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Welcome to the new normal

Technology and regulation have helped push open the doors to the securities lending market where new entrants were once viewed with suspicion

HQLA^{X} goes live | ESMA's SFTR data challenges reviewed | New year, new opportunities

HQLA^X goes live with first trades

HQLA^X, the distributed ledger technology (DLT)-powered securities lending platform, is now live with UBS, Commerzbank, Credit Suisse and Eurex Repo F7 among the first to execute trades.

The HQLA^X platform offers a marketplace for collateral swaps by leveraging R3's Corda DLT solution to provide liquidity and collateral management solutions for institutional clients in the global securities financing markets.

The solution is being jointly developed with Deutsche Boerse, which acquired a third tranche of shares of the platform earlier this year.

As part of HQLA^X's first transactions, which took place in November, ownership of a basket of German government bonds and a basket of corporate bonds were swapped between UBS and Commerzbank, both using Clearstream Banking SA as custodian.

This was followed by a cross-custodian swap between UBS and Credit Suisse, in which ownership of a basket of corporate bonds at Clearstream Banking SA and a basket of German government bonds at Euroclear Bank were exchanged without the need for securities to be physically moved between the collateral agents, according to HQLA^X.

Instead, HQLA^X explained that the change in ownership was recorded on the digital collateral registry, which is one of the four layers of the HQLA^X operating model and was built on Corda Enterprise, the commercial distribution of R3's blockchain platform.

Peter Schmidt, co-head, repo desk treasury at Commerzbank, described the platform as a "fascinating approach" to overcoming the fragmented post-trading landscape by significantly reducing the settlement cycle and avoiding resource-intensive collateral movements.

"It is a first but important step toward a new ecosystem where tokenised assets can be traded in a DLT environment," he said.

Beyond those already trading, HQLA^X is engaged in on-boarding more than 15 other market participants including Citi, Goldman Sachs, ING and CIBC.

Elsewhere, J.P. Morgan is in the process of becoming the third triparty agent in the HQLA^X operating model, alongside Clearstream Banking SA. and Euroclear Bank.

According to HQLA^X, this will add another custody/collateral location to the solution, thereby further increasing collateral mobilisation efficiencies for participants.

Of the platform's go-live, HQLA^X's CEO Guido Stroemer said: "The launch of our production platform is the culmination of strong collaboration, not only with our strategic partner Deutsche Boerse, but also with R3 and several global banks with which we began our journey less than three years ago in an R3 lab."

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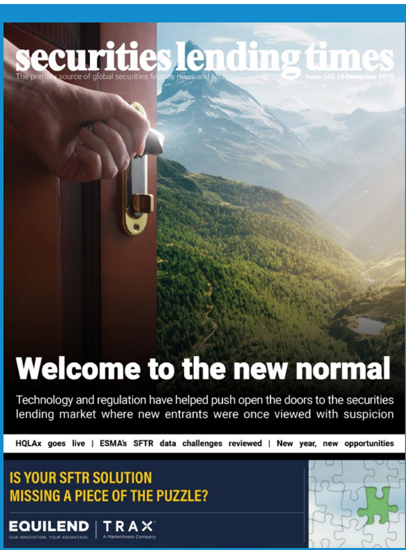

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HQLA^X goes live with first trades

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"Our mission statement from the very beginning has been to deliver solutions for specific pain points in the market, and so we worked very closely with a core group of banks to deliver an operating model that was designed by the market, for the market."

How does HQLA^X work?

HQLA^X leverages a four-layer model that aims to facilitate more efficient collateral management of high-quality liquid assets, which are in heightened demand due to increased clearing and margin requirements of Basel III, among other regulations.

Layer one, which is built on Corda, is the digital collateral registry that enables delivery-versus-delivery ownership transfers of baskets of securities. HQLA^X explained that this eliminates the operationally onerous requirement to move securities across fragmented securities settlement systems.

The other layers are: the Eurex Repo F7-trading system, where transactions are executed; the participating custodians/triparty agents, where the securities are deposited; and the Deutsche Boerse-owned Trusted Third Party (TTP) entity, which links the custodians/triparty agents to the digital collateral registry.

The TTP acts as an interface between the HQLA^X digital collateral registry and existing securities settlement infrastructures.

In a statement on its launch, HQLA^X confirmed that it is already developing further functional enhancements and new business features, including digital collateral record re-use, intraday trades, delivery-versus-payment trades and support for various types of pledges.

ISLA wades in on GPIF affair

The Japanese Government Pension Investment Fund's (GPIF) decision to close its securities lending programme raises important questions around environmental, social, and governance (ESG), says Andrew Dyson, CEO of the International Securities Lending Association (ISLA).

Japan's public pension fund sent shockwaves through the securities finance and short selling markets last week when it announced it would no longer lend out its foreign equity assets as it considers the practice to be too opaque and incompatible with its responsibilities as a long-term investor.

GPIF has around $1,452.5 billion in assets under management, of which $381 billion are foreign equities (as of March 2019), making it the world's largest pension fund.

The fund will continue to lend its government debt assets.

Interested parties from all corners of the market have since voiced concerns about the precedent that could be set by a major lender declaring short selling, and by proxy securities lending, as not being ESG-friendly.

In Dyson's 'Reflections of the CEO', which came out shortly after the fund's announcement, he highlighted that GPIF's reasoning behind its securities lending scrap had been enveloped in "sustainable finance or ESG wrappers".

This, according to Dyson, raises a number of important questions about the developing ESG agenda as well as other important initiatives such as the Shareholders Rights Directive (SRD) in Europe.

Dyson explained that ISLA has seen comments from some quarters suggesting that short selling should be banned, however, looking at short selling through an ESG lens, could to a point, be misleading.

Dyson outlined: "In its simplest form, short selling is a platform for an investor to express sentiment either in a stock or an index, and as such may be no different to an index manager going over or underweight the index that they are tracking."

