it offers tools to support Euro IRS curves, butterflies, and basis structures, adding to its existing portfolio of instruments, with more to be added in the coming weeks.

Joseph Seroussi, co-CEO of Wematch said: "This is a game-changer for a traditionally underserved but enormously important segment of financial services."

"We have built up our network of users and liquidity steadily, working closely with the dealers at the banks to ensure we deliver functionality to enhance the way these instruments are matched and negotiated."

"The addition of Euro Interest Rates in our product offering opens the door to being a truly cross-asset platform. We are offering dealers a system which gives them total control over how their orders go to market, giving them enhanced protection to mitigate conduct issues and information leakage."

Gregory Mimoun, co-CEO, Wematch, commented: "We are working with the banks to improve the whole process of managing IRS products. We have a very strong pipeline of banks either onboarding now or wanting to join the Wematch ecosystem."

BCBS's deadline extension should not 'slow down' preparations

The delay to implement initial margin rules should not cause market participants to slow down their preparations, according to John Straley, executive director, co-COO, DTCC Euroclear GlobalCollateral.

This follows the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commission's decision to extend the deadline to 1 September 2021.

Straley highlighted that regulators recognise the degree of change the industry had to overcome and worked with market participants to agree on a revised compliance timeframe.

According to Staley, firms should establish whether they are in scope and if so, they should act on the steps necessary to meet the new September 2020 or 2021 deadline.

He commented: "This new paradigm, for a significant number of the 'in-scope' firms, will require for the first time the development of third party operational and control processes to manage collateral and data. This effort needs to start as soon as possible as there are many steps required in order to be compliance-ready. Even with a one year delay, firms will encounter significant challenges in meeting the new deadline."

Clearstream sees Q2 revenue increase

Clearstream, the post-trade services provider of Deutsche Boerse, has revealed that its Q2 revenue increased to €66.7 million, compared to €55 million in Q2 2018.

According to Clearstream, the growth was primarily driven by net interest income from the banking business and could "essentially be attributed to higher interest rates in the US and increased customer cash balances".

Except for GSF (collateral management) and the Xetra (cash equities) segments, all segments increased their net revenue.

Overall, Deutsche Boerse generated net revenue of €724.8 million for Q2 2019, an increase of 6 percent, compared to the same quarter of the previous year.

At €291.5 million, operating costs were down year-on-year, compared to €317.2 million reported in Q2 2018.

In addition, Deutsche Boerse generated net revenue of €1,445.6 million in H1 2019, an increase of 5 percent compared to the previous year.

Gregor Pottmeyer, CFO of Deutsche Boerse AG, said: "In the first half of the year we were able to increase structural net revenue by 5 percent, as planned. In addition, net profit rose stronger than net revenue: the 9 percent growth rate is therefore also in line with the guidance for the full year. Hence, we are confident that we will achieve our goals for 2019."

Synechron launches new accelerator solution for LIBOR

Synechron has launched the Data Science Accelerator for the London Interbank Offered Rate (LIBOR) Impact Analysis.

The accelerator will help financial services firms solve complex benchmarking challenges approaching the 2021 LIBOR phase-out deadline.

In addition, it is set to help financial services tap into a digital and data science toolkit to help drive larger global enterprise transformation initiatives.

The accelerator for LIBOR Impact Analysis enables financial institutions to identify and quantify their LIBOR exposure at either a contract level or across all contracts within an institution.

It can also identify and quantify LIBOR exposure at the contract level, or across all contracts within an institution.

The accelerator then allows contracts to be revalued using alternative rates and valuation models for a dramatic reduction of manual LIBOR impact assessments and enhanced productivity.

Faisal Husain, co-founder and CEO of Synechron, said: "Synechron's Accelerator Programmes are business-driven solutions to complex problems our clients are facing every day. They provide strategies to address rapid changes in the regulatory landscape and digital transformation."

AcadiaSoft enters technology partnership with CloudMargin

AcadiaSoft has partnered with CloudMargin in a new technology partnership that will provide its clients with a front to back process for collateral and margin management.

The service offers access to AcadiaSoft and CloudMargin's solutions via a single sign-on to one platform and provides real-time data and processing information.

AcadiaSoft explained that all parties can view this simultaneously, which will enable end-to-end workflow connectivity.

It will also integrate CloudMargin's cloud-based collateral management service into its core platform to provide a seamless risk and collateral solution.

It set to create a fully integrated and modular infrastructure that allows clients to perform the tasks required across the margin and collateral workflow swiftly and seamlessly, it was revealed.

Chris Walsh, CEO of AcadiaSoft, commented: "Our collaboration with CloudMargin enhances the industry-wide infrastructure that AcadiaSoft has developed for collateral and margin management."

Clients start SFTR testing

Trax, a MarketAxess subsidiary, and EquiLend have begun user acceptance testing (UAT) with phase one go-live clients for their joint Securities Financing Transactions Regulation (SFTR) solution.

According to MarketAxess, clients are testing in a live solution environment rather than relying on mock-ups or simulation.

The live solution environment maximises clients' ability to identify process gaps and development areas head of the SFTR deadline. EquiLend and Trax teams have advised all SFTR-affected industry participants to allow at least six months for testing.

Sunil Daswani, head of business development for securities lending at MarketAxess, commented: "The SFTR implementation deadline is fast approaching, and as we get closer to it the more complex it's requirements appear to be."

"We're delighted, therefore, to have our key clients already into UAT in a live environment—and we urge the broader universe of asset management and corporates out there to do the same."

Fintech regulation

A 2017 survey of European Competent Authorities (CAs) found that "31 percent of fintechs [are] not subject to a regulatory regime under EU or national law".

Having dedicated considerable time during the last five years on regulatory reporting, I am acutely aware of the number of fintech firms that perform mandatory regulatory reporting on behalf of the second Markets in Financial Instruments Directive (MiFID II) investment firms. I don't have figures but would estimate that across the union hundreds (possibly approaching a thousand) of firms rely on fintechs to discharge their reporting obligations.

Leaving aside statistical considerations of even distributions, if we assume these 31 percent of unregulated fintechs are performing roles that are key cogs in the national or European regulatory regime, then there could exist latent operational risk. The European Banking Authority (EBA) also notes: unregulated fintechs are operating in crowdfunding and questions their relationship to Capital Requirements Directive IV; fintechs engaged in Payment Services Directive 2; and Electronic Money Directive 2.

