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Issue 247 03 March 2020

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OCC's Renaissance Initiative is in full swing with plans for new term lending and non-cash collateral services

Coronavirus Hits

As the global outbreak continues to worsen, the economic effects are starting to spread to SBL markets

APAC Insight

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ICMA publishes SFTR repo reporting guide

The International Capital Market Association (ICMA) is seeking to decrypt lingering ambiguity around reporting requirements for various types of repos under the Securities Financing Transactions Regulation (SFTR).

As of 13 April, the first phase of SFTR will require EU-incorporated or located entities to submit detailed reports of all securities financing transactions (including repo and reverse repo) to authorised trade repositories.

In total, SFTR sets out 155 reporting fields for transactions, of which 118 are applicable to repos.

The association notes that most of these fields require data from both sides of the trade to match with no or very limited tolerance for inconsistencies.

In addition, ICMA says, firms will have to report any modifications, terminations and corrections throughout the life cycle of a trade and report on a daily basis collateral market values, collateral reuse and margins.

In response to the formidable challenge posed by such a comprehensive regulatory framework, ICMA's European Repo and Collateral Council has this week published a guide specifically for repos to help interpret the regulatory rules and set out best practice recommendations to provide additional clarity.

The 202-page guide applies to both repurchase transactions and buy/sell-backs and covers everything from mandatory collateral and collateral re-use data fields to reporting centrally cleared repos and life-cycle events.

"It is the product of the blood, sweat and tears of ICMA's unsung SFTR task force, who have forged working interpretations of SFTR, the level two and three regulations and other guidance," says the guide's author Richard Comotto.

"Given the nature of the official documents that are the source material, it's not been easy.

"Some of the recommendations will change as more is (hopefully) learned about the reporting regime and new recommendations will almost certainly have to be added as new questions arise."

The guide was released alongside 36 sample SFTR reports and an overview of repo life-cycle event reporting which are available to ICMA members.

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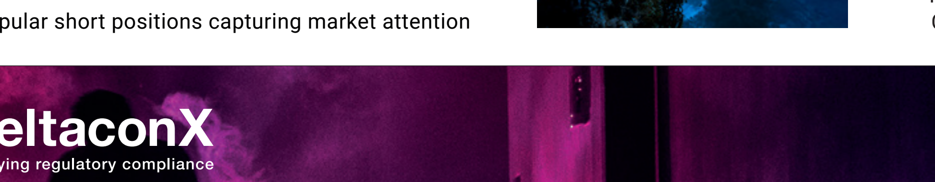

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Investors are twisting hedge fund managers' arms into implementing ESG

The majority of hedge funds have developed a well-developed environmental and social governance (ESG) strategy in response to investor demands, according to new market research.

A survey involving 135 institutional investors, hedge fund managers and long-only managers with total assets of $6.25 trillion in 13 countries, found that 59 percent of hedge fund managers are either at the 'mature' or 'in progress' stage of implementing ESG.

Only 10 percent of those surveyed said they had 'no [ESG] implementation to date'.

The research was published by KPMG, the Alternative Investment Management Association (AIMA), the Chartered Alternative Investment Analyst Association (CAIA) and CREATE-Research.

According to the survey, investor demand was the key driver for buy-side members embracing ESG, with institutional investors accounting for 85 percent of demand for ESG-oriented hedge funds.

However, the survey also found that only 55 percent of hedge fund managers have embedded ESG factors across their strategies.

It was further revealed that although the majority of respondents are embracing ESG to varying degrees, it's so far unclear whether they believe ESG policies are able to work in harmony with, or supplement, alpha seeking strategies.

Just under half (47 percent) of respondents described their attitude to ESG as 'sceptical' compared to 25 percent who said they had an 'opportunistic' take on it.

The majority of respondents pointed to a lack of robust templates, consistent definitions and reliable data as the main factor hampering further progress in ESG strategies.

In a blog post commenting on the research, AIMA CEO Jack Inglis argues that hedge funds are "very well positioned to benefit from a future defined by ESG, and they are more than capable of overcoming challenges in moving towards full-scale adoption".

"While certain strategies might not fit simply within an ESG framework the overall direction of travel in the industry is clear and managers are responding actively to meet their clients' needs," he adds.

triResolve Margin to offer SWIFT payment infrastructure

TriOptima has expanded its triResolve Margin collateral management service to support automated SWIFT payment capabilities, which will help clients in-scope for phases five and six of the Uncleared Margin Rules (UMR).

Asset managers, pension funds and insurance companies are scheduled to start posting initial margin (IM) for non-centrally cleared derivatives under UMR based on their volume thresholds either with phase five on 1 September 2020 or phase six on 1 September 2021.

The addition of SWIFT connectivity means TriOptima clients in-scope for UMR will now be able to instruct SWIFT payments directly via the platform.

According to TriOptima, clients can automate the full collateral management process across both initial and variation margin.

Meanwhile, institutions that are not connected to the SWIFT network typically have to log on directly to their custodian's web interface to key in their settlement instructions manually every day, a TriOptima spokesperson says.

The spokesperson explains that apart from being a time-consuming and onerous task this also introduces an additional operational risk that in the worst case could lead to settlement failures.

The new settlement automation service offers clients instant connectivity to the SWIFT network for cash transfers and securities settlement, as well as direct access to a range of custodians and triparty agents.

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Currently, there are over 11,000 institutions connected to SWIFT including triparty agents and custodians.

This means that TriOptima has access to all connected custodians and triparty agents, which presents an opportunity to clients who currently lack SWIFT support in their current settlement process.

Raf Pritchard, executive director, head of triResolve, comments: “Collateral settlement is often a manual and onerous task for firms, often requiring them to log into a custodian’s portal or even use a fax.

“Combining triResolve Margin with a centrally hosted SWIFT infrastructure removes the headache of connecting to multiple custodians, helping clients to lower transaction costs and significantly reduce settlement risk.”

Hazeltree collaborates with AcadiaSoft to help clients with UMR

Hazeltree, a provider of integrated treasury management and portfolio finance solutions, has partnered with AcadiaSoft to enhance its collateral management platform ahead of the final waves of the Uncleared Margin Rules (UMR).

Asset managers, pension funds and insurance companies are scheduled to start posting initial margin (IM) for non-centrally cleared derivatives under UMR based on their volume thresholds either with phase five on 1 September 2020 or phase six on 1 September 2021.

Under the new rules, derivatives trading relationships become increasingly complex, requiring both sides of each transaction to calculate daily IM, Hazeltree highlights.

In response to this challenge, the partnership will see the Hazeltree Collateral Manager service now include the standard initial margin model (SIMM) calculations, in partnership with AcadiaSoft.

Calculating bilateral margin under SIMM requires sophisticated risk, sensitivities and market data inputs across all covered trading with each respective counterparty, Hazeltree says.