"Furthermore, we now see robust regulation in the form of short selling rules that ensure opportunities to use short selling in an overly aggressive way by using techniques such as naked short selling, are effectively curtailed or banned," Dyson added.

Elsewhere in Dyson's reflections, he noted that the role of securities lending and voting has been another much discussed topic this week, with the issue coming into sharper focus as the industry looks at the governance principles laid out within the ESG framework.

Adding to its prominence, is the implications of the implementation of the SRD, which is due in 2020. On this topic, Dyson emphasised the point that the language within the Bank of England sponsored UK Money Markets Code that specifically highlights that securities should not be borrowed for the sole purpose of exercising voting rights.

Meanwhile, looking at the landscape that is familiar but with increasingly different drivers, Dyson commented: "I think we have to ask ourselves what we need to do and advocate so as to ensure institutional investors continue to both lend securities, but also discharge their responsibilities in the context of ESG."

"As we look at ESG in particular, it is important that investors develop policies around their own preferences in areas such as voting, governance and even short selling. To do this in isolation will over time mean we will see a proliferation of bespoke frameworks, that will present challenges for agent lenders and borrowers alike," Dyson concluded. "I believe it is, therefore, incumbent upon industry associations to lead the way on developing principles that support securities lending in the context of ESG, that the industry as a whole can embrace."

Tesla CEO calls for short selling ban

Elon Musk, the CEO of Telsa, an electric car maker and prolific short target, has waded into an online debate around the ethics of short selling by calling for the practice to be made illegal.

MarketAxess facilitates first US repo trade

Electronic trading platform and market data provider MarketAxess has facilitated its first US repo trade through its automated confirmation engine between J.P. Morgan and Citadel.

According to MarketAxess, its trade confirmation engine provides the ability for buy- and sell-side clients to electronically confirm repos on T+0 and throughout the 'complex' transaction lifecycle.

Repo transactions are typically confirmed manually which can increase the risk of trade failures and cost. By providing an automated service, MarketAxess aims to reduce risks and encourage greater control over their post-execution processes.

Camille McKelvey, head of business development for MarketAxess post-trade solutions, said: "As the Securities Financing Transactions Regulation and the Central Securities Depositories Regulation are raising the profile of risks associated with not having an efficient trade confirmation solution, more firms are now migrating to electronic solutions like ours."

"Citadel and J.P. Morgan have led the way in the US by extending their existing use of MarketAxess' trade confirmation engine outside of Europe, and are ultimately supporting a growing global community," McKelvey added.

More than 50 firms currently utilise MarketAxess' repo trade confirmation service and saw a 94 percent increase in the number of repo transactions confirmed in October, compared with year-end 2018.

Social media was abuzz last week following an announcement by the world's largest pension fund, the Government Pension Investment Fund in Japan, that it was shutting down the foreign equity portion of its securities lending programme.

This was due to concerns around its compatibility with the fund's strong environmental, social and corporate governance ethos.

Musk quickly responded to the news via Twitter, posting: "Bravo, right thing to do! Short selling should be illegal," to his 29.9 million-strong online following.

The Twittersphere promptly erupted with those in agreement and those who see short selling as a legitimate business practice.

Ihor Dusaniwsky, the managing director of S3 Partners, a data provider company, replied to Musk saying: "Short selling is legit, needed and necessary to provide market liquidity and two-way trading in the market.

"Now spreading false info by shorts and longs should be illegal. By the way, as a percentage of trading volume, most of the downward stock price pressure comes from long selling not short selling."

Tesla's outspoken CEO has a reputation as a prolific social media user but he usually focuses his attention on the activities of his own ventures including SpaceX and the latest Tesla car model. However, this is not the first time that Musk has made his views on short selling clear.

Just last month Elon Musk sent a public letter to David Einhorn, a hedge fund manager, mocking him for losses his fund had made relating to its significant short position in Tesla at the time.

Prior to that, in August 2018, Musk took to social media to claim he was taking Tesla private and that he had already secured the funding for doing. Shareholders responded by saying that this was an attempt to manipulate Tesla's stock price and ruin plans for short-sellers.

Following this, shareholders filed a class-action lawsuit, claiming Musk's tweet represented false and misleading information. The US Securities and Exchange Commission went on to charge Musk with a securities fraud charge and charged Tesla with failing to have required disclosure controls and procedures relating to Musk's tweets.

Tesla has been a popular short target over the years, and a year of turmoil led Tesla to rank as one of the top-five earners for short sellers in 2018, according to DataLend.

The data provider found that Tesla, along with the other top earners in 2018 (Celltrion, Ubiquiti Networks, Sharp and Sirius XM) short sellers banked $482 million in revenue.

SGX adds variable rates to securities lending programme

The Singapore Exchange (SGX) is set to introduce variable and more competitive rates to its securities lending programme in a bid to attract more institutional investors to borrow.

According to SGX, this could result in higher frequency of loans and in turn increase lenders' chance of securities being lent out.

Under the current programme, the lending fee is fixed at 4 percent per annum, while the borrowing fee rate is 6 percent per annum.

From 2 December this will change to 0.5 percent for index stocks, real estate investment trusts and business trusts and the rest of securities at 4 percent.

These rates, SGX said, will be reviewed on a periodic basis, taking into account factors such as market rates and demand and supply of the eligible securities.

Meanwhile, lenders' fees will be calculated based on 70 percent of the borrowing fee, meaning that, once the new rates are introduced, any securities on loan will continue to be on loan at the enhanced 70 percent of the prevailing borrowing rate.

SGX noted that these latest changes follow a series of enhancements to its securities lending programme, such as real-time processing of borrowing requests.

Additionally, the exchange also recently added an expansion of borrowers' eligibility criteria beyond central depository programme members and depository agents.