Alongside scores of other fintechs, our firm is among the 31 percent. Our unique trade identifier (UTI) exchange platform is proving highly popular among banks and entities with UTI generation/dissemination responsibilities. Our system is extremely robust and has been stress tested without the slightest glitch, having been built on the power of AWS Amazon's infrastructure. Yet we, and our fellow fintechs, are unregulated. The question is: should all fintechs be regulated?

Regulation is an art:

- Over-aggressive legislation kills industries that create efficiencies and jobs
- Lack of or light-touch regulation allows dangerous levels of risk to accumulate

But there is an additional third category, often over-looked. Lack of regulation can also hinder growth due to risk-averse large players shying away from over fears of lack of legal or regulatory certainty.

The crypto-asset market is primed to boom yet institutional investors remain reticent, unsure of regulatory and taxation implications. I spoke to the CEOs of two of the largest crypto asset trading platforms and they both were crying out for the regulation of the industry.

Spanning out, artificial intelligence (AI) presents a new universe of possibilities and dangers. A sensible middle ground must be reached that realises the benefits of the technology while guarding against the harm.

Bank of America Merrill Lynch estimates that revenue in AI-related technologies will grow from $2 billion in 2015 to about $127 billion by 2025. Yet the dangers are there to be seen. Entire passages of books can—and probably are—being written by AI. I have seen it in real life. The writing is indistinguishable from that of any bestselling author. These trained AI algorithms are, allegedly, already widely used by armies of Russian bots that are flooding social media with realistic fake news and engaging with other users as if human beings.

In the UK, police are testing AI for facial recognition. Yet there is a growing body of evidence to suggest racial bias is deeply entrenched in the algorithms that have been trained on datasets curated from embedded racism that exists in society—thereby perpetuating (indeed increasing) discrimination.

The UK police currently hold 20 million facial images, despite many of these images being retained illegally.

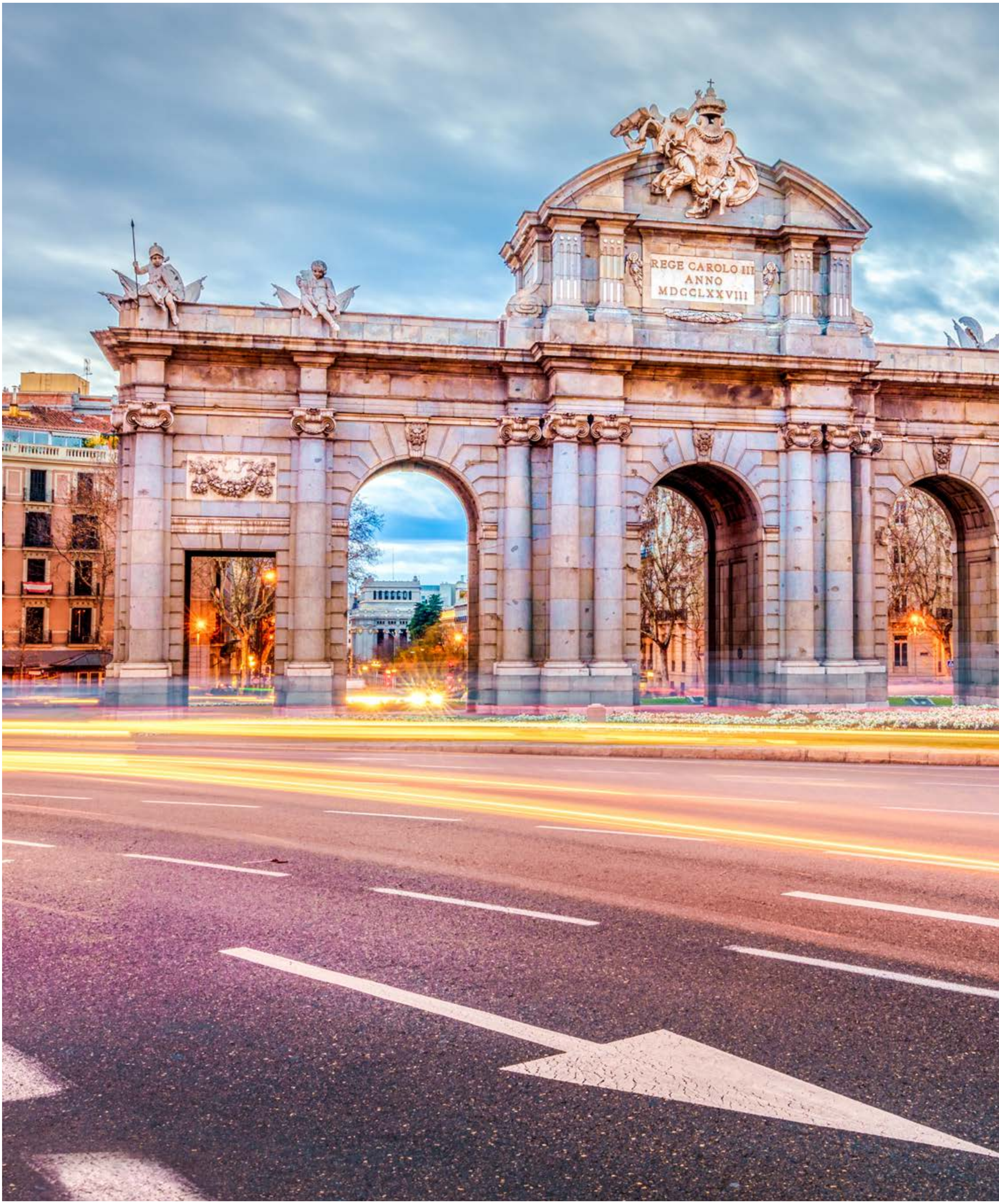
Returning to financial markets, the EBA has found that the aforementioned firms "not subject to any regulatory regime are of an ancillary nature or relate to non-financial aspects of the financial business. These findings support the view that the firms providing such activities and services do not need to be subject to financial regulation".

The regulatory landscape regarding fintech (including regtech) is being cast in the furnaces of the EU and US. The decisions made in the next five years will shape the next century.

The beginning is a statement of philosophical principles. The EU Commission has done so in its recent "ethics guidelines for trustworthy AI" report.

Data gathering and industry consultation is occurring and will likely last another few years. Concrete legislation will finally happen to avoid a fragmented regime. Amazon AWS CEO Andy Jassy said in June, "you'll have 50 different laws in 50 different states". I favour a G20-level minimum framework for legislation, augmented by more robust national laws.

