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Sharpen your edge

Industry experts discuss why demands for real-time data will only continue to grow in 2020

Short Selling

A Canadian lobby group is calling for tighter regulations on short sellers and it has already had some success

Data Analysis

The new year brings SFTR, CSDR and Brexit, but underlying trends such as ESG and short selling will also continue to demand attention

2020 Legislative Update

We are entering a new era of financial regulatory divergence as regulation reflects entities different priorities

MUFG initiates securities lending surge with nine new hires

MUFG Investor Services, the global asset servicing arm of Mitsubishi UFJ Financial Group, has fired an opening salvo in its push to be the first Japanese bank to play a leading role in the global securities financing market.

Earlier this month, the banking group welcomed Tim Smollen as global head of securities lending solutions, fresh from serving in a similar capacity for Deutsche Bank since 2015.

MUFG has since confirmed Smollen will be joined by eight – as yet unnamed – additional hires that the bank says will "support the growth and development of MUFG's securities lending franchise".

The bank was unable to confirm the names of Smollen's new team but it is understood that several members of his Deutsche Bank team will be among the recruits, including Jay Schreyer, former head of agency lending for Europe, the Middle East and Africa, and Asia Pacific, and Anthony Toscano, former co-head of agency lending for North America.

According to the bank, the hires are the latest push "to expand and accelerate the growth of MUFG's global securities lending programme," which has been active for more than 20 years.

In a statement on the hires, MUFG says Smollen and his team will develop custom solutions to match the various needs of its clients and other third-party clients while sustaining lending performance.

"Bringing Tim Smollen on board to lead our expanding team reinforces our commitment to further growing this business and becoming one of the globally recognised programmes in this space," explains John Sergides, CEO of MUFG.

Sergides adds that part of this strategy will include the bank continuing to invest in "leading technology to keep MUFG the forefront of innovation in securities lending".

Commenting on his new role, Smollen says: "At a time of global regulatory change, it is important for investment managers interested in securities lending to find a partner they can rely on that is capable of providing consistently high-quality service and stability.

"I am excited to join MUFG Investor Services as it has continuously proven its commitment to innovating with technology and investing in personnel in order to provide clients with the highest quality solutions."

Inside this issue

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SteelEye's services selected by CIAM

Compliance technology and data analytics firm SteelEye has been selected by CIAM, an investment management firm, to provide trade surveillance, best execution and record keeping.

SteelEye says it will replace CIAM's existing setup in order to "future proof their regulatory requirements and adopt a more proactive approach to compliance".

Unifying a range of their compliance requirements on one platform enables CIAM to adopt a more holistic approach to compliance, according to SteelEye.

Emmanuel Drujon, COO and risk manager of CIAM, comments: "We were looking for an independent vendor that would enable us to proactively manage our regulatory obligations.

"We also wanted a solution that would allow us to respond to regulatory change quicker, he adds. "SteelEye was the perfect fit."

Industry reacts to SFTR's guidelines

As the dust settles following the release of the Securities Financing Transactions Regulation's (SFTR) final guidelines, the securities lending industry has had its say on the incoming reporting regime.

The first phase of SFTR is due to come into force on 13 April for investment firms and credit institutions, and July for central counterparties and central securities depositories.

Multiple market participants were quick to praise the European Securities and Markets Authority's (ESMA) decision to allow a 12-month grace period for the legal entity identifiers (LEI) requirement for third-country issuers, which was set to come in as part of phase one.

Dean Bruyns, senior director, message automation product management at Broadridge, tells SLT that "a collective sigh of relief would have greeted the news that the 'no LEI – no trade' stance in third-country securities has been granted temporary relief".

"This gives the industry time to lobby the issuers of securities to ensure that they obtain LEIs by April 2021," he adds.

Bruyns further explains that the impact of being unable to trade in securities without issuer LEIs would have been "considerable" and had a "detrimental effect on liquidity and fails in the market".

The scale of the market disruption being avoided through the application of the reprive was also outlined by EquiLend, which stated on Monday that requiring third-country LEIs from April "would have severely impacted market liquidity".

In its report on the final guidelines, ESMA noted that, on average, 88 percent of instruments issued by EU issuers have an LEI code, compared to an average of 30 percent from non-EU jurisdictions.

Due to the clear disparity in issuer readiness levels, the EU watchdog stated in its report that "considering the still unsatisfactory level of LEI coverage on the global scale" it was adjusting its rules in order to "ensure the smooth introduction of the SFTR reporting regime".

However, multiple industry figures observed that the delay did not resolve all concerns around SFTR's fast-approaching go-live date.

Pirum Systems' head of SFTR business development, Simon Davies, tells SLT that although the delayed implementation for third-country issuers is a positive step, the fact that more than 10 percent of European securities are missing LEIs means "there will still be an impact on the industry when reporting starts, and firms need to carefully assess the impact this will have on trading, collateral and reporting capabilities".

Broadridge's Bruyns also emphasises that it is "critical that a proactive approach is taken to significantly increase the adoption of LEIs over the next 15 months," adding that some issuers may be slightly reluctant to do so.

"After all, it's difficult for traders to short their security where there is no borrow allowed in it," he notes.

Elsewhere, market participants have begun to pore over the other changes in the level three text, compared to earlier drafts.

Bruyns explains that another win for the industry came in ESMA's acquiescence to industry consensus on the reporting of cash-driven securities lending transactions. The issue, he says, was that these trades have "more repo-like characteristics than traditional stock loans and fit better within the repo reporting template".

Following last year's consultation on the matter, ESMA has now stated that these transactions should be reported as repos.

"This makes sense, the challenge, however, is that counterparties will now need a way of identifying the intention of the stock loan to determine whether to report it as a stock loan or a repo," Bruyns says.

As a result, a method of quickly identifying these types of trades will need to be factored into the implementation of SFTR reporting solutions.

Other key areas to review in the final text, according to Pirum, include the timing of event reports, agreement of collateral quality, valuations, pricing and foreign exchange sources, along with margin loan reporting and variation margin on repos.

Although initial responses to the release were largely positive, some lingering concerns have already been raised.

Sunil Daswani, senior securities lending and repo consultant at MarketAxess' reporting subsidiary, Trax, tells SLT that there are still outstanding issues around front-load backloading, time-stamp validations, settlement (contractual versus actual), lifecycle events, haircuts, collateral quality, securities re-use and corporate actions in general.

Daswani also advocates for further discussions with clients and counterparties on the importance of bilateral "outreach" via the template questionnaires created by the International Securities Lending Association and International Captial Market Association.

He says that MarketAxess is proactively pursuing these discussions in order to "ensure further education on the regulation and coordination prior to go-live".

"It is important to resolve issues around misunderstanding between either party reporting a transaction leading to unnecessary exceptions," he adds.

IHS Markit opens HQLA valuation tool to securities finance clients

IHS Markit has opened up access to its portfolio valuations and reference (PVR) services to its securities finance clients in order to boost utilisation of high-quality liquid assets (HQLA) and allow for more accurate asset valuations.

The financial services and data analytics provider says it has created a model to classify fixed income securities based on "a variety of fundamental and market-based characteristics".

While the model inputs are proprietary and only available to PVR clients, IHS Markit's securities finance clients have now been granted "complimentary access" to the output classifications.

The service also aims to provide more granular insight into the performance and market value of different forms of HQLA to assist in collateral valuation as part of securities lending transactions.

According to IHS Markit, the implications of HQLA classifications to the securities lending market are broad and include the marketability of lendable portfolios and the calculation of utilisation in performance reviews.

In a statement on the decision, IHS Markit says the move comes partly in response to the increased need for accurate classification of the three categories of HQLA in the wake of the implementation of Basel III's liquidity coverage ratio (LCR).

The LCR came fully into force in 2015 and requires banks to ensure they are holding HQLA that is equal or greater than their net cash flow over a 30-day stress period.

HQLA is broadly broken down into the categories of level one for cash, central

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bank reserves and 0 percent risk-weighted government securities; level two (A) for non-financial corporate bonds and 20 percent risk-weighted government securities; and level two (B), which includes BBB rated government securities and common equity shares.

LCH achieves record-breaking repo activity for 2019

Global clearinghouse LCH has reported a record year for nominal cleared in 2019 through its RepoClear platform, with a 7 percent year-over-year growth.

LCH saw €212 trillion nominal cleared by members throughout the year, which the clearinghouse says enabled it to benefit from the netting efficiencies of the EU's Target2-Securities platform.

SwapClear, LCH's interest rate derivatives clearing service, registered over $1,229 trillion in notional for 2019, an increase of 14 percent from 2018's volumes.

Compression volumes also continued to grow, with more than $920 trillion compressed over the course of the year, up 19 percent from 2018.

During the year, LCH was also the first central counterparty to launch clearing for euro Short-Term Rate (€STR) swaps and expanded its non-deliverable swaps offering to cover five additional currencies.

