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ESMA stalls on CSDR's buy-in technical standards

The European Securities and Markets Authority (ESMA) has delayed the release of further clarification on the mandatory buy-in provisions in the Central Securities Depositories Regulation (CSDR).

ESMA's regulatory technical standards for the buy-in process for settlement discipline have been delayed following a consultation period with the market.

There is concern in the market that the penalties imposed may be disruptive to normal activity, according to ESMA.

CSDR itself assumes that transactions that are due to fail can be remedied by market participants borrowing securities temporarily.

Participating member states will be able to decide themselves when they introduce a tax on other instruments, such as fixed income or derivatives, before coming together again to consolidate their efforts.

Finalised technical standards to promote greater transparency, investor safety and resilience in European financial markets were published by ESMA on 30 September, relating to the Markets in Financial Instruments Directive (MiFID II) and the Markets Abuse Regulation (MAR), as well as other aspects of CSDR.

ESMA's standards aim to translate how the legislation will apply in practice to market participants, market infrastructures and national supervisors.

After CSDR, which entered into force in 2014, MAR and MiFID II will be implemented next year and in 2017 respectively.

"The rules put out by ESMA today on MiFID II, MAR and CSDR will notably change the way Europe's secondary markets function. And this will no doubt impact market participants and regulators alike," said Steven Maijoor, chair of ESMA.

"The magnitude of this change should not be underestimated. But the past has taught us that change is needed in order to make markets more transparent, efficient, and safer to invest in."

"This will entail a certain cost but we should not forget the other side of this equation, which is the great benefits that safer and sounder markets will bring to everybody."

Billions worth of revenue at risk from Financial Transaction Tax

The final version of the Financial Transaction Tax (FTT), which could affect 65 percent of the European securities lending market, is closer than ever to implementation, according an update from the International Securities Lending Association (ISLA).

A lessening of the tax's impact on pension funds, and possible exemptions for repo trades, government bonds and market makers, have all been proposed recently during the ongoing negotiations between the 11 member states involved.

ISLA responded to the development by reiterating: "Applying an FTT to securities lending transactions would result in a large reduction in securities lending activity in the countries affected as the economics of these short term, low risk and return transactions, would be dwarfed by the tax."

"This would have very negative implications for the functioning of the wider financial markets, and for the successful delivery of a European capital markets union."

Major EU markets would all be severely affected by the tax regardless of whether they are directly participating in the FTT.

Institutional investors in Europe earned approximately €3 billion of revenue from lending

SLTINBRIEF

Cover story
Natixis is a partner to its clients as they navigate an increasingly important equity finance business
page18

Conference preview
The Risk Management Association previews the annual securities lending conference in Miami
page20

Beneficial owners
Aberdeen Asset Management and PGGM give their take on risk versus reward, regulation and CCPs
page22

Country report
Brazil is Latin America's biggest market, but agent lenders are still seeing its CCP model as a barrier to further growth
page28

Panel discussion
Is South Africa an emerging securities lending market? Experts give their opinions
page34

CCP perspective
OCC is revamping its capital base, working on adding agent lenders and their clients to its ranks, and strengthening the current stock loan, futures and options franchises
page38

Agent lending
BNP Paribas Securities Services explains what its agent lending business is focusing on around the world
page42

Synthetic finance
Synthetic routes to market become more popular as regulations bite, says 4sight
page48

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their securities in 2013. It is estimated that €2 billion of revenue would be seriously at risk if the FTT affects securities lending transactions, according to ISLA.

The association has also strongly advised that, due to their regulatory and economic symmetry, any exemption for repos should also apply to securities lending transactions.

EU repo growth has stalled, finds ICMA survey

The European repo market has shrunk by 2.9 percent since June 2014, according to the annual International Capital Market Association (ICMA) survey.

The survey, published by ICMA's European Repo Council, calculated the amount of repo business outstanding on 10 June 2015 and set the baseline figure for market size at €5.61 billion.

It highlighted a 2 percent increase from the headline figure of €5.5 billion in December 2014 and a 2.9 percent decline in market size from €5.78 billion recorded in the June 2014 ICMA survey.

The survey also noted a further increase in the share of directly-negotiated transactions, which have been increasing since 2012, according to the European Repo Council.

This is presumed to reflect a regulatory-driven shift away from low-margin inter-bank and commoditised transactions, much of which are electronically traded, towards customer and customised business, most of which is directly negotiated.

Domestic repo also continued its long-term decline, probably reflecting the restructuring of the European repo business in the face of regulatory and other challenges.

The share of triparty repo fell back to 10 percent from 10.5 percent and the outstanding value of triparty repo reported directly by the major triparty agents in Europe also contracted.

Together with the drop in the use of general collateral financing facilities, this may reflect a reduced need for funding against a backdrop of continued central bank assistance.

There was a drop in the share of all government bonds within the pool of EU-originated fixed income collateral reported in the survey to 77 percent from 81.5 percent. This change was driven to some extent by an increase in non-government bond and equity collateral.

It may reflect a focus on higher margin business and is likely to be related to the drop in the share of electronic trading. There was a sharp decline in Japanese collateral and increases in the shares of US and high-quality collateral.

Godfried De Vidts, chairman of the European Repo Council, said: "The stability of the headline figure over the last few surveys does not tell the full story. The repo market in Europe is not growing in line with underlying conditions."

"Increased bond issuance, extraordinary excess liquidity from long-term refinancing operations and quantitative easing and increasing demand for collateral driven by regulation might reasonably have been expected to produce an increase in repo trading."

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A further qualitative study on repo in Europe will be released in October.

Taiwan removes uptick rule

The four-week uptick rule in Taiwan has been lifted after renewed market stability.

Taiwan's Financial Supervisory Commission has prohibited the short selling of Taiwanese shares for less than the previous trading day's closing price since 24 August.

There was a 1.8 percent drop in market value immediately after the uptick rule was removed on 21 September, according to SunGard's Astec Analytics.

Balances on loan also decreased by around 5 percent following the rule's repeal.

Borrowing volumes dipped to within a few percent of their 12-month low on the day the rule was applied and rose to around 90 percent of the 12-month peak over the following two weeks, despite the uptick rule being in place, according to SunGard.

A recovery of Taiwan's benchmark index along with the US Federal Reserve's decision to maintain current interest rates and a general unwillingness by the new government in Taipei to maintain restrictive market conditions were cited as key reasons for the rule's removal.

Aberdeen Asset Management open to sec lending in China

Aberdeen Asset Management is open to launching a securities lending operation in China after being granted a business licence.

The licence was offered to the Scottish investment firm during the UK chancellor George Osborne's visit to China as leader of a trade delegation.

"We always look at new markets in relation to the assets that our funds are currently holding and the incremental revenues that can be generated from lending," commented Matthew Chessum, who is an investment dealer at Aberdeen Asset Management.

"Securities lending is not something we would be looking at any time soon but we may consider implementing securities lending once the market develops, if it is conducive to the activities on the investment portfolio."

Aberdeen Asset Management will now be able to operate under the State Administration of Industry & Commerce in China.

As a part of negotiations around the seventh UK-China Economic and Financial Dialogue, China has agreed to allow qualified, locally-incorporated wholly foreign-owned or joint-venture private fund management institutions to engage in private security management businesses, including secondary market trading of securities, according to domestic regulations.

Chessum added: "There are a number of factors that we have to take into account as well as just the potential revenues involved in lending in new markets. We study the risk profile, including what's happening on the ground in the country as well as the overall liquidity and depth of the lending market in general."

"We would also look at any changes needed to existing processes. We find that our portfolio managers aren't overly willing to give pre-sale

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notification, which is needed in some of the newer Asian lending markets, such as Taiwan."

The announcement came during a week-long tour of UK ministers and leading UK business to China.

This continues the UK government's long-standing drive to forge greater links with the Asia Pacific region, and to consolidate London's position as the Western hub for renminbi business outside of Asia.

Aberdeen's chief executive, Martin Gilbert, said: "UK business cannot ignore the structural development of China. It is already the second largest economy in the world and will sooner or later surpass the US."

"The work undertaken to obtain a wholly foreign-owner enterprise licence is part of our overall strategy to ensure Aberdeen Asset Management is well placed for the next 10 to 20 years."

UK secretary of state for business Sajid Javid added: "As we deepen UK-China relations it is rewarding to see Aberdeen Asset Management licensed to operate in China. The company will bring fund management expertise from the UK to the second largest economy in the world. I am committed to building relationships like this between our two nations."

To further its business aims in China, Aberdeen must now apply to be registered with the Asset Management Association of China.

Shorting soars in legacy airlines

Legacy airlines in Europe are seeing an increase in short selling as they face competition domestically from budget airlines and internationally from long-distance start-ups and well-known players.

According to data from Markit, these legacy airlines have seen short sellers doubling their positions. Air France is the most shorted, with 10.3 percent of all shares out on loan, while budget airlines now have about half the short interest they had 12 months ago.

The Markit report suggested that legacy airlines have not seen the benefit of a drop in oil prices, or the improvement in the European economy, as customers have moved towards low-cost competitors within Europe, while sticking to large and well-capitalised foreign competitors for long-haul travel.

They have also had problems with staff striking, as managers have tried to make cost-cutting changes in order to remain competitive.

Shares of the nine listed legacy carriers have dipped 20 percent below those of their 'budget' competitors. This is the opposite of the trend seen 18 months ago, when legacy airlines saw less shorting than their peers.

Short interest on legacy airlines currently stands at 3.5 percent of shares outstanding, a 60 percent increase on the start of the year. These firms are now more shorted than both the European stock market and the airline field in general, which has an average of 2.8 percent of shares shorted.

State Street gets currency swaps mandate

The Department of Finance in Canada has selected State Street as collateral manager and custodian for its currency swap programme, the bank has announced.

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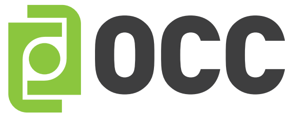

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State Street currently boasts $1 trillion in assets under custody and the bank has grown by 65 percent in the past five years.

"We are very pleased to be selected by the Department of Finance and the Bank of Canada to support their middle-office needs," said Rob Baillie, senior vice president and head of State Street Canada.

"We are dedicated to providing our clients specialised solutions to help them manage their portfolio and regulatory risk. The decision to partner with us is a testament to confidence in State Street's ability to provide a fully integrated collateral management and custody solution."

Kenya looks to boost liquidity

The Nairobi Securities Exchange (NSE) is launching several new products and tools, including a securities lending facility, to boost liquidity and tackle emerging market volatility.

The securities lending tool will feature as part of a securities settlement platform expected to go live in the next few months.

The platform will open the market to short selling and other investment strategies, which have proven to increase overall liquidity in established markets.

It will also facilitate same-day trading and settlement of government securities.

The NSE has not been immune to wider market conditions in the US and China and has suffered a 17 percent drop in investor confidence.

The Kenyan shilling has depreciated by around 16 percent year-to-date against the US dollar to now stand at less that $0.01 per shilling.

Currently, only 4 percent of the population is involved in the markets but the NSE and the Capital Market Authority have voiced a desire to entice more domestic retail investors through investing in long-term growth initiatives.

Half of banks' processing costs are wasted, says Broadridge

Up to 40 percent of banks' processing costs for trades could be saved by adopting a 'utility' model, according a study from Broadridge Financial Solutions.

Large banks can currently spend between $6 billion to $9 billion processing standardised trades annually.

The study, Charting a Path to Post-Trade Utility, suggested that by sharing in a range of trade processing functions—from core post-trade processing, reference data and reconciliations to trade expense management, corporate actions, and tax and regulatory reporting—in a utility model, the industry could save up to $4 billion each year.

The report stated: "Post-trade processing represents a natural starting point for an industry utility. It is central to the trade lifecycle—matching buyer and seller records, confirming trade terms, clearing and settling trades, calculating margins and performing custody and asset servicing."

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functions, including corporate actions, tax and regulatory reporting, and reference data."

"A post-trade utility would mutualise regulatory investments and aid with 'living wills', which require large institutions to show how they would plan for an orderly resolution process in the event of a failure."

SunGard secures French reconciliations mandate

Generali Vie, a French life insurance company and part of the Generali Group, has implemented SunGard's IntelliMatch Operational Control solution for managing cash and securities reconciliations.

The solution provides a single platform that reconciles ledger and custody systems against nostro and securities accounts. The solution is designed to reduce operational costs, minimise risks and improve efficiency as the volume of transactions increases.

By replacing legacy systems and the manual processes associated with them, and by centralising the reconciliation process, Generali Vie should be able to put other transaction types on to the platform more quickly, including system-to-system reconciliations.

Christophe Privat, a manager of information systems at Generali Vie, said: "We aim to offer high-quality service to our customers and a key element of this commitment is ensuring we remain operationally efficient."

"We regard SunGard as a valued strategic vendor that is capable of supporting our long-term enterprise reconciliation requirements. We plan to progressively add further reconciliations on to SunGard's IntelliMatch Operational Control and thus benefit from economies of scale and minimised operational costs. It also gives us the ability to manage significant transaction volumes without requiring additional resources."

Jennifer Hanes, CEO of SunGard's IntelliMatch business, added: "Financial services organisations can benefit from working with a single strategic solutions vendor that is capable of meeting multiple financial technology requirements across the enterprise."

"[It] helps organisations reduce costs by rationalising multiple systems and eliminating manual processes."

Tech partners create data centre trading hubs

Digital Realty Trust and GMEX Technologies have paired up to create several hubs for new product exchanges and trading venues.

Each hub will be located at an existing Digital Realty centre, starting with its Chessington data centre in the UK.

The new trading hub should allow established trading communities to access and trade emerging markets securities cost-effectively and securely. It is intended to allow market operators to expand beyond their own jurisdictions, creating opportunities to access more asset classes such as securities, commodities, derivatives and foreign exchange.

