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Amundi fears onerous SFT reporting

European asset management firm Amundi has expressed disappointment over reverse repos and securities lending being considered securities finance transactions under the Financial Stability Board's (FSB) consultation on data collection and aggregation.

The asset manager filed its response to the FSB's proposed standards for securities finance transaction data collection and aggregation on 12 February, which was the deadline for providing feedback. Amundi said it is "very sorry" to see that reverse repos and securities lending are now called securities finance transactions, "a wording that does not reflect the way they are conceived by asset managers".

Only hedge funds should be included in the scope of any regulation of securities finance transactions, argued Amundi, because asset managers rarely use repos or borrow securities.

UCITS funds should be entirely exempt from the proposed regulation, while alternative investment funds that use significant leverage "are the only ones that can present any risk at a systemic level", argued Amudi.

read**more p2**

Venture capital firm takes stake in CloudMargin

Illuminate Financial Management has invested in CloudMargin, the collateral and risk management technology platform originally backed by a group of senior financial market executives.

The cloud-based solution, which launched in 2013, is a cross-product, cloud-based collateral and margin management technology solution.

CloudMargin was developed to cater specifically to buy-side and non-bank institutions such as corporates, hedge funds, insurers, pension funds and asset managers.

The move marks Illuminate's first investment in a financial technology firm since it was launched last year by Mark Beeston, now managing partner of the company.

read**more p2**

European repo market loses value

The size of the European repo market has fallen to €5.5 trillion, according to the International Capital Market Association (ICMA).

The 28th ICMA European Repo Council survey of the European repo market found that it had reduced in size since the last check in June 2014, when it was worth €5.78 trillion.

Interviews revealed that the continuing reduction in repo activity reflects depressed business, and that new leverage and liquidity regulations aimed at reducing banks' reliance on wholesale short-term funding are beginning to bite, according to the ICMA.

Survey participants cited the Basel III-mandated leverage ratio as a major constraint on balance sheets and addition to the cost of business, said ICMA.

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Amundi fears onerous SFT reporting

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Asset managers are closely regulated and supervised already, and so reporting should not be used to "introduce new regulation".

"[The proposed regulation] should remain limited to its role of getting better information in order to ensure financial stability and track systemic risk."

FSB chair Mark Carney promised in early February to press ahead with the proposed standards for securities finance transaction data collection and aggregation, saying that an implementation timeline will be in place by the end of the year.

Twenty other parties responded to the FSB's consultation, including the International Securities Lending Association and Markit.

Venture capital firm takes stake in CloudMargin

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Illuminate's investment is the only institutional funding completed by CloudMargin as it eyes the next phase of its growth.

Beeston commented: "CloudMargin fits perfectly into our investment thesis of identifying and accelerating the growth of young companies that will lead the next stage of technology innovation within capital markets."

"It is unique in that it offers a low cost solution for a range of industry participants as well as improving efficiency for the major sell-side players."

"This technology is going to be transformational in the evolution of collateral processing and we look forward to supporting CloudMargin's growth over the coming years."

Andy Davies, CEO and co-founder of CloudMargin, said: "We are delighted that Illuminate has chosen to invest in CloudMargin."

"This is a great validation of both our technology and the solution we have created. Illuminate has already played a role in developing better access, connections and relationships with our target market, and we look forward to partnering with them to accelerate CloudMargin's growth and client adoption."

CloudMargin recently announced connectivity to AcadiaSoft, the collateral messaging platform, where Beeston was a former member of the board.

European repo market loses value

Continued from page 1

ICMA's survey did find that European repo participants are working to mitigate regulatory costs, with central counterparties being considered as trading routes and the average maturity of business lengthened.

There are also indications of increasing collateral transformation as banks swap collateral to acquire high-quality liquid assets required by new regulations, said ICMA.

A second report strongly criticised the mandatory buy-in provision in the Central Securities Depository Regulation (CSDR).

Buy-ins act as additional security for the buyer of securities in a trade. If the counterparty fails to deliver the securities agreed, the buyer has the right to appoint an agent to purchase the securities at market value for guaranteed delivery.

The buyer will still purchase the securities for the agreed price, and the seller must make up the difference.

This is currently primarily conducted on a discretionary basis, and occurs fairly infrequently, however, under new CSDR rules buy-ins will become mandatory if instruments are not delivered within a specified time frame.

The responsibility for managing the buy-in could also lie with the central securities depository (CSD), trading venue, or even the central counterparty.

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The situations affecting shares in Schneider Electric, APR Energy, Iomart and more

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New opportunities dominated the PASLA/RMA Conference on Asian Securities Lending in Shanghai

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There's a dark side to the Central Securities Depository Regulation that has remained unexplored—until now

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Data analytics

The US credit card market is undergoing what is arguably its greatest period of change in the last decade, but short sellers have so far held back from betting on the sector's downfall

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According to the ICMA report, the impact of Basel III on the cost of a bank's balance sheet has led to market makers retaining low levels of inventory, and therefore in many cases they will be offering securities that they do not have.

Market makers could be forced to add a premium to their offers. The repo market could also be affected, with more reliance on short-data repo funding, or 'exempt' repo.

Liquidity across secondary European bond and financing markets could reduce, as bid offer spreads widen dramatically. More stable, fixed-term markets may see a dramatic widening of spreads for more liquid securities including some sovereign and public bonds, and most corporate bonds.

The report estimated that the cost of a mandatory buy-in regime for bonds markets would amount to about €1.4 billion per €1 trillion of annual volume.

For the repo market, the estimated annual cost to the market is about €3.14 billion.