LCH cleared its first euro interest rate swaps referencing €STR in October, with Morgan Stanley and LBBW, the parent company of three commercial banks, among the first participants to clear derivatives using the new rate.

In December, RepoClear also cleared its its first Variable Rate Repo trade indexed on the €STR, with Credit Suisse among the first participants to clear the new rate at LCH.

Daniel Maguire, CEO of LCH, and group director, post trade, for the London Stock Exchange Group, says: "2019 has been another successful year for LCH with record levels of activity across many of our services."


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Legislative agenda 2020

Seb Malik
Head of financial law
Market FinReg

A new year, a new decade, a new era

The decade of coordinated international fundamental financial reform is over. We are entering a new era of financial regulatory divergence as regulation reflects the differing priorities of entities. The left-leaning EU is set to focus on consumer protection, governance and lines of responsibility, climate change, including environmental, social and governance financing practices, and a consumer rights-based approach to artificial intelligence with the US (at least under President Trump) adopting different priorities.

In my first memo for the year, I will focus on the short term and present the significant laws and regulations that will affect the industry this year.

Brexit – With the resounding victory of the pro-Brexit Conservative Party in the December 2019 UK General Election, Britain will now imminently leave the EU on the negotiated terms. Focus now shifts to the length of the transition period and the nature of the future relationship between the two entities. With a Leave-dominated, right-wing Conservative government, it remains to be seen how far the UK will diverge from EU trade laws. 'Brexit: Part II' will dominate 2020.

EU regulation of cryptoassets – The EU is considering an initiative that may forward a legislative proposal to regulate what it describes as "crypto-assets such as bitcoin". When (if?) this legislative proposal materialises it will likely be the most eagerly-anticipated legislation since the second Markets in Financial Instruments Directive (MiFID II). Currently, the European Commission (EC) says "there is no EU classification for crypto-assets" which means their relationship with MiFID II is ambiguous. The commission notes in a report on the matter that "there is a lack of clarity on how the existing regulatory framework for financial services applies to such assets". The current consultation references an October 2019 'G7 Working Group on Stablecoins' report. The EU is concerned about the proliferation of divergent national legislation and its concomitant ramifications on the smooth functioning of the internal market. Should the EU legislate by defining crypto-assets, the floodgates of investment will likely open, and, depending on the legislation, many speculative crypto coins' value could drop to zero.

The UK Financial Conduct Authority (FCA) regulating certain cryptoasset activities. Having transposed into domestic law the EU's fifth Money Laundering Directive, as of 10 January, the FCA regulates crypto-asset exchange providers and custodian wallet providers. The FCA's registration gateway is open.

Financial Services Duty of Care Bill (UK). This bill will require the FCA to make rules that introduce a duty of care by "authorised persons to consumers in carrying out regulated activities". While MiFID II greatly expanded duty of care requirements, gaps remained. Under English law, there is no automatic duty of care requirement between contracting parties. This bill will go some way in strengthening investor protection, or at least providing a legal remedy in a breach of the same.

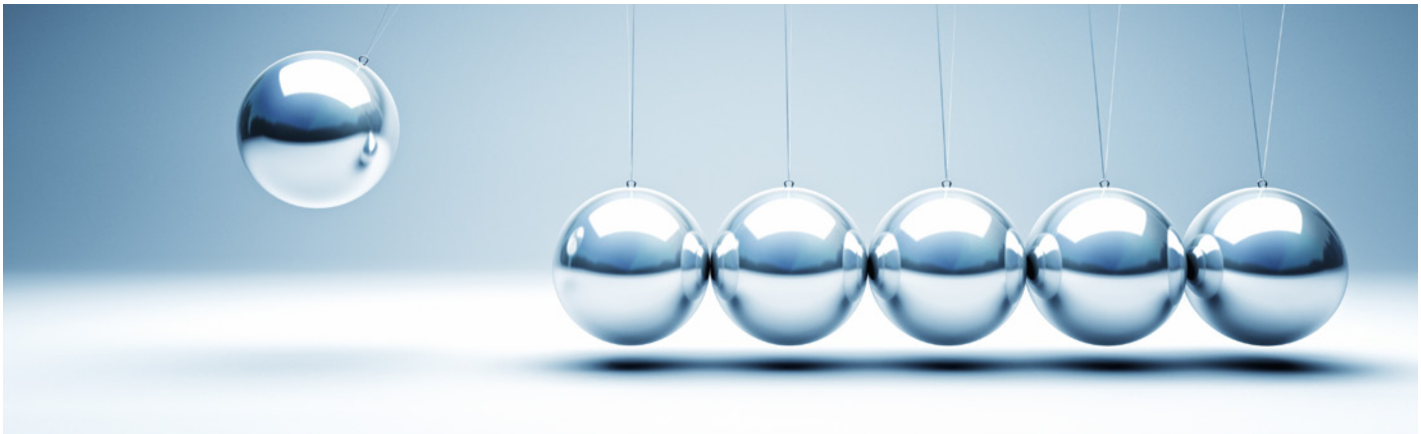
Digital operational resilience for the financial sector. The EC is considering a legislative proposal to set out measures to ensure the financial sector can withstand cyber-attacks and is digitally resilient.

The Securities Financing Transactions Regulation requires no introduction. ESMA released the long-awaited level three guidance paving the way for the final sprint to the April 2020 start date. Teething questions remain but the legislation is finally in a state where market participants can build to something approaching a final set of rules.

The Central Securities Depositories Regulation (CSDR) – CSDR, which aims to improve settlement discipline (efficiency), is due to go live in September 2020 (subject to change). Concerns remain on the likely negative impact on liquidity for certain bonds. The regime's mandatory buy-in regime to aid and smooth over settlement failures remains unpopular for certain securities.

Other notable mentions are the ongoing London Inter-bank Offered Rate to Secured Overnight Financing Rate/Sterling Overnight Index Average, et al. reference rates transition due by the end of 2021; and the passage of legislation to "establish a European investment stabilisation function (EISF) for the period 2021-2027". The EISF "shall provide financial assistance in the form of loans and interest rate subsidies for public investment to a member state which is experiencing a large asymmetric shock in order to enhance cohesion".

Given the aforementioned diverging philosophies and priorities of the largest trading blocs: the EU and the US, it will be interesting to see how G20 entities set up in the 10s, remain relevant and capable of coordinating global regulatory regimes.



The pendulum swings

Maddie Saghir reports

Last year saw questions raised around the place of ethics in financial markets, with the practice of short selling, in particular, put under scrutiny. Now, a Canadian lobby group is calling for tighter regulations on the practice and it has already had some success

A storm of securities lending- and short selling-related news caught the financial world's attention late last year and prompted a fierce debate around the role ethics should play in investment strategies and regulatory oversight.

The war of words was sparked in December 2019 by the world's largest pension fund, the Government Pension Investment Fund (GPIF) in Japan, when it announced it was shutting down the foreign equity portion of its securities lending programme. It claimed that a lack of clarity around who the end borrower was and what they would use the asset for was at the root of its concerns.

In response, Elon Musk, the CEO of Tesla, an electric car maker and prolific short target, waded into the online debate around the ethics of short selling and called for the practice to be made illegal. Musk applauded GPIF's decision by writing to his 29.9 million-strong online following: "Bravo, right thing to do! Short selling should be illegal."

In terms of global regulators' take on the practice, sentiment ranges from active encouragement to low-key hostility. That said, the past few years saw a series of Asian, Middle Eastern, Latin American and African market regulators actively developing their rulebooks to boost securities lending and short selling activity. For example, Argentina lifted its short selling ban in April 2018, and the Asia Securities Industry and Financial Markets Association proposed a workable securities lending regime in China in March last year that would also facilitate short selling.

Elsewhere, the European Securities and Markets Authority also published a report shortly after GPIF's announcement to plant its flag squarely on the side of securities lending and short selling.

The EU watchdog concluded an investigation into "undue short-term pressures in securities markets," which dismissed concerns from certain quarters of the financial market that securities lending and short selling were not compatible with environmental, social and governance (ESG) aims.

However, as has ever been the case with debates around short selling, for every argument won somewhere in the world, another is being lost.

A war on many fronts

While most interested parties' attentions were fixed on the discontent in Asia, the debate around appropriate oversight of short sellers was also flaring back to life half a world away, in Canada.

A lobbying group named Save Canadian Mining (SCM) is currently fighting for Canadian stock exchanges to re-introduce a form of 'tick test', sometimes known as the 'uptick rule', for stock in the country's junior markets.

A tick test requires short sales to be conducted at a higher price than the previous trade, with the idea being that you wouldn't be able to overwhelm the market and put unreasonable downward pressure on stock prices.

Up until 2012, all Canadian exchanges featured a tick test for short selling, but it was removed following the publication of market research in the US that it was not an efficient method of stopping the type of short selling pile-on that it was created to mitigate against. The US also scrapped a similar rule based on the same findings, but subsequently brought it back in a modified form.

