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European Parliament passes SFTR

The European Parliament has agreed to adopt the new transparency regulation for securities finance.

The Securities Financing Transactions Regulation (SFTR), which was proposed by the European Commission in 2014, aims to identify and quantify risks associated with so-called 'shadow banking' trades.

The regulation will have a far-reaching impact on securities lending, repo and margin lending transactions through increased reporting and investor transparency and new collateral management conditions.

Its three main features include the introduction of mandatory reporting for all SFTs, excluding those concluded with central banks, to trade repositories.

Reporting requirements will be implemented at a regional level between 12 to 21 months after the SFTR comes into force.

Investment funds must also disclose information on the use of SFTs and total return swaps to investors in their regular reports and in their pre-contractual documents.

This rule comes into immediate effect with the SFTR but existing funds will receive an 18-month grace period to amend their books.

Finally, the SFTR sets minimum transparency conditions on the reuse of collateral. Disclosure of risks and the need to grant prior consent are just some examples of what the new regulation entails.

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SEC settles six short selling cases for $2.5m

The US Securities and Exchange Commission (SEC) will collect $2.5 million from six firms that settled cases of violations of Rule 105 of Regulation M.

Rule 105 prohibits short selling within five business days of participating in a stock offering.

Such dual activity results in illicit profits by artificially depressing the market price shortly before the company prices the stock.

J.P. Morgan Investment Management received the lion's share of the fine, with more than $1 million levied against the firm.

The fine is made up of a disgorgement, pre-judgement interest and a penalty.

readmore p2

OCC's study finds strength in options users

Options users are passionate, active investors who are more likely to increase their options activity than their trading of either stocks or bonds over the next year, according to a new study by Harris Poll.

The Options Industry Council (OIC) published the results and argued they highlighted the industry's effort to educate investors about the use of listed options are generating positive results.

The OIC is the educational cooperative run by the Options Clearing Corporation (OCC).

Harris Poll conducted the 2015 OIC study of investors online from 2 February to 22 July 2015, polling 964 investors.

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European Parliament passes SFTR

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The collateral management conditions will come into force six months after the launch of SFTR.

Due to these and other conditions, the SFTR has widely been cited by industry figures as one of the EU's regulatory proposals most concerning securities finance this year.

The new rules come as part of a wider initiative by G20 leaders to ensure more transparency on financial markets following the 2008 financial crash.

European commissioner Jonathan Hill, responsible for financial stability, financial services and capital markets union, said: "Today's rules will increase transparency in securities financing markets."

"They will allow market participants to use them for financing the economy, while making it easier to monitor and assess the risks involved."

"This is another element in making our system more resilient in the wake of the financial crisis."

"I am grateful to the European Parliament, and in particular rapporteur Renato Soru, for their hard work in reaching this agreement."

Following the Parliament's vote, the EU Council will now adopt the regulation in the near future.

It wil then be published in the Official Journal of the EU.

SEC settles six short selling cases for $2.5 million

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Auriga Global Investors, Harvest Capital Strategies, Omega Advisors, Sabby Management and War Chest Capital Partners are jointly responsible for the remainder of the total fine.

War Chest Capital Partners is also barred from participating in stock offerings for a year as a penalty for repeated Rule 105 violations.

The Rule 105 initiative was introduced by the SEC's enforcement division in 2013 to address violations and promote a message of zero tolerance.

Rule 105 violations dropped by approximately 90 percent in the year after the initiative was announced, compared to the previous six years, according to the SEC.

Over 2013 and 2014, the SEC brought legal action worth $23.4 million against 42 firms.

OCC's study finds strength in options users

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Two significant trading volume days were recorded in August by OCC with options trading volume reaching 39.4 million contracts on 21 August and 32 million contracts on 24 August, marking the third and ninth highest volume days.

Options trading volume in 2014 was up 4 percent over 2013, marking the second best volume year in history and the fourth consecutive year options volume passed 4 billion contracts.

According to the study, 85 percent of listed options users consider themselves to be extremely knowledgeable investors compared to 66 percent of non-users.

Additionally, users of listed options are much more likely than non-users to use a wider range of risk management tools

This includes exchange-traded funds and investment trusts, American depository receipts, gold, and futures and commodities.