Through the partnership, GMEX will host the servers using Digital Realty's locations. GMEX will also offer access to central counterparty and central securities depository market infrastructure as a managed service.

By using the Digital Realty network, GMEX can create cloud-enabled points of presence, allowing easy access to the hubs.

Hirander Misra, CEO of GMEX Technologies and co-founder of GMEX Group, said: "Building on our established capital markets expertise, this is an exciting extension to our business model of delivering true partnerships with exchanges in emerging markets, with the aim of bringing them to liquidity."

He added: "We can offer our cloud-enabled trading and clearing market infrastructure ecosystem paired with the best talent, technology, operational excellence, and business expertise facilitated by the technical infrastructure provided by Digital Realty."

The UK hub is expected to be available from early October, while others in Chicago and Singapore are expected to be announced in 2016, supporting the Central and South American and Asian markets, respectively.

BCS sparks new partnership with Euroclear

BCS Financial Group, the largest securities broker on the Moscow Exchange, can now access Euroclear, the world's largest international central securities depository, through BCS Prime Brokerage.

Euroclear will allow BCS to broaden its product offering, enhance its operational efficiency, reduce risks and optimise the costs of trading, settlement and custody services.

Tim Bevan, CEO of BCS Prime Brokerage, said: "The Euroclear membership is one of a number of building blocks BCS will put in place over the coming months."

"The membership approval proves our sustainable business strategy and allows further international expansion.

"We have managed to strengthen our business despite the difficult market conditions in 2014."

CTA and macro managers are winners of Fed week

A lack of guidance by the Federal Reserve following its meeting on 17 September played into the hands of global macro and commodity trading advisor (CTA) managers, according to Lyxor's Weekly Brief.

The indecisive stance, which saw the Federal Reserve decided against raising interest rates, has damaged risk assets, while bonds have rallied and the US dollar has eased against

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major currencies, which will fuel global macro and CTA managers, according to Lyxor.

The report, by Lyxor's managed account platform research team, analysed hedge fund flows, performance and positioning, and found that markets were brought to a standstill ahead of the latest meeting.

Hedge funds were flat and there was little dispersion in returns across the managers.

Event-driven outperformed as equity volatility edged lower. Meanwhile, fixed income strategies underperformed as sovereign bond yields moved higher.

Systematic funds are well positioned, being neutral equities and long fixed income.These funds also cut their long US dollar positions, especially against the euro, during the summer.

But there are discrepancies between the positioning of short-term and long-term CTAs.

The former have less directionality in foreign exchange and commodity markets and appear to be better suited to capture any benefits from the new market regime.

In fact, long-term commodity traders are still long in US dollars and short in commodities. The Federal Reserve's stance is likely to put downward pressure on the US dollar and some upward pressure on commodities.

Furthermore, Lyxor found that the Federal Reserve's lack of guidance over future interest rate moves could result in higher risk aversion despite this dovish stance.

"In the long/short equity space, we maintain our strong preference for market neutral and variable bias strategies. Some managers in that space have delivered double-digit returns year to date and we expect this trend to continue."

BBH improves settlement processes with Omgeo

Brown Brother Harriman (BBH) has become the first global custodian to go live on the new Omgeo Alert GC Direct Service.

The service is designed to improve the standing settlement instruction (SSI) data related to trade settlement processes between global custodians, funds and investment managers, and will allow BBH to provide and maintain SSI data for its clients and their investment managers.

Any BBH clients that use the Alert capability will be able to connect electronically. The system is automated and secure, designed for efficiency and to reduce operational risk and costs.

Ray Tyrrell, senior vice president at BBH, commented: "BBH is committed to implementing best-in-class solutions and [work] with the industry to mitigate risk and enhance SSI data quality."

"We're pleased to work with Omgeo using GC Direct in our efforts to deliver improved operational and cost efficiencies to our clients and their investment managers."

According to Omgeo, the launch of GC Direct capabilities marks a milestone as Alert evolves to be more involved in the industry's SSI utility. It will allow global custodians to update, maintain, and manage SSI data electronically for the first time.

Paula Arthus, president and CEO of Omgeo, said: "As the industry continues to reduce risk throughout the trade lifecycle, and with a large number of markets having moved to a T+2 settlement lifecycle, firms are facing increased pressure to ensure efficient, transparent processes are in place across their operations."

"We anticipate further participation from the custodian bank and asset management community," added Arthus.

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CSCS to improve market liquidity

Nigeria's Central Securities Clearing System (CSCS) is looking to boost market liquidity through its securities lending and borrowing (SLB) and post-trade allocation process flows to capital market operators.

The SLB arrangement would enable market participants to lend securities from a registered securities lending agent (SLA), according to Joseph Mekiliuwa, general manager of operations for CSCS.

The arrangement is aimed at custodian banks and their brokers and will help market participants to go short by selling securities that they do not have and lending from the SLA to cover their short position before the settlement date.

For transfers that are required by a borrower to settle short sale transactions the SLA and borrower would have to complete the transfer request by midday, two days before settlement (SD–2) to allow CSCS deliver the shares into the borrower's account a day to settlement (SD-1), according to CSCS.

CSCS also specified that it wouldn't allow shares to be lent on behalf of the owner of the shares either from a segregated or omnibus account without a securities lending authorisation agreement.

FSB's numerical haircut floors framework out 'soon'

The Financial Stability Board (FSB) has moved forward with addressing shadow banking concerns, announcing that it will soon publish its framework for numerical haircut floors in non-bank-to-non-bank securities financing transactions.

In a report summarising the talking points from a recent meeting between top officials, it was revealed that the soon-to-be released framework will have an implementation date of the end of 2018.

FSB officials also discussed maximising market liquidity and ending 'too-big-to-fail' at the same meeting.

In its summary, the FSB highlighted the importance of thorough stress testing by funds to assess their ability individually and collectively to meet redemptions under difficult market liquidity conditions.

Securities lending activities of asset managers and funds and potential vulnerabilities of pension funds and sovereign wealth funds were specifically identified by the FSB as "structural vulnerabilities" of asset management that requires further analysis.

The mismatch between liquidity of fund investments and redemption terms and conditions for fund units was top of the list, with operational risk and the challenges in transferring investment mandates in a stressed condition also featuring in its evaluation of market risks.

The total loss-absorbing capacity (TLAC) proposal to be applied to global systemically important banks was recommend by the FSB as a way of mitigating the risk posed by banks deemed as too big to fail.

The FSB has now agreed the draft final principles and the updated term sheet, and is arguing for consistent implementation, over the appropriate timelines, of TLAC as a minimum standard.

The TLAC standard and its timelines will be finalised by the time of the next G20 Summit in November.

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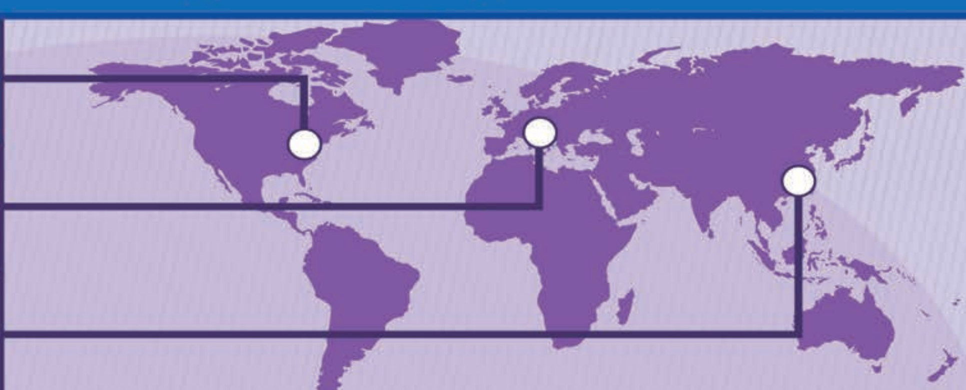
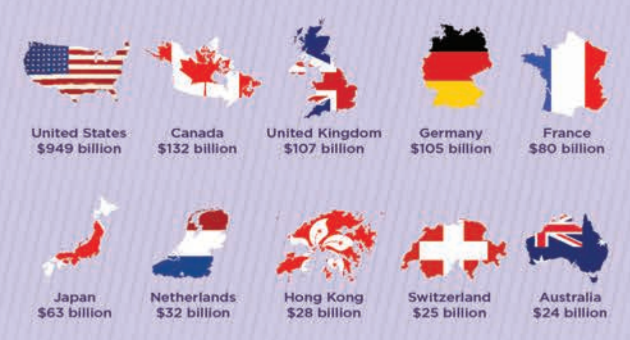
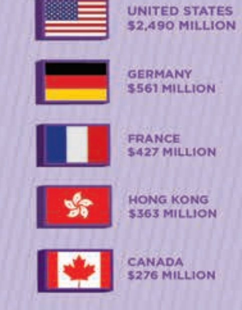


TOP 10 COUNTRIES (ON-LOAN VALUE)



TOP 10 COUNTRIES (REVENUE)



REVENUE & AVERAGE FEE BY SECTOR

REVENUE (MILLION)

VOLUME WEIGHTED AVERAGE FEE (BPS)

$600 $500 $400 $300 $200 $100 $0

150 125 100 75 50 25 0

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Clients are king

Natixis is focused entirely on serving its clients' needs, as Dennis Shikar explains

MARK DUGDALE REPORTS

How is the equity finance business at Natixis organised?

Natixis is the international corporate, investment, insurance and financial services arm of Groupe BPCE, the second-largest banking group in France.

With our strong credit rating and balance sheet, a global network and a highly visible brand, we are expanding our global footprint in equity finance.

Under the leadership of Regis Lavergne, global head of equity finance at Natixis, we are a team of 40, with offices in New York, Paris, London, Frankfurt, Hong Kong and Tokyo.

We are organised into three global, transversal equity financing product groups: securities lending, forward trading, and collateral trading. This allows us to price dynamically and propose solutions that differentiate us in the market.

We have fully integrated the long-term financing and derivative expertise of our forward trading team with the liquidity and financing capabilities of our securities lending and collateral trading groups.

I head the client strategies group globally, which has teams in Europe, Asia and the Americas. We partner with our key global clients to structure strategies tailored to their equity financing needs.

Whether for outperformance purposes, portfolio enhancement, or leverage and financing, we focus on optimisation of scarce resources, through the alignment of our clients' and of our own interests.

Cultivating long-term, mutually beneficial relationships is at the forefront of our mandate.

How would you define the equity finance brand of Natixis?

We deliver custom, bespoke solutions to our clients, who include asset managers, insurance companies, hedge funds, pension plans, mutual funds, and corporates, as well as banks and dealers.

We pride ourselves on being innovative within our product range, and are committed to providing creative and elegant solutions for our clients.

Can you give some examples of the Natixis product offering?

The wide range of solutions that we offer is focused entirely on serving our clients' needs, regardless of the region or underlying currency

Through securities lending, we provide a mechanism for optimisation of embedded asset repo levels; through forward trading, we enable a hedging mechanism to facilitate outperformance; and through collateral trading, we offer products to address a client's balance sheet, liquidity coverage ratio (LCR) or regulatory reserve requirements.

Natixis recently launched a synthetic prime product called Natixis Synthetic Services that embeds market access, execution, leverage and financing, in a dynamic portfolio swap format. This product grants our clients full exposure to the depth of our global securities lending inventory.

Our expertise in insurance solutions provides creative strategies to address the regulatory reserve requirements of this client segment.

From a cash management perspective, we offer an opportunity for clients to extract additional yield on their excess liquidity via our protected asset programme. Regardless of the client's needs, we can tailor the right solution.

To what extent is equity finance a different business today?

This business very much continues to evolve. When I joined the firm in 2005, at the inception of the equity finance business in New York, the landscape was entirely different. We have seen material shifts in our needs, and those of our clients.

Securities lending has changed from merely a tool to facilitate short coverage and monetisation of assets, to one that can also offer LCR and regulatory relief. This is, while very challenging, a great opportunity for us to deliver value-added solutions to our clients.

How have regulations changed equity finance?

They have definitely altered the profile of our flows and the product offering. We pride ourselves on addressing these changes in this landscape, and structuring products and ideas that anticipate those to come. For example, the upgrade/downgrade trade has become very prevalent in the Americas today, following the lead of the European markets.

This structure is at the forefront of securities lending transactions—with the potential to provide benefits in both balance sheet and LCR, while embedding long and short liquidity. There is also a continued push towards central counterparties, to mitigate credit risk and provide balance sheet relief.

At Natixis, we participate in central counterparty (CCP) structures both in the US and in Europe—we were the first French bank to go live on the Eurex Lending CCP.

Going forwards, what do you think the next big change will be to equity financing?