The argument being put forward by SCM is that although the removal of the tick test has helped Canadian markets evolve in a macro sense there is now 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.

However, for Canada to also reintroduce a form of tick test, Canada's self-regulatory organisation for the investment industry, the Investment Industry Regulatory Organization of Canada (IIROC), has said that all 14 exchanges must agree on the benefits of doing so and present new evidence to back up the move.

"IIROC's decision to repeal the tick test restrictions in 2012 was based on studies we had conducted which demonstrated that the tick test had no appreciable impact on price movement," a spokesperson for the regulator explains. "Although we are not re-evaluating the tick test at this time, we would consider it in light of any new empirical evidence."

So far, concrete new evidence has not been forthcoming, although anecdotal evidence has suggested that the unilateral removal of the rule has had a disproportionately negative effect on Canada's junior markets, specifically in mining, technology and fintech sectors due to their limited stock liquidity. Hence the formation of SCM.

Nonetheless, SCM has gained the attention of Canada's TSX Venture Exchange (TSXV), which has confirmed it is considering re-introducing a version of the tick test that would restrict traders to only shorting a stock if it was on an upward trajectory.

The proposed rule would apply to stocks of companies in the 'junior markets', meaning listed companies under CAD 250 million (US$191.22 million), and would give a floor and ceiling to short selling.

Brady Fletcher, managing director, head of TSXV at TMX Group explains that the exchange is also pushing for IIROC to refresh its failed trade study and take a more holistic look at market structures for these junior issuers.

Fletcher adds that conversations are being had around whether reinstating the tick test is appropriate or if it makes more sense for venture listed companies to only trade on one market.

In this vein, Fletcher explains that the increasing number of exchanges and alternative trading systems creates issues when it comes to updating or overhauling market rules.

"It does create a challenge for us because we cannot go and make changes or test things out that we think could potentially benefit smaller or more illiquid issuers," he says. "We need to question whether having 14 trading venues makes sense when you're a company that trades by appointment, or does that end up fragmenting liquidity. What we really need to do in Canada is see where we can change and where we can improve."

Ace in the hole

Despite a slow start, those seeking to impose stricter rules on short sellers on Canadian exchanges do have a trump card: the fact that the US re-imposed a form of tick test a few years after it repealed it, coupled with the precedent that Canada and the US markets are inclined to lean towards continuity and following one another.

The tick test made its first debut in the US in 1938 and remained until 2007. Canada then followed suit in 2012 when it was removed by IIROC.

But, in 2010, the US Securities and Exchange Commission (SEC) approved rules that would require the country's exchanges and the Financial Industry Regulatory Authority (FINRA) to pause trading in a stock if the price drops 10 percent or more in five minutes.

The rules, which were proposed by the national securities exchanges and FINRA and published for public comment, came in response to the infamous "flash crash" of 6 May 2010, according to the SEC.

The crash saw the prices of many US-based equity products experience rapid decline and recovery in a single day, demonstrating the impact of high-frequency traders.

Speaking in June 2010, then SEC chair Mary Schapiro, who convened a meeting of the exchange leaders and FINRA at the SEC following the market disruption, said: "The 6 May market disruption illustrated a sudden, but temporary, breakdown in the market's price-setting function when a number of stocks and exchange-traded funds were executed at clearly irrational prices."

"By establishing a set of circuit breakers that uniformly pauses trading in a given security across all venues, these new rules will ensure that all markets pause simultaneously and provide time for buyers and sellers to trade at rational prices," Schapiro added.

Discussing the US' alternative uptick rule, TSXV's Fletcher notes: "During the financial crisis both Canada and the US banned short selling in certain financial institutions. Following that, the US put in the alternative uptick rule, which meant that if a stock was already under pressure – i.e they have seen a 10 percent share drop in one day – then it gives the long holders the ability to jump to the front of the selling queue."

Fletcher adds: "Therefore, the title of calling it 'the alternative uptick rule' is really a bit of a misnomer because what it does is give long holders of stocks a preference to sell in their position before the shorters can continue to put negative pressure on a stock."

Elsewhere, the US now also boasts a clear and prescriptive pre-locate rule, which means that anybody looking to go short in the US has to be able to prove where their borrow requirement was coming from. "Now, in Canada, we have something similar but it is a bit more of a commercially reasonable effort," Fletcher explains. "The Canadian rule says that we have to have a 'reasonable expectation' of finding that borrow requirement at the time of completing the short sale."

The IIROC spokesperson explains that its real-time market surveillance activities include monitoring for extreme price movement both up and down regardless of whether a short sale or otherwise.

According to IIROC, single-stock circuit breakers automatically halt trading for five minutes when a covered security's price moves up or down beyond a specified threshold.

A game of groans

TSXV and groups like SCM have brought further debate to the table regarding short selling. And, as well as the tick test, SCM and TSXV have initiated a conversation on the market structure as a whole, which the exchange says needs to be looked at deeply to see what it should look like for entrepreneurs trying to access public venture capital.

However, considering IIROC requires new research favouring the reinstatement of the uptick rule as well as a unison of agreement from 14 exchanges, it may seem that the lobbying groups have reached a stalemate because, besides from TSXV, there has been no public declaration of support from Canada's other exchanges. But, it is not quite an endgame yet.

Beyond Canada, ESG's growing prominence and its relationship with short selling is not something that will be dying down anytime soon. It is believed that other beneficial owners are considering whether covered short-selling is fully aligned with ESG principles.

Globally, the war of words on short selling continues, further intensifying the spotlight on short sellers which, through the most optimistic lens, could help to further improve market practices.

Looking back to previous decades, regulation of short selling has heightened dramatically, and naked short selling is banned in almost all financial markets. It would not be out of the question then to expect a return of an alternative tick test rule in the next decade to benefit those small-cap issuers, including mining companies, technology companies and fintech issuers. Change may be slow, but it is coming.

Sharpen your edge

Industry experts discuss why demands for real-time data will only continue to grow in 2020 and beyond as both borrowers and lenders seek a competitive advantage

Panel participants

Jennifer Hanes, division executive securities finance & processing
FIS

Laura Allen, CEO
Trading Apps

Michele Filippini, executive director collateral services
J.P. Morgan

John Tootell, head of service delivery
Pirum Systems

Paul Wilson, global head of securities finance equities data and analytics
IHS Markit

The demand for near real-time data visibility on SBL transactions and portfolios was a major technology trend of 2019, how much of an advantage does having access to up-to-date data give you as a securities lending participant?

Laura Allen: Having access to up-to-date data allows for better decision-making. Firms that make evidenced-based decisions derived from data analysis, rather than based on human preferences, have a competitive advantage as it results in higher utilisation and profitability. Furthermore, access to data allows for the creation of smarter products, which automate manual processes and provide for artificial intelligence (AI) capabilities, freeing up traders to do more creative, complex and interpersonal tasks.

That being said, having access to the data is one thing, actually engaging with it requires several steps. The data needs cleaning, stripping and storing, the right technology is required to analyse the data, identify patterns and automate the decision-making processes and prediction and modelling tools are needed to determine how the tool should react based upon data changes.

Therefore, to truly benefit from up-to-date data each individual firm has to encourage the change, and needs to implement a strategy to become a data driven organisation. This requires creativity and a clear vision, defining how they want to do business, what people they need, what data to collect and what technology is required.

Michele Filippini: For many of our collateral providers in triparty, having real-time data available allows a more complete picture of the pre-trade decision making process. While previously the decision to borrow was a function of price, now the regulatory impacts of a pre-trade decision can alter the economics of the trade. Having complete real-time data that extends beyond the borrow fee to incorporate factors such as counterparty rating, trade term, the flexibility of the collateral set and the operational efficiency of the counterparty can all impact the pre-trade decision. Therefore, having these data points available at the point of execution is key.

Jennifer Hanes: The securities finance and collateral market is advancing in complexity faster than ever and, as a result, the need for real-time data has never been greater. It is no longer just about the latest and most up-to-date fee or rebate rates. Securities lending traders need real-time access to a range of information and performance statistics, from inventory to counterparty exposures and from balance sheet usage to portfolio performance. Fingertip access to this information allows them to leverage their assets to their full potential at a moment's notice.

John Tootell: At Pirum, our clients have been utilising near real-time comparisons for more than 10 years. During 2019, we saw an increase in the number of real-time reconciliations by more than 50 percent, with increased interest in collateral, exposure management as well as settlement status with our customers getting ready for the impacts of the Central Securities Depositories Regulation (CSDR).

Enabling intraday feeds can give market participants access to powerful automation including automatic returns and mark to markets, both of which will help to reduce breaks and significantly reduce manual effort.

The more real-time the dataset, the higher the level of straight-through processing (STP) the client can expect – at Pirum we regularly see STP rates at the 99 percent level.