Options users are also more likely to be early adopters of new products, according to the study.

SLT IN BRIEF

"OIC's mission is to help educate investors on the responsible use of listed options," said Scot Warren, OCC executive vice president of business development and the OIC.

"Due in large part to our educational and outreach programmes, investors are becoming increasingly aware that listed options are a versatile financial risk management tool. As a result, investors' use of options has grown dramatically," he added.

"Total trading volume of listed options in 1995 was 1.1 million contracts—an amount that is surpassed within the first half hour of trading today where the average daily volume exceeds 16 million contracts."

US sec lending dwarfs next nine markets combined

The US securities lending market is nearly twice as big as the next nine largest markets combined, according to DataLend's latest report.

On-loan securities in the US were valued at $994 billion in total, compared to the next biggest market in Canada at $130 billion, as of 8 October.

The UK, Germany and France all trail on $101 billion, $96 billion and $78 billion, respectively.

Recorded fee scales also reflect this chasm with the average recorded fee in basis points (bps) in the US set at 42 bps, compared to 23 bps in Canada and 26 bps in the UK and France.

In contrast to market size, the percent of portfolios on loan by region shows that Europe actually has 13.5 percent on average on-loan, with the US fractionally lower at 13 percent. Asia is only slightly behind on 11 percent.

Globally, DataLend has valued on-loan securities at $1.74 trillion of the available $13.25 trillion of securities available in lendable portfolios.

This can be partly broken down into $907 billion equities and $830 billion fixed income securities on loan.

The consumer discretionary sector saw the most lending activity, valued at $162 billion. Information technology and financials came close at $136 billion and $134 billion, respectively.

China cuts interest rates…again

The People's Bank of China (PBC) has cut its one-year benchmark interest rate by 0.25 percent to 4.35 percent.

The PBC also cut rate of yen it requires Chinese banks to hold. The one-year benchmark deposit rate was lowered by 0.25 percent to 1.5 percent.

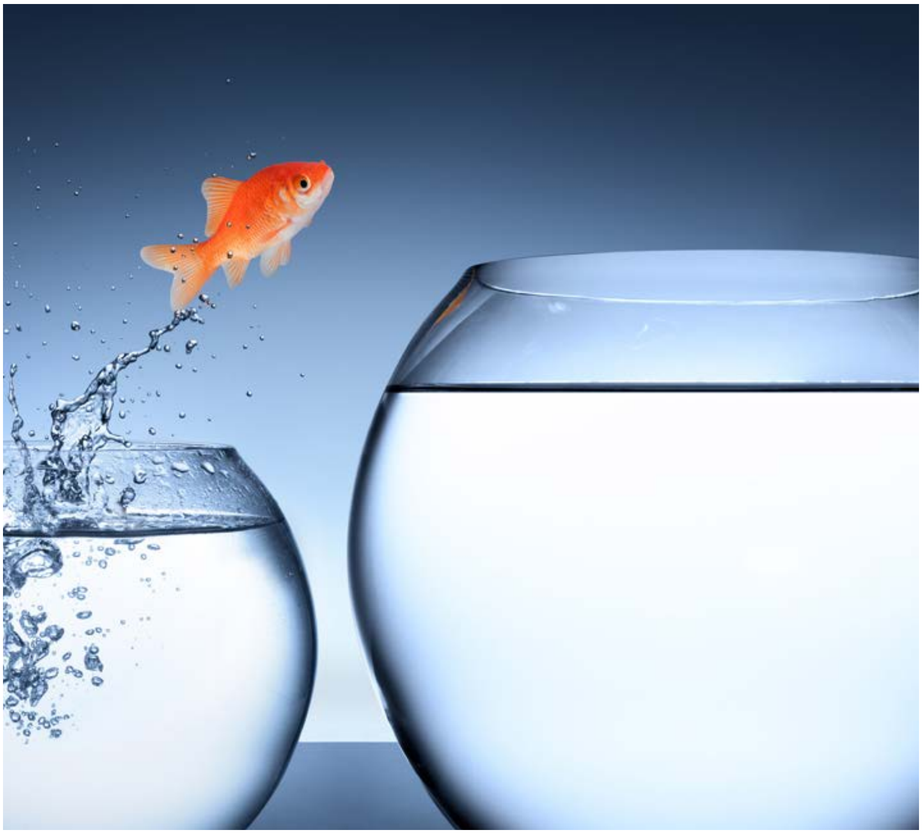
The change came into force on 26 October, but has so far failed to significantly encourage investors, according to reports.