The regulatory environment will undoubtedly continue to create hurdles for our business. What is clear is that our clients and the marketplace are recognising the importance of equity financing products as a mechanism to structure solutions for the next, great challenge. SLT

Dennis Shikar
Head of equity finance Americas
Global head, equity finance client strategies group
Natixis

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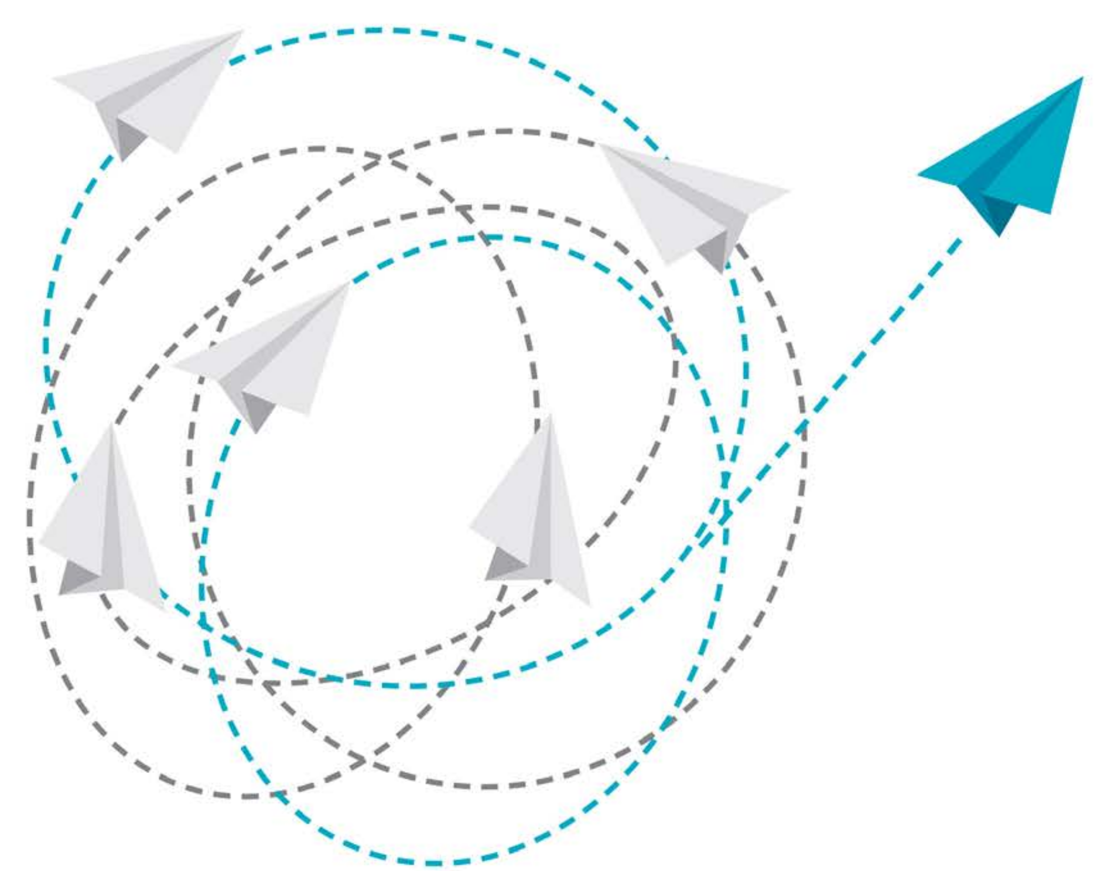

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Conference calling

Risk Management Association securities lending director Fran Garritt previews the annual conference in Miami, where regulation will continue to be challenged

DREW NICOL REPORTS

What can attendees expect from this October's RMA Conference on Securities Lending in Miami?

Our conference planning committee, including co-chairs Tejash Patel of Morgan Stanley and Judith Polzer of J.P. Morgan, have put together a great agenda.

We have two high-quality informational sessions on the first day to make sure everyone in attendance is up-to-date on all the current key legal and regulatory developments.

There will be a discussion of the International Swaps and Derivatives Association's (ISDA) 'stay protocol' and its likely impact. Everyone needs to be more aware of and knowledgeable about the ISDA stay protocol.

It will be finalised by the end of the year and implementation for some countries will begin immediately on 1 January 2016. A few markets will have a three-to-six-month implementation period, but by this time next year, it will be fully in place. The protocol will affect a lot of firms so we've deliberately made sure there will be an in-depth discussion during the conference.

There will be a discussion on the future structure of the securities lending market and all of the regulatory challenges facing agents and brokers. We will discuss what can be done to alleviate some of those pressures. It's a great group of panellists so we should get

some good insight on how the industry will change over the next few years.

Are you happy with the panel line-up? Are there many old faces returning or new ones joining in?

Of the 56 speakers, 27 have never spoken at a Risk Management Association (RMA) conference. We always make a real effort to get new faces on the panels to ensure our programmes don't become repetitive, with the same topics and speakers every year.

We work hard to have diversity on our panels in terms of gender, industry sector, and spectrums of opinion. It's our duty to provide the best possible education for our members and a diversity of viewpoints is the best way to do that.

How do you choose the experts for your panels? What do you think makes for the most educational and entertaining event?

I think it's important for the panellists to be the people on the front line day-to-day, taking the punches. Many have participated in adopting or working through the many changes over the last several years. Those are the people our audience wants to hear from.

One of the most exciting people we have speaking is our keynote speaker, Harold Ford Jr, who served Tennessee in Congress for 10 years and is currently with Morgan Stanley. The US is one year away from a presidential election, with no incumbent. Given the current situation in the US, Ford should be able to give a really interesting viewpoint.

Ultimately, the result of this election will have further impact on the banking and securities industries, including securities lending and repo. Elections always bring market disruption because there's fear of the unknown. The next 14 months will be filled with primaries and debates so we expect a lot of action.

Other than regulation, what topics do you think are the most important to raise and discuss?

Personally, I think awareness around the issues of technology and operations needs to be raised. In one panel, several operations experts will discuss how the day-to-day operations of securities lending will be affected by regulation and how technology investment can help.

We also have a panel dedicated to data and transparency, which aims to highlight data issues and the impact on the people that actually have to do the data management side of reporting. It will also touch on agent-lender disclosure and its growing importance tied into collateral issues for borrowers.

Our overall aim here is to shine a light on the work done by operations groups and allow the senior staff in attendance to better understand and respect the work they do and the resources they need to optimise their firm's capabilities.

What sort of industry demographics are you expecting this year?

We expect at least as many people as last year, if not more. There will be people from all areas of the securities lending and repo sectors, which will hopefully promote a good level of socialising and debate at the events.

The panel topics are based on the most relevant industry developments of the year. What will be discussed?

One of the timeliest topics regards the bond markets and balance sheet optimisation. The industry and the regulators often don't seem to meet in the middle over whether regulation has affected liquidity in the bond market so it's something that needs to be discussed further.

There is also a timely panel on the Chinese market, which is quite relevant at the moment with respect to securities borrowing and lending.

The industry has fared pretty well overall in 2015 but there are always things to work on—regulation being at the top of the list. At the same time, the shortened settlement timeframe, although it won't go live for two years, will have a big impact on operational preparedness.

Without exaggerating, this year has definitely been one of the busiest in recent years for dealing with and responding to regulation. Meeting with regulators to discuss issues like the transparency initiative is a critical and time-consuming effort. The equity-as-collateral initiative, as well as the debate around central counterparties (CCPs), is a major focus at the moment.

Do you think CCPs will be one of the main talking points of 2016?

Making CCPs viable for agent lenders and passing over the regulatory hurdles with regard to beneficial owners is vital for creating a clear CCP model. Without a clear model we are unlikely to be in a position where we have several functional CCPs up and running.

At the RMA, we are more focused on the clients of CCPs than the CCPs themselves. That's why the vast majority of our speakers are from financial institutions. CCPs are working for broker-dealers in the US, such as the OCC hedge product. Agents have a variety of reasons, from a regulatory standpoint, why they cannot yet participate, but they are working on task forces to help CCPs understand those issues and see if they can work through them.

Looking forward into Q4 and 2016, what should the securities lending market expect in terms of highlights and challenges?

Everything around managing the Federal Reserve's exit from asset purchases and reinvestment along with its management of monetary policy will be important. The Federal Reserve's position on interest rates in the near future will be of importance to the securities lending and repo industry.

There are also questions to be answered on the advantages and disadvantages of asset sales in the Federal Reserve's reverse repo programme.

Additionally, the importance of indemnification on borrower default will continue to evolve.

Furthermore, liquidity and the management of liquidity will be crucial over the next few years, especially from a regulatory compliance point of view. Liquidity risk is now developing as a discipline unto itself.

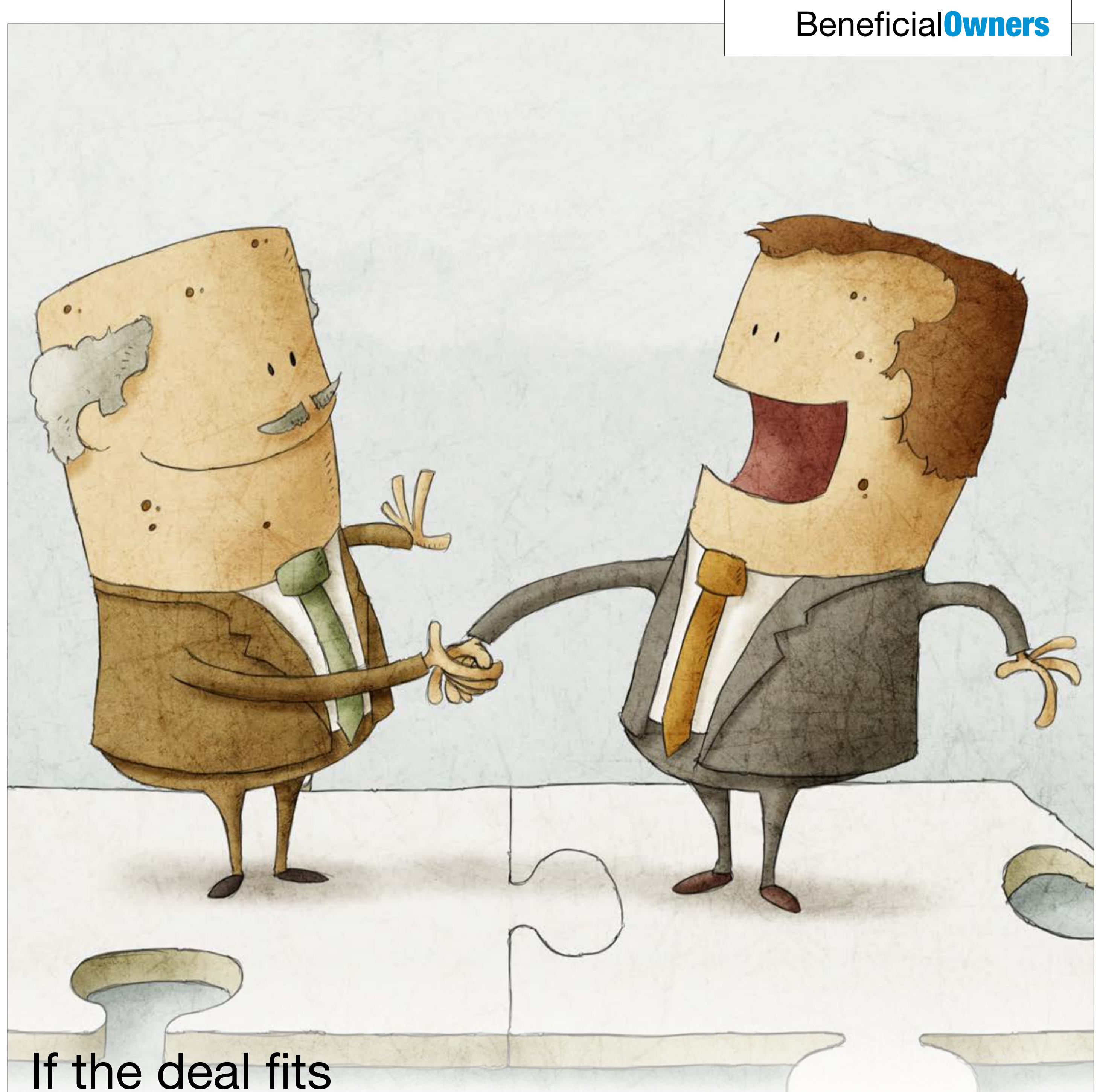
Going forward, the RMA has several working groups focused on technology and the various technological challenges the industry will face in the future.

Technology providers need to be ready and willing to listen to the industry, and be prepared to contribute with solutions.

There is still a lot to do. We have been very active since 2009, when some of the first rules started to come out post-financial crisis.

Now that a lot of these rules have been finalised, we are going to start hitting implementation dates, and that's why our implementation and technology working groups are so important. **SLT**

Fran Garritt
Director, securities lending
Risk Management Association



If the deal fits

Aberdeen Asset Management is not a house that will to lend just for the sake of lending, says Matthew Chessum, who stresses the importance of risk versus reward

DREW NICOL REPORTS

Aberdeen Asset Management was one of the first managers to dedicate resources specifically to securities lending. Looking back, did you enjoy a first-mover advantage?

It's very much in line with how Aberdeen Asset Management does things. Aberdeen wanted to ensure the best level of risk management possible was being provided for our clients. It was decided that value could be added by having someone within the organisation who fully understood securities lending within the wider context of the investment process.

Securities lending is considered an investment practice like any other within a fund so it's vital to have someone with the relevant expertise to oversee the programme.

The way Aberdeen lends is very specific. Our funds tend to hold fewer positions but of a greater-than-average size, so we are conscious of how we lend them out.

We aren't a big general collateral lender. We generally lend for specials only, although we are open to transactions where we can generate decent returns in a risk-adjusted manner. We're not a house that's going to lend just for the

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sake of lending. Risk versus reward is a very important concept for us.

How would you define Aberdeen's lending strategy?

We're always careful about what and how we lend. We lend where it makes sense to do so but we're always conscious about how much we are lending in the market relative to the size of our positions.

We are very keen on stress testing the collateral received on a quarterly basis with a view to making any adjustments necessary. Our programme remains flexible, from restricting borrowers to changing haircuts or collateral requirements.

Flexibility gives us the upper hand in managing our risk profile. That doesn't mean we make changes every month but we do review our programme regularly and make adjustments when needed so we can calibrate our risk profile as required.

Historically, we've only ever accepted government bonds, but have recently expanded our collateral profile so that we can also accept main index equities. We will only look at specific trades, however, where we believe it makes sense and where there is a genuine premium available for lending versus equity collateral.