In addition, with the Securities Financing Transactions Regulation (SFTR) going live this year, having the ability to clear breaks on a T+0 basis is critical to ensure that match rates are as high as possible.

Paul Wilson: We have seen a dramatic increase in the number of contributors and recipients of intraday data during 2019, with that coming from both lender and borrower side of the market. We have seen several instances throughout the year, whether in initial public offering stocks or stocks moving quickly from general collateral to special, where the availability of intraday data allowed these participants to be more proactive in managing their inventory, loan positions and fee levels. In market conditions that are generally over supplied with a lack of demand, the ability to be in front of opportunities and developing market scenarios is an advantage.

What are the main drivers of intraday and real-time data demands? Is it new technology, regulation, or something else?

Filippini: The existence of new technologies including distributed ledger technology (DLT) allows the market as a whole to better explore avenues of efficiency in the traditional securities lending workflow. Regulatory changes are also driving this evolution, as they increase the cost of being inefficient for financial institutions.

Settlement efficiency, optimal asset allocation and mobilisation are crucial in ensuring post trade friction does not affect the ability of the front office to generate returns. Adopting new technology that reduces timing and increases the velocity of collateral mobilisation will create a more efficient collateral ecosystem.

Wilson: Creating out-performance for lenders or lowering financing costs for borrowers are increasingly dominant factors in the market as participants look to differentiate themselves. Investments in technology and regulation have dominated the environment over the past five years so on that front nothing has really changed. So what we hear from our clients the pursuit of alpha or cost savings are the primary driver of the demand for intraday data.

Tootell: Regulation has clearly been a significant driver towards real-time comparison. Needing to report trades on a T+1 basis for SFTR means that an overnight comparison process is no longer fit for purpose. Correspondingly in 2019, we have seen an increased demand in the fixed income repo/bond borrow space for real-time comparisons.

Regulation coupled with a drive for greater efficiency as a result of reducing revenues seem to be the main reasons for this shift in behaviour.

A further tail-wind for real-time has come through ease of integration, with Pirum working with other technology vendors to create standard integration interfaces and files, thus reducing the burden of standardisation to our clients.

Hanes: The need to be regulatory compliant, particularly given the impending impact of SFTR, is driving many organisations to upgrade their data management to meet the reporting demands being applied to them. The complexity of the regulation, demanding highly-granular reports in a tight timeframe leaves no option but to employ real-time or at least intraday data protocols simply to meet the deadlines set.

Modern technology enables market participants to gain a competitive edge, armed with data their competitors may not have. Intraday data has long been the market standard delivered by FIS in the US but is now gaining much wider acceptance elsewhere in the world, in part driven by regulation, but also the need to be increasingly competitive.

Allen: Regulation (specifically SFTR and CSDR) has been instrumental in providing accurate, consistent and timely data to the market and smarter products are being developed as a result of the increase in real-time data availability.

I don’t think technology is a driver for real-time data: it’s the facilitator. Providing software which is capable of machine learning increases the demand for a wider range of data points and more frequent updates and we are definitely experiencing this at Trading Apps. Traditional, on-site databases have proved cumbersome, expensive and limiting in the area. The continued introduction of cloud-based solutions and distributed architecture have improved scalability and performance.

The need to stay ahead of the competition in an increasingly competitive, low-margin market is more likely to be the driver. Our clients support this theory with their main motivation being price discovery and revenue optimisation.

2020 will usher in the settlement discipline rules under CSDR, which includes cash penalties and mandatory buy-in rules for fails. How much can timely data updates contribute to the solution to these new challenges?

Tootell: At Pirum we have been actively discussing challenges from CSDR with our clients for over a year and welcome those not engaged currently to contact us. We estimate that CSDR will cost our clients €300 million in fines and fails management costs – and using functionality available today will reduce this dramatically, whilst product enhancements we are working on will help improve this further and create additional efficiencies.

With the Pirum real-time pending screen, we can compare and display any breaking trade attributes that would affect settlement within seconds, and we have made enhancements to help firms prioritise CSDR impacted trades to reduce potential costs in the future.

When out seeing clients this year, we have been reiterating that Pirum isn’t a replacement for the data that you receive from your agent, but rather can complement it. Having Pirum in your toolkit will definitely provide benefits in ensuring that trades are pre-matched and penalties avoided.

Prevention of breaks is always better than cure, so it is always preferential to fix issues at their root cause – using our automation suite is a way to ensure that trades and returns are automatically booked correctly in the first place. Similarly using automation in the trading space should also ensure that trades are booked more accurately – ultimately though the real-time pending screen is there as your safety net.

Wilson: We think that more data points and more timely availability of a broad set of data points will generally assist in managing new challenges such as CSDR. At IHS Markit we make available to our clients reports which look at lending levels and liquidity levels across securities and make that relevant to each security a lender has on loan. This helps them better understand if liquidity levels are falling and making the likelihood of a failed re-call higher. By using data to understand changing circumstances allows our clients to get in front of issues before they arise.

Allen: The majority of traditional position management tools within securities finance assume good settlement, as often real time settlement and depot position feeds are not available. The drive for inventory optimisation results in operations having to call for more securities to cover failing purchases or increased collateral substitutions.

Operations within our industry has lacked investment in technology, CSDR requirements will challenge current practices. To be compliant firms will need to know projected and real-time depot positions and have these visible within the securities finance position management systems. Furthermore, firms will need automated processes to recall collateral and loans to make good settlement.

Hanes: In the age of instant access to real-time data across every aspect of our personal and professional lives, it would not appear surprising to any outside observers that trading on aged data creates unnecessary and unacceptable risks. FIS is working on several projects to bring real-time global position and inventory management to life to ensure that our client's trading commitments are fulfilled and fails eradicated wherever possible.

Filippini: Providing access to real time reporting, whether it be on our portal or via report feeds, has the potential to significantly increase the settlement efficiency of securities loans. With the delivery of collateral being a precursor to loan release, faster collateral allocation and subsequent reporting will allow for a more efficient release and settlement of the underlying securities lending trade. This becomes even more critical in the no fails environment of CSDR.

As a financial institution or service provider, how important is real-time data to you and your clients?

Wilson: As already noted, we have seen a dramatic increase in the demand from our clients for intraday/near time data, so therefore this becomes an important part of our overall data strategy.

Allen: An ability to harvest real-time data is very important and forms the foundation of many of our initiatives. Furthermore we've seen a distinct change at some of our clients as they implement strategies to become data driven organisations. They have appointed people who value evidenced-based reasoning and can think creatively about how to use the data, what thresholds to set and what metrics to monitor in order to drive business outcomes.

Our clients are looking to make price-reactive decisions based on the quantity, repetitiveness of requests, the breadth and depth of the client base and how quickly trades are executed with a view to automatically moving rates as availability/demand shifts.

Furthermore, our clients are monitoring the profit-and-loss impact of lifecycle events, real time, allowing them to dynamically manage their securities financing revenue. They require real-time notification when the market appears to be changing and tools that allow them to react quickly to those changes.

Tootell: There are so many benefits of using real-time data in your workflow – as well as reducing the impact of CSDR and SFTR, clients general operational efficiency will increase and they will be able to improve risk management through real-time collateral and exposure management with counterparts.

Supporting processing on a real time basis is not new for Pirum and it has been around for almost 10 years. What is really encouraging is the take up and momentum of real time from our clients throughout 2019 within not only their securities lending business, but also now across their repo and over-the-counter derivatives ones.

Furthermore, in the collateral space our clients can now see all their exposures consolidated in one place using real-time data. In an environment of increasing demand within firms for collateral it is sub-optimal to have to wait to see the results of an action performed – be it triparty-required value posting, projections or even dispute resolution. Pirum can now reflect and process real-time collateral, as well as exposure management and dispute resolution.

With declining revenues and compressed margins, it is critical that operational cost is minimised and, in that regard, we take our job of automating the securities financing lifecycle very seriously. The good news is that this can largely be achieved by adopting our real-time collateral management and trade lifecycle products,

minimising the time to achieve true real-time processing and the benefits this brings.

Hanes: With financial markets demanding ever faster, more secure and quicker settlements and payments, real-time data is proving vital across our entire client base. Real-time data is vital for FIS to manage our global payments services in support of more than 20,000 clients in 130 countries, including Worldpay from FIS, where we process more than 40 billion transactions each year. As a global provider in this space, we understand exactly how vital real-time data is to our securities finance clients in the management of their businesses.

Filippini: As a service provider, we have to be in a position to respond to our client's needs to request data-driven changes to our platform. In the past year we have completed the digitisation of the collateral eligibility set workflow, allowing our clients to execute schedule changes intraday and near real time. Functionality like this is key to helping clients responding quickly to new trading strategies or in stress environments where eligibility changes need to be applied quickly to minimise risk.