The new initiative will provide the buy-side community with seamless margin calculations for their entire margin workflow, all in a single cloud solution.

Hazeltree explains that its collateral service helps optimise usage and minimise operational risks, as well as strengthen controls and enhance treasury return on investment through a streamlined, automated over-the-counter collateral management process.

Fred Dassori, head of strategic development at AcadiaSoft, says: “By partnering with Hazeltree, we’re able to offer the buy-side community a state-of-the-art integrated solution that both helps our clients meet their UMR obligations and takes another step toward standardisation across the industry.”

“The more consistency we can bring to these services, the more efficient we’ll make the entire margin process for our clients,” Dassori adds.

Pirum releases new CSDR fails cost analysis tool

Pirum Systems has imbued its Central Securities Depositories Regulation (CSDR) toolkit with a new fails report and an

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enhanced standing settlement instruction (SSI) enrichment services.

The report for failed trades aims to enable clients to more accurately determine the regulation's cost on their securities finance business that could come as a result of its settlement discipline regime ahead of its go-live.

CSDR's settlement discipline regime, which includes mandatory buy-ins for failed trades, as well as cash penalties, is slated to come into force in February 2021.

However, many corners of the market are concerned that the rules in their current form risk heaping significant additional costs on those in scope.

Pirum's own research shows that its clients could face fails fines of €80 million to €110 million per year, with an estimated fails management cost of €120 million and CSDR fines management costs of up to €85 million.

The total costs could be as much as €300 million per annum, Pirum says.

Estimates of the potential costs related to CSDR's settlement discipline regime vary significantly but the current letter of the law, especially with regards to the mandatory buy-ins, has spooked the market.

Concerns reached fever-pitch earlier this year when 14 trade bodies sent a letter to the European Commission calling for delay as the original go-live date of September this year was predicted to cause a liquidity squeeze as participants fled the market to avoid potentially unlimited costs.

As a result, the European Securities and Markets Authority formally requested that the commission grant a delay to the regime's implementation until 1 February 2021.

Elsewhere, Pirum's bolstered SSI enrichment services aim to allow firms to enrich and reconcile SSIs at the trade level,

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in order to prioritise and minimise fails due to mismatching settlement instructions.

According to Pirum, more than 35 firms are now using the service to enhance their trade files with over 100,000 SSIs and to get a real-time view of SSI instruction problems across all markets.

Robert Frost, head of product development and client services at Pirum Systems, says that the new features come in response to clients' need to automate their processes to reduce costs and avoid falling foul of CSDR's regime rules.

"Following feedback from our CSDR working group, we are introducing a new CSDR fails report that includes estimated CSDR cost – to enable firms to see what the impact is today, in order to remediate their processes ahead of the go-live date," he says.

Frost adds that Pirum is also working with clients to develop new solutions to assist with fails prevention for all markets.

Securities lending revenue starts strong, says IHS Markit

Borrow demand for equities with pre-IPO lockups expiring has helped drive January global lending revenue to $789 million, says IHS Markit.

Shares in the fitness equipment producer Peloton and teledentistry company SmileDirectClub were among the most sought after according to the UK data analytics firm in its monthly report, in a trend that first emerged last year.

Shares of Peloton generated $21 million in revenue, while SmileDirectClub generated $5.6 million, combing to deliver 10 percent of the January US equity total of $258 million.

Another January stand out according to the report, was Tanger Factory Outlet, which generated just over $13 million in revenue in the month – largely due to volatility in shares available for borrowing.

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Another trend that's carried over from last year was a demand to borrow cannabis-related equity.

Lending fees for this sector accounted for 15 percent of North American equity revenues in January, up from 13 percent in Q4 2019.

Overall, revenues declined 2.5 percent compared with December, however, most of the drop-off was the result of not having an event like the Danaher exchange offer, says IHS Markit.

But, a month-over-month comparison shows that securities lending revenue has stolen a march on 2019's figures, with last month's revenue figures outperforming January 2019 when markets were emerging from the Q4 2018 sell-off.

Elsewhere, global corporate bond revenues remained below the early 2018 peak, although new ways of generating revenues by lending credit instruments are still emerging. Corporate bond lending revenues came in at $42.1 million for January, a decline of 0.8 percent compared with December 2019.

The report's author Sam Pierson, director, securities finance, at IHS Markit, notes: "So far so good for 2020, though an exchange offer certainly wouldn't hurt!"

Writing for SLT in May 2019, Pierson explained that exchange offers reflect the key role that securities lending plays in the plumbing of global financial markets.

"This corporate action type is also a boon to the securities lending industry itself, driving significant loan balances and fees," he said.

DTCC's SFTR community grows to over 160 firms

Citadel, Franklin Templeton, Nordea Investment Management and PIMCO are among the latest firms to join the Depository Trust & Clearing Corporation's (DTCC) Global Trade Repository (GTR), ahead of SFTR's go live.

The latest surge means DTCC has signed up 138 clients and partnered with more than 30 vendors for its GTR service, which is offered by DTCC's Repository and Derivatives (RDS) division.

The GTR service aims to mitigate the challenges posed by the incoming Securities Financing Transactions Regulation (SFTR).

SFTR is due to come into effect for banks and broker-dealers in April, for exchanges and CCPs in July, and for buy-side firms in October this year, followed by non-financial counterparties in January 2021.

According to DTCC CEO Chris Childs, the new joiners will stand alongside Barclays, Goldman Sachs, J.P. Morgan, SEB and Societe Generale, which all signed up last year.

The service was opened to industry-wide user-acceptance testing in October 2019 "so that clients could benefit from an extended period of testing," DTCC explains.

Val Wotton, managing director, product development and strategy for RDS at DTCC, adds: "Broker-dealers have made good progress in their readiness for SFTR implementation and our goal is to help support asset managers as they look to do the same. We're ready to assist them as they prepare for this new mandate."

EquiLend's collateral trading service goes live

EquiLend's much-anticipated collateral trading service has gone live.

Clients from the Americas and Europe were active on the service it went live last week, with users in Asia set to join in April.

Many of the counterparties were involved in the EquiLend collateral trading working group.

EquiLend Collateral Trading aims to offer funding and financing desks a centralised way to execute and manage trade structures with their counterparties.

The new workflow supports collateral trade negotiation, execution and management of lifecycle events, such as substitutions and transaction rolls, EquiLend says.

The initial rollout supports collateral upgrade and downgrade trades and the service promises to meet client needs for high-quality liquid assets to meet regulatory demands.

According to EquiLend, their collateral trading service assists clients with their Securities Financing Transactions Regulation and Central Securities Depositories Regulation obligations through its tools for unique transaction identifiers, legal entity identifiers and transaction timestamps, which are produced at the point of trade.