We are open for like-for-like lending, but we wouldn't lend a fixed income instrument against equities because for us there isn't a good risk-adjusted return being offered.

There is a very busy regulatory pipeline over the next 18 months. Do any of the new requirements concern you at all?

The collateral guidelines covered in the Alternative Investment Fund Managers Directive (AIFMD), which are likely be translated in the UCITS regulations, may lead to the segregation of collateral at the sub-custody level, which may affect the ability to hold collateral at a triparty collateral agent.

Managing collateral accounts will become very complicated and to me, ruling out the use of any triparty collateral provider, given that they are the entities that specialise in this area, seems illogical. Triparty providers are best placed to both price the collateral and manage it effectively with any restrictions you want to impose.

If you can no longer use triparty collateral providers, especially when you're using an independent third-party securities lending agent, then you might come up against quite a few headaches with costs and operational risk increasing. There are also questions about who pays for these costs. Does it come out of our fee split or the agent's?

Securities lending has to stay relevant to the investment strategy and it has to generate acceptable returns for the funds, or there's little point in doing it. Once you get bogged down with too many reporting and setup costs, it simply takes up too much time and the revenues become irrelevant to the funds overall performance.

Would you say that AIFMD will be a step toward over-burdensome regulation that could push people out of the market?

It's possible. Securities lending is always going to be an up-hill struggle because it's a very misunderstood and emotive practice. There will always probably be more fund managers that are anti-lending than pro-lending. You have to make sure you educate as many people as possible and keep those in charge well informed about the benefits of securities lending.

Ultimately, securities lending is just one of the activities that takes place in a fund to contribute to its overall performance. If lending simply becomes too cumbersome and expensive, then it will be replaced by an alternative activity or stopped altogether.

When you say securities lending is emotive, you're referring to the implication that lending securities facilitates short selling?

Yes and that mindset never seems to move on. If you don't know too much about the real drivers behind most securities lending transactions then making the association between securities lending and shorting seems like the logical conclusion. In reality, however, the situation is usually very different. A number of different factors are involved in the efficient pricing of stocks. In a nutshell though, if you see someone trying to short your investment that perhaps puts downward pressure on the price, instinctively you aren't going to be happy about it.

That's why we apply a number of controls and rely upon the flexibility of our programme to make adjustments where needed. We also work actively work with our fund managers to share information and manage their concerns.

Is there any expectation that Aberdeen will have to change its lending strategy in response to new regulatory requirements?

I don't believe so. We're very happy with the programme that we run and the amount of revenue we generate in relation to the level of risk we assume. If regulation or broker demands push us too far down the risk spectrum then I think we would rather leave the market than take on more risk.

What would you say to beneficial owners considering taking on additional risk to create more demand for their portfolios?

I would say make sure you understand all the risks involved and talk to your agent lender, but make sure you are not being led by them. I think some agent lenders think that their clients are the borrowers, not the beneficial owners.

It's down to your agent lender to make your portfolio as attractive as possible. In days where revenue is more difficult to come by I can understand why an agent lender would focus on clients with the widest collateral parameters or the best fee splits, but ultimately they should be working on behalf of all of their clients to try to lend stock where appropriate.

Agent lenders shouldn't be beating you up trying to get you to change your parameters. They should be exploring the best way to facilitate your strategy on your behalf, given that you're generating their revenues out of your lending activity. Ultimately, securities lending is supposed to be a behind-the-scenes, relatively risk-free activity that adds incremental revenue. In my opinion, this should never change.

What about CCPS? Will 2016 be the year they take off?

I think we are a bit further away from it than next year. I can see how it could be a sell side to sell side tool, but at the moment I can't see too many beneficial owners wanting to go through a central counterparty (CCP). It will have to be driven by the agent lenders and the borrowers.

Unless it becomes mandatory, at the moment, I'm not going to go through the time and effort it takes to add a CCP to my counterparty list given what I can currently lend through it.

For me, it's a question of the CCP widening its parameters to ensure you can lend a greater spectrum of assets through the existing model, which will in turn make it more accessible to many more lenders. **SLT**

Matthew Chessum
Investment dealer
Aberdeen Asset Management

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Risk for the right reward

Roelof Van der Struik of PGGM explains why managing risk is his business

DREW NICOL REPORTS

Can you outline PGGM's securities lending strategy?

Most of our clients operate under the rule that their securities can be lent unless otherwise specified. We have a proven track record for responsible investment and so our clients trust us to lend and manage their securities on their behalf.

To our clients that don't feel securities lending fits with their strategy, I would still always advise that they turn that option on for their portfolio because securities can always be recalled and the tool can be switched off again. It's a useful tool for many reasons, such as liquidity.

With regard to collateral, adding risk to our programme is not something I'm interested in doing, so I will only accept the highest possible collateral, meaning government bonds from the major countries.

We accept bonds for equity lends but we don't lend our own bond portfolio, which I think pleases the regulator. We stopped lending our bonds after the Lehman Brothers collapse. We learnt the lesson—we felt we were giving up liquidity without being sufficiently rewarded for it.

We would take other forms of collateral, such as equity, as long as it doesn't affect our risk profile as a whole. Equity could work as collateral when lending equities, because the correlation is good.

However, we don't accept equity at the moment because triparty collateral agents don't yet have the right tools to do it properly. For example, they use yesterday's price for equities, which is ludicrous. I understand the general logic, but I don't think the right instruments are in place at the moment.

There are a lot of regulations in the pipeline at the moment. Is there any specific one that you find particularly troubling?

The International Swaps & Derivatives Association's 'stay protocol', which requires an extra two-day waiting period before declaring insolvency, worries me because it's very difficult to predict how the regulator is going to apply it. It is always scary when there are no firm rules and a lot of discretionary powers. I don't think it will make the world a safer place.

Do you expect your lending strategy will have to change as a result of any of the regulations?

I don't think so. At the moment we are investing a lot of money in improving our collateral management capabilities with a collateral dashboard. This will allow us to chart our risks more efficiently across all our products.

Up until the Lehman collapse, unsecured was the default for deposits with banks, but now everything is collateralised, so you have to become smarter with it. That means pricing, managing and aggregating better.

It has been suggested that the wide disparity between supply and demand in securities lending has put pressure on beneficial owners to accept a wider variety of collateral. Are you feeling this pressure?

At the moment we're sticking to our current strategy. We only deal in high-value, intrinsic trades so the cost of collateral is less of an issue. At the same time, although I do understand the case for accepting equity as collateral, we can only consider taking it onboard if it can be done in a safe way. We refuse to take on more risk.

Does the central counterparty model interest you as a way to mitigate the risk of equity as collateral?

I'm not a big fan of any form of mandatory central counterparty (CCP), to be honest. I struggle to see the advantages of it as a product.

The CCP, in my opinion, is just another mouth to feed in the chain, and the pie isn't getting any bigger.

If the model was changed so that it didn't operate through your lending agent, or at least at a lesser fee, then we could look at it, but I'm not happy to be forced to use something. If you make a product I like, I'll buy it.

There has been a suggestion that the reason it hasn't been taken up more by beneficial owners is because we don't understand the product. That's nonsense—we just don't like it.

What's worse is that because there is talk of making CCPs mandatory they think they will have a monopoly soon and can just play the waiting game.

What aspects of the proposed CCP model for securities lending would you like to change?

The main aspect is the cost. If mandatory clearing was introduced on all our products, there has been a prediction that the cost to pensioners, our ultimate clients, would be a 3 percent decrease in their pension.

Regarding the risk mitigation argument, I believe we have a very robust risk model ourselves already. A CCP centralises risk but I don't think it makes things any safer than the current situation.

I do see an advantage to having CCPs as an option within the securities lending industry, but with regard to costs, it's not clear who should give up their part of the pie.

Do you think less ambiguous regulation will see an up-tick in borrowing demand from those that were hesitant to invest before?

On the macro scale, regulators would like less leverage in the market and a safer world, which wouldn't be consistent with more demand. When the wider economy picks up I'm sure there will be more utilisation, but regulators will continue to squeeze leverage out.

I think demand will remain stable for the near future. **SLT**

Roelof Van der Struik
Investment manager
PGGM

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Task half full

Brazil is Latin America's biggest market, but some agent lenders are still seeing its central counterparty model as a barrier to further growth

DREW NICOL REPORTS

Throughout the securities lending industry, professionals agree that Brazil is a market with ample potential for further growth that offers rich returns to early investors.

"We [J.P Morgan] were the first non-domestic lending agent to go live in the Brazilian market and we have been very active there on a custody and non-custody basis for five-and-a-half years," explains Paul Wilson, global head of agent lending product and portfolio advisory at J.P. Morgan Investor Services.

"We have a good 'outbound flow' of business from Latin America-based clients and it continues to be an area of interest for us."

But he adds: "We do see strong demand from borrowers to borrow Brazil and there is also a lot of interest from clients to lend in this market, but it's still not mainstream."

"What will likely drive volumes up is more supply. We're not at the stage where there is so much supply that fees are driven down."

Other stumbling blocks exist in the Brazilian securities lending market, specifically the requirement to use the BM&FBovspa central counterparty (CCP).

All collateral offered by the borrower is held within the CCP in broker-level accounts and the lender does not receive or even have clear sight of it.

This system is made more secure through the financial backing of the Bank of Brazil, but beneficial owners losing sight of their collateral remains a concern.

Wilson explains: "The Brazilian market doesn't come without a number of complexities, such as operating via a CCP. One of nuances is that while the CCP does collect and hold collateral from the borrower, this is not passed on to the lender nor does the lender have sight or reporting what and how much collateral has been collected by the CCP."

"For a number of lender types, such as UCITS or US mutual funds, the market is challenging as it is not apparent under their own regulations that these clients could participate given the absence of collateral."

Agent lenders such as J.P. Morgan have tried to combat this concern by offering to indemnify lending transactions in Brazil, but the strict mandates that the likes of mutual funds operate under are not up for negotiation.

This is unnerving for international beneficial owners that are more accustomed to enjoying full control of their collateral management processes.

This divergence from traditional lending protocol also creates further operational challenges regarding recalls and market timeframes.

"We have a sense that if the CCP would allow individual collateral accounts per lender and provide reporting of that collateral, then one of the biggest barriers would be eliminated," concludes Wilson.

Northern Trust's head of international product management, Mark Jones, offers an overall vote of confidence in the effectiveness of the Brazilian CCP model, but also echoes the concerns of Wilson on the controversial point of collateral management.

"Through working closely with BM&FBovespa we gained some comfort in the sophistication of their risk management techniques and their fairly conservative approach to collateral margining," says Jones.

He adds: "We are also confident that they understand the market they are supporting and the needs of its participants. However, the operational processes involved in lending in Brazil through the CCP are significantly different to a 'standard' lending market and require the adoption of some very bespoke solutions to manage."

"The lack of visibility of collateral is a significant hurdle for some offshore lenders and educating our beneficial owner clients on the intricacies of the market has been key to our ability to implement. The model does work, but there are some areas that could be developed to attract higher offshore participation."

Unfortunately, BM&FBovespa could not comment before press time, but a spokesperson

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for the CCP said in September 2014: "As the CCP model for securities lending is mandatory in Brazilian regulation, these international investors need to understand the system's safeguards, a process which may take some time, as well as understand access to such a model vis-à-vis their own regulatory framework and modus operandi."

"To overcome this issue BM&FBovespa has been working along to major international associations, intermediaries and the beneficial owners to engage the market participants on the discussion of the CCP model and the regulatory framework in Europe and the US."

"Regardless of these challenges, high return for lenders in the Brazilian market seems to be an additional stimulus for them to start doing business in it. The only institution currently authorised to provide securities lending in Brazil is BM&FBovespa," said the spokesperson.

"As the CCP model has proved extremely reliable even in stress situations like the 2008 financial crisis, it is unlikely that regulators in Brazil will accept a different model than a CCP-based one for the market."

Further evidence that market participants will, and are, learning to adapt to this mandatory system can be seen by data that highlights a recent uptick in securities lending transactions in June compared with the month before. The CCP saw the total number of transactions reach 123,285, compared to 117,292 in May.

The financial volume related to securities lending amounted to BRL 61.64 billion ($19.05 billion) compared with a total of BRL 58.62 billion ($18.97 billion) in May.

It would be unfair and incorrect to accuse the CCP model of being the sole reason behind some beneficial owners' lack of interest in the Brazilian securities lending market.

As Jones points out, there are wider national economic and social issues that have negatively affected and delayed Brazil's emergence into the mainstream market.

"I think the main challenge at present is the economic and political situation in Brazil. No matter how good the product, concerns over the likelihood of further deterioration of the economy are likely to outweigh any benefits that can be obtained through lending in the minds of many asset owners," says Jones.

He adds: "If those macro issues can be addressed, I am confident that there will be a successful lending market in Brazil, but those issues should not be underestimated."

Ultimately, all debate around increasing complexity of securities lending, either through regulatory, reporting or cost burdens, is confronted by the fact that securities lending is just one, relatively small scale, of many operations of asset managers, and if regulatory demands become too onerous people will simply opt out—and Brazil is no different.

In the rest of Latin America, the picture is less complex. "Demand to borrow Chilean securities is minimal," says Wilson. "Demand to borrow Mexican equities is generally low to moderate and there are generally few specials in that market."

Mexico's securities lending framework subscribes to the standard model of not requiring a CCP be used, which makes the process of signing up new beneficial owners a lot more straightforward. This means agent lenders that are active in Latin America can open their beneficial owner clients to the Mexican market without the high level of ongoing involvement required in Brazil.