There is a concern that this is a cost that will directly affect investors as well as issuers, who will have to pay a 'liquidity premium' for their primary debt issuance. Changes are likely to have cost implications for both public and private borrowers.

The report's author, Andy Hill, pointed out that these estimates do not take in to account the probable market contraction that would follow the introduction of a mandatory buy-in regime, which could be considered a greater cost in itself.

Either way, he maintained that a buy-in regime's ability to improve settlement efficiency remains unproven.

The report follows a similar study from the European Central Securities Depositories Association, which found that a mandatory buy-in regime would result in more than 1.8 million buy-ins per year, with a total transaction value of €2.5 trillion.

Hill's report concluded: "While initiatives to improve the efficiency and safety of Europe's settlement systems should be supported, every indication suggests that mandatory buy-ins is an ill-conceived and poorly constructed piece of financial markets regulation with no obvious benefits or likely positive outcomes."

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Godfried De Vidts, chairman of ICMA's European Repo Council, said: "Today we face many challenges which are rocking the repo market on its strong foundations and endangering its ability to provide secured finance in the service of Europe's real economy."

"The cumulative impact of market legislation and prudential regulation is putting the safety and function of the repo market and other products at risk."

Swiss franc shock affects US securities lending

The thematic focus of January securities lending in the US was on the unpegging of the Swiss franc and further deterioration in the oil and energy space, according to Deutsche Bank.

As the Swiss National Bank shocked markets by uncapping the Swiss franc to the euro, FXCM, an online foreign exchange broker, warned that client losses threatened its compliance with capital regulations.

The stock subsequently traded down to a low of $1.60, down from over $16 at the beginning of 2015.

While FXCM was relatively liquid in the securities lending market prior to the unpeg, long selling created significant recall pressure throughout the market and rates spiked in conjunction.

Short interest doubled, going from six to seven million to nearly 14 million shares essentially overnight. According to Deutsche Bank, levels in the spot borrow market are "well north" of 30 percent, with collateral mismatch due to low stock price "exacerbating the current dynamic". Oil spent most of January under the symbolic level of $50 per barrel. In addition to the usual names such as Transocean, Diamond Offshore, and Linn Energy, others like Sanchez Energy, Energy XXI and CARBO Ceramics experienced particular borrow pressure in January.

As well as dealing with the Swiss franc macro "shock", Europe also saw the election of an anti-austerity government in Greece.

According to Deutsche Bank: "This has introduced significant further volatility into Greek stocks as the market tries to guess the nature of an accommodation between Greece and its international financiers."

Stock Connect gets short selling

Short selling of certain Shanghai-listed A shares is now permitted through the Shanghai-Hong Kong Stock Connect programme.

Some 414 securities could be sold short through Stock Connect from 2 March, including Industrial and Commercial Bank of China, KPC

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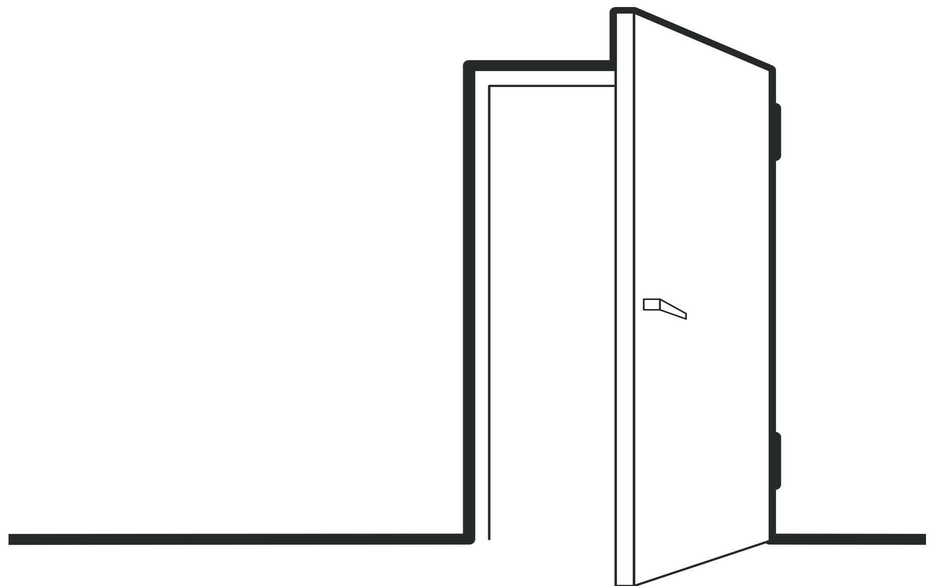
Naked short selling is prohibited for northbound trading under Stock Connect's rules.

Stock Connect, Hong Kong Exchanges and Clearing's mutual market access programme with the Shanghai Stock Exchange, launched in November last year.

Deimos Asset Management enters hedge fund space



Deimos Asset Management has launched a new hedge fund management business with strategic investment from Ares Management.

Multi-strategy hedge fund manager Deimos is focused on the development of a suite of alternative asset management products, which is expected to include a multi-strategy hedge fund as well as a variety of individual strategies.

It launched its operation with nine investment strategies focusing on the US and Europe, and has plans to expand in to other markets over time.

The new business will offer high-quality infrastructure and the ability to pool resources for multiple managers. Operational, compliance and technology resources intend to mitigate the challenges faced by new and small funds, particularly around regulatory requirements.

It will also allow investors to minimise the expense and timeframe of due diligence, offering investors the flexibility to access multiple high-quality investment teams via one single relationship.

The global alternative asset manager Ares Management made a strategic investment in Deimos to aid the set up of the hedge fund management business, and the Ontario Teachers' Pension Plan is an anchor investor through a managed account platform.