EquiLend has confirmed it is already planning further enhancements, including additional collateral trade types and straight-through processing capabilities and connectivity to EquiLend Spire's books and records and inventory management modules.

Brian Lamb, CEO of EquiLend, says: "In the same way NGT revolutionised securities finance trading, and Swaptimisation brought unparalleled liquidity and efficiency to the swaps industry, we believe EquiLend Collateral Trading is set to transform collateral trading and management."

Northern Trust to offer outsourced trading services to Illinois pension fund

Northern Trust is set to expand its 30-year old business relationship with Illinois Municipal Retirement Fund (IMRF) to equip it with its Integrated Trading Solutions service.

The US bank's mandate with Illinois' second-largest public retirement plan, worth $44 billion, already includes securities lending, global custody, banking, treasury services, and investment management, among other services.

Now, the Integrated Trading Solutions will provide outsourced trading and middle-office functionality for a domestic equity portfolio managed internally by IMRF.

"Through Integrated Trading Solutions, we provide global trade execution, matching, and transaction cost analysis reporting that supports IMRF's commitment to delivering quality and cost-efficiency," says Grant Johnsey, head of institutional sales and trading, at Northern Trust Securities.

"Our trade execution solution is helping the IMRF team free-up resources while allowing them to exercise the high levels of oversight and governance that they and their participants demand," he adds.

Euroclear sees revenues and collateral surge

Euroclear, the Belgium-based financial services company, has reported a revenue increase of 8 percent for 2019, compared to the year prior, amounting to €1,435 million.

In its end-of-year report, Euroclear explains that business Income rose by 6 percent to €1,145 million due to the delivery of its "strategic initiatives and benefit of positive market conditions".

Moreover, its banking and "other income" increased by 13 percent to €290 million, which Euroclear says was "boosted by higher US interest rates in the first half 2019".

Elsewhere, the firm revealed that its Collateral Highway platform mobilised a yearly average of €1.3 trillion, up 6 percent on 2018.

The average value of securities held on behalf of Euroclear clients continued to grow up 5 percent €31.4 trillion in 2019, compared to the €28.8 trillion in 2018.

At the end of 2019, Euroclear held €31.4 trillion of assets under custody.

Euroclear says its FundsPlace product continued to attract asset managers and exchange-traded funds issuers with fund assets under custody rising to €2.4 trillion last year.

Commenting on the results, Lieve Mostrey, CEO of Euroclear, says that 2019 was a record year for the firm.

"Looking forward, despite headwinds from lower interest rates environment, we continue to invest in customer and product expansion, and to enhance our technology," she adds. "By remaining focused on delivering our strategic objectives, we expect to create further value for all our stakeholders."

ISLA's ESG council lays out plans for principles for sustainable securities lending

The International Securities Lending Association's (ISLA) Council for Sustainable Finance (ICSF) has met for the first time to begin the drafting its set of universal standards for environmental, social and corporate governance (ESG) in securities lending.

ISLA formed the ICSF in December last year after wide-spread market debate around the compatibility of asset managers' lending programmes and the growing trend of socially-conscious financing.

The council aims to offer a solution through the launch of its principles for sustainable securities lending (PSSL).

PSSL is a new voluntary sustainable finance mechanism for securities lending, following proposals by Radek Stech at the IMN's 25th Annual Beneficial Owners International Securities Finance and Collateral Management Conference in September 2018.

The principles were formed and developed by a high-level working group comprises beneficial owner institutions, including Aberdeen Standard Investments; Aviva Investors; BlackRock; KBC Asset Management NV; NN Investment Partners; and PGGM.

They are joined by ESRC funded Sustainable Finance – Law – Stakeholders Network of Exeter Law School; the World Pensions Council; Financial Decisions; and the Pan Asia Securities Lending Association.

The council is chaired by Stech, who is also council chair and founder of the Sustainable Finance, the Law, Stakeholders network.

According to ISLA, the PSSL remit is to have a strong and clear impact on the social, governance and long-term thinking elements of sustainable securities lending.

The principles will also enhance transparency around the impact of securities lending on the environment, ISLA adds.

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ESMA's second wind

The European Securities and Markets Authority (ESMA) delivered its first ever report into the overall state of the European market, entitled 'ESMA Report on Trends, Risk and Vulnerabilities'.

ESMA was created a decade ago in 2010 and commenced operations in January 2011. This report reflects the growing maturity, confidence and influence of the EU's market and securities regulator. I believe in years to come we will come to view this report as a watershed moment where ESMA graduated from laying down the foundations of the EU's capital markets into its second phase of refinement and market insight. We see this approach in its forthcoming review of the second Markets in Financial Instruments directive, mimicking its approach in refining the European Market Infrastructure Regulation (EMIR REFIT).

As an avid reader of the International Monetary Fund's annual report and Global Financial Stability Reports, I welcome this addition to the library that provides a more focussed analysis on a trading bloc that represents an estimated $18 trillion per annum.

ESMA considers, "[r]isks in markets under ESMA's remit remained high, particularly in securities markets and for consumers. Market risk stays at very high levels, with asset valuations exceeding fundamentals, amid weakening economic growth prospects and continuing geopolitical uncertainty".

Credit risk is elevated with corporate debt quality deteriorating and concerns around 'fallen angels'. Indeed, not one of the categories under ESMA's remit is green.

Market environment: Growth remains anaemic (forecast at 1.1 percent for 2019) having been cut from 1.2 percent. (By comparison, the US grew at double the rate - 2 percent.) This led to looser central bank monetary policy (the European Central Bank (ECB) dropped its deposit rate 10bps to -0.5 percent) and the ECB restarting its asset purchase programme in November 2019 (€20 billion/month).

Tangentially, this fact was advanced by Brexiteers as a reason for realigning Britain towards higher growth economies.

Geopolitical risks are affecting market sentiment, most notably tension with Iran in the Middle East (the September attacks on Saudi oil facilities led to a 20 percent spike in oil price). The ongoing US-China trade dispute, Brexit and more recently the coronavirus potential pandemic all contribute to an elevated risk profile.

Securities markets: But the greatest concern (red status) for ESMA remains the securities markets. The decade credit binge created by quantitative easing has led to rip-roaring returns from equity markets. Traditional valuations and price/earnings ratios are extreme. Any asset revaluation risks leading to a market rout. On the fixed-income side, the low-yield environment has fuelled a search for yield fuelling a growth in BBB-rated debt share (BBB and lower corporate bonds "now account for around 50 percent of outstanding bonds, while AAA securities only account for 5 percent")

Effects of legislation realised: ESMA has noted a sharp drop in over-the-counter activity, while noting the share of systematic internalisers (SIs are investment firms which, on an organised, frequent, systematic and substantial basis, deal on own account by executing client orders outside a regulated market, multilateral trading facility or organised trading facility remains significant at 20 percent of total volumes. Central clearing has increased over the decade (due to EMIR) and now remains stable – although concentrated in a few central counterparties (CCPs). Over-collateralisation by CCPs beyond margin requirements reached 20 percent in 2019 and central securities depositories (CSD) settlement fails remained below average (page eight of the report).