Will demand for more timely data increase in 2020 and beyond? Do you expect it to become an industry-standard in the near future?

Hanes: The need for more better-quality data that is delivered faster and engineered to make a true impact will only get higher. As a provider of intraday data to the securities finance market for almost 15 years, I'd say that it is already an industry standard. Trading on data that is a day old simply isn't acceptable any longer.

Filippini: We expect the demand and use cases for different types of data consumption to continue as clients need--and gain access to--more dynamic data. The use of APIs and the ability to consolidate data into a real time view are critically important to helping them make decisions in real time based on the clearer picture that data provides. A good example is our ongoing work to help clients achieve their optimisation objectives as it relates to efficient collateral allocation. Each institution will have a different approach to allocating collateral depending upon their regulatory binding constraints. The information we provide through digitised eligibility schedules, position information and exposure values gives clients the real-time data required to run their internal optimisers. Connecting their own optimisers to the algorithms within J.P. Morgan triparty presents an opportunity for our clients to maximise returns.

Allen: I expect market participants demand for more timely data will continue in 2020 and beyond. It is encouraging that market participants are looking to make their workflows more efficient and are striving to implement rule-based automation. This is a solid foundation to then move towards AI and machine learning, once the appropriate technology is in place to identify patterns within the data, create algorithms and models for applications to call upon when decisions need to be made.

As an industry we share data on trades, lifecycle events and products and as a vendor, Trading Apps spends an inordinate amount of time cross-checking data sets and comparing terminology when looking to integrate with other systems. For our industry to truly move forward we need to adopt a common domain model to create a single definition of those things, thereby creating standardisation.

Tootell: I think the simple answer is yes. Firms that haven't adopted real time will find it increasingly difficult to adhere to upcoming regulation requirements and are likely to see costs increase.

It seems the industry is in the midst of a paradigm shift and we are seeing significant change across most organisations. Many firms are transitioning from the planning stage to the execution stage. In doing so, institutions are data gathering to ensure they make the right informed choices. Pirum is looking to assist clients and the market in general, in effecting this change and transformation in global real-time operating models.

Wilson: The demand for more data, broader data, associated data and intra day data is only going to increase in 2020 and beyond. A good example is we very recently added high-quality liquid assets (HQLA) designations against every security in our dataset so our clients can see inventory, loan, fee and other data in the context of HQLA. This gets updated every day. We are the only securities finance data provider that provides this incredible important piece of data to its clients and allows our clients to better understand their books in the context of HQLA.

We are working on an exciting variety of similar types of additions to our dataset in 2020 that will allow our clients to be more proactive and precise in managing their books. As the industry evolves and adapts, and 2020 will be a challenging year with SFTR implementation, boundaries will be moved in terms of data and timely data.

Getting the timing right on SFTR compliance

Rasa Balsyte
Director, sales and relationship management
CME Group Regulatory Reporting

With less than four months until the first phase of SFTR comes in effect, there are some big choices to be made by those in scope. Rasa Balsyte of CME Group Regulatory Reporting discusses

What is SFTR and what are businesses doing about it today?

As the April deadline for the first batch of businesses to comply with the Securities Financing Transactions Regulation (SFTR) creeps closer, increasing numbers of market participants are in the midst of preparations.

We have worked with a range of businesses already to perform the significant amounts of business-impact analysis and data-gap analysis that is required to comply with this piece of regulation.

SFTR is a European regulation that will introduce enhanced reporting requirements for a range of specialised market transactions that are all essentially 'loan-like' in nature.

The regulation establishes a reporting framework for all repo transactions, lending and borrowing of securities or commodities, margin lending transactions and buy-sell or sell/buy-back agreements.

The increased transparency the new rules will create is expected to deliver greater fairness in the market and will better support analytics in trading. But to meet the impending deadlines, firms in scope should not delay the preparations further. These include gathering, aggregating, standardising, enriching and verifying data for securities financing transactions (SFTs).

Firms then need to select the right reporting services. For sell-side as well as buy-side firms, partnering with an experienced and knowledgeable regulatory reporting provider to serve their needs will be a crucial decision.

What are the first steps towards getting ready?

One of the core elements of getting SFTR-ready is making sure that your compliance, operations and technology implementation staff fully understand the regulation and its ramifications.

As such, we have seen a sharp rise in demand for client training on the subject. Each investment firm in the market has its own product approach and structure and as such many of our clients have requested bespoke training that is highly tailored to their needs.

One important aspect of SFTR is the staggered nature of the deadlines for compliance depending on what type of business you are operating. Before doing anything else, firms are planning in accordance to the deadlines that will affect them (*see Figure 1*):

Credit institution, investments firms, central counterparties, central securities depositories and other buy-side firms all need to have reporting mechanisms in place in 2020. It is important that all firms ensure their house is in order as they speak with service providers to better understand what levels of support they might need and the level of access to the trade reports issued to repositories if they take the delegated-reporting approach. For example, a fund manager will need to ensure they have the right controls if the prime broker they are trading with does not give them access to the reports themselves.

Getting into the weeds – what comes next?

We are observing clients performing extensive analysis on the regulatory guidance itself, particularly the regulation's draft schema and validation rules.

Figure 1

Timeline: SFTR Implementation Deadlines

April 2020	July 2020	October 2020	January 2021
Credit Institutions and Investment Firms	Central Counterparties (CCPs) and Central Securities Depositories (CSDs)	Insurance Firms, UCITS Funds, Alternative Investment Funds, Pension Funds	Non-Financial Entities

SFTR contains 153 data fields that will have to be supplied for SFTs. Most businesses that we meet are anchoring their efforts around the data gap analysis and sourcing the correct data fields. For mid-tier and smaller firms, with lesser regulatory resources, reporting so many fields may be daunting.

Another challenge that clients are raising is the generation of unique trade identifiers (UTI). There is no centralised mechanism for generating a UTI code every time an SFT is set up, and currently the obligation lies with venues to provide them.

Later, the UTIs used by both legs of a transaction will be required to match and this presents a challenge somewhat like the ISIN issue that had to be addressed in the implementation of the Markets in Financial Instruments Regulation (MiFIR). Back-loading questions for repos with various maturities also poses an additional challenge.

Partnering with the right reporting software vendor

Firms are performing gap analysis to better understand the data they have and to consider vendors who may help.

Working with the right partner should start at the point of data analysis. If a service provider can help its client to understand the data they have, in the context of their requirements, and to understand where differences lie, the weight of SFTR becomes a lot lighter.

Ideally, a trusted reporting partner will be able to provide domain experts who can work directly with their clients, advising on the shortcomings of the data and how that data quality can be improved to meet requirements.

Working with your vendor partner under a modular ‘step-by-step’ approach is likely to be useful, to determine the scope of the programme required before committing to the programme.

Help may be sourced for the gap analysis of data, for the construction of the test file, iterating the data file to comply with the final validation rules set out by the European Securities and Markets Authority. The vendor may also help with any stress testing and running through a validation rules engine to assess readiness. All these aspects may be needed in full or in part based on the firm’s own capabilities and resources.

Flexibility is a paramount consideration to optimise the in-house resources and limit operational, technology and compliance risks inherent to the process while ensuring successful go-live ahead of the deadline.

Our three top-tips for success

The CME Group Regulatory Reporting SFTR Readiness Programme provides clients with a modular programme of activity tailored to your business needs.

As part of our Readiness Programme, we will be hosting educational events for market participants. These events will be attended by Richard Comotto, an advisor to the International Capital Market Association and author of ‘Repo Best Practice Trading Guide’, who will lead discussions about the relevant regulatory text and requirements.

Meanwhile, our technology and product teams have been implementing a next-generation technology architecture to coincide with the introduction of SFTR. The next-generation SFTR hub is built on a micro-services technology model, which provides benefits including more scalable data management, interrogation, compression and archiving.

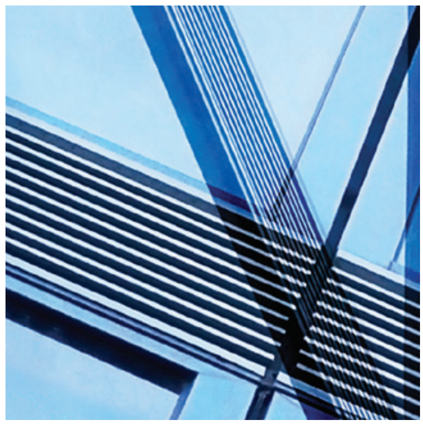
Our core SFTR product is now available for client testing and we are trade repository agnostic.