Michael Arougheti, co-founder and president of Ares, said: "Having known the partners of Deimos professionally for many years, we are excited to work with this team to enter the large and rapidly growing hedge fund asset class, which represents 30 percent to 40 persent of all alternative investments today."

He added: "We believe we can create value with this strategic partnership by cross selling its hedge fund advisory services to our global investor base."

"This is a natural extension of our firm's continuing diversification across alternative asset classes, which we believe enhances our value proposition to our investors."

Deimos was originally formed through a management buy-out belonging to Guggenheim Global Trading, the hedge fund platform of Guggenheim Partners.

It is led by Patrick Hughes and Loren Katzovitz, former co-heads of Guggenheim Global Trading, plus Mark Standish, who was formerly group executive of Royal Bank of Canada and co-CEO of RBC Capital Markets.

Katzovitz commented: "We could not be more pleased to be working with Ares and to have Ontario Teachers' as an anchor investor."

"Ares possesses a world-class distribution and marketing team which will be invaluable to us as we expand our hedge fund offerings."

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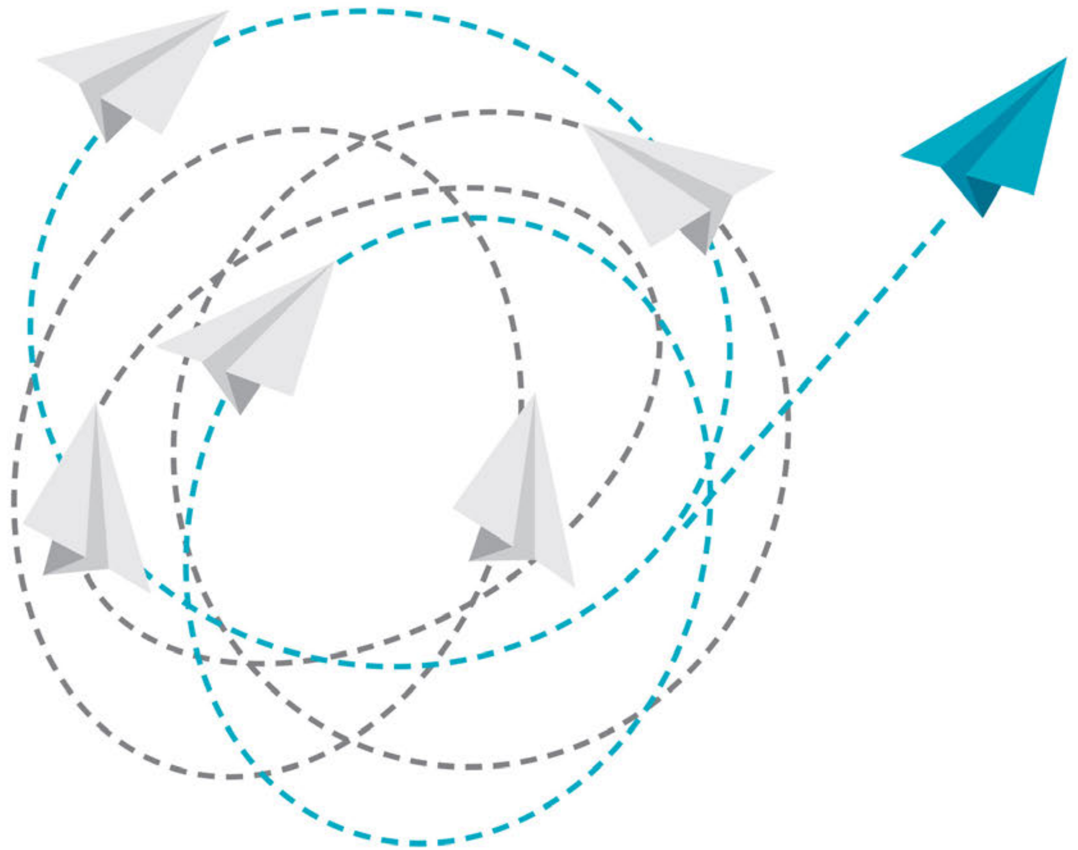

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"We look forward to building this business and executing on what we see as a very large opportunity within the hedge fund space."

Rise in notifications on SS&C platform

SS&C GlobeOp's forward redemption indicator for February 2015 has shown notifications of 3.64 percent, up from 2.49 percent in January.

The data on the GlobeOp platform represents approximately 10 percent of the hedge fund industry.

"Redemption requests increased for the month of February, but remain consistent with historical averages," said Bill Stone, chairman and CEO of SS&C Technologies.

Forward redemptions as a percentage of SS&C GlobeOp's assets under administration on the GlobeOp platform have trended significantly lower since reaching a high of 19.27 percent in November 2008.

LCH.Clearnet expands SwapClear service

LCH.Clearnet is launching new interest rate portfolio margining capabilities within its SwapClear service.

Market participants using SwapClear and LCH.Clearnet's listed rates service will be able to maximise margin offsets between OTC and listed interest rate derivatives.

The new service aims to help clients manage their collateral obligations more efficiently.

Portfolio margining will be available on an open access basis to those regulated venues that list suitable interest rate derivatives. The service should go live within the next 12 months, subject to regulatory approval.

Daniel Maguire, global head of SwapClear and listed rates at LCH.Clearnet, said: "This is a transformational initiative for the interest rate derivatives market. SwapClear is delighted to be delivering even greater efficiencies in processing, capital and collateral for our members and their clients across the world."

"SwapClear is uniquely positioned to efficiently aggregate, clear and portfolio-margin interest rate derivatives from multiple venues across multiple products."