Seb Malik
Head of financial law
Market FinReg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A decision in sight

Current restrictions prevent locally domiciled funds from fully engaging in securities lending, but industry experts are optimistic that this could be relaxed

Maddie Saghir reports

Securities lending can play a vital role in the well-functioning of the secondary markets and can be an important enabler for market-making programmes and covered short selling, industry experts have suggested.

Currently, there are restrictions in Spain which prevent locally domiciled mutual funds from fully engaging in securities lending, however, the industry is closely watching to see if there will be a relaxation of these restrictions.

Market participants have argued that this marks one of the main challenges for the Spanish securities lending market.

Benoit Dethier, head of sales and RM, Citi Securities Services, Iberia, highlights that Spain is probably the last European market that does not allow it.

He adds: "Having said that, many holders of Spanish assets are domiciled outside Spain and do have access to lending. Only the Spanish funds cannot access the lending market. By nature, this excludes them from this industry, which is bad for the local asset managers, their clients and end-investors, and in general for the local industry."

Harpreet Bains, executive director, agent lending, global product head, J.P. Morgan, says that if the relaxation of current restrictions were introduced, this change would be another step closer to achieving greater harmonisation across EU regulatory frameworks that address securities lending for similar fund types in other domiciles.

Bains explains: "Importantly, it would be providing additional liquidity to the marketplace by making available securities that are otherwise shut away in portfolios, as well as generating additional income for fund investors, which can be significant in respect of comparable fund performance."

Current restrictions

According to Dethier, the restrictions on securities lending are still in place initially because the local industry has not seen this as a priority and asset managers have not been openly asking for this limitation to be removed.

He outlines: "The local asset manager association, Inverco, has always understood this was important and defended the relaxation of this limitation, but the asset managers themselves have not pushed for it. One explication is that the Spanish fund industry is very much retail-driven. This means that the competition takes place at the retail banks level and not really between asset managers that, being part of the same group, were automatically getting the retail client investment flow, without having to fight directly for the business."

Dethier notes that in 2007/2008, there was hope to get the new regulation signed and that some asset managers showed interest in lending the assets of their funds. However, they would not openly ask for it because of reputational risk, at a time when securities lending was very badly regarded in Spain, often because of the lack of understanding or other interests. He explains that this has significantly improved with the crisis, as regulators and academic reports have confirmed the contribution of short selling and securities lending to healthy markets.

He comments: "As an entity involved in securities lending, we are actively working on educating the Spanish industry, both the asset managers and their depositaries, on the mechanic and dynamic of securities lending, reviewing the business potential, the operational and legal set up as well as the risk management angles. Recently, the CNMV, the Spanish supervisor, strongly defended the necessity to finally remove this limitation that hurts the competitiveness of Spanish-domiciled funds."

Dethier continues: "The second Markets in Financial Instruments Directive (MiFID II) is also contributing by forcing to embrace open architectures allowing retail clients to also access funds that do not belong to the AM of the banking group they bank with. This obviously facilitates the comparison between the returns of the funds and allows the competition to force changes."

Trends and opportunities

In terms of trends, Boaz Yaari, CEO, Shargain, notes that there are offshore fund managers, operating in the Spanish market, who are not bound by Spanish regulation, are able to enhance their returns and reduce their expense ratios by lending out their securities. Yaari also observes that there are onshore Spanish fund managers who aren't able to benefit, which is creating a competitive disadvantage to the latter. He says: "As a result, we are seeing Spanish asset managers looking to open offices in other European countries, in order to overcome this disadvantage."

Also discussing the disadvantages, Dethier states: "Today, mutual funds domiciled in Spain play at a disadvantage, as they cannot access one of the instruments described by the European Securities Markets Association (ESMA) as an Efficient Portfolio Management Technique. There is, therefore, no level playing field for Spanish-domiciled funds. The very same fund domiciled in Luxembourg, for example, has the opportunity to enhance their return by accessing the lending market."

However, in terms of the opportunities that the relaxation of current restrictions could provide, Dethier affirms: "Relaxing that limitation would automatically open an opportunity to improve the returns of the Spanish funds, allowing them to better compete and generating new revenues for the investors. This is clearly in the best interest of the end investors and the local industry in general."

Securities lending education

The current restrictions in place raise questions over whether there is a lack of education about securities lending in Spain. Dethier states: "Back in 2007 and 2008 when we first hoped to get securities lending allowed for mutual funds (until Lehman went down and stopped the process at the very final stage), the lack of education was evident. Short selling was considered as evil and securities lending was the tool that made it possible."

"Today, short selling is much better-understood thanks to the numerous academic analysis published since the crisis, as well as the statements from several regulators around the world defending the usefulness of the securities lending to healthy financial markets."

He continues: "But securities lending is still a new concept for most local entities and we actively work on ensuring securities lending is better understood in order to allow the industry to take an educated decision on whether they want to develop this activity. We have done much progress over the last two years, but there is still work to be done."

Meanwhile, Dethier says that his biggest surprise is that most local asset manager does not actively consider an Efficient Portfolio Management Technique that would generate new returns and make the funds more competitive.

He adds: "But as soon as the first one will move into it, I have no doubt the rest of the pack will at least have to review it and decide what to do."

Yaari comments: "We had numerous meetings with Spanish asset managers, many of whom would be keen to utilise securities lending to generate additional revenue when Spanish regulation will allow it. More education is always needed as we have found that firstly, there is some degree of scepticism surrounding securities lending, particularly with reference to the role it played in the 2008 global crisis; and secondly, securities lending is perceived to only be for the benefit of large financial institutions."

Additionally, Yaari points out that many small and medium asset managers are unaware of their ability to benefit from securities lending and that this is a basic right and an important practice that should be in everyone's toolkit.

Predictions for the future

While the new regulation was anticipated to be signed over a decade ago, industry experts expect that the new regulation could, in fact, be signed within the year.

Dethier comments: "We were already convinced to get the new regulation signed in 2008 and 12 years later we are at the same stage. But, call me an optimist or even utopist, I would say that the new regulation allowing the Spain-domiciled funds to lend their assets will be signed within 12 months."

"The ministerial order required already exists and probably just needs to get signed at this stage. I believe that the local authorities understand how negative for the local industry the current situation can be, at a time when they increasingly see Luxembourg as a threat."

He concludes: "At the same time MiFID II makes it easier to compare the returns of the local funds compared to funds domiciled in other jurisdictions where securities lending is allowed. Finally, it becomes important to get ready to compete with entities that are used to fight for institutional business, where each bips of return counts. In a market where we expect a significant development of the private pension system, it will be very important to fight for those bips."