Commenting on the latest enhancements, Michael Syn, head of equities at SGX, said that the programme improvements will give borrowers access to a wider range of securities, including small to mid-cap stocks, with real-time lending pool availability.

"By improving the rates, range and accessibility of our securities lending programme, we are improving the mobility of loan collateral, better serving our clients as owners of this collateral, and promoting liquidity in the stock market," Syn added.

Canadian commodities lobby group takes aim at "predatory" short sellers

Canada's TSX Venture Exchange is considering re-introducing an uptick rule that would restrict traders to only shorting a stock if it was on an upward trajectory.

The rule would apply to stocks of companies in the 'junior markets', meaning listed companies under CAD 250 million (USD 188.84 million)

A similar rule existed in Canada until 2012 but it was scrapped after market research found that it was not an effective tool for restricting significant and rapid systemic declines in prices.

Due to this and other research on Canadian short selling, the rule was removed for all 14 of Canada's trading venues by the Investment Industry Regulatory Organization of Canada (IIROC).

Now, an anti-short selling group representing the Canadian mining industry is lobbying the IIROC and the country's exchanges to revive the rule to protect smaller participants against what it describes as "predatory short selling".

The Save Canadian Mining (SCM) advocacy group has also proposed banning short selling of junior market companies but would settle for the return of the uptick rule.

According to the group, short selling activities on stocks from junior markets increased after 2012 and now there is a dynamic where "short selling activities, high-frequency trading, and algorithms are 'exploiting' the lack of a tick test to the detriment of Canada's junior markets".

Terry Lynch, CEO of ChileanMetals, who founded SCM last month alongside several other commodities market participants, described in a statement how "for smaller cap mining companies, short selling activity spooks true investors into selling prematurely, effectively stunting the growth of these businesses at critical early stages".

"SCM is dedicated to helping ensure Canada's capital markets remain viable for junior miners now and into the future," he added.

The group also wants to secure a public commitment from investment banks to allow listed companies to sell private placements to brokers without having to be approved by a named committee.

According to SCM, brokers have a fiduciary responsibility to act in their clients best interest, which should govern whether or not they're able to have their investors in private placements. They should also receive compensation similar to the fees they get from participating in an initial public offering, the group argues.

Responding to the group's claims, the head of TSX Venture Exchange, Brady Fletcher, highlighted that "the practice of short selling plays a role in maintaining a healthy, efficient market," but went on to note that the exchange "understands that certain changes to market operations in Canada, specifically related to the removal of the tick test, may have had unintended negative consequences for our junior, or more illiquid issuers".

Fletcher confirmed that the exchange is working with SCM and other industry stakeholders to engage Canada's regulators in evaluating the reinstatement of a tick test.

The question of a new uptick rule was raised earlier this year at a TSX Venture Exchange roundtable discussion where it was debated whether shorting rules should be tied to the liquidity and/or size of companies, to restrict short selling in illiquid securities.

Elsewhere, SCM is seeking to drum up support with an online petition and has already gathered support from several commodities industry associations and junior market participants.

The IIROC is yet to respond to questions regarding SCM's claims.

ISLA releases SFTR report modeller

The International Securities Lending Association (ISLA) has launched a report modeller for the Securities Financing Transactions Regulation (SFTR), to help members meet new trade reporting obligations due in April 2020.

The modeller allows users to construct an example report to simulate the expected output of any securities lending transaction for any lifecycle event, ISLA noted.

This example report would be illustrated in the regulatory technical standards real-time format using the European Securities and Markets Authority's (ESMA) latest validation rules (VR) standards.

The latest VR standards and XML schemas for SFTR were officially released on 31 October, but are understood to still be in the process of gaining ISO registration.

According to ISLA, the interactive nature of the spreadsheet for the modeller allows members to select one of their preordained trade scenarios, identifying their business model and trade type.

The logic within the modeller prompts users to systematically work through the report via data input or list-box selection.

ISLA explained that in-built governance will indicate if there are any population or formatting errors, prompting users to make the necessary amendments prior to completion.

Richard Colvill, ISLA's SFTR project lead, commented: "We are pleased to be able to offer a solution that allows ISLA members the ability to produce a full range of sample reports and see the manifestation of the SFTR in ESMA's recognised RTS format."

"Feedback received to-date has been very positive and we hope this will be a useful tool to help our members deliver their project obligations," Colvill added.

The first phase of the EU's SFTR is due to come into force in April 2020. It will require financial institutions and other entities to report their securities financing transactions to a registered trade repository for the first time in a bid to increase market transparency and expose risks.

RepoClear clears first variable rate repo indexed on €STR

RepoClear has cleared its first Variable Rate Repo (VRR) trade indexed on the Euro Short-Term Rate (€STR), with Credit Suisse among the first participants to clear the new rate at the clearinghouse, LCH.

€STR, launched on 2 October, is the euro risk-free rate that is set to replace the Euro OverNight Index Average (EONIA), which was previously the preferred overnight rate of all overnight unsecured lending transactions.

Dipen Mistry, a director in the global liquidity group at Credit Suisse, added: "The ability to clear repo trades index to €STR is another important step in the market's transition to new reference rates. We're proud to be one of the first participants to centrally clear these trades, underlining our proactive engagement in the EUR market."

In October, LCH cleared its first euro interest rate swaps referencing the €STR, making it one of the first clearing houses to offer the swaps benchmarked to the new reference rate.

2019 in review … march on 2020

Christmas is just a few weekends away but lingering concerns remain over funding liquidity through year end as the market traditionally settles over the festive period and takes stock. In this spirit, I wish to review 2019 and offer steer for 2020.

The Securities Financing Transactions Regulation (SFTR): For the securities lending industry the year has been dominated by preparation for the complicated SFTR that will commence in April 2020. Only four months from reporting go-live, the European Securities and Markets Authority still has to finalise the level-three reporting guidelines. SFTR is set to continue to dominate 2020, tailing off slightly only in Q3/Q4.