"Portfolio margining across both OTC and listed interest rate derivatives, on a fully open access basis, will give our members and their clients execution venue choice and access to our deep global pool of liquidity."

The NSE reaffirms naked short selling ban

The Nigerian Stock Exchange (NSE) has reminded dealing members about the naked short selling prohibition in place.

In a circular issued on 12 February, the NSE reaffirmed the naked short selling ban, reminding members that any dealing member

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found in violation will be fined up to 10 percent of the total transaction value.

Any dealing member found in violation more than once will be suspended from trading, added the NSE.

The NSE introduced market making and securities lending in 2012 to boost liquidity.

BM&FBovespa enjoys January increase

Securities lending transactions reached 132,115 in January of this year sat Brazilian central counterparty BM&FBovespa.

The CCP saw more transactions in January than it did at the end of last year, beating December 2014's total of 113,232.

Trading value amounted to BRL 52.49 billion ($18.26 billion), compared to BRL 48.61 billion ($16.91 billion) in December 2014.

triResolve expands APAC presence

Taipei Fubon Commercial Bank has become the first Taiwanese financial institution to join TriOptima's triResolve portfolio reconciliation service, further expanding triResolve's reach in the Asia Pacific and China (APAC) region.

The triResolve service's presence has increased by 350 percent in the APAC region since 2012, and it is now used at companies in Australia, Hong Kong, Japan, Singapore and South Korea, as well as Taiwan.

APAC participants are increasing reconciliations in order to accommodate US and European counterparties that are required to reconcile their portfolios and manage collateral disputes quickly.

Yutaka Imanishi, CEO of TriOptima in the APAC region, said: "We are working closely with Taiwanese institutions to advance their risk management initiatives by joining triResolve."

Contrasting housing markets in UK and US, says Markit

Homebuilders' returns in the UK are seemingly on the up with increased dividend payments, marking a contrast to the US housing market where short sellers are congregating, according to Markit.

As concerns of a sharp UK housing market slowdown abate, homebuilders' shares have performed well over the past 30 days. UK homebuilders have averaged a 12 percent return, with firms such as Bellway and Redrow edging up by 11 percent and 34 percent respectively.

Markit analyst Relte Schutte commented: "Using the average shares out on loan across the largest homebuilders in the UK to gauge sentiment reveals that short sellers covered positions in the second half of 2014. Average shares outstanding on loan peaked in June 2014 at 1.2 percent, declining by 75 percent to hit 0.5 percent at present."

US homebuilders are seeing 15 times more short interest than their UK counterparts, racking up an average of 7.8 percent.

Despite this, the US market has seen short sellers cover slightly from a high of 8.7 percent reached in October 2014. Currently, the most short-sold homebuilder in the US is KB Home with 17.4 percent of shares out on loan.

According to Markit's dividend forecasting, distributions to shareholders among homebuilders in the FTSE 350 are expected to increase 50 percent this financial year reaching £1.3 billion, with ordinary payments up 25 percent to £668 million and expected special distributions totalling £642 million.

Dividend growth is expected to slow following the significant jump in payouts in 2014.

Barratt Developments, Berkeley Group Holding, Persimmon and Taylor Wimpey represent 80 percent of the payout of the sector (around 20 percent each).

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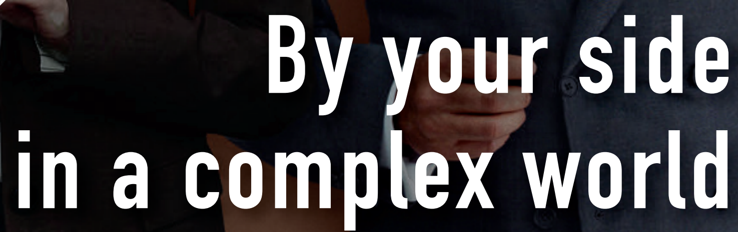

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Taylor Wimpey is expected to increase its payout by 280 percent due to a commitment from the management to pay £250 million in July 2015 and £200 million thereafter.

In comparison, dividends for US homebuilders such as KB Home and Lennar are expected to remain constant, while Toll Brothers, lack of dividend programme is also expected to continue.

Schutte continued: "Despite strong rallies in both housing markets, historical returns highlight differences in investment outcomes."

"The average returns across the largest UK homebuilders in 2013 and 2014 were 51 percent and 12 percent respectively, the largest US homebuilders delivered on average a negative return."

OCC sec lending activity decreases in February

OCC's securities lending central counterparty activity was down 9 percent in new loans in February compared to the same month in 2014.

The CCP saw 97,356 transactions last month. Year-to-date stock loan activity is up 4 percent from 2014, with 203,122 new loan transactions this year.

The average daily loan value cleared by OCC in February was $165.1 billion.

Total cleared contract volume in February fell to 306.5 billion contracts, a 13 percent decrease from last year's February volume of 350.5 billion.

OCC's year-to-date average daily cleared contract volume is down 9 percent from 2014, with 17 million contracts.

Cleared futures volume was down 28 percent on the previous year, reaching just over four million contracts in February 2015.

Equity futures volume did increase 14 percent on the previous year, hitting 837,327 contracts.

OCC's year-to-date average daily cleared futures volume is down 18 percent from 2014, with 233,960 contracts.

Steep peaks and troughs for OneChicago

OneChicago saw an increase of 14 percent for its trading volume in February 2014, despite a 59 percent drop in the number of exchange-traded funds (ETFs).

In its latest figures, OneChicago reported that its average daily volumes for ETFs reached 5,492, while the total trades for February 2015 reached 104,352. This is a 59 percent decrease compared to February 2014's total, which hit 254,576.