For clients preparing for SFTR implementation, our top tips are:

- Don’t leave it until the last minute. Clients tend to benefit from early testing and data cleansing preparation.
- Clients benefit in the long term when they manage each new regime as a dedicated project. There are efficiencies to be gained from using the same vendor for the European Markets Infrastructure Regulation (EMIR) and/or MiFIR.
- Have a dedicated project manager or business analyst that works closely with the reporting provider to provide greater control over the implementation process. While SFTR may resemble the original EMIR regime, it is of a very different nature and contains a significant number of new data fields.
- Work closely with a provider to work out where you need help, and where you can do the work yourselves. SFTR requires you to understand your reporting requirements and ensure the correct data is submitted in the right format, therefore preparation now is key.

We clear the path

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



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

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THE FOUNDATION FOR SECURE MARKETS

PEOPLE ARE THE PATH TO AI, JUST ASK THEM

Patrick McCreesh
in association with Pirum Systems

The second piece of a series on the future of technology breaks down some of the most prevalent myths around the consequences of bringing AI and automation into financial markets

'Dear tech, let's talk' is the sentimental opening to a recent IBM advertising campaign. This anthropomorphism of technology is not just a clever quip; it raises interesting and provocative questions about how we view and interact with technology in the workplace today. It is clear that technology will always be changing how we work, and we should be encouraged to engage in conversations about this fact.

Over the past century, technology has vastly distorted and disrupted the landscape of the workplace. From Henry Ford's assembly line of the 1910s to Toyota's 'just-in-time manufacturing' from the 1970s and, more recently, online help bots for sales and customer support as firms have strived to reduce human-based procedural overhead to add value in more important facets of business. Perhaps the most notorious disruption to the workplace in the past decade has been the introduction of achievable and effective automation and artificial intelligence (AI).

Automation and AI are coming (if they haven't already arrived) to the financial securities market and will vastly change the way teams function. We are already beginning to see these technologies being integrated into the modern work environment, and this mass propagation has introduced a provocative tension between employees, stakeholders and the technology itself. The automation and AI market is set to reach $70 billion in 2020, according to Forbes, and it is therefore paramount that firms address the origin of the tension felt by their employees which is borne predominantly from a misguided fear of human redundancy.

It is no secret, then, that the cleanest process for integrating automation and AI into critical aspects of business is acknowledging that it is not the technology at the heart of successful AI, but rather the people. By engaging your teams on how you intend to leverage the power of Automation and AI to lift the shackles of cognitive fatigue and stress associated with menial, repetitive tasks, you create an atmosphere of optimism over adversity. Employees are less likely to make disastrous mistakes in data entry and rationalisation and can instead begin to focus on adding value to the business in other, more creative ways.

Due to the manual nature of many processes, the securities finance industry has not been alone in encountering challenges relating to human input errors. Firms often encounter erroneous bookings made by trading desks and persistent idiosyncrasies surrounding static data which take a significant amount of time to understand, let alone, remedy. These can often result in detrimental outcomes for market participants and even the smallest error can leave businesses dangerously exposed down-stream.

Using tools from the modern deep learning and automation arsenal, we can introduce trust-worthy, data-driven solutions to these problems that will engender a symbiotic relationship between AI, automation and employees. This will boast huge advantages such as boosting productivity, creativity and morale. Because AI predominantly excels in pattern matching, it seems that the securities finance industry could be an optimal ‘playground’ for these algorithms. We are confident that in the near future solutions will begin to provide ‘what if’ scenarios and simulations with narrowing latent space to provide collateral management efficacy, among other post-trade processing benefits.

The IBM advertisement strikes at the heart of what needs to be acknowledged – namely that we have an inescapable and intrinsic relationship with technology in our modern lives. This intrinsic relationship aptly justifies the bold use of personification. Technology, like a ‘dear friend’ whom we may indeed write a letter to, helps us complete goals, organise ourselves and connect with the world on the international playing field. In recent years, technology has garnered good press for its ability to connect the world, allow social mobility and simplify our lives. However, current discourse surrounding automation and AI does not reverberate with the same levels of optimism. Instead, a mention of AI or automation is shrouded in numerous layers of mystery and fear of almost mythical proportions. Why is our potential relationship with AI so different to that of other technological advancements in the workplace?

Myth #1: AI is just automation with extra steps

It is extremely important to educate employees on the nature of AI in order to help direct thought processes about the new technology.
Perhaps the most important distinction to make between AI and automation is that of routinisation. Automation is the adoption of an approach that removes routine work from the process flow of organisations. The integration of a factory-like, blue-collar style to white-collar work has created aspects of our jobs that are repetitive and can be streamlined through automation. In order to deploy automation technologies effectively, we must have a clearly defined set of activities and a clear process flow for those activities. This is not AI.

AI is vastly different to this prescriptive process in that it does not require a clearly defined workflow. Instead, AI is focused on learning and reasoning, the way humans do, in order to help support a decision or outcome. AI does not work on a rigid and routine assembly line with next-to-no variability, but instead operates by learning functional approximations to solve problems based on previous instances of a similar feature set.

In securities finance, we still see significant straight-through processing and efficiency gains to be had using automation and then leading onto AI. This could be through the use of trained predictive models for detecting violations related to the Central Securities Depositories Regulation, or front-office fraud detection through activity analysis with historical data made available through automation techniques.

Myth #2: AI and automation will replace jobs

Forrester estimated that 10 percent of jobs were to be automated in 2019. It is to be seen if this happened. Gallup reports that nearly half of all jobs in the US are at risk of automation. It is true that commercially motivated tasks are becoming more automated than ever before. However, it is rare to find an employment position outside of a factory that involves completing one menial task on a repetitive basis. In this way, AI and automation should be complimentary technologies to today’s work force and not a displacement. For example, we often encounter tasks that centre around binary segmentation of data; should this entity receive credit? Should this entity be filled for a sought-after special stock? is this entity a risk? In order to make these decisions, although it often seems like all of this data should already be joined up, a human must collect hundreds of data points from systems relevant to the decision, organise the data (often mentally), and determine the relevant course of action. A combination of automation and AI can gather all the data, perform a functional analysis and recommend a decision with a certain level of confidence. The informed human with tacit knowledge of a particular industry is often still required to make the final decision. This relationship not only serves the client, but also helps to train the AI further.

In this way, the AI augments the decision-making process of the human by completing and performing a regression over accurate, historical data. Humans are still at the conceptual helm, still using emotional reasoning, client relationships and implicit knowledge while adding value to a business where it is truly required and valued.

AI, as it currently stands, cannot contextualise or empathise. AI cannot retort 'that must be hard' to empathise with an emotional client who may need to cover a position in order to fulfil an important commitment to their counterparty. It cannot determine that a transaction was fraudulent or that a new counterparty is unlikely to settle on time, based on a set of features it hasn't been trained on. It cannot decide the most socially acceptable time to make a work-related phone call. This is predominantly why job security is not endangered as we enter the new epoch of workplace automation and intelligence. Augmenting an employment position with AI will serve to reduce the impact of human irrationality in decision making while redirecting this emotional intelligence into other, more beneficial areas – such as liaising more effectively with clients and stakeholders.

How to successfully implement AI

These commonly held misunderstandings demonstrate the challenge for organisations to leverage and excel with AI. Many employees lack a deep understanding of what AI means for them and their firms, and this uncertainty can breed fear, especially when it is uncertainty regarding job security. Any new technology leads to a potential sense of loss, because there is always some task that the technology will address that will be 'taken' from an employee.

This is especially true in the case of AI, because it seems to be appropriating everything. However, as demonstrated above, this is merely a myth. That AI is 'appropriating' is a dangerous ideological viewpoint to adopt, instead, 'augmenting' is more accurate. The pertinent question then - is how do firms successfully adopt AI while augmenting the valuable work of employees and simultaneously reassuring them? Here are three ways to start:

Take on the myths: Leaders and stakeholders need to explore what they seek to gain from the integration of AI into their business. They need to consider to what extent they want or are even talking about AI or solely automation? In short, don't beat around the conceptual bush. Deal in facts and not conspiracy – be transparent with employees about the tasks that are intended to be automated but explain the opportunity for them to make new, more valuable contributions.

Engage your team. In each use of AI, there will be a point where the machine stops, and the employee picks up the work. If AI is about the relationship between humans and technology, begin by talking to people about the relationship between humans and technology.

Engage your workforce about where the machine ends, and the human role begins. Have your team define those tasks where they could use support collecting and parsing data that will equip them with the right insight to make critical decisions. Traditionally the workforce could not build exceptional client service and relationships at the same time as being high tech, efficient and effective. AI can enable your team to be both high-tech and high-touch.

Acknowledge the loss. As discussed, with technological advancement comes tension. Work to reduce the entrenchment of misguided beliefs through encouraging a mindset shift amongst employees. In the case of AI and automation, this shift is difficult because we are asking employees to do something we have not asked since the birth of the knowledge worker - to be more human.

We want employees to be creative, to have time to explore interesting and profitable avenues of thought while we leave the mundane to the machines. There will still be a sense of loss because we are creatures of habitual nature. But your team, once given this push in the right direction, are more likely to embrace the change and create positive outcomes.