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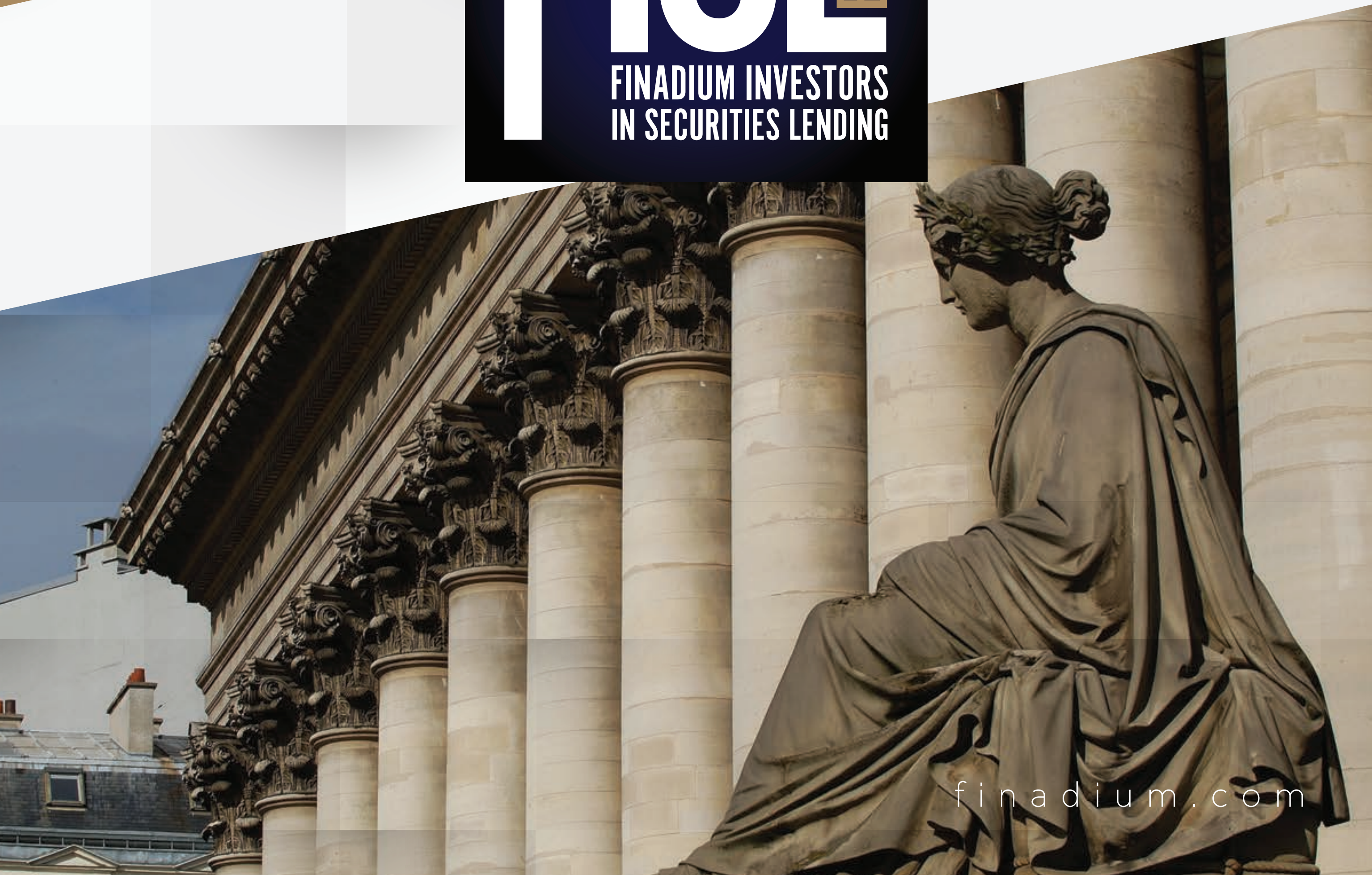

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The effect of LIBOR on banks

RMA's Global Markets Risk and Securities Lending councils have identified LIBOR replacement as a significant issue for banks over the next several years. By offering best practices, informative round tables, and other events, RMA wants to ensure that association members and the industry are prepared to thrive under a new benchmark system

What is happening with Libor at this time and where do you see it going?

The Financial Conduct Authority (FCA) would like to see the demise of LIBOR sooner rather than later. It has put out a very firm message to the industry that LIBOR will not be available beyond the end of 2021, and it would be a "black swan" event were that not to happen. They are pushing the industry extremely hard to work toward a safe conversion to the use of risk-free rates (RFRs). They've used their regulatory powers already in the UK, through a "Dear CEO" letter, to make sure banks are planning for the cessation of LIBOR and, ultimately, the adoption of the alternative risk-free rates, such as the Sterling Overnight Index Average (SONIA) in the UK and the Secured Overnight Financing Rate (SOFR) in the US.

However, there is a recognition that a significant problem lies in the existing LIBOR-referencing contracts that may not be migrated to RFRs by the end of 2021. The total notional amount of instruments—both cash and derivative—estimated back in 2017 was on the order of $350 trillion. Therefore, all market participants, banks, in particular, are obviously looking at their contracts to understand what will happen to them in the event LIBOR is no longer published—the so-called fallback language.

It would be fair to say that the derivative market is significantly ahead of the curve with respect to developing a fallback protocol. There has been an extensive consultation by market participants who would prefer an industry-agreed protocol as a fallback, and the preliminary results of that consultation have already been published.

The presumed LIBOR alternative for the US is secured. What about the proposed rate in other countries?

For the five LIBOR currencies—US dollar, pound sterling, euro, Swiss franc, and Japanese yen—the central banks have gone a long way toward identifying replacement interest rate benchmarks that could be successfully adopted according to the IOSCO principles, which were published in the aftermath of the benchmark-fixing scandals, based on transactions in liquid markets by arm's-length participants.

Different central banks have come back with different solutions based on the unique characteristics of each market. For the US dollar, SOFR was published in April 2018, based on the daily repo rate for US government securities. For sterling, the Bank of England chose the already existing SONIA. This is an unsecured rate for overnight loan/depo transactions.

Although some changes were made to the underlying methodology at the same time, SONIA had been around for several years prior. The other currencies have headed down the unsecured route, likely because their repo markets are much less deep than in the US. Daily trade activity in transactions that would form the SOFR index is well over $400 billion per day.