Brexit: The UK's drawn-out departure from the EU has been the other big story of the year and will continue to dominate the first half of 2020. A slight narrowing of the polls and the UK will be left, once again, with a hung parliament. If the British electorate returns a split decision for the second consecutive Brexit election then, to break the impasse, a second referendum will become irresistible. The latest polling suggests 52/48 percent in favour of Remain. I suspect the actual result would be stronger in favour of Remain. In the final analysis, should there be a hung parliament, I predict Remain in 2020, otherwise the UK is out on Johnson's deal.

The Central Securities Depositories Regulation (CSDR): It is due to commence in September 2020, although this is susceptible to delay. The regulation seeks to reduce settlement failures by: introducing CSD-led penalties for failures; and obligating mandatory buy-ins. The industry remains wary of the mandatory buy-in regime, especially vis-à-vis the non-cleared bond markets, with concerns over the likely negative impact on liquidity with market makers reluctant to offer. While SFTR has taken pole position this year, CSDR will rapidly race up the grid as the deadline looms.

European Market Infrastructure Regulation (EMIR): Intra-group derogations for margin followed by intra-group derogations for clearing are due to expire in 2020. The next wave of phase five entities is due to commence being subject to uncleared margin rules. Meanwhile, EMIR review (REFIT) is due to commence in June 2020.

Next year I shall outline the main legislative acts for 2020 including MiFID II changes for crowdfunding; covered bonds; non-performing loans; sustainable finance; sovereign bond-backed securities; the formation of a single resolution fund et al.

2020 will be the end of the decade of fundamental financial reform in the EU. For a snapshot of the state of EU banks, I commend the European Banking Authority's (EBA) 29 November report entitled: 'EBA confirms progress in banks' balance-sheet repair but points to a bleak outlook for their profitability'.

As for the financial macro themes of 2020, they will continue to be:

- IT/technology: The adoption of blockchain solutions; Outsourcing of IT to fintechs, coupled with investment in the same;
- Low bank profitability (due to regulatory capital requirements and clearing obligations);
- Lingering stress in the funding repo market;
- A looming global recession (coupled with a new European Commission);
- Incremental adoption of pre-legislation guidance on crypto-assets; and
- Adoption of pre-legislative principles on artificial intelligence… all of which I have written on in 2019!

In my final piece for the year I wish to extend a heartfelt thanks to the many readers who have contacted me to exchange views or express gratitude. I hope you have found my memos interesting and wish you a peaceful festive season.

Seb Malik
Head of financial law
Market FinReg

Let there be light

SFTR promises to shine a bright light on the dark corners of the securities finance industry but it is still unclear what regulators plan to do with the reported data, or how they will manage it

Maddie Saghir reports

In the beginning, when the securities lending industry was first created, the market was a formless void and darkness covered the face of the deep. Then, in the year of regulator, 2016, the European Commission said: "Let there be light", and there was light.

And the commission called the light the Securities Financing Transactions Regulation (SFTR) and it was good.

The EC first revealed its intentions to introduce direct regulation of its securities financing transactions back in 2016, but now, with only four short months until the first wave of SFTR's reporting requirements go live, the final picture of what the transparency initiative will actually look like is far from clear.

There are still lots of questions surrounding the data that SFTR will generate, such as: how will the regulator even begin to process it? Will firms be able to afford heavyweight technology in order to cope with producing and reporting data? Where will all of this new transaction data be stored? Is the commission likely to use this data to form even more stringent rules down the road?

The general consensus among market participants is that even those in Paris or the hallowed halls in Brussels do not truly know all the answers. It is widely understood that the European Securities and Markets Authority (ESMA) will put the market's transaction data to use in some way, but it is as-yet unclear how.

Tim Smith, managing director, business development at Hazeltree, suggests, for example, that access to securities finance data will enable ESMA to analyse the industry in more depth and see if there is any overlap between various capital market derivative businesses.

Smith goes one step further and predicts that ESMA's initiative is likely to be copied around the world even though SFTR already has impacts on entities outside of Europe.

Lessons from the past

The securities finance industry has seen ripples and waves of regulation over the past few years, in the aftermath of the financial crisis, from the European Market Infrastructure Regulation (EMIR) to the Markets in Financial Instruments Regulation (MiFIR), and now SFTR.

As a result, it has been argued that they also serve as a strong foundation for both the regulator and the industry to approach the formation of SFTR from a much more educated position than they did with its predecessors.

"SFTR is in many ways similar to EMIR and the MiFIR reporting and all of those datasets that ESMA expected from EMIR and later from MiFIR are very similar to SFTR, albeit in a different asset class," explains Alexandra Foster, director of insurance, wealth management, financial services at BT. "ESMA has a lot of experience in dealing with data-related challenges by now, and I would hope that they will draw from the lessons learned previously to ensure smooth implementation of SFTR."

Also reflecting on previous regulations, Mark Steadman, executive director, European head, product development and change management at DTCC, stipulates: "Data quality is now in a relatively good state for derivatives, following the implementation of EMIR and the continued rounds of changes, guidance and tightened validations under that regulation."

"ESMA, for example, used the data in the trade repositories (TRs) to help set threshold limits for MiFID. For SFTR, I expect data quality to follow a quicker trajectory than EMIR as ESMA have imposed tight validations and have standardised submission formats through ISO 20022 from day one," Steadman says.

Old habits die hard

It may be true in theory that the foundations of SFTR were laid many years ago, but with the go-live just around the corner many in the industry will be getting a nasty sense of deja vu as some lessons of the past seem to have been missed.

First and foremost, as we race towards the festive break, the industry is still waiting to see the level three text that will spell out once and for all what form their SFTR reporting solutions must take. The results of market surveys on SFTR readiness and the mood and industry events paints a bleak picture of what day one of SFTR will look like next year.