Although the interest in securities lending in Mexico isn't ready to challenge Brazil as the top Latin America market, once uptake does develop it will not have to tackle the regulatory challenges that Brazil may have to face if it wants to join the big leagues. **SLT**

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Is South Africa an emerging securities lending market, or is it more established? Experts discuss the issues

> Securities lending liquidity continues to increase and, generally speaking, lendable supply in South Africa is plentiful

Jonathan Lacey, Head of international equities trading, Northern Trust

South Africa has been described as an emerging securities lending market. Is this accurate, and why?

Jonathan Lacey: South Africa is classified by the leading index providers (for example, MSCI and FTSE) as an emerging market, so it's logical that it retains the same classification from a securities lending perspective. This said, it has had an established securities borrowing and lending model in place for a number of years, and Northern Trust has been actively lending since 1998, so securities lending is not new to this market.

Securities lending liquidity continues to increase and, generally speaking, lendable supply in South Africa is plentiful. However, despite its well-established securities lending model, its burdensome settlement regime is categorist of traditionally less mature markets, and therefore it's a big differentiator versus more developed markets in Europe and other parts of the world.

Farzana Khan: The South African securities lending market is a well-established market with strong regulatory oversight. Coupled with a reasonably liquid cash and currency market, it allows global investors to consider South Africa as a 'proxy' for emerging market strategies. However, it is unfortunately perhaps not as sophisticated as our foreign counterparts and is often described as being 'vanilla'.

Michael Wright: Securities lending is now an established element of South Africa's capital markets, which is one of few active markets on the African continent. There has been an active securities lending market since the early 1990s and it is officially recognised by the National Treasury, and is supported by our other regulatory bodies, namely the South African Reserve Bank and Financial Services Board.

The South African securities lending market encompasses more than 20 institutions comprising banks, insurance companies, pension funds, asset managers and service providers. A recent survey of South African lenders estimated that between ZAR 120 billion ($8.6 billion) and ZAR 140 billion ($10 billion) worth of South African securities are on loan at any given time.

The South African securities lending market is mature and well entrenched, and therefore shouldn't be considered an emerging securities lending market.

Is there much general collateral business in South Africa? What about specials?

Khan: Lending specials can form a sizable portion of business for lending desks, however, the local liquidity on such stock diminishes fairly quickly, thereby leaving lending desks with the option of borrowing stock from offshore sources.

Wright: There is an active general collateral business in the South African market, with the top 40 securities being the bulk of the trading activity. Fees for general collateral securities out on loan typically average 35 to 45 basis points (annualised), but can be as high as 900 basis points in times of extreme demand and, conversely, as low as 20 to 30 basis points for general collateral stock.

Lacey: Trading activity in South Africa is a mix of both general collateral business and specials activity, with the balance between the two fluctuating depending on trading conditions and market sentiment. As a more established emerging market with relatively good levels of trading both on the equity cash market and securities lending liquidity, South African lending and borrowing of equities have often been used by hedge funds for directional trading of the 'emerging markets' sector rather than being stock-specific. As such, it has been the source of both robust general collateral and specials activity.

What about the structure of the market? Are agent lenders and prime brokers the main facilitators of business?

Wright: The majority of lenders of securities in South Africa are comprised of the large pension funds. It is estimated that 70 percent of all funds (with net assets above ZAR 10 billion ($716.5 million)) are participating in some form of securities lending programme.

Historically, custodians have been the primary facilitator of securities lending, acting as an agent on behalf of their underlying custody clients. However, we are seeing more third-party agents entering the market, offering alternative securities lending options to beneficial owners. There are also two intuitional investors that have chosen a direct lending model and lend directly to the borrowing community.

It is estimated that non-South African participants comprise approximately 40 percent of market activity.

Lacey: The structure of the South African market offshore lending market is fundamentally no different to other markets. The catalyst for demand is largely being driven by the prime-broker client base, with both onshore and offshore lenders providing the source of supply.

Khan: Since the global financial crisis in 2008 and the subsequent sanction on many firms' proprietary trading activities, the greatest portion of borrowing is facilitated by prime

> The South African securities lending market is mature and well entrenched, and therefore shouldn't be considered an emerging securities lending market

Michael Wright, Chairperson, SASLA

JSE

> South African exchange control regulation controls the 'flow' of money in and out of South Africa and securities lending transactions with offshore counterparties are limited to authorised dealers only

Farzana Khan, Head of securities lending, Rand Merchant Bank

brokers. Agent lending is not the norm in South Africa, with most participants assuming a principal position from both a legal and credit risk perspective.

How active is the association in working with other associations or liaising with regulators, and what is it currently working on?

Wright: The South African Securities Lending Association (SASLA) is an industry forum established in 1989 to represent the common interests of the participants in the South African securities lending industry. SASLA works closely with regulators and is represented on several industry committees.

SASLA has contributed to a number of major industry initiatives, including the development of the South African Stock Borrowing and Lending Code of Guidance, and has published standard securities lending documentation to be used in conjunction with the Global Master Securities Lending Agreement. The association—with the backing of the Banking Association of South Africa and supported by Strate, the Association for Savings and Investment South Africa, and the Johannesburg Stock Exchange (JSE)—was successful in lobbying the National Treasury for an exemption of collateral arrangements from Securities Transfer Tax (and other tax impacts).

The first Securities financing master class in South Africa was also arranged in early 2015, which proved a huge success. The association is currently actively involved with the JSE in the move to a T+3 settlement cycle in the South African equities market.

Khan: SASLA is very active in liaising with regulators and other organisations such as the JSE, Strate, the Financial Services Board and National Treasury. SASLA has represented the industry before the National Treasury on the tax exemptions required for outright transfers of non-cash collateral. Similarly, SASLA worked quite closely with the Financial Services Board on the draft securities lending note as it pertains to Regulation 28 of the Pension Funds Act.

How well developed is South Africa in terms of cross-border collateral transfer? Is it a useful source of liquidity and/or HQLA?

Khan: South African exchange control regulation controls the 'flow' of money in and out of South Africa and securities lending transactions with offshore counterparties are limited to authorised dealers (generally banks) only. Owing to these regulations, as well as the uncertainty around the 'pledge' mechanism in respect of non-cash collateral, cross-border collateral transfers are typically settled in cash only, and most specifically, South African rand as opposed to foreign currency.

Anthony van Eden: The South African market lags behind its European counterparts when it comes to cross-border collateral transfer. This is mainly due to the local exchange control restrictions, taxation implications on equities collateral under cession, regulatory equivalence, and the use of triparty collateral management services offered by Strate (which have been available to the South African market since August 2014).

The ability to access foreign-held assets to collateralise local financial obligations, and local assets to collateralise foreign financial obligations (whereby the assets remain and settle in the local jurisdiction under local regulations and legislation), would greatly improve liquidity and the efficient use of high-quality liquid assets (HQLA).

What developments are you looking forward to in the next 12 months?

Lacey: The JSE is looking to reform its settlement regime, with the aim of reducing the current protracted T+5 settlement cycle to bring it in line with other more developed markets. Northern Trust is excited about the prospect that the JSE is migrating to T+3 with a target date of between May and July 2016. It is hoped that this change will also be the catalyst for South Africa to adopt a more streamlined trade matching system, with notably removing the current pre-matching requirement.

If this is the case, we should expect liquidity to increase. However, should the pre-matching requirement remain post-migration to T+3 then it may create challenges within the securities lending market and could have an overall negative impact on lendable supply. We await further details from the JSE to clarify the scope of the settlement regime reforms.

Brett Kotze: The JSE is currently spearheading a project that will see the South

> The South African market lags behind its European counterparts when it comes to cross-border collateral transfer

Anthony van Eden, Head of collateral management services, Strate

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> "Moving to T+3 is a highly complex undertaking that will bring about many changes, one of them being increased demand for securities lending and borrowing to bring down the potential fails rates from a settlement perspective"

Brett Kotze, Director, JSE

African equities market moving from a T+5 to a T+3 settlement cycle. This is a highly complex undertaking that will bring about many changes, one of them being increased demand for securities lending and borrowing to bring down the potential fails rates from a settlement perspective.

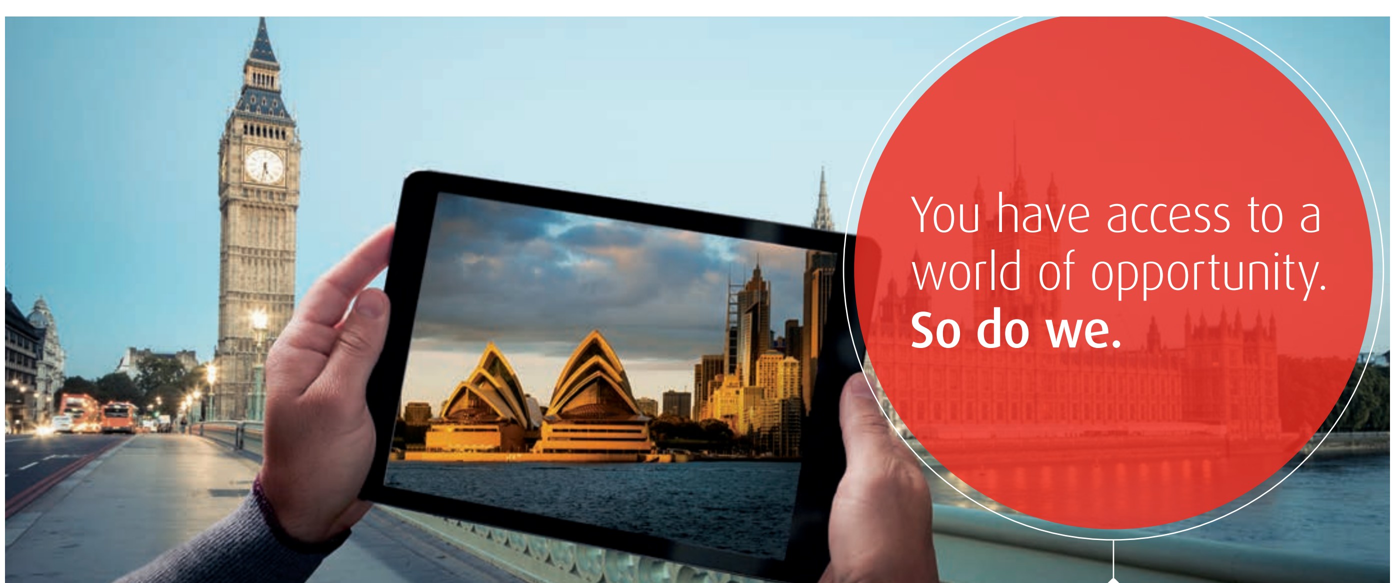
Wright: The proposed tax dispensations for equities transferred under cession of transfer (under a financial collateral arrangement) will significantly improve market liquidity and relieve the pressure on available HQLA. The collateralisation of financial obligations has traditionally been in the form of cash or by the pledging of securities in order to avoid attracting tax charges.

The finalisation of the triparty collateral management model will assist with seamless cross-border collateralisation for foreign exposures covered by domestic collateral and domestic exposures covered by foreign collateral. Local providers of securities lending and borrowing platforms will be offering enhanced straight-through processing for this service, to assist the market in its daily activities and with the move to T+3.

Van Eden: There will also be mandatory clearing of standard over-the-counter derivatives through a central counterparty (CCP).

This could see greater use of CCPs, perhaps for securities lending and repo transactions.

Khan: The JSE is moving to a T+3 settlement cycle in the equity market, which will have a significant impact on securities lending and borrowing activity. We also anticipate that the changes in outright transfer of equity collateral will bring about a definite change in the way that non-cash collateral is managed. **SLT**



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Where there's OCC there's a way

Options Clearing Corporation is revamping its capital base, working on adding agent lenders and their clients to its ranks, and strengthening the current stock loan, futures and options franchises. Scot Warren explains

MARK DUGDALE REPORTS

How is OCC's securities lending CCP faring at the moment? Are volumes and notional value meeting your targets?

We're here to serve the industry, so we don't really set targets for transaction volume or notional value. Rather, we're prepared to serve the industry and what it demands from a cleared stock loan programme. Having said that, we've taken a programme of 10 clearing firms in 1993 to 70 clearing firms conducting an average of 5,000 trades a day with $190 billion in notional value. Year over year, we are up 12 percent in trades and up 36 percent in notional value.

What's really indicative of the growth and interest in cleared stock loan is that since 2011, we're up more than 1,000 percent in notional value. Those figures speak to the reception that we've had from market participants, who have looked to us to meet their clearing needs.

We're satisfied with the reception and the support of the industry. And we're working in a very collaborative fashion with the industry to figure out the future direction of cleared stock loan.

Is the CCP becoming a more attractive route to market?

The regulatory balance sheet relief and collateral efficiencies make OCC a compelling value proposition for market participants. I think part of the attraction of a CCP is also looking at how the programme can be expanded, which is always done in collaboration with market participants and undertaken with care.

We're working with a coalition of industry participants to ensure that we have the solution that not only meets the needs of today, but also those of tomorrow. A good example is our work on broadening the eligibility to participate and bringing in agent lenders.

What's the plan with expanding eligibility to participate in OCC's stock loan programme, because it's quite a complicated process, isn't it?

The market's desire is to allow agent lenders to directly participate in the market, and the clients they represent—the traditional '40 Act and Employee Retirement Income Security Act funds. Certain funds need additional regulatory approvals, because their current statutes have not contemplated cleared lending so those types of entities would need regulatory relief to be able to use a cleared solution. More broadly, market participants are also looking at the possibility that sovereign wealth funds could participate as well.

We currently have a coalition of industry participants working with us to design the exact specifications of how the market needs to function, and around that we plan to build a technological and regulatory framework. So we're at the point of putting together the nuts and bolts of determining how that programme will work, and the next step is board of directors and regulatory approval, then actually building out that solution.