Single stock futures, however, saw an increase of 53 percent from 480,638 in February 2014 to 732,975 in February 2015, with an average daily volume of 38,578.

Overall, the total trading volume reached 837,327, a 14 percent increase on the total for February 2014, when it reached 735,214.

Year-to-date, OneChicago reported a trading volume of 1.38 million, a 3 percent increase on the same period in 2014.

Year-on-year, open interest decreased 10 percent to 577,578 contracts at the end of February 2015.

In February, 834,503 EFP and blocks were traded on OCXdelta1, representing a value of $4.1 billion.

At the end of the month, 43 percent of the open interest was in the OCS.NoDivRisk product suite, an equity finance tool that removes risk for customers carrying synthetic equity delta exposure.

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Latest pre-events in Europe

Adnan Siddique discusses Schneider Electric, APR Energy, and more

Schneider Electric [EPA: SU] has a variety of share price drivers ahead including margin growth, buybacks and acquisitions. The 2014 financial year results press release did stress organic growth, but hidden away in the disclosure was the mention of "bolt-on M&A in core … businesses" and a share repurchase programme of €1 billion to €1.5 billion. The buyback is planned over the next two years.

Schneider stated it would not engage in large mergers for two to three years following its €2.8 billion purchase of Invensys in 2013. This means the self-ban could lapse towards the end of the year. Although it's clear that cost optimisation and organic growth are the priorities, an acquisition shouldn't be completely ruled out.

Schneider should comfortably have the firepower for a €1 billion-plus acquisition at some point this year, especially given that leverage is forecast by brokers to reach 0.6x. Schneider joins peers **Legrand [EPA: LR] and ABB [VTX: ABBN]** in indicating M&A is back on the agenda, which could mean competition for the best sector acquisitions.

UK utility mid-cap **APR Energy [LON: APR]** has revealed it's in discussions with its creditors, raising the prospect of a covenant breach. The disclosure states that "although currently in compliance with its financial covenants, the group has advised its banking syndicate that it may not be able to satisfy certain financial covenants going forward". The statement is the latest blow to the company that has had a string of setbacks in the last year and lost 70 percent of its market value.

APR's decision to exit Libya is likely to stress the balance sheet and push the company through its net debt/EBITDA (earnings before interest, taxes, depreciation, and amortisation) covenant threshold of 3.25x. APR may be able to renegotiate its debt obligations as, following the acquisition of **GE's [NYSE: GE]** power rental unit in 2013, its covenant was temporarily relaxed to 4.5x. Later in August 2014 the covenant was raised from 2.5x to 3.25x. A further easing may come with constraints attached.

At the turn of the year, Dutch oil services firm **Fugro [AMS: FUR]**, suffering from the low oil price, renegotiated its debt facilities, which cost the company a higher interest charge, dividend payment restrictions and an obligation to allocate proceeds from significant disposals to debt reduction.

If debt negotiations prove protracted, APR could turn to a rights issue or private placement. Whether the debt constraints are relaxed or equity is raised, a dividend cut is a real possibility. This won't be good news for heavyweight investors **Fairfax Financial Holdings [TSE: FFH]** (18.3 percent), Brandes Investment (15 percent) and Mason Hill Advisors (12.1 percent). These investors have a similar value-investing outlook and DealReporter wonders whether they could club together and agitate for change or even a bid. Recently, Fairfax launched a takeover of UK insurer **Brit PLC [LON: BRIT]**.

DealReporter has noted recent actions of event-driven and activist hedge fund Toscafund. Tosca Midcap and Tosca Opportunity funds have built a 5.8 percent position from scratch in UK cloud-computing group **Iomart [LON: IOM]**. This move comes just a month after it closed a buyout of another UK TMT company, Daisy Group.

Iomart was courted in takeover discussions by private equity group Cinven in the second half of 2014, but talks broke down. Of particular note was Cinven's £3 informal offer price, which was just a sliver above Iomart's August high of £2.846.

Daisy, which provides IT and business communication services to small- and medium-sized enterprises and middle-market customers, was bought out for £494 million. To pull off the takeover, Tosca teamed up with two other parties to form a consortium. Iomart is somewhat smaller than Daisy, with a market cap of £215 million. Tosca could be predicting renewed takeover interest in Iomart—the UK cloud sector has had high private equity interest in the last year and could also appeal to sector consolidators. An outside option is whether Tosca is weighing up a combination of Iomart and Daisy, which offers a cloud service that Iomart could potentially bolt on to.

While we're on Tosca, we should briefly mention its 4.9 percent stake in **Quindell [LON: QPP]**. Quindell shares jumped 26 percent recently as it announced that **Slater & Gordon [ASX: SGH]** had extended its exclusivity period for discussions on buying its professional services division. SLT

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Asia's potential

New opportunities dominated the PASLA/RMA conference in Shanghai

STEPHEN DURHAM REPORTS

The Pan Asia Securities Lending Association/ Risk Management Association Conference on Asian Securities Lending kicked off with a panel discussion on some of the emerging securities borrowing and lending markets in the region, with South Korea, Indonesia and Taiwan under the spotlight.

According to the audience of borrowers and lenders, 2015 looks set to be another year of growth in South Korea, with 38 percent predicting rates to be in line with 2014.

While the country's unique market circumstances were identified as an obstacle by almost 60 percent of the audience, the panel praised South Korea's "well-understood and well-respected" regulatory framework.

Indonesia's primary concern in 2015 (according to 82 percent of the audience) will be the next steps in regulation, with issues on taxation and Indonesian Financial Services Authority approval yet to be resolved.