Industry research, perhaps unsurprisingly, has repeatedly highlighted that the less time market participants have to complete their builds has a directly detrimental effect on the quality of data reported as testing times are sacrificed to expedite the construction process.

Compounding this trend, it was only last month that ESMA released the third draft of the SFTR, XML schemas which was found to be containing several defects that meant it was not ISO registered at that time as many were expecting.

> **We continuously see the regulators not really understanding important things and releasing the XML formats six months prior to go-live is not good enough.**

Matt Smith, CEO of SteelEye, a London-based regtech and data analytics provider, said: “We continuously see the regulators not really understanding important things and releasing the XML formats six months prior to go-live is not good enough. In this time, firms need to build reporting capabilities and go through thorough testing, validation and preparation.”

Turning attention to past regulations, If you look at the MiFIR, one of the big issues there was around reference data, he argues.

“If the reference data isn’t ready then you’re not able to report. Although I am a big believer in the standardisation of formats, if everything was more prescriptive, including reference data, then I think the entire market would benefit,” Smith added.

Are ESMA’s eyes bigger than its belly?

A further challenge ESMA has saddled itself with is the heightened need for more data to be produced and stored. David Shone, vice president, Europe, the Middle East and Africa, business solutions, policy and control at State Street, said: “The negative aspect [of SFTR] is obviously that with more data, there will inevitably be more anomalies for ESMA to investigate.

“It should be interesting to see how they initially respond upon go-live and whether they will be more stringent than previous regulations given how much time firms have had to get this right.”

Highlighting the enormity of the data ESMA is set to receive, Fabien Romero, director, SFTR, business development at IHS Markit, says that under new requirements, National Competent Authorities (NCAs) and TRs will send ESMA a vast quantity of data on a daily basis; one estimate is that up to 150 million SFTR related events may be reported on a single day.

“Multiply this by the five years of data retention required by SFTR and you can measure the enormity of the data pool available to ESMA, NCAs, TRs. To manage this, vast resources are needed to store data in clouds or data centres,” Romero adds.

Reaching Nirvana

Transparency is one of the main objectives of SFTR, which SteelEye’s Smith says means that data integrity will be of the utmost importance, and the industry is working toward the standardisation of data, which is partly driven by regulation, but also by the industry itself.

Illustrating this, Martin Seagroatt, marketing director securities finance and collateral management at Broadridge, says: “One example is the discussion around adopting initiatives like the ISDA Common Domain Model, which represents trade events and actions in a common representation across the market.

“This standardisation harmonises data across markets which facilitates interoperability across the regulatory landscape and beyond.”

Seagroatt identified that while much of the data in the financial system is already digitised, the concept of improved tools to monitor the health of markets, identify build ups of systemic risk and perform ‘preventative maintenance’ is the same.

He explains: “Regulators could then use macroprudential levers like haircut floors or capital buffers, in addition to rate setting/access to central bank liquidity to improve the resiliency of the system in a more proactive manner than is currently possible.”

This, Seagroatt says, is the nirvana state for regulators - but due to the system’s complexity we are still years away. **SLT**

SFTR will require market participants to report data into as many as 153 different fields, which is something that the market has not had to deal with before.

Financial counterparties will be required to report their securities financing transactions to an approved registered EU trade repository, and structurally, it is the same as reporting under EMIR, requiring two-sided T+1 reporting model.

Welcome to the new normal

Technology and regulation have helped push open the doors to the securities lending market where new entrants were once viewed with suspicion

Maddie Saghir reports

Securities lending was once thought of as a murky world that played host to several scandals that were finally brought to light when the financial crash hit between 2007, revealing the dark underbelly of an otherwise legitimate industry.

In 2007, the US Securities and Exchange Commission (SEC) charged 38 people, including Wall Street traders, in a series of fraudulent schemes involving phoney finder fees and illegal kickbacks in the securities lending industry.

According to the SEC, these traders conspired in various schemes with 21 purported securities finders – intermediaries who help locate shares and arrange the loans of hard-to-borrow stocks – to skim profits on transactions. The defendants pocketed more than $12 million over a period of nearly a decade.

In the wake of events like this, regulation has come in stricter and more complex forms than ever before to help combat some of these shadowy areas of the industry. However, disruption also brings opportunity and as the securities lending market has opened up to new entrants seeking to capitalise new opportunities to provide services to the market or offer their assets for loans.

Where in the past the market was dominated by a close-knit community of large entities, today's landscape is populated with a wide variety of new market players from new, smaller lenders and borrowers to fintech service providers, platform hosts and other intermediaries.

However, the way ahead for new-comers is still far from clear with start-up costs, regulatory burdens and industry stalwarts resistant to change all standing in their way.

Letting in the light

Transparency is becoming a more welcome feature in the industry but before the financial crisis, market players operated in an opaque environment – and some liked it that way.

Market visibility is advantageous for new market entrants because, as Yannick Lucas, senior consultant, securities financing at Margin Reform, points out, it allows for competition, which is good as it will aid price discovery. According to Lucas, the industry now welcomes new entrants and new supply.

Hazeltree's managing director, business development, Tim Smith, also sees that these cultural barriers are coming down. "They [the barriers] were high but they are now becoming lower as all stakeholders recognise that the doors can't be pulled shut anymore," he says.

Smith outlines that even as recently as a few years ago, some market participants thought of transparency as a dirty word.

"Adjusting to this, the concept of transparency has transitioned from being unwelcome through being tolerated to most recently being embraced," Smith continues.

Indeed, according to Smith, cultural barriers meant that participants used to say that they didn't want more counterparties and they were happy with their own intermediary group, but that attitude has dissipated significantly now. In fact, he says that intermediaries have now turned into facilitators and their clients are appreciative of the assistance they obtain.