Regarding settlement failures, the International Capital Market Association and 13 other trade bodies have levelled stringent criticism on the CSD Regulation's mandatory buy-ins regime aimed at reducing settlement failure. ESMA responded by writing to the commission to recommend a delay in its implementation while industry concerns are analysed (covered by SLT on 4 February in "Delayed: CSDR settlement discipline regime").

The report contains a chapter on financial innovation analysing artificial intelligence, machine learning, distributed ledger technology and crypto assets.

In summary, the report is an invaluable insight into the state of play and will become essential reading for all involved in the financial sector.

As I have intimated, I consider this report to be somewhat of a watershed moment where ESMA graduates into its second phase of providing deeper market insight and analysis. Expect more in the years to come.

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Renaissance reboot

Scot Warren
Chief operating officer
OCC

The Options Clearing Corporation's Scot Warren sits down with SLT to talk the Renaissance (no not that one), the approval of the CCP's capital management policy and the potential for changes to collateral rules

What's new at OCC?

We are currently undertaking a three-year transformation effort to completely rebuild our technology stack. It's a project we internally call the Renaissance Initiative. Fundamentally, we're going to re-do our technology and re-engineer our processes so we can better serve our customers.

We currently have a stock loan clearing programme that's only available to sell-side participants and has about $80 billion in balances. With the Renaissance Initiative and through our rule filing process, we are working to add new capabilities such as non-cash collateral and term lending, for example.

OCC started stock loan clearing so that firms could get margin benefit for the risk offsets that their stock loan positions have on options portfolios. Now capital efficiency and stability of financing are a greater focus, so bank-owned firms want to bring more of their business into a central counterparty (CCP) like OCC. To meet these goals OCC is looking at ways to support term financing and non-cash lending.

Earlier this year your capital management policy got approved. How important is that for your plans?

It is very important. It gives us the pre-funded financial resources to meet our expectations as a systemically important financial market utility for operational resilience. The approval of this policy allows us to demonstrate that we are well funded and provides transparency to market participants.

We had a great deal of cooperation with the Trading and Markets Division of the US Securities and Exchange Commission (SEC) and through our industry outreach. This was essential to ensure market participants understood what we are doing and why we are doing it. Our effectiveness at communicating our plans was demonstrated by the very few letters received by the SEC as part of its public comment period on our plan and that helped to accelerate the approval process.

Clearing volumes indicate there's a trend towards moving to a cleared solution beyond what's mandated. What's driving this in the US?

From the agent lenders' point of view, there's a clear benefit because it would potentially lower the cost or even replace their need to provide indemnification to the beneficial owners they act for. However, the buy side still needs to be convinced of the benefit of clearing. As they see a capacity for better pricing or higher utilisation from dealers they will become more interested.

Reducing the cost or need for indemnity could increase the profitability of general collateral lending so that the buy side can make more of their portfolio available to lend.

Overall, I think the buy side is more aware of clearing than they were a few years ago but they still need more transparency on why they should change their model and how it affects their risk profile.

The question of what's in it for the buy side comes down to whether they are getting the full potential from their lendable inventory and are they getting the best rate of return on their loans? Broker-dealers that are borrowing from an agent on a bilateral basis can have a 100 percent capital charge and so it costs them more to do it outside of CCP clearing. Therefore, theoretically, buy side participants should start seeing a better rate paid on lending through a cleared solution and that will also create more capacity for borrowing general collateral, not just hard-to-borrows and specials.

Lending revenue in 2019 didn't live up to bumper profits we saw the year prior. Does clearing become more or less attractive the more earnings pressure grows?

The clearing model becomes more attractive the more pressure revenue is under. Right now a lot of the lending agents cannot profitably manage general collateral so they don't do it. That means the buy side is sitting on assets they could be lending but aren't. At the same time, the buy side may not be getting the best possible rates on the hard-to-borrows because a bank has to put up more capital to do that trade bilaterally.

Speaking of collateral, there are rumours that SEC Rule 15c3-3 will finally be amended to allow for the wider acceptance of equities by lenders. Thoughts?

For the broker-dealer community, it's critically important to effectively manage their assets and regulatory capital requirements. Changing 15c3-3 so that borrowers can post equities as collateral would enable broker dealers to free up more liquid assets and utilise their inventory of equities to collateralise their borrows. This would enable better management of cash flows and reduce regulatory capital for liquidity requirements.

If equities are used to a larger extent, then both lenders and borrowers must carefully consider whether this increases their operational or financial risk.

Regarding operational risk, it's important to make sure that you have the right staff, systems, and processes to ensure that the collateral is managed in an effective an efficient manner. OCC is entrusted with managing on average $125 billion in equity collateral each day. We have and continue to make significant investments to ensure that our collateral management processes are both effective and efficient.

Regarding financial risk management, it's important to consider a number of different factors that could lead to shortfalls in a liquidation scenario if they aren't effectively managed. OCC has developed sophisticated systems to account for a variety of different risk factors such as likely changes in the value of individual securities, volatility, the correlation between equities, potential changes under stress scenarios, and the cost to liquidate a pool of securities just to name a few. The traditional practice of establishing a set percentage that loans must be overcollateralised by may not be sufficient in order to effectively manage the financial risk associated with a pool of equities.

What effect do you think it would have on the market if the rule was changed?

In theory, it would expand the use of non-cash as a collateral type for loans. Non-cash loans are typically less expensive from a capital and liquidity perspective, so allowing dealers to utilise their equity inventories should boost their demand for loans.

What are the challenges to reform?

The SEC has a wide mandate and a lot of issues to deal with. Moreover, the constituency that this affects is small so it's low down on the SEC's priorities.

Theoretically, buy side participants should start seeing a better rate paid on lending through a cleared solution

Scot Warren, chief operating officer, OCC

Asia's patchwork quilt

Paul Solway
Head of securities finance, Asia Pacific
BNY Mellon Markets

BNY Mellon's Paul Solway discusses Asia Pacific's securities lending trends in 2020 including the impact of ESG, the fallout from GPIF's departure, and predicts how the coronavirus outbreak could influence borrower behaviour

One of the big stories to come out of Asia in 2019 was GPIF's decision to partially pull out of lending. How big a shock was this and what is the impact on the market in Asia and further afield?

The decision of Japan's Government Pension Investment Fund (GPIF) to suspend equities lending was based on its belief that the transfer of stock ownership rights during the course of a securities loan is "inconsistent with the fulfillment of the stewardship responsibilities of a long-term investor".