This issue of secured versus unsecured rates will matter to those who trade derivatives, especially cross-currency swaps, as they will need to access different types of markets to hedge the resulting exposures.

Why should panel banks continue to contribute to the calculation of LIBOR?

The panel banks will continue to contribute until the end of 2021 because they have already agreed with the FCA to do so. The FCA recognised there was a very big problem: under EU benchmark regulations, there was a risk that LIBOR would be considered ineligible and could die within a two-year time frame. So the FCA asked all panel banks to continue contributing until the end of 2021 to provide a longer transition period.

I expect there was some arm-twisting involved, but the FCA got pretty much all the panel banks to agree to contribute in order to reduce the systemic risk that a poorly planned end of LIBOR could create.

Why wouldn't panel banks contribute after 2021?

There are some good reasons why a panel bank would choose not to contribute beyond 2021. First, there is an ever-present small risk that a bank could be found failing in its governance of the controlled environments around its LIBOR submissions and thus be subject to fines.

Second, there is the direct cost of maintaining the infrastructure and staff time involved in providing those submissions. Many LIBOR submissions still rely on "expert judgment" due to the paucity of eligible transaction data, so there are systems and control processes that have to be maintained. And there have to be independent second-line-of-defence review processes in place.

Then there will be internal and external audit costs that have to be borne. This all comes at a time of increasing focus on costs. The FCA estimated the annual costs of being a panel bank at £2.4 million. That's a lot of money at a time of other significant regulatory changes, such as the implementation of Fundamental Review of the Trading Book and Standardised Approach Counterparty Credit Risk.

Would you describe the process for submissions?

The first stage is to identify transactions that are eligible across all the branches for which the firm has indicated it takes deposits in that currency. It has to collect all the transactional data from the last 24 hours. Then this data has to be sorted into those that are potentially eligible as Level 1 transactions. Counterparties have to be classified by type to identify whether they're eligible because these have to be wholesale transactions.

There are also minimum-size criteria for the transactions. And there are related-party criteria. If customers transacted three times with different branches or three times during the same day, these transactions would have to be aggregated to ensure that no attempt is being made to manipulate the market.

Once Level 1 submissions have been determined, eligible transactions from previous days can be adjusted by market movements to compile Level 2 submissions, according to a very rigorous specification including time and volume weighting. Absent the ability to compute a Level 1 or 2 submissions, then we're back to a Level 3 submission: "expert judgment." This requires the submitter to estimate the rate at which it could raise funds in the wholesale market for the requisite term. Given that this market barely exists for many tenor/currency pairs, this is a very challenging task—and ultimately the reason why the regulators want to kill off LIBOR. It's too subjective.

What should the second and third lines of risk management be looking at with regard to the transition between now and the end of 2021?

ICE Benchmark Administration (IBA) took over the administration and publication of LIBOR following the financial crisis. It has worked with the regulators and the panel banks to make the submission process much more robust and thus de-risk the process as much as possible. The latest innovation is the waterfall methodology of Level 1 to 3 submissions. This ensures money market transactions are used in the determination of the submission wherever possible.

It is only when recent transactions are not available that the submitter has to use expert judgment. Panel banks have been migrating to the waterfall methodology since the summer of 2018, and all were expected to be using it by April 2019. The second and third lines of defence have to ensure that the data capture of potentially eligible transactions is accurate and robust. Then the algorithm to compute the ultimate submission must be validated against IBA's specification.

Finally, of course, all Level 3 submissions where expert judgment is applied need daily testing to ensure that the bases for final submission can be substantiated by reviewing multiple markets data sources.

At a recent RMA round table, attendees discussed the issue of people trying to determine a credit spread and term rates. Would you explain the issues?

LIBOR has two major differences to the new RFR benchmarks. LIBOR comes in seven different tenors—overnight, one week, and one, two, three, six, and 12 months—and aims to measure the risk of unsecured lending between banks: a bank credit spread component.

But the new RFRs come in one flavor—overnight—so there's no term, and essentially no credit component, especially for the US dollar SOFR index, which is a secured rate. The industry's challenge is to transition all the existing instruments from LIBOR to the new RFRs. But they are not "plug and play." So the industry has to do two things: first, wean itself off its dependency on trading LIBOR-linked products and begin transitioning to the use of RFRs; and second, know that it won't achieve that for the entirety of its legacy stock of LIBOR products and recognise the need for a conversion process.

FCA chief executive Andrew Bailey made it very clear in his July 2018 speech that he wants industry participants to remove the stock of LIBOR instruments as much as possible before the end of 2021: "The wise driver steers a course to avoid a crash rather than relying on a seatbelt. That means moving to contracts which do not rely on LIBOR and will not switch reference rates at an unpredictable time."

So the banks are now working on significant outreach programmes with their clients to ensure they are aware of LIBOR's pending demise, the need for new products to be based on one of the RFRs, and—most challenging—to work out what to do with their existing stock of LIBOR-referencing bilateral derivatives with maturity dates after December 2021. That could be to renegotiate them to reference RFRs.

What are the risks in being an early or a late adopter?

The challenge is that these markets in RFRs are not yet liquid and not well accepted or understood by clients. It's a chicken-and-egg situation: traders won't trade something until there's a narrow bid-offer spread. They will continue doing what they like to do, which is to trade LIBOR-based products because those markets still remain very deep and very liquid. So if they're trading swaps today, they are more likely to trade a fixed versus floating swap, where the floating leg is LIBOR. Few swap traders are trading RFRs, especially for longer-dated swaps where the market barely exists.

While there is an increasing number of floating legs that reference an RFR, it will be some time before the RFR market is the size of the LIBOR market. The Bank of England recently published volume data, showing that a traded volume of SONIA futures was just 3 percent of LIBOR futures. The SONIA swaps market is more developed with LCH showing that SONIA swaps were at 67 percent of the LIBOR swaps (notional traded YTD). And while swap traders' books only contain LIBOR-based risks, they won't use an RFR-based swap to hedge a LIBOR risk because that is simply opening up a significant basis risk.

The reason you want to be trading RFR products today is that you want to be out there demonstrating your commitment to reform to the regulators by promoting the adoption of these new RFR indices. There is a significant amount of pressure and influence being exerted by regulators, the US Federal Reserve, the FCA, and the Prudential Regulation Authority to do just that. Banks, US agencies, and supranational are responding by issuing RFR-linked debt, so SOFR and Sonia-linked bonds are now being issued by institutions that want to be seen as participating in those markets and promoting the use of the new benchmarks.