> "Certain funds need additional regulatory approvals, because their current statutes have not contemplated cleared lending"

We're working to allow direct participation and expanded participation of new types of members, and that work is proceeding and we're looking forward to seeing it through to completion. We want to have the blueprint for this nailed down before the end of 2015, so that we can begin seeking regulatory approval and building out the technology solution early next year.

OCC partnered with CalPERS on a liquidity deal earlier this year—what effect has this new liquidity source had?

With our credit rating and operating history, OCC has long been respected as a foundation for secure markets. What the relationship with CalPERS has done is show our innovation and ability to collaborate to secure new committed credit facilities. I think our team should be proud of the innovation they've shown in finding new sources of credit facilities and it's been a very well received programme.

In fact, we've had more interest in similar partnerships, but a committed credit facility is a function of the size of the need, and so we have the benefit of having more interest than that our current needs. It's also a good way for a beneficial owner to earn a different income stream, and for us it's a counter cyclical source of financing.

What else is OCC working on?

Of course, our agent lender work doesn't diminish our ongoing effort to enhance the existing securities lending programme that we support for market participants. We want to grow and expand and enhance the risk management programme, which is also an ongoing effort.

We're also working on our capital plan to enhance the resiliency of OCC, and that has been a central focus. We are pleased that the Securities and Exchange Commission (SEC) agreed with us that the concerns raised by the petitioners do not justify maintaining the stay during the dependency of the commission's review. The SEC's decision to discontinue the stay and proceed with their review of our capital plan permits us to further strengthen our equity capital resources so that a compelling public interest can be served.

We're also continuing to strengthen and enhance our risk management capabilities not only in securities lending, but also in the options and futures franchises. **SLT**

Scot Warren
Executive vice president of business development and the Options Industry Council
OCC

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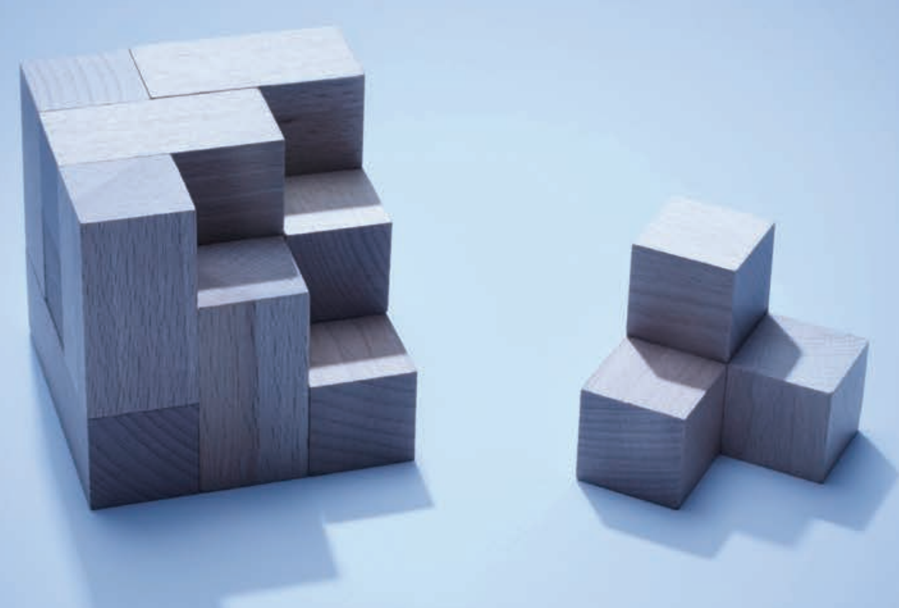

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Collateral rising

Intrinsic lending has arisen as regulatory pressure on collateralisation has created new sources of demand. Michael McAuley of BNY Mellon explains

MARK DUGDALE REPORTS

Is intrinsic value lending still the aim of the game for beneficial owners?

Yes. Beneficial owners and agent lenders are both focused on intrinsic value lending. The practice of lending securities solely to raise cash with the expectation of deriving most of the revenue from the cash reinvestment is basically gone from the market. This is due to several factors, including the low interest rate environment and the fact that many lenders have adopted more conservative guidelines for cash reinvestment.

Even if interest rates increase, it is unlikely that this practice will return due to structural changes that have taken place in the lending market resulting from new regulation.

While lending is based upon intrinsic value, it does not mean that all loans are 'specials' or hot stocks. Looking at data across the securities lending market, approximately 70 percent of loans still fall within a more general collateral bucket. But those loans are demand-driven and can produce good revenue streams for lenders. It's important for lenders to understand how their securities lending revenue is being generated.

At BNY Mellon, we can provide our clients with detailed attribution analysis that shows exactly how their revenue is derived, which should allow them to make better decisions on how to structure their lending programme.

Where are you seeing demand for client assets?

Demand tends to fluctuate as economic conditions change. Demand can also vary by geographic location. Global equities and small and mid-cap equities are generally in demand. Some of the top sectors in the equity space include IT, consumer discretionary and healthcare. The energy sector is of interest right now due to pressure on oil prices.

Also, recent volatility has increased the volume of macro hedging, resulting in increased demand for China-centric, high-yield bonds and general index exchange-trade funds.

For fixed income, there is good demand for sovereigns resulting from volatility, the flight to quality, and increased collateral needs. European debt is also benefiting from current central bank policy, along with decreased issuance.

How new would you say the concept of the collateral upgrade trade to beneficial owners?

Collateral upgrade trades are not new to the securities lending market. What's new is that regulatory changes such as liquidity ratios and mandated clearing have created new sources of demand. This, coupled with increased leverage ratio requirements affecting borrowers, has resulted in a significant increase in the number of transactions collateralised by securities collateral. This makes collateral flexibility key to taking advantage of these new opportunities.

> "The markets in Europe and Canada have been more open to securities as collateral in general, but now US lenders are accepting a wider variety, ncluding equities"

Many lenders have already expanded, or are in the process of expanding, their collateral guidelines. The markets in Europe and Canada have been more open to securities as collateral in general, but now US lenders are accepting a wider variety of securities as collateral, including equities.

How are CCPs developing to meet beneficial owners' needs?

Central clearing models for the agency securities lending market are still in their infancy. BNY Mellon has been working with industry participants to develop a clearing model that meets the needs of beneficial owners. I expect that a workable model will emerge in the near future. However, certain regulatory changes will be needed to allow for broad participation.

The move to central clearing is being driven in large part from the pressure on dealers' balance sheets as a result of increased leverage ratio requirements. Central clearing will allow dealers to maintain their existing volumes, but in a more balance sheet-efficient manner due to the increased netting benefits. As a result, central counterparties will become an important distribution channel for our clients' assets that could allow them to maintain balances and, in some cases, potentially obtain better pricing.

I expect to see central clearing develop as a point of trade discussion just like any other loan term. The negotiation with respect to how the trade will be cleared (centrally or in the traditional bilateral manner) will likely be based on the benefits that the borrower may derive from central clearing.

Accordingly, I would expect to see a pricing differential develop between centrally cleared loans and traditional bilateral loans.

What other trends are you seeing?

Due to increased collateral requirements resulting from mandated clearing, many beneficial owners are becoming interested in the role that securities lending can play in meeting their liquidity and collateral needs while reducing costs and improving fund returns. This is particularly applicable for funds that employ liability-driven investment strategies, which typically involve large derivative positions that can require significant amounts of liquidity to meet margin requirements and result in a drag on the overall fund return.

By combining securities lending with collateral management tools, overall fund returns may be improved while still meeting liquidity needs. **SLT**

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Managing director
Global head of product and strategy
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The complete package

Securities lending professionals Lance Wargo, John Arnesen and Natalie Floate explain what BNP Paribas Securities Services is focusing on around the world

MARK DUGDALE REPORTS

The BNP Paribas securities lending offering has been in place for 20 years. Can you review your 'new news': your recent ramp up in the US and what's happening globally in your rapidly expanding programme?

Lance Wargo: The US team has had a phenomenal quarter, which I attribute to the strength of our expanding team. As a desk, we have grown the agency business to 70 beneficial owners and more than 20 borrower relationships, including all of the major prime brokers. Our approach and business philosophy is simple; we let our clients define the programme they want, and then we build it. We put forth a truly customisable programme based on client-directed parameters.

In addition, we offer complete programme transparency. Clients can call the desk directly and speak with myself or Mike Saunders to inquire about balances, new supply, or the latest trading strategy for a particular asset class. We understand that lenders and borrowers have choices, and we would like both to want to do business with BNP Paribas.

We'd like them to consider our history as a reputable global firm that has never lost money for a client in a securities lending programme. Collectively, our senior management team has more than a 100 years of experience in the industry. Frank Souder has written a book about securities lending and Richard Chen is a global credit markets specialist. Clients remain hungry for information related to our business, and we strive to satisfy that need.

John Arnesen: We have also recently been recognised in an industry survey, with BNP Paribas Securities Services a global runner-up for fixed income trading this year. In addition, we were highly recommended by the borrowing community for our Asia Pacific business. These awards illustrate our laser focus on these disciplines and the global resource that our clients have in being able to utilise specific areas of desk expertise.

Natalie Floate: In the Asia Pacific it's been a transforming year in terms of focus for both us and, importantly, our clients, but in slightly different ways depending on their location and the dynamics of their underlying investments.

For our established clients, there has been a focus on understanding the drivers behind lending activity in more detail, what new asset allocations and markets mean, what levers are available to increase revenue, and what this means in terms of risk/return. For these clients new developments like our online, flexible reporting have been key as we typically have one or two stakeholders within our client's offices who manage the securities lending activity and having direct access to data—in granular detail or in board-ready graphs—has become vital for them in undertaking their internal reporting and governance responsibilities.

For newer clients and prospects, it has been about flexibility in approach, and this is another key that we have to unlocking the value of our lending desks. For new clients in the Asia Pacific, we are seeing a desire to enter into a non-cash collateral programme, especially for an institution that may be lending its securities for the first time. As we have a history of consistent performance when operating on a non-cash basis and full flexibility in regards to

> "Our approach and business philosophy is simple; we let our clients define the programme they want, and then we build it"

Lance Wargo, Head of agency lending US, market and financing services
BNP Paribas Securities Services

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> The demand for high-quality liquid assets has been growing for a number of years and in 2015 we have experienced the highest demand, coupled with a shift in fees

John Arnesen, Global head of agency securities lending, market and financing services
BNP Paribas Securities Services

our collateral parameters, this has resonated well with new clients that want to start with a conservative programme and then gradually expand it.

And you cannot talk about securities lending without talking about regulations. This has been quite key for us in the Asia Pacific as even though many of our clients are not directly governed by the European Securities and Markets Authority (ESMA) or other regulators or regulations, there is a strong desire to ensure best practice is being adopted. In this regard BNP Paribas is naturally positioned to be able to leverage our European experience for the benefit of our local clients, and our clients support our taking an active role in industry discussions and bodies such as global securities lending associations.

What are you seeing in the local market, and internationally?

Wargo: Daily, we see clients asking what's next for securities lending and our programme. Serving a wide range of clients, we still see brisk demand for intrinsic-only programmes. However, in addition to the traditional cash collateral lending programmes, we are seeing more and more interest in US programmes exclusively using non-cash collateral. This interest varies among clients, and admittedly, some clients are still wedded to the traditional cash collateral model. Still, we see a growing interest in non-cash programmes. We are definitely following the industry efforts to change US Securities and Exchange Commission Rule 15c3-3, and we are ready to serve all of our clients that wish to move to non-cash collateral.

In addition, we are also seeing clients show interest in markets such as Taiwan and Australia. BNP Paribas's global presence allows us to quickly arrange client access to experts in each region and each specific trading discipline. Our trading desks in Sydney and London regularly coordinate to maximise returns on clients' portfolios.

Arnesen: The demand for high-quality liquid assets (HQLA) has been growing for a number of years and in 2015 we have experienced the highest demand, coupled with a shift in fees. As an increasing number of counterparties appear to be de-centralising their liquidity coverage requirements and applying compliance at the business unit level, we see demand coming from a variety of trading desks. Given the drivers of this transaction are centered on financing long positions of other assets classes, it suits our non-cash collateral programme in Europe well and we work closely with our clients that need to approve the term nature of this activity.

We have found, more than ever, a fragmentation in the market in that demand is becoming relatively specific to each borrower, which makes for an interesting market and leads to a healthy distribution across our top 10 borrowers by volume.

Our business in the Asia Pacific is expanding with a number of high profile clients joining the programme this year in Australia. This will provide an injection of not only domestic Australian assets to our lendable base but a slew of international assets as well. We are continuously searching for opportunities in the Asia Pacific, be that unilaterally or by partnering with other institutions. We are currently assessing some interesting proposals that will expand our market presence and demonstrate our true commitment to the region.

Floate: The Asia Pacific represents optimism and an expectation of revenue growth for our clients and we share that view in regards to securities lending. It's a complex region with regulations, taxation requirements and investor posture changing each time you cross a border. But this brings opportunities and we are extremely active with new clients representing new supply locally and offshore, new markets, and new borrowers. This has meant that we cannot rely of the traditional agency lending model and we have needed to adapt—examples include third-party lending, sub-agents, partnerships and agency borrowing agreements—and the challenge is to ensure that as we have new supply we increase our demand at the same rate to maintain the same levels of value for our clients.

That said, we are also seeing a return to basics in some cases, and as complex as the markets and regulations are, or as good as our reporting may be, we do not take good old-fashioned conversations with our lenders or borrowers for granted. These are critical for us as they are a key to our ensuring local flexibility, differentiation, and relevance with our clients.

Getting back to the US. What is your take on the regulatory changes and how are you positioned?