Studies undertaken by regulators have reached a different conclusion. Most recently, the European Securities and Markets Authority (ESMA) published a detailed report on securities finance in December 2019 which found that "securities lending, if done in a controlled way, is an opportunity to add value for fund investors and [is] compatible with long-term investment strategies".

We've not seen any measurable wider market impact from the GPIF suspension so far, which may suggest that beneficial owners agree with ESMA's conclusions that lending and long-term investment are entirely compatible.

That said, it is more important than ever to have a strong corporate governance policy underpinning lending activities. This has been a major area of focus for regulatory bodies in recent years, including ESMA and the United Nations, both of which have written at length about what a strong corporate governance framework should entail.

Just this past December, the International Securities Lending Association announced the formation of a new Council on Sustainable Finance which will also introduce a new series of Principles for Sustainable Securities Lending, so there are resources for beneficial owners to turn to when looking for guidance around developing robust lending policies.

Every year the developing markets of Asia are catching up with the more established markets. Which Asian markets do you expect to shine in 2020?

I would expect that South Korea will emerge as the Asia Pacific (APAC) market to watch in 2020. It's only been 15 years since South Korea established offshore securities lending but the growth we've seen has been absolutely tremendous. In that time we've seen insurance companies, sovereign wealth funds and others begin lending and participation has increased year on year. Today, South Korea is the fourth largest lending market in APAC with $120 billion in Korean equities available to lend at the end of Q3 2019, and with around $13.2 billion of that out on loan. We expect that number to grow as more institutions recognise the potential for yield enhancement through securities finance.

Lending in local fixed income has also been growing rapidly as demand for Korean treasury bonds (KTBs) has swelled. Roughly 10 percent of the overall financing flows in KTBs are for securities lending purposes, with the remainder of the demand stemming from onshore banks and alternatives raising short-term cash by pledging KTBs as collateral. IHS Markit found that just 3.3 percent of available Korean government bonds were being loaned out as of Q3 2019, so there is a huge amount of runway to grow lending activity in KTBs. Given all that, South Korea is definitely a market to watch.

Asia's securities lending revenue outperformed on the global stage in 2019. What drove this trend and can we expect it to continue this year?

Certainly, the first part of 2020 is going to be dominated by the ongoing COVID-19 situation, which we must anticipate will continue for at least a while longer. Consequently, we can expect APAC lending activity to focus on tourism and retail securities, and particularly in any names linked to China.

Once that situation is resolved – or at least stabilised – we could see a jump in lending activity as investors try to make up for lost time. We suspect that stocks in technology, biotech and biochemical industries could be popular in 2020 in addition to names in the healthcare space.

Looking at individual APAC nations, in Australia we can't see any specials on the horizon, so we expect 2020 lending to centre around the banking and retail sectors. Retail is also where we are looking for activity in Hong Kong, along with property, tourism and any names linked to the Chinese tech sector.

In Japan we're looking at export firms and the technology sector, with tech also being the centre of lending activity in Taiwan, as it almost always is. Finally, returning to Korea, we are watching out for borrower interest in bio names, export and the tourism sector.

2020 will see big moves in Europe to harmonise markets and improve data quality and transparency under SFTR, could a similar framework exist in Asia? Would you want it to?

With so much focus on the Securities Financing Transactions Regulation (SFTR) in Europe, many participants forget that there are many markets in APAC that already offer full transparency around securities finance trades to both investors and regulators.

In countries such as South Korea, Taiwan and Malaysia, lending trades are facilitated by domestic intermediaries that include brokers, custodians and depositories. Those intermediaries track and record in some detail the movement of all domestically listed securities.

With so much focus on SFTR many participants forget that there are many markets in APAC that already offer full transparency around securities finance trades to both investors and regulators.

Admittedly, those records don't encompass the more than 150 fields required to be reported under STFR, but they certainly provide enough information to ascertain volumes and fees by security and tenure.

What other challenges do you see on the horizon for the securities finance industry in Asia 2020?

There are a number of issues across the region with different challenges in different regions. The perennial challenge in domestic-only lending markets such as India and China is the question about when will they open up. There's little clarity on that issue on the horizon, beyond the much anticipated results of China's QFII/RQFII consultation that could see more market friendly developments potentially being rolled out.

Then there are issues around the differing routes to market we've seen emerging globally in recent years and the ongoing questions about when we are going to see them being embraced in APAC. Just to mention a few, we've seen the rise of central counterparties (CCPs) really accelerating in the past year or two, with repo clearing at the Fixed Income Clearing Corporation in the US and the first cleared securities lending trades in Europe taking place in 2019. We're yet to see comparable developments in APAC, although we are seeing clearing in Japan through the Japan Securities Clearing Corporation, but at this stage it's only used onshore by domestic counterparts.

Then there is the development of pledge structures being deployed in other parts of the world, which has delivered some meaningful operational efficiencies over the title transfer model. There has certainly been an uptake of pledge models in APAC, but there is definitely room to do more in this space and to expand the utilisation of these types of structures.

One of the challenges here is that these changes require a substantial investment in time, documentation, manpower, financial resource and operational support, so we made need to provide a bit more of a helping hand to see more clients in APAC through those issues.

Additionally, from a technology standpoint, the industry continues to automate right across the spectrum of active regional markets, vertically through the asset classes as well as the varying degrees of specialness (general collateral, warm and specials). Clearly the quant/algo space requires as much straight-through processing (STP) as possible in order to reduce latency and increase volumes but it's fair to say that the classic trader role even in securities lending is changing. Answering the question 'why' is becoming a differentiator across the street, as the buy-side continues to seek greater transparency over the qualitative and quantitative aspects of this business. This 'datatech' arms-race is set to continue whether it be lenders facing beneficial owners or primes feeding their hedge funds – all the while the cost-benefit conundrum keeps banging on in the background.

Coronavirus uncertainty sparks angst among experts in securities lending

Natalie Turner reports

As the global coronavirus outbreak continues to worsen with no sign of abating, the effects on global economies are starting to spread to securities lending markets

After the securities lending markets got off to a strong start for revenues in 2020, a highly contagious virus broke out, commonly known as the coronavirus. It is believed that patient zero originated in Wuhan, China, but at time of writing, 47 countries are battling the pathogen. Most recently, major outbreaks have sprung up in Italy, Iran and Japan crippling local economies and contributing to more than 82,000 confirmed cases world wide. Comparatively, the death toll is mercifully low but is still in the thousands.

Despite drastic measures enforced by the Chinese authorities to contain this strain, including mass quarantines of whole cities and a permanent ban on the sale of wild animals, the nature of mass tourism and global supply chains has provided the ideal vehicle for the virus and the disease it causes, known as COVID-19, it continues to spread itself across the world.