Reinforcing this point, IHS Markit's global head of securities finance, Paul Wilson, emphasises that competition is a positive force that drives innovation and choice and delivers a much better outcome for everyone, especially beneficial owners considering entering the market. "That competition exists in virtually all aspects and across all segments of market participants and providers," he explains.

Further to this, Boaz Yaari, CEO and founder of Sharegain, a fintech newcomer aiming to open up securities lending and to relatively small investors, including high-net-worth individuals, notes that today most banks and custodians enable their clients freedom of choice with regards to the routes to market, for example joining their custodians' lending programme, lending directly or appointing an agent.

While transparency, and with that, the healthy appetite for competition, is one of the opportunities that have come from regulation, Hazeltree's Smith says: "The twin-pronged attack of regulatory and transparency initiatives has now meant that the pressure to do one's own lending and the pressure to allow different participants in the value chain to talk to each other and negotiate with each other has led to further opportunities for direct lending."

According to Smith, institutions are now able to see around certain intermediaries to the direct borrower and are recognising that they are able to undertake their own lending programme.

And, undertaking your own programme can provide opportunities in terms of having more direct control over risk, compliance, reporting and revenue generation.

Meanwhile, location can also play a role in the ease of entering the securities lending market. Smith identifies that in North America, for example, it is the norm to undertake securities lending via your custodial lending programme, and in Europe, it is easier to initiate your own securities lending programme with the custodian bank facilitating it.

Meanwhile, in Asia, for local participants, it has been more challenging due to historical local regulations.

The double-edged sword

While cultural aspects and regulation have placed new-market players wanting to start their own lending programme or offer a service to those lenders in good stead, technology is somewhat of a double-edged sword.

On one hand, new players have the advantage of starting from scratch without having to rely on old legacy systems. This can give them a competitive advantage against their peers to create something new and innovative.

Sakti Narayan, senior consultant, securities financing at Margin Reform, argues that new entrants have more choice as they can benefit from the advances in trading platform technology brought forward by new vendors or opt for the established platforms.

"With new technology, I would expect the onboarding time-frame to be shorter and the post-implementation support/maintenance less expensive and less painful compared to using legacy technology," Narayan says. "New entrants will benefit from the post-trade automation services - these are efficient, easy to onboard and to use."

However, on the other hand, technology comes with costs and for many new entrants, these can still be too high.

Sharegain's CEO has expressed that there are lots of hurdles to cross if you're a newcomer trying to set up a new programme and cost is a major factor. "Setting up an internal securities lending programme is an operationally intensive process, requiring both expertise and IT resources," he adds.

As well as this, establishing relationships with counterparties and collateral managers is also a high hurdle for many financial institutions. And, on top of the set-up costs, one should take into consideration the additional resources needed for keeping up-to-date with the evolution of the securities lending industry and regulatory changes.

"Even for large financial institutions with significant resources, this could be quite a challenge," Yaari says. "That is why we see more and more financial institutions looking for a different offering that can give them the best of both worlds – benefitting from the additional revenue without operational and IT constraints."

However, despite its cost, technology is not something that can be overlooked by new entrants. For example, when institutions set up a new programme, Smith highlights that the first discussions will look at how it will be monitored and booked.

Emphasising this, Smith adds: "Technology is critical – and I'll go a step further to say that cutting-edge technology and continued investment in technology are essential. When you consider the volumes traded and the risk involved, to establish any potential competitive advantage, new entrants absolutely need cutting-edge technology to grow their market share."

Meanwhile, at Sharegain, Yaari sees technology as the catalyst for the democratisation of the securities lending ecosystem and explains that in many cases, financial institutions are constrained by their own legacy technology and have decided not to develop securities lending solution in-house given the lack of adequate IT budgets.

He continues: "Instead, many of them are looking for a solution that can integrate with their systems without the need to overhaul them and is based on a software-as-a-service commercial model."

Still more to do

Entering the securities lending industry and starting up your own programme has become easier over the years and as Margin Reform's Lucas remarks: "Given the new regulatory landscape, with the emphasis on trade matching, timely settlement, and good bookkeeping - it's a great time for new entrants to start a business from scratch since the bespoke operational model will have to be regulatory compliant."

Additionally, according to IHS Markit's Wilson, it is relatively easy for beneficial owners who are looking to start their own programme.

Wilson explains: "At IHS Markit, we work extensively with new entrants to help them understand the revenue opportunity and associated risk from a number of different programme styles – from high-value intrinsic lending to a voluminous general collateral programme. We also help new entrants create the right framework, guidelines and internal governance structure to support the type of programme they wish to operate."

While regulation has made the path smoother for starting your own programme, there are still hurdles to overcome, and the industry is not out of the woods just yet. Further education, guidance and lower costs could be a start in further opening the door and ensuring it stays open in the years to come. **SLT**

The known unknowns

As the decade draws to a close, the securities lending industry arguably has more questions than answers about what the future will bring. David Lewis of FIS takes stock of what's ahead

Financial markets love certainty. Certainty brings stability, predictable growth, political balance and public harmony. It can even dispel the threat of war and civil uprising. If certainty is capable of bringing all these positive outcomes, at least in theory, is it possible that the opposite is also true? If that is the case, as the second decade of the third millennia counts out its final days, we may well be in for quite a ride.

Between us and the end of the decade (who could believe the Millennium Bug drama will soon be 20 years old?) lies the UK election; arguably one of the most pivotal in living history. Its outcome may shape the political landscape across the UK and Europe for many years to come, and that outcome is probably the least certain one ever. Brexit will undoubtedly affect the securities finance industry to a greater or lesser extent, and some organisations have already taken action setting up new entities, either physically or just legally, to ensure representation in the UK as well as mainland Europe. This has been an active part of our work here at FIS as we help our clients prepare for what may come, but some market participants remain on the sidelines waiting for some certainty before making a move.