Some markets are ahead in the UK. An early adopter is the liability-driven investment community—pension funds. They are happy to transact in swaps referencing RFRs. They never needed bank credit spread risk built into their risk profile, so having a pure interest rate reference is a much cleaner hedge for their risk.

If you were tasked with writing a letter from the FCA to chief risk officers at banks, what would it say?

The FCA has essentially done that but the letter went to CEOs. The FCA has a history of using "Dear CEO" letters as a way of delivering a clear message to the industry about potential systemic failings in business practice. In this case, while the letter was only sent to a limited number of the largest London banks, the underlying message is that all banks must take heed. That letter is available on the FCA's website.

Clearly, the FCA is concerned that banks are not putting sufficient resources into planning for the end of LIBOR. The purpose of the letter was to seek assurance that firms' senior managers and boards understand the risks associated with this transition and that they are taking appropriate action now so that they can transition to alternative rates before the end of 2021.

The FCA has also used its senior manager regime very effectively by requiring recipient banks to specify the individual who will oversee the implementation of the LIBOR transition. That is going to focus attention.

Which financial institutions do you see being impacted the most?

The banks that likely will be most impacted are those that are the biggest derivatives dealers and the biggest lenders in the leveraged loan space, such as BAML, J.P. Morgan, and Morgan Stanley.

If a financial institution gets this transition to LIBOR wrong, how bad could it be?

It could be awful. If it were a smaller bank, the risk is a massive operational risk. If it's a small commercial lender in the US, the risk is that an awful lot of manual workarounds will be required for a long time while the systems get straightened out. These banks are probably very dependent on vendors who actually deliver the changes that small- and medium-sized institutions need and that in and of itself will be a challenge.

Small regional banks with loans referencing three-month dollar LIBOR may not even have picked up on this, or they may just be starting to pick up on it and don't really understand its seriousness. The other risk is that they don't deal with their clients early enough and their clients insist on staying on LIBOR-based contracts after the market has moved on. The big risk here is ending up with major litigation disputes.

What should business people or traders be talking about now?

It's all about educating your own staff and then your clients. There are hundreds of documents available on LIBOR transitions—from the big banks and the major consulting firms. Smaller institutions can educate themselves and then explain to their clients that they need to consider how they will end their dependence on LIBOR-based products, whether that's swaps, bonds, mortgages, or loans, and ultimately adopt the new SOFR index for US dollars. The industry is working on finding a fair, equitable, and operationally simple solution.

A major goal here for the industry has to be finding a solution that doesn't create winners or losers. This is going to be very difficult, but we all have to work together. It's not just about derivatives or valuations. It's about operational capability. It's about legal robustness of contracts—about sitting down and understanding what the exposure is between a bank and a client. What are the fallbacks that exist? Are we happy with those fallbacks and, if not, how will we renegotiate them using RFRs? What would be sensible and fair for both?

Could a single universal formula be used to make the process less challenging?

The clear regulator messaging is that we need to tackle this problem now, not leave it to the last minute. Between now and the end of 2021, there's time to renegotiate contracts with clients and counterparties.

A clear second-best option is to use the fallback protocols being constructed by the industry associations for each asset class. It's likely that most asset classes will follow an International Swaps and Derivatives Association-endorsed protocol. At least that way, cash instruments hedged with derivatives could remain hedged in lockstep if they both "convert" to an RFR index in the same way at the same time.

One area that will be greatly impacted is model development and, more importantly, model validation?

Yes. This is certainly a competing priority problem, alongside the fact that the standards around model vetting that originated from the Fed have rippled through the industry in such a way that the standards for vetting in 2018 and 2020 are much higher than a decade ago.

I hesitate to think about the number of model-vetting quants that banks now, have relative to a decade ago, but it would be an interesting survey. There are probably double the number of people doing this compared to a decade ago. If you're a US institution, it's probably a lot more than double.

Fran Garritt
Securities lending and global markets risk director
RMA

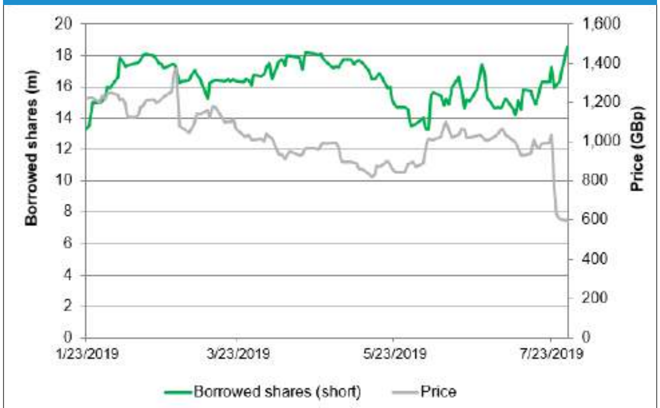
Taking a plunge

Sam Pierson of IHS Markit discusses increased borrow demand for Aston Martin securities

The share price of Aston Martin has declined by more than 40 percent since the firm's 24 July trading update and revised outlook. The firm stated that: "The challenging external environment highlighted in May has worsened, as have macro-economic uncertainties. We anticipate that this softness will continue for the remainder of the year and are planning prudently for 2020."

Short sellers perceived that the firm could fall short of expectations this year. Following the initial public offering in October 2018, short-sellers borrowed an increasing number of shares until the firm announced its FY 2018 results on 28 February, prompting a 21 percent decline in the share price. The GBP value of Aston Martin Lagonda (AML) shares on loan peaked the day before on 27 February at £235 million. Following the February windfall of profits, short-sellers reduced their position by approximately one million shares and have maintained the position at an average of 16 million shares, or approximately 150 million, since then. At the start of July, short-sellers began to add to the position. Reaching a post-IPO record of 18.2 million shares, or 8 percent of outstanding shares, they continued to add to the short position following the 24 July update; likely eyeing the firm's upcoming earnings release as a potential downside catalyst.

Aston Martin Lagonda Global Holding Plc equity short demand & share price



Source: IHS Markit Securities Finance © 2019 IHS Markit

The firm's debt has also seen an increase in borrow demand, the total borrow balance reaching £64 million, a 32 percent increase since the start of July. Similar to equity, recent weeks saw an increase in demand, persisting through the outlook update. The trading of credit default swaps (CDS) tied to the firm's debt is not liquid enough to be priced by our consensus pricing service.

Aston Martin CEO Andy Palmer was quoted in the report as saying, "While retails have grown by 26 percent year-to-date, our wholesale performance is adversely impacted by macro-economic uncertainty and enduring weakness in the UK and European markets."