Financial market participants are scrambling to adjust their shorts to hedge against inevitable losses in their long strategies and rumours abound that the outbreak will influence decisions on interest rate cuts in the US later this year.

“The spread of the virus outside of China, with South Korea and Italy both now imposing radical containment measures, has spooked equity markets,” says Rupert Thompson, chief investment officer at Kingswood. “It has also fuelled further gains in safe havens such as gold and US treasuries.”

Securities lending affected?

Observers in Asia have noted that events such as this should act as a reminder to participants to ensure they have strong business continuity procedures and technology in place, such that securities lending programmes and client experience do not suffer.

For securities lending participants specifically early data is indicating that major movements may yet come, despite there being no significant macro change as a result of coronavirus so far. What movement there has been is in the sectors most vulnerable to the immediate impacts of the virus: travel, tourism and healthcare.

Paul Solway, head of securities finance, Asia Pacific (APAC), for BNY Mellon Markets, predicts that the first part of 2020 is going to be dominated by the ongoing COVID-19 situation and that APAC lending activity will focus on tourism and retail securities, and particularly in any names linked to China.

“Once that situation is resolved – or at least stabilised – we could see a jump in lending activity as investors try to make up for lost time,” he says. “We suspect that stocks in technology, biotech and biochemical industries could be popular in 2020 in addition to names in the healthcare space.”

Global ripples

Sam Pierson, director of securities finance at IHS Markit, tells SLT that: “The places where the impact has been notable tend to be very small cap stocks with specific exposures, for example the face mask company Alpha Pro Tech, however, it’s a tiny market cap so it’s not going to have a large overall impact.”

Research by the data provider and financial services firm shows that US luxury cruise operator Carnival Cruise Lines has seen increased share borrowing but that there are still plenty of shares available for borrowing. Elsewhere, US hotel chain Wynn Resorts has seen a trend of increasing share borrowing and short interest as the share price has declined over the last week of January and the first three weeks of February.

“For some of the larger firms which might be expected to have some exposure, there is an increase in borrowed shares and disclosed short positions. However, for just as many of those firms there has been a muted reaction or decline in short positions, so there doesn’t appear to be a consistent move toward shorting firms with more exposure to the spread of coronavirus,” Pierson continues. “This may mean that the risk approach by investors is more toward macro hedges or just reducing long exposure rather than short positioning.”

What about China?

The vast majority of confirmed coronavirus cases and deaths are in China and investors are reacting accordingly. According to S3 Partners, the top China exchange traded-funds (ETFs) being targeted by short sellers include the iShares (ISHS) MSCI China ETF, ISHS China Large Cap ETF (FXI), Kraneshs CSI China Internet Fund ETF (KWEB) and SPDR S&P China ETF (GXC).

Ihor Dusaniwsky, S3 Partners managing director of predictive analytics, explains: “We expect short selling to continue with the larger market cap securities leading the pack, especially with the Chinese markets closed.

“Most of these names are easily borrowable and trade at or near general collateral levels on the US exchanges, it is unknown whether there will be restrictions or difficulties short selling in China and Hong Kong in the future.”

Recession ahead?

It hasn’t taken long for the ‘r’ word to start being uttered in the hallways and meeting rooms of Canary Wharf, Wall Street and elsewhere as the predicted final act of this year’s first major market-shaking event.

One stark warning has come from Nigel Green, founder and CEO of deVere Group, an international financial services and advisory organisation, who notes that Asian-Pacific, European stocks and US futures markets fell to their lowest point earlier this month as part of a global market sell-off triggered by the outbreak.

“It seems that this week the world is waking up to the reality of the situation as the containment of coronavirus hasn’t yet materialised and confirmed cases soar in different countries,” Green writes in a blog post on 26 February. “Until such time as governments pump liquidity into the markets and coronavirus cases peak, markets will be jittery triggering sell-offs.”

“Whilst I am confident that we’ll narrowly avoid a global recession in 2020, no-one can accurately predict the future – as we have seen with coronavirus, which markets wrongly assumed would be limited to mainly China,” Green concludes.

With daily news updates of new mass outbreaks in areas far removed from the original epicenter it is still far from clear how much further the virus can spread or the extent of the chaos it can cause. As we enter March, experts hope that as we slowly come out of the cold winter temperatures, a warmer climate may help reduce the spread of the flu-like virus.

Nevertheless, we are clearly not out of the woods yet and for now financial markets will remain on edge.

Coronavirus statistics as of 28 February:

According to worldometer:

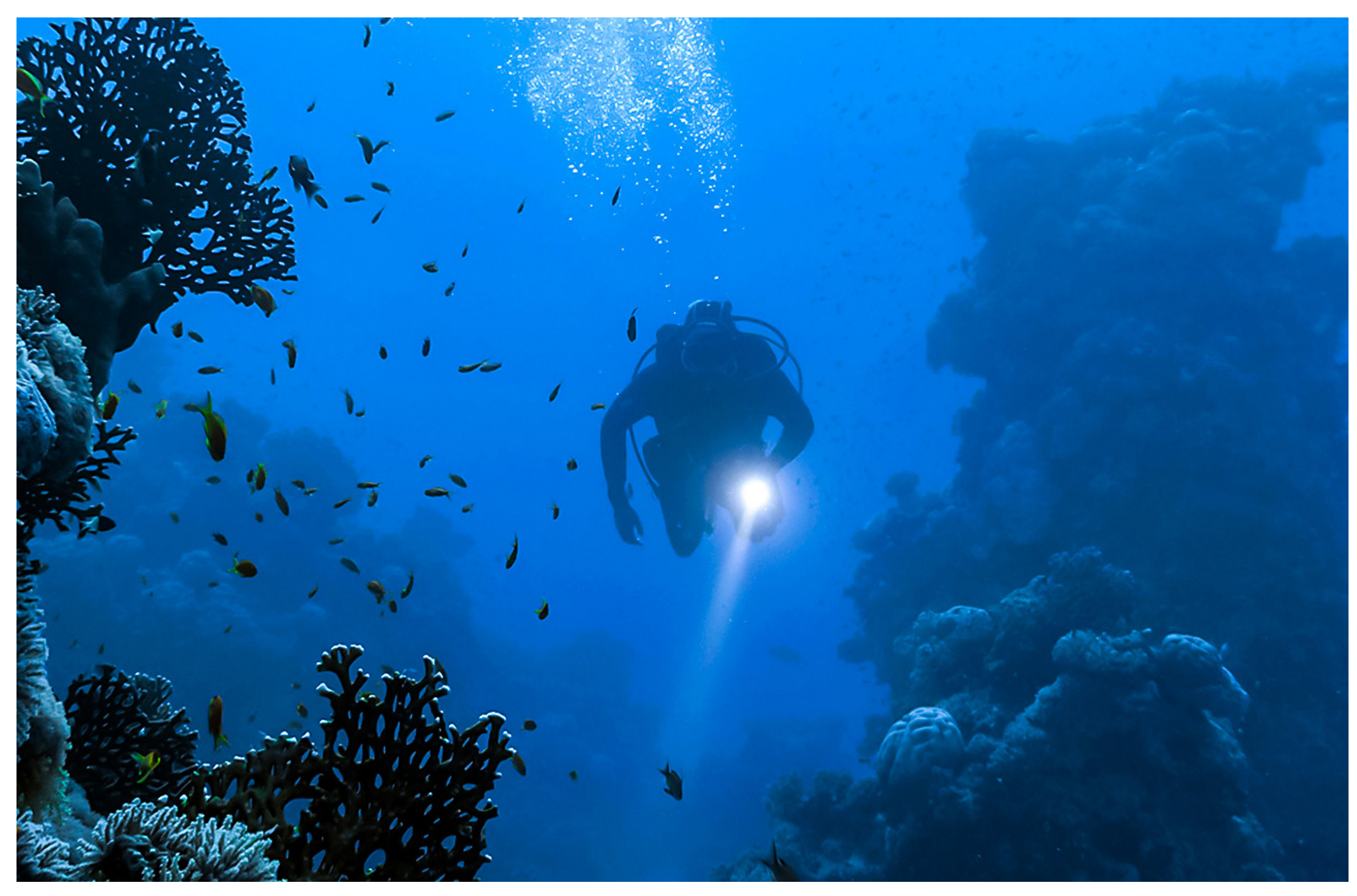
- Infected: 82,588
- Deaths: 2,814
- Recovered: 33,345
- Currently infected patients: 46,429
- Patients in mild condition: 37,958 (82%)
- Patients in serious or critical: 8,471 (18%)