In Taiwan, operational complexity was singled out as the biggest impediment to adding new inventory by 58 percent of the audience, though this was offset by an optimistic outlook for 2015—the audience predicted an increase in both supply and demand.

Next up for discussion was the Shanghai-Hong Kong Stock Connect programme, which was launched in November last year.

Since its launch, there has been a lack of activity in southbound trading, due in part to the absence of genuine demand, according to 64 percent of attendees at the conference.

Fifty-six percent of the audience also felt that the reason for the northbound trading quota's disappointing results, compared to pre-launch projections, was due to "operational issues".

Despite these responses, panellists were more optimistic, stating that the only market participants who meet the requisite thresholds for southbound trading have already invested.

In relation to northbound trading, the panel claimed that the quota was not, in fact, at a level lower than expected pre-launch. One panellist said: "Although some clients are more measured and cautious, the quota is exactly where we expected it to be following conversations with them. It is simply a question of time."

Stock Connect was also pinpointed as a likely access point to China's margin financing and securities borrowing and lending markets for qualified foreign institutional investors (QFIIs) and their renminbi counterparts.

Panellists suggested that, with the growing influence of Stock Connect and demand rising from QFII/RQFII themselves, integration is a possibility in the future.

Although QFIIs and RQFIIs can presently invest in cash equities and the like, a panellist explained that Chinese regulators are wary of allowing foreign investors to conduct shorter-term transactions such as margin financing and short selling.

An audience survey at the conference showed that 86 percent of those in attendance were in favour of allowing QFIIs, RQFIIs and foreign institutional lenders to participate in onshore margin financing and securities lending in China, and the majority of panelists agreed.

Panellists also claimed that amendments to the country's securities law, which are expected this month, could give investors more opportunities to achieve eligibility. They also predicted an increase in integration overall with the introduction of Stock Connect, which began allowing short selling on 2 March.

China's margin finance sector was slow to start after its introduction in 2005, although it has picked up in recent years, jumping from 25 securities companies licensed by 2010 to 91 by 2012, according to the panel.

The overall message coming out of the conference was one of optimism, with 65 percent of the audience expecting to generate greater year-on-year revenue in Asia in 2015.

A panel of industry leaders also expressed their positive outlook, with many "excited" about the potential opportunities granted by the introduction of Stock Connect.

Fifty-six percent of audience predicted that Stock Connect would be workable and accessible within two years, and the panellists agreed.

Criticisms levelled at Stock Connect for its slow start were addressed by the panel, who urged patience and suggested that the initiative should be viewed as a long-term project rather than a "quick fix".

The audience also voted on how they viewed the next two to three years, with the majority (56 percent) feeling that it is "likely" that agent lenders and beneficial owners will be facilitating regular swap transactions within that time frame.

The final subject broached by the panel was that of regulation.

Although those present in the audience deemed the global push for increased regulation to be "excessive" (44 percent) or "adequate" (52 percent), the overwhelming majority agreed that it is still not enough of an encumbrance to push them from the industry altogether. **SLT**

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Buy-in damage

There's a dark side to the CSDR that has remained unexplored—until now

STEPHANIE PALMER REPORTS

It is a truth universally acknowledged that a central securities depository operating in the EU must be in want of a regulation. In July last year, the European Parliament and Council made this so, passing the Central Securities Depository Regulation (CSDR) into law, and now we are on the cusp of new legislation being added to this, due to come in to force in 2016.

Generally, the added legislation has been welcomed. It aims to improve efficiency and make trading through CSDs safer for all involved. In the midst of the legislative text, however, is a section entitled 'settlement discipline', which is designed to reduce the number of failed trades, and is made up of three sections.

The first involves fairly uncontentious improvements to settlement instructions and trade matching information. The second is a little more controversial, imposing cash penalties on failing counterparties. But it is the final stipulation that is a cause for serious concern, and that is mandatory buy-ins.

There is nothing new about the concept of buy-ins. They already exist as a layer of additional protection for the buyer of securities. If one counterparty fails to deliver as agreed, the buyer has the right to appoint an agent to purchase those securities at the higher market price for guaranteed delivery.

The buyer then purchases the securities for the agreed price, and the seller is obliged to make up the difference.

Currently, this is purely on a discretionary basis, and occurs fairly infrequently. In fact, according to Andy Hill, a director in the market practice and regulatory policy team at the International Capital Market Association (ICMA), and researcher and author of ICMA's impact study on CSDR mandatory buy-ins, an average large international bank might see three or four mandatory buy-ins per quarter.

"It's quite an aggressive thing to do, and brings stresses to a relationship," he says.

"Also, if you're an investor and you want an offer in a relatively illiquid security, that's how you get a decent price and how you get exposure to the instrument you're trying to buy. This therefore allows the market maker a little bit of flexibility, a little bit of comfort."

Under CSDR, a trade will be considered 'failed' if it has not delivered after seven days for illiquid securities, or after just four days for liquid securities. If it misses these deadlines, then a buy-in would be mandatory, and it wouldn't just be conducted by a third-party agent, either.

Hill says: "You will be bought in, but it could be by the counterparty you failed to, or the settlement system you elected, the trading platform, or, in the case of a cleared trade, a central counter party."

"This complicates things. It not only puts a responsibility on the settlement system, which has been nominated, but also the trading platform, which has no knowledge of whether the trade fails or not."

CSDs will be burdened with more responsibility under the new rules, taking on mandatory tasks of collecting information, appointing agents and running consistency tests.

The European Central Securities Depository Association (ECSDA) has openly criticised this, calling the obligations impractical, and pointed out that the move is more likely to increase a CSD's risk profile and create new liabilities. Like the ICMA report, it suggests that buy-ins should be handled on a trading level, not on a settlement level.