The securities finance industry, outside of political issues affecting the wider market and community, faces a very high level of uncertainty going into the new year. The Securities Financing Transactions Regulation (SFTR) has been looming ever larger on the horizon as the April 2020 go-live date draws nearer (which is curiously on a weekend), but it is one of the few certain things about it. Much remains unknown as the market awaits the release of the level three documentation which will detail the reporting requirements. For those going live in the first phase, that will leave them a period of around or under four months to complete the reporting developments. This is no small ask: it will require analysis of the requirements, design and build of the actual reporting outputs, or at least the amendment of reports constructed so far, connectivity testing and go live. In the middle of this will be the Christmas break and technology year-end freezes. As far as certainty goes, it will be in short supply, save for the fact that many are facing a very busy holiday season.

Few expect the launch of the legislation to be delayed so it seems that April will indeed herald in a level of regulatory transparency that the securities finance market has never experienced. The rollout of other large-scale reporting requirements, such as the European Market Infrastructure Regulation (EMIR), would also suggest that post April will be no holiday either.

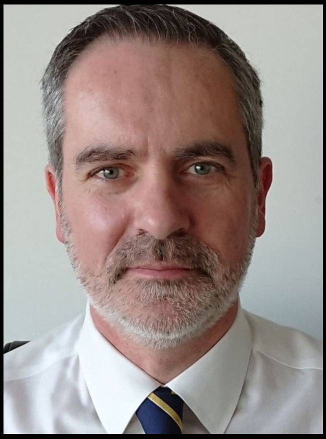
Not too far in the future, in September 2020, Central Securities Depositories Regulation (CSDR) will also go live. As far as the regulation itself goes, it has certainty written all over and indeed through it. Certainty is, in fact, its core purpose as it aims to enshrine the process of fails management into a strict set of rules with punitive fines attached. What is uncertain is the effect this regulation will have on the market. Already some firms are indicating it may be the final straw with regards to their voluntary involvement with the securities lending market, citing the risk of large fines outweighing the revenues that they earn. This will have the knock-on effect of withdrawing some liquidity from the market and, contrary to the aims of the legislation, potentially decreasing settlement certainty as lenders remove their supply. The European Securities and Markets Authority has acknowledged a delay in implementing the regulation is likely, casting further uncertainty around the settlement certainty regulation.

Turning back to politics, 2020 will also bring us the US elections. Much like the UK, the outcome could bring about a seismic change in direction for the world’s largest economy, with the effects felt around the globe. On one hand, there may be a continuation of the regulatory bonfire that has been burning for the past three years, bringing looser control of both the financial markets as well as the industry at large. Alternatively, a sharp change in direction will bring taxes to the wealthy, the big corporations and significant amounts of legislation and regulation to reign in the banks and corporations. Coupled with Brexit and our own elections, the UK faces significant uncertainty over the coming months, and potentially years to come.

The rise of environmental, social and governance (ESG) influences will also increasingly affect the securities finance markets as beneficial owners behaviour and investment strategies change. Differing asset mixes, potentially greater involvement in voting obligations and less involvement in dividend trading will all affect the way the market operates. In potential conflict with this is the fiduciary need to lend funds’ assets to earn much-needed revenues, particularly as many funds drop their management fees to zero.

How is our industry expected to cope with all these changes? Data and technology will certainly be two key elements in any organisation’s survival strategy. Being seen to deliver best-execution to satisfy the requirements of the second Markers in Financial Instruments Directive will require sophisticated intra-day data to correctly rate trades and actively mark-to-market. The need to deliver accurate and timely reporting to the relevant regulators under SFTR will require a sophisticated technology lift, ensuring accurate and on-time deliveries of significant quantities of data. All the while, new collateral and governance schedules from beneficial owners applying their new ESG policies will change the dynamics of the lendable pool. New entrants to the market will be disrupting the traditional transaction chain, bringing additional routes to market and extra liquidity, but while demand remains low, automation through advanced technology will be required to keep the returns at an acceptable level.

2020 is the start of a new decade and a whole new era for the securities finance market. The challenges the market will face will demand that you have a strong technology partner to make the most out of the changes to come. Are you ready for those changes? If that’s a yes, can you be certain of that?



David Lewis
Senior director
FIS

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Coming and goings at Deutsche Boerse, Pirum and more

Exane, an investment firm focused on cash equities, derivatives and asset management, is seeking to "elevate" its US securities lending, Delta One and collateral management business with three new hires.

In a statement on the expansion, Exane said it intends to become "a truly full-service derivatives shop" that will also focus on portfolio trading and volatility desks at sell-side institutions, as well as acting as a "significant asset" for liquidity seeking market makers and asset managers globally.

Amarbir Jawanda and Matt Koren have joined from prime broker Forte Securities.

Jawanda spent just under 20 years building equity derivatives businesses at several sell side firms including Credit Lyonnais, HSBC and RBC before joining Forte in 2018.

Meanwhile, Koren spent seven years between Citi and Jefferies developing top-tier Delta One exchange-traded fund swaps and index/financing arbitrage business before joining Forte in 2019.

The third new team member, who has not yet been named, will join in early 2020 from a competitor to Exane, once their non-compete period has ended.

All three will be based in New York.

Prior to these hires, Exane said it primarily focused its attention in New York on a number of niche businesses, which were largely reverse conversions and single stock volume.

Exane expanded internationally in order to be as 'close to clients as possible', with Paris and London as its main offices.

Deutsche Boerse CSDR buy-in agent gains Deutsche Bank veteran

Deutsche Boerse's new buy-in agent has lured Marko Niederheide away from Deutsche Bank after 23 years with the bank.

In July, the German exchange formed Eurex Securities Transaction Services, a subsidiary of Eurex Frankfurt, to develop a neutral buy-in agent for market participants facing the challenges posed by the Central Securities Depositories Regulation (CSDR) incoming buy-in provisions.