- Alpha Pro Tech, micro-cap maker of facemasks, share price 81 percent year-to-date. Was 124 percent at peak 27 January. Currently 2 million shares on loan (increase from more that 15,00 shares at start of year)

- The balance in securities lending and borrowing hit a 21-month high in South Korea, as investors flocked to heavyweight stocks for investment gains amid prolonged coronavirus uncertainties, data showed Wednesday.

- The SLB balance stood at KRW 58.25 trillion (US$23.25 billion) on Monday, up 22.86 percent from the end of last year and the highest level since 31 May, 2018, according to the figures provided by the Korea Securities Depository.

- Samsung Electronics topped the list at KRW 7.4 trillion, followed by Celltrion at KRW 3.4 trillion and SK hynix at KRW 2.6 trillion.



European equity shorts

Sam Pierson
Director, securities finance
IHS Markit

IHS Markit takes a deepdive into the drivers behind popular short positions capturing market attention

Overall, the short loan value, that is the amount of securities finance transactions deemed likely to be related to short selling, has increased by just over 4 percent year-to-date (YTD). That suggests little overall change in positioning, with the short positions little change shares terms so that the increase in balances matches the advance for broad EU market indices. Beneath the surface of relatively steady aggregate short demand there have been some movers which warrant a closer look. As the table overleaf shows, Premier Oil's (PMO) share price surged following the early January announcement of a debt refinancing plan.The increase in share price was met with an increase in share borrowing, making PMO shares the most heavily borrowed in Europe as a percentage of outstanding shares. The largest publicly disclosed short position is from Asia Research & Capital Management (ARCM), which revealed a position of more than 140 million shares in July 2019 (there are a total of 217 million shares on loan). ARCM is also Premier Oil's largest creditor and released a statement on 12 February indicating that they will "vigorously oppose" the firm's proposed restructuring plan in court on 17 March.

Shares of Cineworld have seen a 23 percent increase in borrow demand YTD, largely maintaining a consistent borrow value of around £530 million despite a 20 percent decline in the share price. Short sellers may be betting against the prospects for the firm, specifically the debt assumption required to facilitate the proposed takeover of Cineplex (an all-cash deal expected to close in the first half of 2020) and other challenges faced by global theatre brands. The latter concern is also reflected in the increased short demand for AMC shares and the 18 February bankruptcy filing for VIP Cinema Holdings (a maker of luxury cinema chairs).

Hammerson has also seen increased borrow demand, likely driven by a perceived likelihood that the UK real estate investment trust will cut its dividend. IHS Markit Dividend Forecasting predicts the August 2020 dividend will be cut 23 percent year-over-year. Hammerson currently has 15.5 percent of outstanding shares borrowed, worth £268 million.

Borrow demand for Future surged following the 31 January release of a research report from Shadowfall Capital & Research, which was linked to a post on Twitter that disclosed its short position. The number of borrowed shares has more than doubled after the report was released to 7 million shares for settlement on 18 February. The borrow cost remains low with more than 15 million shares reported as available for borrow.

Borrow demand for shares of Wirecard (WDI) has been flat over the past month, however, that follows demand surges in October and December. Shares of WDI are the most heavily borrowed for any EU equity in nominal terms, with more than €3.4 billion on loan. The massive borrow balance is the result of the share price increasing just over 30 percent from the December low, while shares on loan have increased by just over 20 percent.

Moving in the opposite direction, the number of Aston Martin shares on loan decreased 22 percent from the post-initial public offering peak observed on 24 January. The move toward the exit appears to be motivated by the 31 January announcement of strategic equity investment in the firm by a consortium led by billionaire Lawrence Stroll, which provided a boost to the share price. Another UK equity with declining borrow demand is NMC Health. The United Arab Emirates healthcare group came under increased scrutiny following a Muddy Waters report in December, which revealed that it held a short position.

While the share price has declined by 67 percent since the report was released, the trajectory hasn't been on a straight line with four days seeing a greater than 10 percent increase in price, two of which were increases of more than 30 percent. The volatility may be shaking some short sellers out of the trade, reflected in a 50 percent decline in share borrowing YTD. The decline in borrowing is also notable in that the 52 percent decline in share price YTD may have been softened by the impact of short covering.

To wrap up, we'll head back to the continent to look at shares of AMS, which have seen a net increase in share borrowing YTD, based on coronavirus related concerns for the Apple supplier and questions surrounding the acquisition of Osram Licht. The number of borrowed AMS shares has more than doubled YTD, to 10.8 million shares, however, that figure also represents a decline from the peak borrow demand of 14.4 million shares on 4 February. The share price has oscillated, but is little changed, with a net increase of 1.1 percent YTD.