In its response to the European Securities and Markets Authority (ESMA) on the subject, ECSDA estimated the market-wide effect that mandatory buy-ins would have, putting the approximate number of buy-ins at 1.8 million per year. This would represent securities amounting to about €2.5 trillion, while the gross amount of late settlement penalties could reach €2.2 billion.

This would mean 7,500 buy-ins per day, compared to the current three or four per business, per quarter.

"It's un-implementable, un-manageable. It cannot work," says Hill, but the figures provided in his report are perhaps even more shocking.

ICMA contacted sell-side traders, asking how the inconvenience and lack of flexibility involved in mandatory buy-ins would affect their pricing in real terms, including government, public and corporate bonds, both liquid and illiquid.

The lowest projected price increase was from public illiquid bonds, which could see a rise of 74 percent. The highest was corporate liquid bonds, with expected increases of 155 percent. Public illiquid, sovereign illiquid and sovereign liquid bonds all predicted price increases of about 120 percent, and corporate illiquid bonds expected to increase costs by 99 percent.

The survey also questioned whether they would continue to offer securities not currently on their books. While no sovereign liquid bond traders said they would cease offers, 25 percent of sovereign illiquid bond traders said that they would. This is compared to 23 percent of public liquid bond traders and 33 percent of those trading public illiquid bonds, to 20 percent of corporate liquid bond traders, and 40 percent of corporate illiquid bond traders.

Calculating the actual costs of these buy-ins is tricky, given the lack of solid data for the European bonds market, and without knowing the scale of the impact on market players—which companies will withdraw or scale back offerings, and which clients will pull out after a price hike.

Hill says: "We wanted to be a little bit careful about pinning down an exact a number, so we worked out the cost per trillion euro of volume. Based on this, it will cost almost €1.4 billion per trillion."

Hill came to an estimated cost using market data from Trax. It assumed the split of secondary volumes across sovereign, public and corporate bonds would remain stable, and that the ratio of liquid to illiquid bonds would be determined by the Markets in Financial Instruments Directive (MiFID) II.

The numbers were estimates, and so the report worked to the lower possibilities. Even so, Trax puts the annual market volume of 2014 at about €24 trillion, which would have incurred costs of about €33.6 billion.

Hill pointed out in the report: "Even if the true number is a fraction of this, the resulting annual cost will still run in to several billions."

On top of this, a somewhat accidental knock-on effect of the proposed regulation is the costs to the repo market.

Buyers of repo trades also have the right to affect a buy-in style transaction. Under CSDR, these will become compulsory at both the start and end stages of a repo trade, "where practical".

'Practical' is expected to mean within 14 days, meaning a 14-day grace period between the initial fail and the buy-in taking effect. Based on the ICMA repo study data from December 2014, Hill made a conservative estimate of what the costs to the repo market would be.

The analysis was based on a current market size of $5.8 trillion, applied only to sovereign bonds, and assumed that all underlying repo assets were liquid. These factors are more likely to under-estimate the total costs than exaggerate them, and, if nothing else, it is based on an original survey that is thought to capture only 80 percent of the market.

Even taking this in to account, the estimated market cost is more than €3 billion per year.

According to Hill, what is most worrying about these costs is that they hit the end user hardest.

"These are not costs to the banking sector, these are costs to investors. This is the additional spread they will have to pay," he says. "The figures also don't fully capture the withdrawal of liquidity, and you can't really put a price on that."

Godfried De Vidts, chair of the ICMA's European Repo Council, supports the findings of the report, calling for it to be presented to the European Commission and parliaments. He references the MiFID pre-and post-trade regulations, which are expected to cost the commodities sector about €4 billion, or €20 per household in Europe.

He says: "We are talking much bigger numbers here. Can you really justify to the taxpayer that they should pay more and get a less safe system? Nobody would actively object if the regulation made the system much more robust, but here it just unwinds the work that we have done over the last 20 or 25 years."

His advice to ESMA is to slow down and wait to see what effect Target2-Securities (T2S) will have on harmonising the market.

"A lot of fails are settled the next morning, because deadlines are not coordinated in Europe. Sometimes things get stuck in the piping, and it's only when you give it a good flush that everything goes through, and that's T2S. If CSDR comes in before that, it will be a disaster."

ECSDA also supported a delay in the implementation of CSDR because of the impact of T2S, suggesting an extension of the phase-in from 18 months to 24 months.

De Vidts goes further though, saying ESMA should consider making amendments to the level-one legislation.

"Our recommendation would be to wait to implement this until they know what the impact of T2S is going to be, and to see the improvements. Then decide if we need mandatory buy-ins or not, because right now this is a solution looking for a problem."

"ESMA can change the rules. It has happened before, it can be done."

Regulations are there to protect the industry and the end user, and one little clause can be enough to lead to damaging effects for consumers who are largely unaware of any change.

"This is creating unsafe markets, instead of making them safer," says De Vidts. "It's a cost to you and me, to the investor or the pension holder."

More than a mere irritation, regulations must be studied to unearth the real, and often unintended, consequences.

"Nobody believed that CSDR would really achieve settlement efficiency," Hill concludes. "But this is the first attempt to quantify the impact, and it's actually quite shocking." **SLT**

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Shorts not betting against credit card market

The US credit card market is undergoing what is arguably its greatest period of change in the last decade, but short sellers have so far held back from betting on the sector's downfall. Markit analyst Simon Colvin reports

Credit card companies are some of the best placed firms to take advantage of rising American consumer spending as their agnostic revenue generating model, which charges volume based fees, should reflect the fact that US consumer spending has largely outpaced the wider economy.