Wargo: The regulatory environment is changing fast. The only certain thing that we can say about the future is that it will be different. In the US, we see the industry focused on liquidity, leverage and capital because of the requirements mandated by the US Dodd-Frank Act—particularly the Collins Amendment and Rule 165(e). We see some industry participants considering shedding their indemnity obligations, dropping less desirable customers or changing fee splits.

As a team, we are fully engaged in the industry groups that are at the forefront of analysing and responding to changing regulations. We are also supported in our efforts by BNP Paribas employees throughout the world who monitor and analyse laws and regulations.

We are highly confident of our ability to continue to serve our clients and to operate in the foreseeable regulatory environments. **SLT**

> The Asia Pacific represents optimism and an expectation of revenue growth for our clients and we share that view in regards to securities lending

Natalie Floate, Market and financing services for the Asia Pacific
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A backbone of innovation

Matthew Bernard, partner and co-founder of ENSO, explains what the company can do for hedge funds and prime brokers, now and in the future

DREW NICOL REPORTS

What is the background of ENSO? How did the company come about?

ENSO was founded on the backbone of innovation. In 2011, Matthew Bernard, Michael Gentile and Dwaine Alleyne, all of whom have deep backgrounds in designing technology platforms and proprietary algorithms for some of the world's largest banks, including Barclays and UBS, saw a critical need to improve the way that hedge funds and their counterparties communicate. They set out to build a platform that helps optimise the exchange of information between hedge funds and prime brokers.

The result has been a transformation of the hedge fund-counterparty relationship, providing the community with a fully hosted portfolio and treasury workflow solution. ENSO enhances the value of these relationships by providing informational alpha that uncovers collaborative opportunities.

Today, ENSO employs more than 70 professionals in the US and UK and has more than $800 billion in client assets under advisory.

ENSO is also currently backed by ICAP, a leading markets operator and provider of post-trade risk mitigation and information services. ENSO received an initial investment in May 2013 and a follow-on investment in October 2014.

What does ENSO offer hedge funds that its competitors do not?

ENSO provides a comprehensive view of hedge funds relationships across multiple prime brokers and counterparties. We deliver data and insight on counterparty credit risk, collateral management, portfolio financing and treasury to our clients through various mediums on a daily basis.

ENSO is a contributory database and our clients get access to unique amalgamated datasets that add value to internal traders, portfolio finance people and treasury teams at the fund.

ENSO also has a dealer platform called the ENSO Color Portal. ENSO has created a technology platform that allows each of the participants to communicate and exchange information and make use of this data through one cohesive platform. Prime brokers are able to share information, advertise axes, disseminate commentary and narrowcast and target clients that are part of our growing community.

In today's ever changing regulatory environment where balance sheet is a scarce resource, both dealers and clients need to work together to improve and enhance relationships. ENSO is providing a platform that creates this connectivity.

What are the main hurdles facing hedge funds and how they interact with their counterparties? How does ENSO tackle these challenges?

Both market and regulatory pressures, in some cases, have increased costs of prime brokerage for hedge funds, and in other cases have caused friction between both buy- and sell-side counterparties. The business of extending financing to hedge funds once was a very attractive and stable business for the prime broker, yet today many are dealing with regulatory pressures that cause balance sheet inefficiencies that need to be rectified across the franchise and ideally at the client level.

The prime brokers that are best suited to handle this new environment have been investing in their technology platforms for many years, while others are now allocating resources in effort to understand their business to a very granular degree, and create efficiencies and opportunities to share with their clients as means to improve profitability and client profiles.

ENSO sits in the middle and solves the communication, data management and optimisation issue for both the dealer and for the fund. We have created a utility to be consumed and used by the street. Both buy- and sell-side counterparties can be part of the same platform. Dealers can use our platform to advertise balance sheet opportunities to the funds on ENSO's Core Platform.

Funds are alerted to these opportunities through our portal and use the tools that we have created to optimise their positions across the street. Both sides are alerted, and both sides communicate and cohesively work together to find the most optimal opportunities for each party.

Managers face a constant deluge of information about potential trades and the costs of financing those trades from an array of prime brokers. Sifting through this information is costly, as it takes time and resources away from what hedge fund managers do best—making investment decisions. Adding to this complexity is a wave of new regulations, including Basel III and the US Dodd-Frank Act, which have forced many brokers to rethink the way that they interact with their hedge fund clients.

Our proprietary technology and software platforms, namely ENSO Core and ENSO Color Portal, seek to address these challenges from both the hedge fund and broker side.

For hedge funds, our services allow managers to customise what commentary and securities pricing information they receive, thereby optimising the investment decision-making process and making them better clients to their brokers. For brokers, we provide the ability to share position lists with the ENSO hedge fund community, which further connects the supply of and demand for collateral.

Will ENSO expand beyond the hedge fund demographic?

ENSO continues to build out its infrastructure and technology offerings based on clients' needs. We recently hired CTO Michael McMahon to establish additional structure to our technology efforts. Similar to how ENSO started, we have recognised an additional gap in the market and highlighted many emerging managers that can also benefit from access to our technology and analytics. Expanding our offering to assist these managers with the same high quality operational insights and alpha-generating analytics is just another solution that we can provide the street.

What do you do for prime brokers?

As our ENSO community expands, we plan to enhance our broker-dealer offering on the platform. ENSO will be providing dealers with feedback and reporting which will summarise their overall platform usage and effectiveness.

ENSO also has plans to offer our clientele new shared utility solutions to solve for the non-differentiating aspects of the high-cost post-trade inefficiencies that are arising out of the recent regulatory hurdles.

What does ENSO have in the pipeline for 2016?

Over the next year, we plan to allocate our resources globally to develop innovative analytics and pre- and post-trade services to our ENSO community, engaging both the sell side and buy side.

We see a bright future for ENSO in the next year and for many years to come. **SLT**

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Synthetically pleasing

Equity derivatives trading is gaining transaction due to regulatory reforms. Martin Seagroatt of 4sight Financial Software discusses the technological issues

Synthetic finance trading using equity derivatives is becoming more important as new regulations increase costs for all market participants.

New regulatory mandates including Basel III, the US Dodd-Frank Act and the European Market Infrastructure Regulation (EMIR) are having a seismic effect on prime brokers. This is resulting in a much closer consideration of the impact of a given trading strategy or client relationship on:

- Balance sheet;
- Leverage ratios;
- Capital costs; and
- Liquidity buffers (eg, the liquidity coverage ratio and the net stable funding ratio)

On the buy side, interest in difficult to access emerging markets continues. Transaction taxes and the rise in UCITS hedge funds that are unable to pursue physical short selling strategies are also resulting in demand for synthetic routes to market.

The trends discussed above are all increasing volumes of portfolio swaps, total return swaps and contracts for difference as market participants seek to enhance their existing prime brokerage, delta one and securities financing activities or launch new offerings in this space.

Synthetic trades offer a number of benefits in terms of balance sheet, leverage ratio and liquidity efficiency compared with physical financing transactions.

A recent survey of 56 market participants carried out by swaps technology provider 4sight and consultancy The Field Effect revealed that 57 percent of participants are currently booking synthetic financing transactions such as total return swaps and portfolio swaps.

A further 32 percent plan to in the near future. Firms surveyed included a range of tier one and tier two investment banks and asset managers. The full survey results are shown in the infographic on the next page.

Technology as a key differentiator

These changes in the market are leading firms to redefine their target operating models. The reduced profit margins in the current regulatory environment also mean technology solutions that offer efficient processing of both physical and synthetic trades are becoming important to running a profitable trading strategy.

The equity swaps lifecycle can be complex. This is particularly the case for synthetic structures such as portfolio swaps, which are significantly more complex than their single-name total return swap predecessors.

The situation can be aggravated by trying to make a system that was designed to manage simple single-name total return swaps into a system that can also cope with high volumes of complex portfolio swaps.

This approach often results in a sub-optimal outcome with operational inefficiencies and manual intervention. The data structures, workflow and volume processing capacity of the legacy system are incompatible with the demands of portfolio swaps.

However, the choices open to institutions considering their build versus buy options are limited. Options range from a handful of expensive risk management systems to standalone swaps booking systems with limited scope of functionality and limited integration points, to other prime finance functions.

Regardless of the choice to buy or build, the complexity of portfolio swaps demands a technology solution that:

- Automates the trade lifecycle;
- Supports high transaction volumes;
- Reduces manual processing;
- Minimises the number of interfaces; and
- Maximises the integration between system components.

To meet this demand, 4sight has designed its 4sight Swap system to address the weaknesses of existing swaps solutions and create a new, future-proofed and practical alternative.

4sight Swap is cost effective, quickly integrated and provides full portfolio swaps and total return swaps trading, corporate actions, settlement, margin, position management and reporting.

Defining a target operating model

The challenge that many firms also face is that though they are experts in their business, they do not often design target operating models (TOMs). So the approach may not be familiar and they may lack the necessary skills.

A structured process is needed to design the TOM quickly and efficiently, within cost and timescale constraints.

Start by writing down the vision for the synthetic finance business: what is it trying to achieve and how will it measure success? What existing bank capabilities can be re-purposed, perhaps from cash equities or derivatives lines of business?

Draw out the target process, function and controls. Identify the programme building blocks that are needed to deliver the target state, and develop high-level cost and effort estimates, leading to an indicative business case to justify the investment.

In our experience, this can be achieved in about three to four months with the right sponsorship and the right skills, supported by relevant templates and tools.

It is perfectly possible to design low-touch efficient infrastructure to support a synthetic finance business. However, it is critical to start with the end in mind, and to adopt a structured approach that delivers the TOM design quickly to enable the business to progress rapidly.

Future trends: the holistic model

In terms of future trends within the synthetic space, many firms have already reached a point where they have achieved a reasonable level of operational efficiency with their synthetic finance operating model and technology. However, a number of models are emerging that may offer ways to further optimise systems and processes.

In recent years, there has been a convergence between different products, business functions and desks. This has seen a more integrated focus on areas such as cross-product collateral optimisation and netting, balance sheet usage/capital analysis, liquidity management, and internalisation.

A more holistic view of all trading activity with a given client provides opportunities to identify the true costs and benefits of the relationship, based on the resource base consumed by the client. This can result in a more objective allocation of increasingly scarce resources based on concrete data.

However, it also offers a way to identify operational efficiencies for clients, for example, around cross-margining and more effective internalisation of longs and shorts.

Brokers can then pass these cost savings on to customers, offsetting the increased costs of doing business imposed by Basel III and other rules.

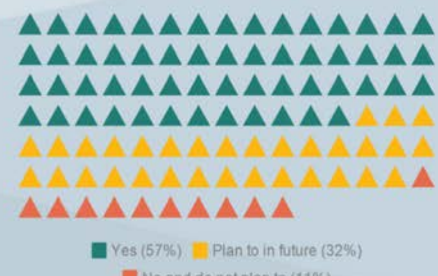
While this fully optimised model requires an investment in integrated technology that offer STP, it can help to reduce IT costs through use of a single IT vendor.

It also allows the firm to take advantage of the synergies between physical and synthetic financing, collateral and liquidity management and central management of the firm's resources. **SLT**

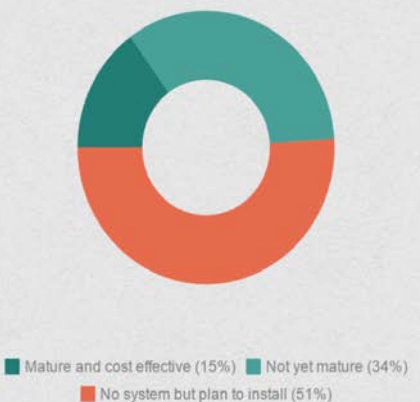
This article is an excerpt from a 4sight and The Field Effect whitepaper, Synthetic Finance: Target Operating Models and Technology Challenges. The full paper can be accessed from: http://www.4sight.com/products/4sight-swap/synthetic-finance-whitepaper---target-operating-models-and-technology-challenges

Trends in Synthetic Finance Technology

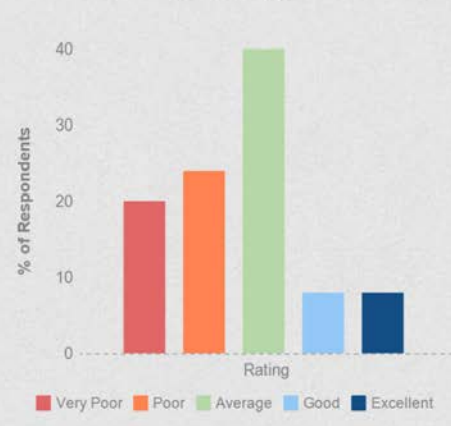
Does your firm book or plan to book synthetic financing trades using equity swaps?