The Chinese authorities are relying on a more liberal monetary policy to improve annual growth forecasts that have recently slipped from the 7 percent growth target.

Market analysts are predicting that cash released from these policy changes is likely to be between RMB 600 billion ($279 billion) and RMB 700 billion ($325 billion).

The move marks the sixth time China has revised its interest rates in less than a year.

CloudMargin and OpenGamma improve OTC clearing



CloudMargin and OpenGamma are joining forces to tackle clients' increasingly complex risk management needs.

The joint venture aims to assist clients with challenges arising from the central clearing obligations for over-the-counter derivatives.

CloudMargin's collateral management platform will be integrated with OpenGamma's margin analytics to provide clients with a single portal to validate clearinghouse margin calls from their clearing broker and 'what-if' tools to optimise their choice of clearing brokers and clearing venues.

Stuart McHardy, co-founder of CloudMargin, commented: "This responds directly to our clients' requests for pre-trade value add services and far more transparency around the collateralisation of their cleared derivative portfolios with their clearing brokers."

Dave Wong, head of buy-side strategy for OpenGamma, said: "As mandatory OTC derivative clearing is introduced to the buy-side, firms with OTC derivative positions will be subject to regular posting of margin to their brokers."

"The CloudMargin and OpenGamma solution will allow those firms to independently validate and understand the margin they are charged by the central counterparties."

"For CloudMargin customers, this service can be delivered without adding any overhead of systems deployment or data integration."

ETFs' AUM increasing

Domestic assets under management (AUM) for US exchange-traded funds (ETFs) have grown by 6.1 percent from August 2014 to 2015, according to a new Pershing report.

The report, What Lies Beneath: Understanding the Structure and Costs in ETFs, states that ETFs' AUM has risen from $1.88 trillion in August 2014 to $2 trillion, as of August 2015.

"ETFs have a long way to go to match total assets of their mutual fund counterparts, PwC conservatively forecasts that global ETF assets will reach $5 trillion by 2020, nearly doubling its current levels of $2.7 trillion in less than five years," states the report.

In contrast, domestic assets for mutual funds fell by 1.6 percent in the same time period.

Total US mutual funds' AUM dropped from $15.88 trillion to $15.63 trillion.

The report also analysed expense ratios for ETFs and mutual funds.

"ETF expense ratios are generally less than those of corresponding mutual funds", the report stated.

"One important reason," said Brian Brennan, vice president of global ETF product management at BNY Mellon, "is the creation and redemption mechanism unique to ETFs."

"The cost of trading the underlying securities is borne by market makers who drive the primary trading of ETFs, rather than by the actual fund."

"Conversely, a mutual fund bears the costs of trading its underlying securities itself."

"But those costs don't always stay low for long." Brennan pointed to "nuances" in certain types of ETFs that are not included in expense ratios, which can quickly add up.

"It's important to watch for those when considering more complex types of ETFs," he said, specifically mentioning leveraged and inverse ETFs, as well as master limited partnerships ETFs.

Clearstream's sec financing service dips for September

Clearstream's global securities financing (GSF) services figures showed its monthly average outstanding dropped 8 percent in September.

The combined services, which include securities lending, triparty repo and collateral management, saw its average drop from €632.2 billion to €581.3 billon between September 2014 and the same month this year.

Clearstream's GSF monthly average outstanding did increase 2 percent, from €601.7 billion between January and September 2014 to €613.2 billion in the same period in 2015.

The overall value of assets under custody held on behalf of customers registered an increase of 6 percent to €13 trillion compared to €12.3 trillion in September 2014.

Securities held under custody in Clearstream's international business as international central securities depository increased by 8 percent from €6.6 trillion in September 2014 to €7.1 trillion in September 2015.