Jaguar Land Rover is another UK automaker whose bonds have seen significant borrow demand over the last nine months. Credit shorts built a position coming into 2019 and were temporarily rewarded in early February when the firm announced a significant write-down of assets. That joy was short-lived, as the bonds have rallied from the February low point and have traded in a range since then. In the weeks after the write-down, the face value of JLR bonds on loan reached a peak of £266 million. The spread on the five-year CDS referencing the Jaguar Land Rover (JLR) bonds peaked above 900 basis points in early February, subsequently declining to a year-to-date low of 563 basis points in April, before widening to 678 basis points at present.

The challenging economic outlook for the UK, based on concerns for global growth combined with Brexit uncertainty, is reflected in the challenging position faced by UK automakers. Although the borrow demand for related securities has been elevated, the lendable supply of those securities has kept a lid on borrow costs. The availability of securities has frustrated efforts to generate significant excess returns through lending, however, the elevated balances and "warm" fees for AML made it the eleventh most revenue-generating UK equity in Q2. If the struggling sector can regain its footing, current prices may prove attractive to long investors; they may also take into account the potential need for short sellers to cover. Earlier this year, the JLR bonds were a good example of short-covering helping to fuel a rally in the credits. However, with a remaining borrow balance of £181 million, it would be hard to claim that short-sellers have given up on that trade.

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Comings and goings at Margin Reform, Citi and more

Margin Reform has appointed Shaun Murray as managing partner.

Murray has 30 years of experience and is a highly regarded collateral and margin specialist, according to Margin Reform.

Most recently, Murray served as managing director, head of strategic collateral management at Standard Chartered Bank. Prior to this, he worked as director, enterprise collateral optimisation at Royal Bank of Scotland.

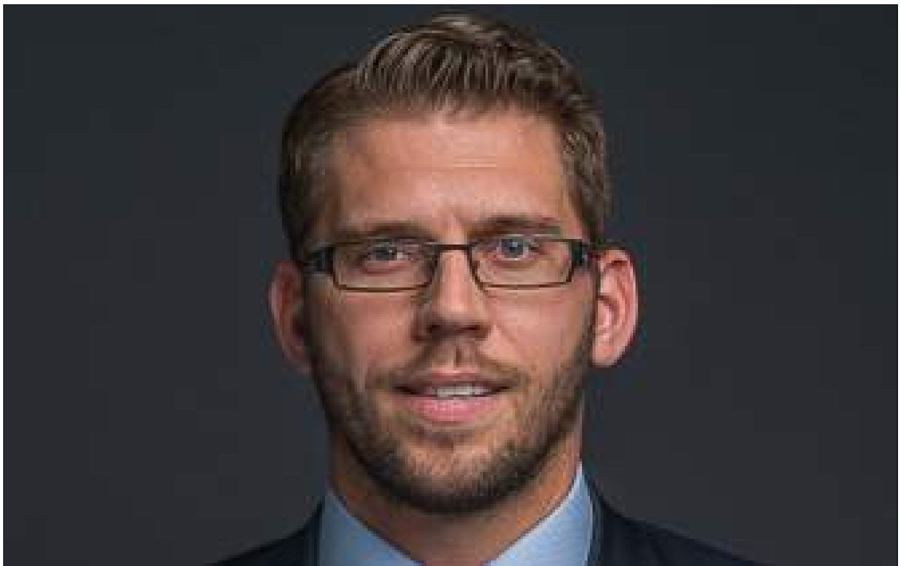
Commenting on his new appointment, Murray said: "I am very excited about the new challenges that leading a bespoke, focused, practitioner-led consultancy brings."

"I firmly believe that the time for collateral to be treated as a front to back product in its own right is here. It's no longer viable or economically sound to treat collateral as an afterthought or to leave it in a silo."

"Our founding partner, Chetan Joshi, the senior leadership team and I will be striving to bring that understanding to the market and to make Margin Reform the go-to consultancy for all clients when they need help with collateral, margin, and legal issues."

Murray added: "Margin Reform already has a number of senior leaders operating in the industry and has built some amazing partnerships that can be leveraged by our clients."

"We will be based in London initially, although recognising the global nature of our product, there will be more to come."



Promotion for Citi's Matt Glennon

Matt Glennon has been promoted to head of Europe, the Middle East and Africa (EMEA), equities lending of Citi, effective 1 September.

This follows the recent departure of Marcus Rudler who was director of EMEA, head of equity agency securities lending trading at Citi.

In his new role, Glennon will be key to the ongoing development of the regional and global product.

He will report to Stuart Jarvis, head of EMEA agency lending from an EMEA perspective. In addition, he will also be a member of the global strategic trading team, reporting to Dave Martocci.

Glennon brings a wealth of industry experience to the role that has been built over his 20 years at Citi.

Most recently, Glennon managed the principal stock lending desk within the prime brokerage.

Prior to this, he held various roles on the fixed income finance and repos sales desks.

Citi has appointed industry veteran Curt Engler as Asia Pacific head of execution services, based in Hong Kong.

In his new role, he will be responsible for Citi's regional execution business.

He will oversee all the execution desks for Citi's cash equities business in the region where clients buy and sell stock via Citi's high touch, programme and electronic desks.

A key focus under his leadership will be to ensure Citi's franchise continues to embrace the latest technology to meet the changing needs of clients.

Most recently, Engler worked at JP Morgan Asset Management in New York, where he was head of trading for the Americas.

Prior to JP Morgan Asset Management, Engler was a trader and analyst at BlackRock, in the Quantitative Equity Group.

Richard Heyes, head of equities, Asia Pacific, said: "Curt Engler's market knowledge will be invaluable for Citi and our clients as Asian markets continue to evolve rapidly."

Dan Keegan, global co-head of Equities, cited: "I am delighted to welcome Curt Engler to Citi. This addition to the team underlines our commitment to investing in the best talent to support clients. The Asia

Pacific is a key market for our global equities business and I am confident this addition to the strong bench will support further growth with clients across the region."

BCS Global Markets has named Dmitry Trub as their new CIO, based in Moscow.

In his new role, Trub will be responsible for driving software development to maximise BCS GM's investment banking functions.

He will also drive efficiency in the service provided to BCS GM's institutional clients.

Further responsibilities at BCS GM include development and implementation of IT strategy, rise of automation level for providing clients operations and regulatory reporting and connecting new markets.