CSDR will usher in the European securities finance industry's first mandatory buy-in requirements for failing transactions from 14 September 2020, although this date is currently under review by the European Commission.

Deutsche Boerse's buy-in agent, which is the first of its kind to be created as a direct response to CSDR's settlement discipline provisions, is set to go live in September next year ahead of the regulation.

At Eurex Securities, Niederheide will join the company's co-founders, Marcel Naas, formerly of Eurex Repo, and Marcus Addison, who shifted over from Eurex Clearing.

He will be responsible for business development and ensuring the product meets the market demand for a solution to the regulatory requirements of CSDR.

Niederheide has already left his position at Deutsche Bank but will not begin his role with Eurex Securities until the new year.

He brings a wealth of experience from two-decades at the German bank. In a LinkedIn post outlining his new role, Niederheide said he began his career in August 1996 as an apprentice in banking in a small branch of Deutsche Bank in his hometown of Cottbus, in northeast Germany.

He rose through the ranks to serve in roles including head of transaction services for Frankfurt and later as head of loan exposure management group operations, before assuming his most recent role as European head of global transaction banking market advocacy in 2008, based in Eschborn.

Pirum Systems grows SFTR team, again

Pirum Systems has strengthened its Securities Financing Transactions Regulation (SFTR) team with four new hires.

The EU's SFTR, the first phase of which is due to come into force in April 2020, will require financial institutions and other entities to report their securities financing transactions to a registered trade repository for the first time in a bid to increase market transparency and expose risks.

The final details of the reporting requirements are set to be revealed in the regulation's level three text due to be published by the European Securities and Markets Authority in December.

Ahead of SFTR's go-live, Pirum has welcomed Glenn Baldwin, Payal Lakhani, James Cosh and Pradeep Rana to its ranks.

Baldwin brings 15 years of securities finance expertise and joins from J.P.Morgan, as well as bringing experience from roles at Goldman Sachs and eSecLending.

Lakhani makes the move from Citi where she served as part of its risk and oversight, global corporate actions, business for the past two years.

Meanwhile, Cosh boasts a 20 years of experience in product post trade businesses from roles at Deutsche Bank, Nomura, Leman Brothers and Saxo Bank.

Finally, Rana brings a prime brokerage skillset, having worked at J.P.Morgan for the past seven years as a prime brokerage client service manager.

All four will report to Duncan Carpenter, Pirum's head of SFTR.

As part of its SFTR solution, Pirum has partnered with IHS Markit and it is understood these new hires will bring their combined SFTR team more than 55 strong.

Most recently, the joint solution saw the addition of a unique trade identifier sharing system for third-party firms.

Commenting on the new hires, Pirum COO Phil Morgan said: "The addition of these high calibre individuals to our already highly respected SFTR team, means Pirum remain fully committed and resourced to help our clients as they ramp up on-boarding, implementation and testing."

"Our joint solution with IHS Markit has well over 60 clients mandated, with a further 20 anticipated to provide the green light in the coming weeks."

Nomura Holdings has named Koji Nagai as its new chair, effective 1 April 2020 as part of several management changes.

Nagai is currently representative executive officer, president and group CEO of Nomura.

He joined Nomura in 1987 and has worked in various roles, including most recently as executive managing director and group co-COO of the company. He was also director and deputy president of Nomura Securities and CEO of Nomura Holding America.

Nagai will replace Nobuyuki Koga, the current chair. Koga will become Nomura's director as of 1 April 2020.

Meanwhile, Nagai's current responsibilities will be taken over by Kentaro Okuda, who currently serves as executive officer, deputy president and group co-COO.

Kentaro Okuda is set to become a representative executive officer, president and group CEO, also effective from 1 April 2020.

Nomura operates through five business divisions: retail (in Japan), global markets, investment banking, merchant banking, and asset management.

The European Securities and Markets Authority (EMSA) has named Robert Ophèle as acting chair of the central counterparty (CCP) supervisory committee, effective 1 January, until a permanent replacement is appointed.

The committee will consist of a chair and two independent members as well as national competent authorities responsible for the supervision of CCPs and central banks of issue of EU currencies, however, these are yet to be named as the recruitment process is ongoing.

The committee will be responsible for preparing draft opinions or decisions in relation to EU and third country CCPs for adoption by the board of supervisors.

ESMA said: "EMIR 2.2 strengthens ESMA's role regarding the authorisation and supervision of EU CCPs, promoting supervisory convergence among the activities of national competent authorities, and to the recognition of TC-CCPs, entrusting ESMA with direct supervision of systemically important third country CCPs."

Ophèl is currently the chair of the Autorité des marchés financiers (AMF), the stock market regulator in France.

He started his career in finance when he joined the Banque de France in 1981 and spent three years in banking supervision before joining the Monetary Studies and Statistics Directorate as an economist, specialising in the interaction between financial market developments and monetary policy.

Following a secondment to the Federal Reserve Bank of New York between 1990 and 1991, he returned to the Banque de France as head of the budget division, according to AMF.

He then subsequently took up the position of director of the management control and budget directorate. In this role, he represented the Banque de France on various Eurosystem committees.

In July 2006, Ophèl was appointed deputy director general economics and international relations before being promoted to director general operations in 2009.

Broadridge has appointed Matthew Nelson who will be working in strategy and business development to support the buy-side business globally.

Based in the US, Nelson will report to Betsy Stephens from the global technology and operations strategy.

Nelson previously worked at the Depository Trust & Clearing Corporation (DTCC) institutional trade processing as a managing director in global business management from 2015 to August 2019.

During his career, Nelson also served as an executive director, global head of strategy at Omgeo, a senior analyst at TowerGroup and a senior product manager at Fidelity Investments.