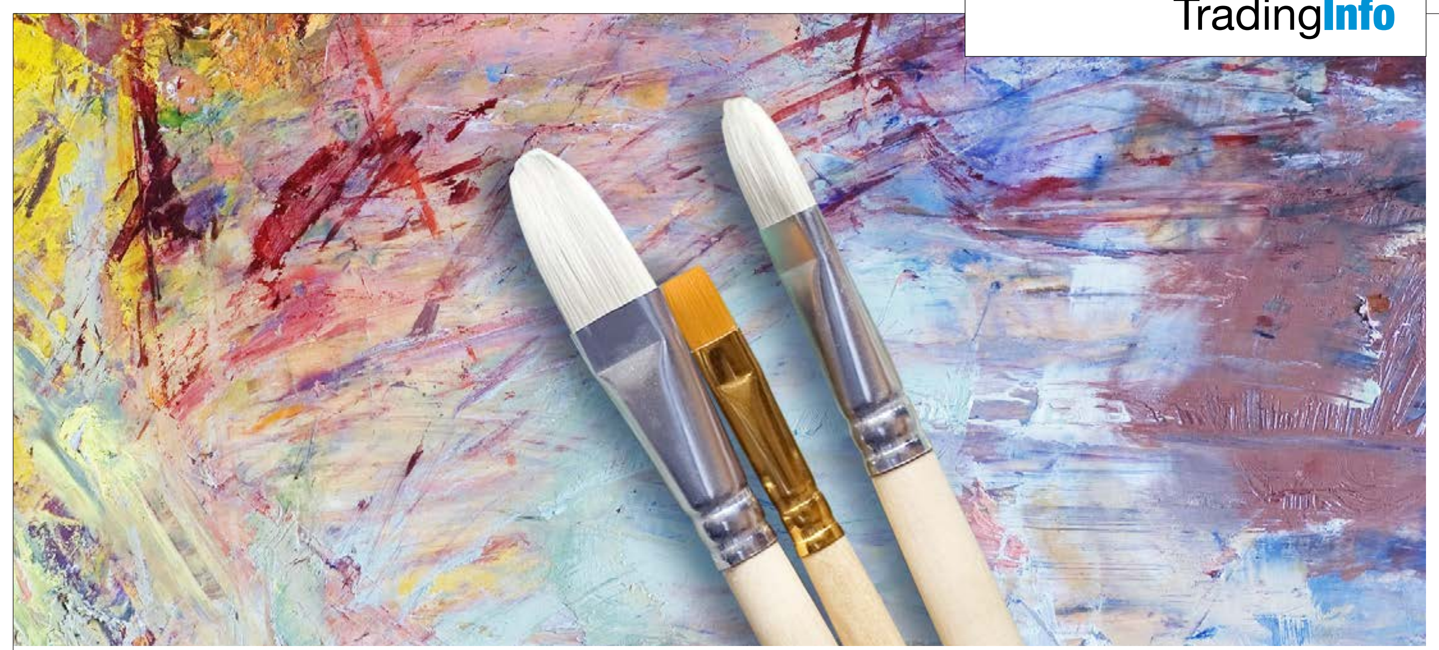
What is the state of your swaps technology infrastructure?



How would you rate your current technology systems for synthetic financing?



Martin Seagroatt
Director of marketing and product innovation
4sight Financial Software



The art of the US domestic easy-to-borrow list

The official easy-to-borrow list for your firm isn't the list you begin the day with but the list as it stands at day's end, says Rob Sammons of Anetics

According to US regulators, a broker-dealer may generate and post a list of easy-to-borrow securities for the benefit of its own customers to allow short selling in any name on the list, without the customer securing an explicit documented locate for the security prior to issuing the sell order. The theory is that any name that makes it on to the list is deemed to be readily available with a margin of adequate liquidity expected to be in excess of the day's routine short selling. How to create such a list is as much art as it is science and requires knowing your customer as well as having deep and well-known sources for inventory supply.

As a technology vendor that provides a system to a number of different brokers to generate such an easy-to-borrow list, we've found the best method starts with a round-up of all the available supply that is being shown to the desk in sufficient quantity to achieve easy-to-borrow status. This inventory should be as of start-of-day (after the night cycle), not stuff left over from yesterday. And it should be from trusted sources that have an at least close-to-average track record of being able to provide securities shown on an availability list.

From this list of potential good names we start the vetting process—the art of determining what names to remove because of risk that the item may not be available on settlement date. We start with the obvious things, such as high rebate rate on current open borrows, a look at price and current trading volume, internal compliance restrictions and threshold status, and myriad other factors. We do this as a once-a-day process, early on, and the list should be good for the day. Well, maybe.

Since easy-to-borrow status is such an important factor in so many intra-day and end-of-day processes, it would be nice to think that a stock either is or isn't easy-to-borrow for an entire effective trade date. This is important for everything from compliance reporting at end-of-day to determining the rate that gets applied in the locate and rebate allocation process. Easy-to-borrow items get one formula—premium and other items are handled differently.

The issue now is that regulators expect broker-dealers to monitor the easy-to-borrow status throughout the trading day, and if any event should occur that would alter that status, the broker must have a mechanism in place to remove the name from the list and update all locations and end-points everywhere the list may have been published. Essentially, you have to notify all of your customers and end users of the status change.

Some of our customers are even monitoring intra-day short selling in easy-to-borrow names and if the total short position is approaching the anticipated available quantity of supply, the name is removed from the easy-to-borrow list. Another event that would warrant removal is simply being unable to borrow a security in sufficient quantities to make today's deliveries. Intra-day news and announcements can prepare a desk and let it know when a stock may become tough to borrow.

We've had to modify our processes to continuously monitor on a five-minute cycle all of the events that would keep a name off the easy-to-borrow list in the first place. Should such an event occur, we remove the name from the list (keeping track of this action in a second list), republish the list to all end-point users, and send an email notification with a report showing the name or names that were removed and why. We keep an audit trail of what time the name came off the list and if promulgated by firm personnel, who the person was to trigger the action. Some triggers are systemic based on a rule or algorithm.

A firm's easy-to-borrow list used to be a sleepy little process that didn't require much attention; it happened once a day and was then ignored. That is not the case in today's US domestic trading world. The list requires constant monitoring for status change and the ability to remove any name at any time for any reason, with a corresponding method in place to ensure that all stakeholders have been notified and updated. The official easy-to-borrow list for your firm isn't the list you begin the day with but the list as it stands at day's end. **SLT**

Rob Sammons
Director
Anetics

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Messer Financial Software, a global technology company that helps you to control financing costs

Messer Financial Software, previously known as Messer Fund Services, is an award-winning global technology company providing solutions to hedge funds, asset managers, family offices, private equity funds and investment banks. We specialise in trade capture, financing cost management, comprehensive analytics and reporting from front to back office through our core product, DataCube.

Messer was founded in 2013 by Bryan Messer who was previously the CTO at Azentus Capital Management in Hong Kong. In the 17 years before that he worked in a variety of senior trading and development roles at Goldman Sachs, Barclays Capital, British Energy, Enron, and Microsoft. Messer was founded on the feedback of industry peers who were seeking a complete, comprehensive, and user-friendly solution to their financial software requirements.

At Messer, we seek to control financing costs through unparalleled, transparent management of stock borrows and loans, improved operational efficiency and accuracy in the middle and back office and automated repetitive manual tasks such as reconciliation. We provide the front office with the timely, accurate data required to manage their portfolios. We offer a modular solution in the form of our DataCube, from trade entry and order management to portfolio analytics, data aggregation and flexible reporting. Our solutions exist to enable better decision-making. Our simple, predictable pricing model allows clients to grow without any unexpected costs.

We work alongside internal IT teams to integrate with existing technologies, systems and proprietary solutions. We differentiate ourselves not only through our software but with our best in class on-going support. To that end our team of highly qualified staff are always at hand to provide their expert guidance throughout the implementation process and after sale-support periods.

Our latest solution is a stock loan and bond borrow system which industry peers have highlighted as a necessary solution needed to streamline trading activities. The system manages the entire process from short sell through to cover and return, tracking the cost and reconciling with each counterparty. Comprehensive reports show inventories, current rates and fees, changes in rates, pay-to-hold inventory and duration, as well as alerts on user defined triggers, such as a rate exceeding a threshold.

We currently have various funds who have crossed over from using spreadsheets to manage their stock lending activities to using our surprisingly affordable stock and bond borrow solution as the benefits far outweighed their costs to implement.

All of our current clients have reported huge benefits from using this system, some of which include: automated full trade life-cycle, quicker front office trading, reduced manual and repetitive effort, improved risk management, increased trading volumes, easy to understand views of positions, fast and accurate trade entry tools, and generally improved relations with clients and counterparties, just to name a few.

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- Intra-day alerting: intra-day alerts to your borrow needs as well as upcoming events such as dividend dates and record dates for relevant markets.
- Interactive dashboard: interactive web-based dashboard for booking and updating borrows, and custom reporting.

Messer Financial Software is headquartered in the centre of Hong Kong's financial district and we recently set up our new UK office in London Farringdon to help provide a better overall client experience for our UK and European client base.

Our model at Messer is very hands-on. Our consultants work directly with our clients on site throughout the implementation and post-go-live to ensure we offer the highest quality solutions and ongoing support.

We would love to schedule a stock borrow demo with you and the team to show the full capabilities of our new system and would be happy to offer a consultative session on any other fitting solutions your management firm may require.

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"Messer understood the complexities of what we were trying to achieve, worked within our existing IT and application framework and implemented a solution within the established timeline. We continue to be impressed by the speed of the enhancements and have benefitted from the savings this system's information provides."

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Is Caterpillar getting back on track?

Machinery manufacturers may suffer as the cyclical industries they rely on for their sales remain stuck in the mud, says David Lewis of SunGard's Astec Analytics

In the internet age, one has come to expect edgy and unusual names for corporations that often have no apparent relevance to their industry—I am not specifically fruit preferential, but Orange and Apple jump to mind as prime examples. On the flip side, you might expect older, more established brands to have more sensible-sounding names, like General Motors and British Petroleum. Then there's Caterpillar (CAT), a 90-year-old company with a name that seems highly unrelated to the massive yellow tracked machines and power plants they are known for across the world.

The success of Caterpillar (perhaps like its smaller insect namesake) is subject to the environment in which it lives, and that environment is not currently in great shape. The mining, metals, energy and commodities (such as oil and gas), railways, shipping and construction industries, to name a few, make up a rogues gallery of highly cyclical industries suffering in the last few years of the global economic slowdown. Reduced expectations of growth in China and their now faltering, but previously seemingly insatiable demand for raw materials and minerals means bluntly that fewer mines are being dug and fewer products are being shipped around the world.

In what some might describe as a rather curious press release, Caterpillar recently announced that it is expecting next year to be the fourth year in a row where sales and revenues are heading downwards—a trend never seen before in its 90-year history and not perhaps one you would willingly draw attention to.

However, perhaps this is Caterpillar's version of 'forward guidance', which is increasingly practiced by central banks and others not wishing to spook the markets unnecessarily. If that is the case, it seems that a press release indicating an expected $1 billion fall in revenues next year surprised enough of the market to immediately shave 6 percent off the share price and place additional pressure on similar machinery sector companies that may have already been under significant scrutiny.

Clarity of communication does seem to be a Caterpillar style, though. The chairman and CEO, Doug Oberhelman, has been clear and open about his strategic announcement and corporate restructuring, including plans to reduce the workforce by some 10,000 people by 2018 to save the company $1.5 billion in annual costs by the time it is finished. Given the demand challenges in their chosen markets, it cannot be a surprise to everyone that even giants like Caterpillar would suffer in such a downturn.

There did appear to be a number of short sellers willing to take up positions expecting a downturn in revenues and sales for Caterpillar. Figure 1 shows the balance of shares on loan, used here as a proxy for short interest, for Caterpillar as well as Japanese company Kawasaki Heavy Industries (7012) and the South Korean Samsung Heavy Industries (010140.KS).

Short interest in Caterpillar took a decisive shot upwards at the end of July, very nearly doubling overnight. On 29 July, Caterpillar closed at $77.33 a share, and after the announcement on 24 August, the shares were trading at less than $66, indicating an unrealised gain of just under $200 million for the short positions taken out on 29 July. Comparable producers in the machinery sector (as defined by MSCI GICS model) include Kawasaki Heavy Industries.

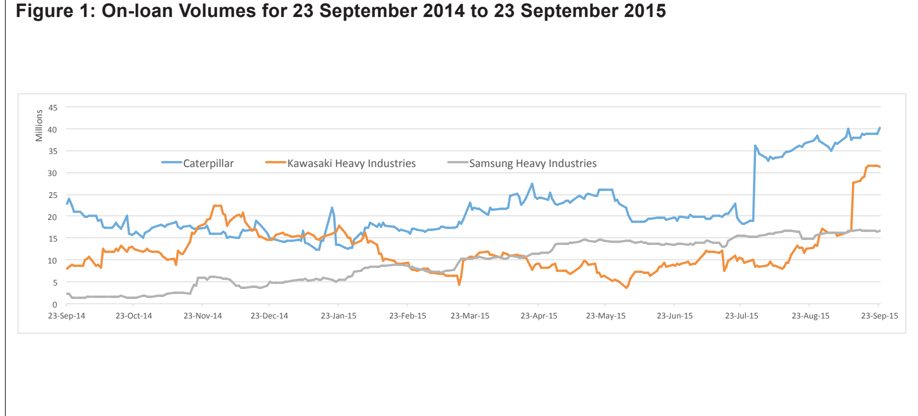
As Figure 1 shows, Samsung has seen a gradual but substantial increase in short interest over the last 12 months, with balances growing eightfold over the period. Kawasaki has been more volatile, including a similar but later spike than Caterpillar when balances rose by almost double between 10 and 18 September. Kawasaki shares have fallen RMB 18 since the extra short positions were taken out, which, at 4 percent, is a much smaller percentage loss than Caterpillar.

Looking back over 12 months, Kawasaki shares are almost level at around RMB 440, but are a long way short of the 12-month peaks seen twice this year at over RMB 635. With short interest building, it would suggest that some quarters expect a further correction in the valuation of Kawasaki somewhat in line with the fate befalling Caterpillar.

Caterpillar has been quick to point out that its market share is up, and in typically candid fashion, that its "product quality is better than it has ever been", to suggest that Caterpillar is outperforming its peers in difficult markets.

The samples taken here are not exhaustive by any means, but the data would suggest that machinery manufacturers may suffer for some time to come as the cyclical industries they rely on for their sales remain stuck in the mud. It remains to be seen whether the restructuring plan for Caterpillar is enough to help the big yellow excavators dig themselves out of the economic downturn. **SLT**

Figure 1: On-loan Volumes for 23 September 2014 to 23 September 2015



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