Trub has almost 20 years of experience of both developing and making decisions related to technically complex solutions for corporate and investment banking.

Most recently, Trub was a director and head of global market equities, Russia, at Deutsche Bank where he was responsible for software development and focused on stability of production environment.

Prior to this, he was Deutsche Bank's co-head of trading technologies for Russia Technology Centre.

Roman Lokhov, CEO of BCS Global Markets, commented: "I am pleased to welcome Dmitry Trub to our team and am confident that his unique experience in shaping technology development strategy will enable him to make a great contribution to the future of the company."

BTIG has appointed Concetta Mastrangelo as senior vice president of prime brokerage.

In the newly-created role, Mastrangelo will help enhance BTIG's family offices effort.

According to BTIG, by building out a specialised team, it is strengthening the resources available to this segment of the market.

BTIG's prime business is led by Justin Press and Brian Petitt, managing directors and co-heads of BTIG prime brokerage.

Its platform currently supports the needs of more than 330 hedge funds, many of which are family offices.

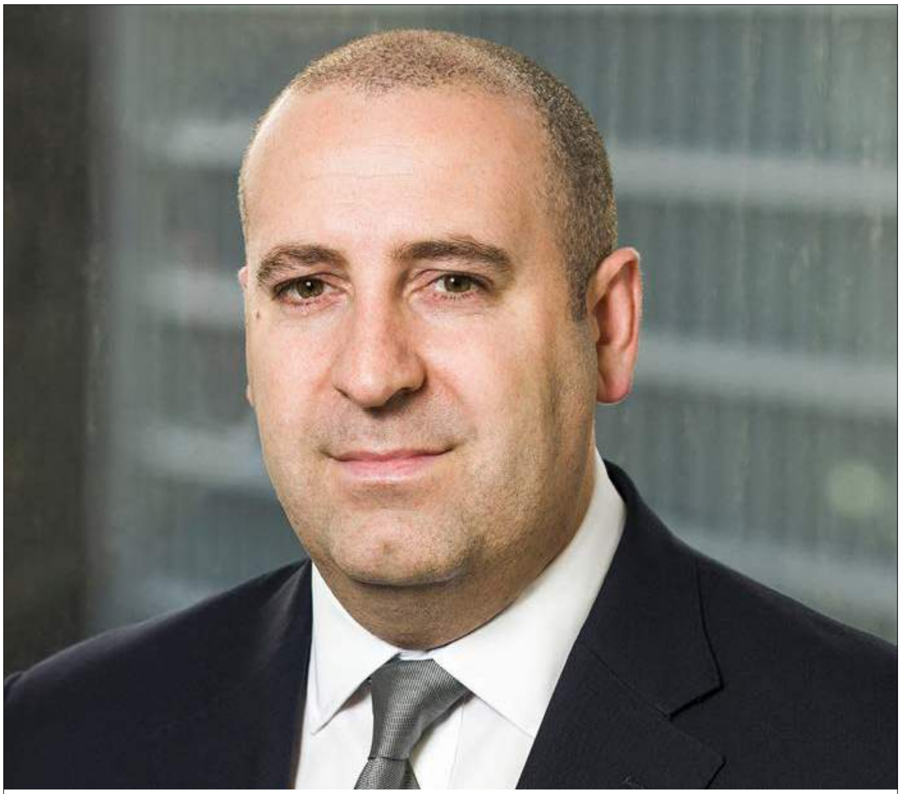
Petitt said: "Increasingly, family offices are looking to BTIG for our full-service offering. As an institutional prime broker, we provide advanced portfolio reporting, high-touch service, day-to-day trading services and operational support."

LCH has appointed Isabelle Girolami as CEO of LCH, effective on 1 November.

Based in London, Girolami will report to Daniel Maguire, CEO, LCH Group.

In her new role, she will be responsible for driving continued expansion across LCH's services, with a focus on continued growth, innovation and operational excellence.

Girolami joins from Crédit Agricole.



Mark Wilson promoted at eSecLending

eSecLending has promoted to Mark Wilson to managing director, trading, based in London.

Wilson has worked at eSecLending for just over 14 years and most recently served as senior vice president, trading.

Commenting on his appointment, Wilson said: "It gives me a great sense of pride, having started in operations 14 and a half years ago; showing that hard work and dedication bears fruit."

He added: "Being surrounded by good people has helped to make this happen and I'm now looking forward to playing my role in helping eSecLending grow further in our industry's ever changing and challenging landscape."

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Head of Repo, AXA Investment Managers

Business Quality Manager - Securities Financing, Trading and Securities Financing, AXA Investment Managers

Analyst, Collateral Management, Bank of England

Dealer/Analyst, Sterling Markets Division, Bank of England

Sr. Adviser, Sterling Markets Division, Bank of England

Head of Securities Lending & Repo, Banque Lombard Odier & Cie SA

Managing Dir, Global Head Securities Fin and Delta One, BCS Financial Group

Director, Deputy Head, BCS Global Markets

Head of Treasury Services & Securities Lending Oversight., BMO Global Asset Management

Securities Analyst, BMO Global Asset Management

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VP, Global Derivatives, Trading and Index Portfolio Management (DTI), British Columbia Investment Mgmt Corp

Portfolio Manager, Dimensional Fund Advisors

Portfolio Management Associate, Dimensional Fund Advisors

Senior Portfolio Manager, HSBC Global Asset Management

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Senior Fund Manager, Quantitative Equity Strategies, HSBC Global Asset Management

Custody, IBM Retirement Funds Europe

Head of Operations, Jupiter Asset Management Limited

Derivatives Operations Manager, Jupiter Asset Management Limited

Head of Derivatives Operations, Jupiter Asset Management Limited

Head of Operational Strategy, Kuwait Investment Office

Operations, Kuwait Investment Office

Securities Lending Analyst, Kuwait Investment Office

Project Manager, Legal & General Investment Management

Business Analyst, Legal & General Investment Management

Senior Trader - Sub 2yr, Legal & General Investment Management

Fund Manager, LGIM

Treasurer, LIM Advisors

Senior Collateral and Securities Lending Manager, MN Investment Management

Executive Director, Morgan Stanley

Investment Operations Manager, National Grid UK Pension Scheme Trustee Limited

Senior Dealer, Nationwide Building Society

Sr Manager, Collateral & Encumbrance Optimisation, Nationwide Building Society

Settlements and Collateral Manager, Treasury, Nationwide Building Society

Treasury Technical Specialist, Nationwide Building Society

Senior Manager, Treasury Operations, Nationwide Building Society

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