European Equities - top 10 highest European share borrowing

Ticker	Instrument Name	Shares borrowed (m)	30 day %chg shs borrowed	% SI Shares Outstanding	Active Utilisation	Price 30 days %chg
PMO	Premier Oil Plc	212.0	-4.6%	25.3%	73%	-8%
CINE	Cineworld Group Plc	308.9	17.6%	22.5%	76%	-7%
WDI	Wirecard Ag	25.9	1.1%	21.0%	85%	8%
HMSO	Hammerson Plc	119.0	30.4%	15.5%	36%	-14%
ERF	Eurofin Scientific Se	2.6	-2.7%	14.6%	64%	-1%
SDF	K&S Ag	27.7	17.9%	14.5%	94%	-14%
AML	Aston Martin Lagonda	32.0	-15.5%	14.0%	97%	-7%
AMS	Ams Ag	11.1	73.1%	13.5%	37%	-7%
AMBU B	Ambu A/S	28.1	-14.2%	13.3%	55%	48%
KWS	Keywords Studio Plc	8.6	-6.6%	13.1%	45%	6%

Upcoming Securities Finance Training

SFTR Analysis

Date: 19 March 2020
Location: London
Provider: Consolo

SFTR is the biggest regulatory change for securities lending in decades. This course will provide you with a good understanding of the regulation and what is needed to ensure compliance

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Location: London
Provider: ICMA

Securities Lending & Borrowing has been an important activity within the securities marketplace for many years. This course will tackle common operational challenges

Securities Finance Regulatory Update

Date: 26 March 2020
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Provider: Consolo

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Securities Operations Foundation Qualification (SOFQ)

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Provider: ICMA

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Comings and goings at Eurex, FIS and more

Deutsche Boerse Group is set to welcome Nick Barnes from MarketAxess to become a senior vice president for sales and relationship management for Eurex Clearing.

Based in London, Barnes will focus on Eurex's buy-side initiative and report to Jonathan Lombardo, head of fixed income derivatives funding and financing sales for Northern Europe.

Eurex's European sales team is led by Frank Gast, while Philip Simons heads fixed income sales globally.

Barnes makes the move from MarketAxess where he was sales and business development lead for its post-trade repo confirmation tool that connects the buy and sell sides.

He also previously worked at Barclays for 16 years, where he held a number of senior front-office roles including government bond repo trader and fixed income sales.

The push for more buy-side participants on Eurex Clearing's Lending CCP offering has been a priority for the firm for several years now and is widely seen as a critical step in the use of clearing services gaining even wider market acceptance.

Panellists, including Eurex representatives, speaking the Deutsche Boerse Global Funding and Financing Summit in Luxembourg last month were unanimous in highlighting that gaining more buy-side acceptance of central clearing was a top priority for many central counterparties (CCPs).

Speakers noted that in both the US and Europe, the incentives to clear trades beyond what is mandated by regulation is now clear for the sell side, especially for banks acting as agents, but many of the buy side is yet to be convinced.

Eurex secured its first direct buy side member in 2017 when Dutch cooperative pension fund PGGM agreed to lead the way for its market demographic.

Speaking at the time, Roelof van der Struik, investment manager for treasury trading and commodities at PGGM, said: "At PGGM, we believe by connecting to Eurex Clearing, using the full capabilities of EquiLend, the CCP model enables new stock lending structures and business opportunities for beneficial owners as well as helping to manage the rising burden of balance sheet regulation and costs for the securities lending market."

PGGM went live on the CCP in June 2018 by leveraging Eurex's ISA Direct service.

As part of the on-boarding, PGGM became one of the first to use EquiLend Clearing Services' full connectivity offering to access Eurex Clearing's lending CCP.

Hilltop Securities, a Texas-based financial services provider, has hired Jennifer Pimental as its new senior operations specialist.

Pimental, who is based in New Jersey, took on on her new role in December after serving more than four years in securities lending based roles for E*TRADE (soon to become part of Morgan Stanley).

Before that, Pimental has worked for Cowen and Company as vice president and a consultant for maple securities.

She has also held positions as head of operations at Quardriserv for over five years, an operations specialist at Cantor Fitzgerald and in securities lending at Banca IMI.

Elsewhere, Hilltop also recently promoted John Muschalek to become its head of wealth management with its securities lending and clearing services.

Muschalek took on his new role last month after serving more than 27 years with the firm, including his most recent role as chief administrative officer.

Former managing director of BMO Global Capital Markets, Anthony Venditti, has been reincarnated among the management team of US broker-dealer South Street Securities, seven months after retiring.

Venditti left his role as co-head global prime finance and delta one trading at BMO in July 2019, but has now returned to the securities financing market to pursue "an exciting opportunity" with "a well capitalised US broker-dealer".

South Street was established in 2001 and concentrates solely on repo cash investment and repo security financing services.

SAVE THE DATE

7

May 2020

The 7th of May sees a return of the industry's only conference dedicated to securities finance technology focusing on the current operational environment and the future market structure

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The firm says it is the only broker-dealer that is a tier-one member of the Fixed Income Clearing Corporation with full repo netting rights and is dedicated to the repo market.

South Steet's model only allows for collateral comprised of US treasury and agency securities, along with short repo tenors, which the firm says helps keep its capital costs "very low". "This translates into very competitive rates for repurchase agreements," South Street states.

In a statement on his new role, Venditti says: "With a first-class management team, they [South Street] have established themselves as a fairly large player in the US repo markets with multiple opportunities for growth within their existing businesses and capital structure."

Venditti also argues that South Street is "one of the few firms" that have a technology company integrated into its business model, adding that his "strengths within the equity finance/delta one trading business, along with [his] deep relationships across the industry can evolve this opportunity with South Street into something special".

In a letter sent to "colleagues, clients, and friends" Venditti says: "I look forward to working with all of you for many years to come as we build a strong global securities finance business and platform."

Venditti, based in New York, boasts more than 35 years of experience in the securities financing industry having spent 10 years at Nomura Securities prior to his 13 years with BMO.

FIS continues European securities finance sales hires

FIS has continued to build out its London sales team with the appointment of Emmanuelle Charriere from EquiLend.

Emmanuelle Charriere is expected to join FIS next week as a senior member of its sales team in Europe with responsibility for its securities finance and collateral management business.

SLT understands that she will focus predominantly on her native land of France, but will be based in London.

In her new role, Charriere will report to fellow EquiLend alumni Jonathan Hodder, FIS' European head of sales for its securities finance and collateral management business.

Previously, Charriere was part of the business development team for BondLend, the securities finance technology platform of EquiLend, which she joined in 2011.

Before that, she served in several roles for Merrill Lynch over a five-year period, including her most recent as a business analyst for global equity derivatives technology.

As part of the FIS sales team, Charriere will work alongside Lee Bernini who joined from IHS Markit last month.

FIS was unable to immediately respond to questions on the new hire.

The appointment comes a few weeks after FIS undertook a re-shuffle of staff with several figures taking on more senior roles.

Movers included Andrew Murray who stepped up to become head of sales for post-trade solutions in Europe.

Igor Salzgeber, based in Switzerland, has also risen to become head of product for FIS securities finance and collateral products, including Astec Analytics.