Leaders must engage their teams by articulating their vision of what they see over the horizon. Then we are truly 'talking to tech'.

SFTR Continuous Compliance challenge

Julian Eyre
Commercial manager
Delta Capita

Firms must look inwards to break down silos and outwards to smooth-out market-wide data inconsistencies to effectively solve the challenges posed by SFTR and other new rule-sets coming down the pipe

The Bank of England's 'Dear CEO' letter in October 2019, regarding the reliability of regulatory returns focusing on the importance of maintaining regulatory quality and diligence on a continuous basis post go-live, highlighted that some banks have dropped below the regulatory standards required.

While the letter was focused mainly on Financial Reporting Standards (FINREP) and Common Reporting Framework (COREP) reporting the principle will apply to all regulatory reporting obligations.

We believe that banks have an opportunity to adopt a consolidated, consensus model for SFTR continuous compliance. In this article I discuss some of the challenges and a potential solution.

Banks struggle to keep up with the volume of notifications being published by multiple regulators.

In 2015, Deloitte estimated there were 43,000 regulatory updates globally. In 2019, Thomson Reuters estimated there is a new regulatory alert issued every seven minutes. The Securities Financing Transactions Regulation (SFTR) can be expected to add to this overhead.

For the securities finance industry, the SFTR regulation is both comprehensive and complex.

The March 2017 technical standards had 394 pages, the December 2019 XML schema doc had 660 pages, the January 2020 guidance notes had 216 pages, the final report a further 90 pages.

Following detailed analysis of all the associated regulatory documentation and the industry best practice publications, Delta Capita has developed a detailed understanding of the regulation and the reporting challenges. As a result of working with 11 tier-one banks on our standardised SFTR test packs we are also providing traceability (at clause level) to the regulatory and best practice documents. This is mapped to a standard Bank Securities Finance Operating model – data, processes and systems.

Challenge

For any updates or regulatory amendments pre- and post-go live, notifications need to be filtered to identify which are relevant based on the bank's specific footprint.

It can be difficult for banks to understand which functions of the bank the regulatory change will impact and the impact it will have on their global operating model, systems and people.

Furthermore, banks find it challenging to implement a strategic solution to regulatory compliance as banks' often siloed approach to change results in a fragmented response at all levels.

As different functions of the bank are often impacted, multiple stakeholders are often tasked with implementing regulatory compliance, yet are not aligned to a single SFTR regulatory agenda resulting in inconsistent and duplication of processes, effort and spend and different interpretations internally within a bank resulting in multiple compliance activities, which are not aligned.

The securities finance industry itself is not aligned and so the SFTR regulation is often interpreted differently which can lead to further challenges in exception management for example.

There is an ever-increasing dependency on key people as the structure of banks are often changing. Knowledge needs to be captured otherwise it's lost and a consistent ongoing controls function for regulatory compliance needs to be maintained, managed and enforced. Without a strategic approach to continuous compliance tactical changes often fail and cause thousands of technology related remediation actions.

An example requiring active on-going maintenance is the management of exceptions (NAKs) from each trade repository, with an intuitive investigation mechanism, to support NAK remediation.
In our experience most banks implement a new compliance obligation within their 'reg change' function. The ongoing reliability of returns obligation commonly sits within the business 'BAU' team. It is often this team that carries any future compliance penalties and fines and therefore a risk mitigation approach would be valuable to address the challenges identified.

Solution

In Delta Capita's opinion, banks would benefit from aligning with a single regulatory change agenda:

- They need a solution that addresses SFTR regulatory change across multiple functions thus enabling headcount reduction.
- It needs to be scalable and provide a single repository for all requirements, broken down by a single functional model of the bank.
- The solution needs to cater for the compliance requirements on go-live and looking forward.
- Banks need an aggregated view of compliance across SFTR, that covers all asset classes and entities.

This will give the bank improved command, control, continuity and regulatory transparency and decrease compliance risks.

Post SFTR go-live (for sell side banks on 13 April), there will be significant duplication of effort across the market to track, understand and maintain the required levels of compliance returns.

At Delta Capita as a result of our innovative RegTech initiative on SFTR we will be proposing an SFTR Continuous Compliance service. The solution facilitates a controlled and transparent test strategy for SFTR and enables a comprehensive control solution for ongoing SFTR compliance.

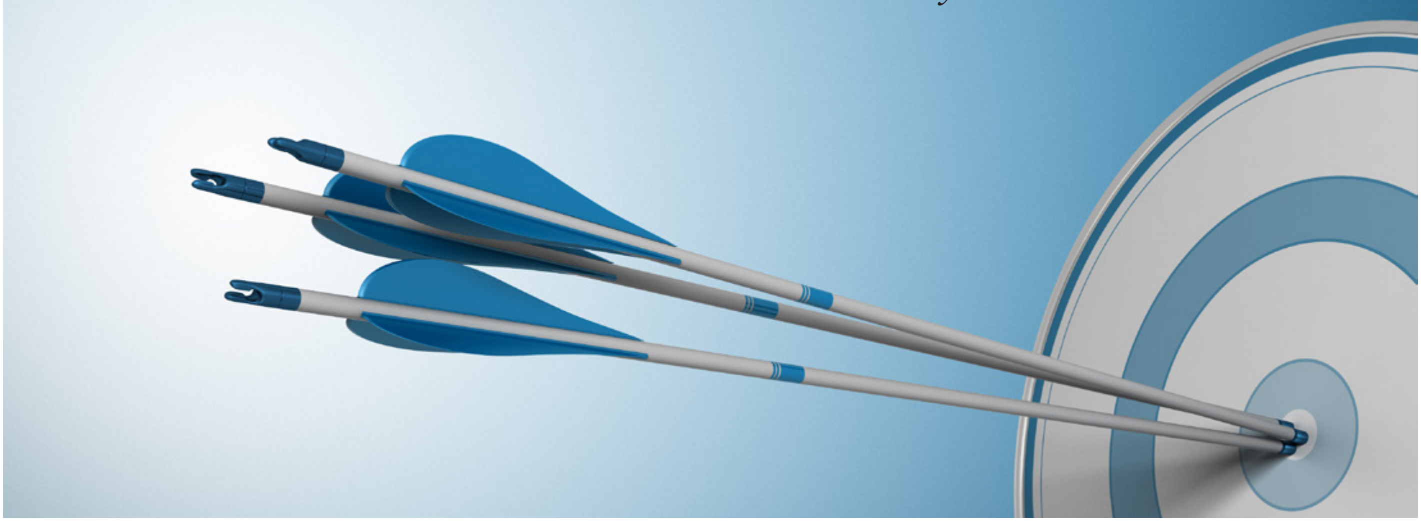
Key benefits:

- Ongoing completion of regulatory analysis and production of associated business requirements and functional designs derived from the originating regulation.
- Create a client operating model for efficient processing of future regulatory change requirements, reducing duplication of effort and application of best practice processes.
- Fully governed and auditable process with full traceability of the change to the SFTR regulation, to support client regulatory analysis, to support client business requirements, to support client functional design to build and test.
- Provides an on-line portal to access the service model with visual tracking and monitoring.
- Delta Capita's dedicated teams quickly deliver a thorough solution to any ongoing amendments and changes at a competitive price point reducing ongoing Reg BAU costs and risks.

New standards

David Lewis
Senior director, securities finance
FIS

The industry faces some key milestones in 2020 with SFTR, CSDR and Brexit all on the horizon. But, underlying trends including the continued discussions around ESG and short selling will also continue to demand attention in the year ahead



January 2020. The start of a new year and a decade. Much has changed and more is due to change as the new year gets under way. Two issues that have been on the horizon are now suddenly much closer and their impact will be appearing in sharp relief very soon: Brexit and the Securities Financing Transactions Regulation (SFTR). The new regulation commences in April and is the first implementation of the Financial Stability Board's (FSB) transparency directive, but there is much to do before then to get the market live and compliant with the new era of transparency. Brexit, on the other hand, has been a somewhat more flexible deadline over the past three years; until now, that is. The December election in the UK delivered the government the kind of majority that will allow them to take decisive actions and deliver certainty of timing, irrespective of whether you agree with it in principle or not.

These are not the only changes that are affecting our market. A long laundry list of physical and tangible changes could be made and an analysis of each one documented. However, there are other changes afoot, perhaps as a reflection of trends in the wider financial markets, that are a little less tangible. Securities lending has always had its detractors, most commonly linking it with the market mechanism of short selling, where an investor can make a return on a falling share price rather than where a rising one can benefit the holder of a long investment. Much has been written about the whys and wherefores of this practice, seeking to prove definitively one way or another that it does or not damage long-term investments and does or not provide for efficient price discovery of a financial instrument. The data behind these arguments will not be re-examined here. Instead, what's more interesting is the underlying concern that seems to be driving some organisations to exit lending, just as many others are joining.