But recent court judgements and increasingly heated competition between Visa, MasterCard and American Express, which are responsible for more than 80 percent of credit card purchases by volume, look set to shake up the established industry status quo.

Despite recent drastic share price movements, short sellers have shown little appetite to trade on the back of the recent industry changes over the last few weeks.

American Express sees headwinds

American Express, which unlike its other two large peers is both a primary issuer and payment processor, has been at the losing end of both industry shifts over the last month. The firm recently lost an anti-trust ruling, which could see retailers shun its higher cost cards, something its previous merchant agreements forbade.

This ruling added to an already fraught month for the firm as Costco, a large retailer and American Express's largest co-branded card partner, terminated its relationship and ultimately partnered with Visa. The end of this longstanding relationship, which was responsible for one tenth of American Express cards on issue, has been viewed as a shift in the established status quo between card issuing firms and partner firms.

This development could see competition grow for consumers by credit card providers. Incentives such as miles and cash back have already started to eat into industry profits and an all-out price war between card issuers could do so further.

Shares of American Express have taken a double-digit percent hit following the recent developments, but short sellers have not shown much appetite to bet against the firm, which has less than 0.2 percent of shares out on loan. This is despite the fact that analysts are expecting the company to post flat revenues for the coming year, contrasting with a forecast 10 percent gain from rivals Visa and MasterCard.

Visa and MasterCard benefit

Visa, which is arguably best placed to capitalise from the recent developments, sees much higher levels of short selling activity compared to American Express. Demand to borrow Visa shares now stands at 6.5 percent of shares outstanding. Borrow demand has remained roughly flat since the start of the year despite the announcement that Visa would replace American Express as the exclusive Costco credit card partner, which was news that sent Visa shares to a new record high.

MasterCard has also seen its shares trade at all-time highs in recent weeks, but the firm has not been the target of any tangible short interest, with just 0.4 percent of its shares out on loan at present.

Western Union targeted by short sellers

One firm that has seen consistent short selling activity in the payment services space is Western Union. While the company operates largely outside the scope of the big three credit card firms, advances in mobile payments could challenge the firm's existing transfer business. The firm has seen short interest climb to recent highs and there are now 16 percent of Western Union shares out on loan, three times the level seen two years ago. SLT

Simon Colvin
Analyst
Markit Securities Finance

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Industry Events

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24th Annual Securities Finance and Collateral Management Conference

Date: 23-25 June 2015
Location Portugal

Please join ISLA at their 24th Annual Securities Finance and Collateral Management Conference that will take place on 23-25 June 2015 at the Epic Sana Hotel in Central Lisbon, Portugal.

Industry appointments

Wells Fargo Securities has added three directors to its prime services sales and capital introduction groups.

Kira Bazile has joined the prime services sales group as a director focused on supporting equity long-short managers. She will report to Patrick Travers, head of sales and distribution.

She has more than 17 years of experience in the prime brokerage industry, previously serving as president of North Street Global.

Kelly Marsch has joined the prime services capital introduction group at Wells Fargo Securities as a director focused on futures commission merchant clients. She joins after serving nine years with Trading Technologies.

Paul Schultz has also joined the prime services capital introduction group as a director focused on institutional allocators.

He has 13 years of experience in prime brokerage, having most recently served as director in the global capital introduction group at Citigroup, where he was responsible for ongoing capital introduction coverage for hedge fund clients.

Marsch and Schultz will both report to Patrick McCurdy, head of capital introduction at Wells Fargo.

OCC has appointed **Scot Warren** as executive vice president for business development and the Options Industry Council.

Warren has experience in global equity and equity derivatives markets, including index services.

In his new role, he will provide oversight to further strengthen OCC's business and product development efforts as well as its communications programmes. His responsibilities will also include oversight of the Options Industry Council and investor education.

OCC has also appointed **David Prosperi** as first vice president of public relations, and **Patricia Overstreet-Miller** as first vice president of corporate communications, both reporting directly to Warren.

Thomas Cardello and **Robert Litterman** have also been appointed to OCC's board as public directors.

Cardello is the owner of Venice Group and Litterman is chairman of the risk committee at Kepos Capital.

Drinker Biddle & Reath has recruited **Matthew Silver** as counsel for its investment management practice group in Philadelphia.

Silver assists clients with broker-dealer and investment adviser regulations, as well as other aspects of their businesses.

He also has experience of commodity trading advisors, hedge funds, alternative investment vehicles and the regulation of derivatives.

Christopher Masse has joined up with Rory Zirpolo at Cantor Fitzgerald.

Masse joins Cantor Fitzgerald as senior vice president, having spent a brief spell at Cowen Equity Finance last year.

He previously worked as director of equity derivatives sales and trading at Gleacher & Company Securities.

Masse was also director of equity derivatives sales and trading at Saratoga Capital.

Zirpolo left Cowen Equity Finance after its parent announced it was winding the business down. He joined Cantor Fitzgerald at the beginning of February, as managing director and head of securities lending in New York.

BondLend has hired **Gary Ross** and **Jeff Ryan** as fixed income business analysts, to help support the platform's continued growth.

Ross most recently worked in the fixed income markets at Deutsche Bank. Before that, he worked in prime services at Barclays and Lehman Brothers.

Ryan was previously a consultant in the triparty repo and collateral management groups at J.P. Morgan and Barclays. Prior to that, he held sales and operations roles at Barclays and Lehman Brothers.

BondLend has experienced significant growth in recent years, with fixed income trading volumes up by 46 percent year over year from 2013 to 2014. **SLT**

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