The Government Pension Investment Fund (GPIF) of Japan, reputed to be the world's largest pension fund managing $1.4 trillion of assets, mostly through outsourced fund managers, made a very public announcement recently regarding its decision to cease lending its foreign equity assets. Debt instruments will continue to be lent and domestic Japanese equities remain unavailable to borrowers. The decision to abandon around $115 million of annual revenue (averaged over 2015 to 2018) attributed to this activity was considered a price worth paying to support the fund's environmental, social and governance (ESG) objectives. The executive managing director and chief investment officer of GPIF, Hiro Mizuno, cited a lack of transparency with regard to who is borrowing shares and for what purpose as a significant factor in the decision to curtail lending. Further, with an investment time horizon of 100 years, the GPIF has made it clear that focusing on short-term gains and strategies conflict with meeting its overall investment objectives. With such a bold move, just as other funds and fund managers are increasing their involvement in securities lending to boost revenues, it begs the market to question whether there has been a fundamental shift away from simply monitoring the financial returns of a fund as a way of measuring its success.

In December, the International Securities Lending Association (ISLA) launched its Council for Sustainable Finance (ICSF). The announcement indicated that this launch had been the culmination of some 16 months of preparation work, suggesting that this was not a knee-jerk reaction, but perhaps the considered response to a growing trend in the wider financial markets. The stated objective of this council of experts is the promotion of "sustainable securities lending" through the promotion of new and relevant principles that will assist the adoption of ESG principles into securities lending practices.

It will be interesting to see how this works in practice and how such principles can be implemented, particularly when many consider there to be a potential conflict between a fund managers fiduciary responsibility to its clients to make the best returns possible and some of the new ESG objectives.

Applying ESG-like principles to investing might be a relatively simple process to undertake. Restricting investments in tobacco companies or weapons manufacturers, for example, is a binary decision once a fund has determined its investment principles. However, the physical lack of eligible securities to invest in could lead to crowding and result in over inflation of asset prices. If this does occur, it could become a serious issue that, in fact, fuels additional short selling activities. It is telling that the $1.4 trillion GPIF fund states that just $28 billion is invested in ESG compliant funds: 2 percent of its total portfolio.

Applying ESG principles to securities lending activities could be extended relatively simply to exclude banned assets from permitted acceptable collateral schedules in securities lending programmes, but again could present risks in excessive issuer concentration or lack of market liquidity. ESG principles are also likely to extend much further, including voting on shares held as well as potentially not even lending them, as GPIF has chosen to do.

The GPIF has stated that transparency was a key issue for it, and specifically the impact of not knowing whether its assets were being borrowed to facilitate short selling activities. Given the implication that GPIF may have continued to lend its assets if it could guarantee they would not be used for short selling exposes the real underlying reason for this decision – the belief that such actions can drive prices of assets downward. For such an argument to be true goes against most fundamental asset pricing principles, not to mention ignoring the existence of many alternative mechanisms through which an investor can profit from a falling asset price. What it does highlight is the almost sentimental view that it is somehow distasteful to profit from an asset falling in value.

On that measure, t GPIF has likely erred in its logic. Having a 100-year investment time horizon makes the value of an asset from one day, week or month to the next almost completely irrelevant to its long-term strategy. Refusing the available securities lending revenue is, therefore, arguably a fiduciary mistake but only if the measure of success of the fund is no longer accounted for in terms of overall financial provision for the pensioners it serves, but a more intangible measurement of compliance with ESG principles.

Few can claim to have not noticed the general shift in investment funds on offer today, including the rise in ESG-style funds and "responsible investing" as a new-age mantra. For some, the simple financial returns of an investable asset are not the sole, or perhaps even key, determinant in the decision to invest. Balancing the activities of the securities finance industry with ESG principles will not be an easy task, but the opening of ideas for fund performance beyond the traditional basis point returns is likely part of the solution.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Comings and goings at FIS, Margin Reform and BlackRock

Margin Reform has secured two new hires for its securities finance practice in London.

Sakti Narayan and Yannick Lucas have joined as senior consultants with a focus on securities lending and repo.

As part of their new roles, the pair will be assessing the suitability of clients' securities lending programmes from a risk and investment guidelines perspective and identifying the intrinsic value in the lendable inventory.

A spokesperson for Margin Reform tells SLT that other services include offering end-to-end business process analysis for the design and development of the IT and operational infrastructure required to meet the business objectives and regulatory obligations.

Moreover, they will perform due diligence with regards to selecting third-party trading platforms, post-trade automation solutions and securities financing benchmarking data providers.

Most recently, for Margin Reform, Narayan and Lucas managed the design, development, testing and implementation of a bespoke securities lending internal agency for a €500 billion German asset manager.

Margin Reform describes Narayan as an expert in securities lending business process analysis and optimisation, new operations design and implementation and project delivery services.

He brings experience from various risk management roles at Deutsche Bank between 2011 and 2017. Before that, he held positions at Vanguard Strategy and Cognizant.

Meanwhile, Margin Reform says Lucas has long been supporting securities lending and repo initiatives as well as the evaluation and execution of operational programmes for asset managers.

Previously, Lucas was the head of European fixed income sales at RBC before moving into research and consultancy.

Morgan Stanley has tapped Arianne Collette to become its global head of strategic client engagement.

Collette first joined the bank's New York office in 2005 as a securities lending equity trader and has since held a variety of roles including fixed income repo trader and global securities financing transaction project manager of central counterparties.

Most recently, she had served as an executive director since 2015.

Elsewhere, Collette is also a founding member of the Women in Securities Finance industry group, which was formed in 2018 and is based in New York.

She serves as joint chair for the group, alongside fellow founding members Elaina Kim Benfield, senior counsel at Vanguard and Jill Rathgeber, director at BNY Mellon.

The founders say the Women in Securities Finance's guiding principles are to encourage and empower women in securities finance to connect professionally, collaborate and share insights.

In November the group opened its first European chapter in London, led by J.P. Morgan's Harpreet Bains and BNY Mellon's Ina Budh-Raja.

FIS has promoted Jonathan Hodder to become its European head of sales for its securities finance and collateral management business.

Based in London, Hodder joined FIS from EquiLend in April 2019 as a senior sales executive, before officially taking on his new role earlier this month.

At EquiLend, Hodder served as global head of sales and marketing between 2011 and 2018.

It is understood that his new role comes as part of a wider push by FIS to expand and update its securities finance data and services offerings.

FIS' securities finance suite includes data service Astec Analytics, Apex Collateral and Apex Securities Finance, among other auxiliary services.

CloudMargin has promoted Armando Hernandez to the newly established role of head of North America.

The role represents the latest step in the

firm's push into North America, which previously saw the opening of its first US office in New York in 2016.

CloudMargin CEO Stuart Connolly explained that the new position reflects the US' "ever-increasing role" in the firm's expansion plans.

CloudMargin says Hernandez, who now reports directly to Connolly, will take responsibility for the entire North American operating unit, including sales, relationship management, partnerships and client onboarding.

Hernandez joined CloudMargin in September 2018 as director of new business development for North America.

He made the move from Lombard Risk where he served for just over three years as head of business development for buy side relationships in the Americas and the Latin American region.

Hernandez also brings experience from a nine-year stint with Citigroup as vice president, in addition to a role as director of North American collateral products sales support for Omgeo, a post-trade services provider that is now part of DTCC.

Hernandez, who is based in the New York office, adds: "It is a great honour to have the opportunity to lead the North American division for CloudMargin at this time of significant growth."

CloudMargin has created a number of new roles to support its global growth. In September Karl Wyborn took on a new role as global head of business development in charge of marketing and sales strategy, team development and global sales targets.

BlackRock has hired Thomas Kinnally, former managing director of Morgan Stanley

Based in New York, Kinnally will now focus on all things balance sheets and funding related.

He brings experience from a more than 16-year tenure with Morgan Stanley, where he served in a variety of roles including global head of firm financing, collateral management and business relationship management (BRM) sales.

He also previously served at Eurobrokers as head of repo brokerage.

Kinnally left the banking industry in July 2019 to pursue an entrepreneurial venture in the fitness industry. It is understood that he now intends to manage those responsibilities in tandem to his role at BlackRock.

Elsewhere, Bruce McDougal has rejoined the New York-based bank from Charles Schwab to serve as its chief compliance officer (CCO).

McDougal, who is based in San Francisco, spent the past five years as deputy CCO for Schwab. He was also leader of its investment management's compliance advice team.

Before that he worked for BlackRock from 2001 to 2014, specialising in regulatory strategy, securities lending and finance.

During that time he spent more than seven years as senior counsel providing legal advice and then moved onto a director role monitoring legal and regulatory changes that could impact BlackRock's Securities Finance Business.

While at BlackRock McDougal also served as co-chair of the Risk Management Association's 30th Securities Lending Conference in 2013.