Investment fund services (IFS) slumped 3 percent with 710 million transactions processed in September compared to 730 million recorded in September 2015.

SunGard's hottest stocks

SunGard's Astec Analytics has compiled its list of the most desirable stocks for securities lending for the week beginning 26 October.

Publicis Groupe, a French advertising group, came in first place for Europe, the Middle East and Africa (EMEA) after it slashed its annual organic growth target following flat sales in September.

Regardless, short sellers have not leapt on the news and have instead continued to cover their positions for the previous two weeks. In fact, borrowing interest in the advertising group has actually fallen by 52 percent.

LivaNova, the newly created product of a merger between Sorin SpA and Cyberonics earlier in October, came straight in at second place for the EMEA.

The first week of borrowing activity was met by a surge of interest, jumping from just 300,000 shares on the first day to about 2.7 million three days later, although "early signs already suggest this may be tapering out", according to Astec Analytics.

The cost of borrowing shares in the new entity held at 50 basis points. End of week trading saw a 30 percent drop off in volumes.

A less surprising entrant in the list is the Luxembourg-based steelmaker ArcelorMittal. Credit Suisse revised its rating from 'outperform' to 'neutral' in reaction to ongoing global growth concerns and the soft commodity market.

Borrowing volumes are up 23 percent as short sellers continue to take a bearish stance towards the commodity provider.

In the Americas, it was the well-known US logistics company FedEx that caught the markets' attention. Its €4.4 billion takeover of rival TNT was implied to be all but certain to receive approval from the European Commission, causing its share price and borrowing volumes to fall 24 percent over the past two weeks.

In second place was another major US brand, Weight Watchers International. The company enjoyed a massive boost in share price after TV megastar Oprah Winfrey publicly invested in a 10 percent stake in the dieting company. Shares doubled overnight and peaked just shy of triple the pre-announcement price.

Astec Analytics noted: “This side of the market is attempting to make money on the shares being overbought—a classic signal when a large increase in price is met by a large increase in borrowing—with the number of Weight Watchers shares being borrowed climbing 25 percent over this same period.”

In the Asia Pacific, Australian energy company Santos jumped straight to the top-spot after it rejected an AUD $7.1 billion (US $5 billion) takeover offer from investment group Scepter Partners. The offer was described as “opportunistic in nature” by the energy provider.

Santos is another victim of the soft commodities market but short sellers seemed to side with the energy provider and began to cover their positions. Borrowing volumes fell 19 percent since 6 October.

China’s Evergrande Real Estate Group reappeared in the hottest stocks list after it agreed to pay HK $7 billion (US $900 million) for a property development project in the city of Chongqing in Southwest China.

The news caused the share price to go up while borrowing volume dropped 18 percent as short sellers covered positions for a second week.

Solid as a BlackRock

BlackRock’s Q3 securities lending revenue stood firm year over year but fell $32 million below the previous quarter.

The US asset manager’s Q3 sec lending revenue was valued at $115 million, the same amount earned in Q3 2014, according to BlackRock’s latest figures.

The Q2 to Q3 2015 drop reflects the “effect of lower markets on average equity AUM and seasonally lower securities lending fees, partially offset by the effect of one additional revenue day in the current quarter”, according to BlackRock.

BlackRock’s exchange-traded funds, iShares, saw long-term net inflows of $23.3 billion, including fixed income net inflows of $18.2 billion. This represented strong flows into US treasuries.

Equity net inflows of $5.3 billion were driven by flows into European-listed iShares and reflected demand for developed market exposures.

Bond volatility affecting asset managers, says Moody’s

Asset managers are becoming more exposed to disruption in secondary credit market liquidity as investment banks reduce their exposure to volatility in the bond markets, according to a report from Moody’s investors service.

The report suggested that concern around bond market volatility means that asset managers are facing a higher exposure to disruptions through revenue and reputational risk compared to banks and insurance companies. However, these financial institutions are in a position to absorb a decline in market liquidity, the report said.

Managing director of Moody's Marc Pinto said: "Asset managers' fees are dependent on asset price levels and they could see a significant drop in revenue if there is a sustained decline in secondary bond market liquidity."

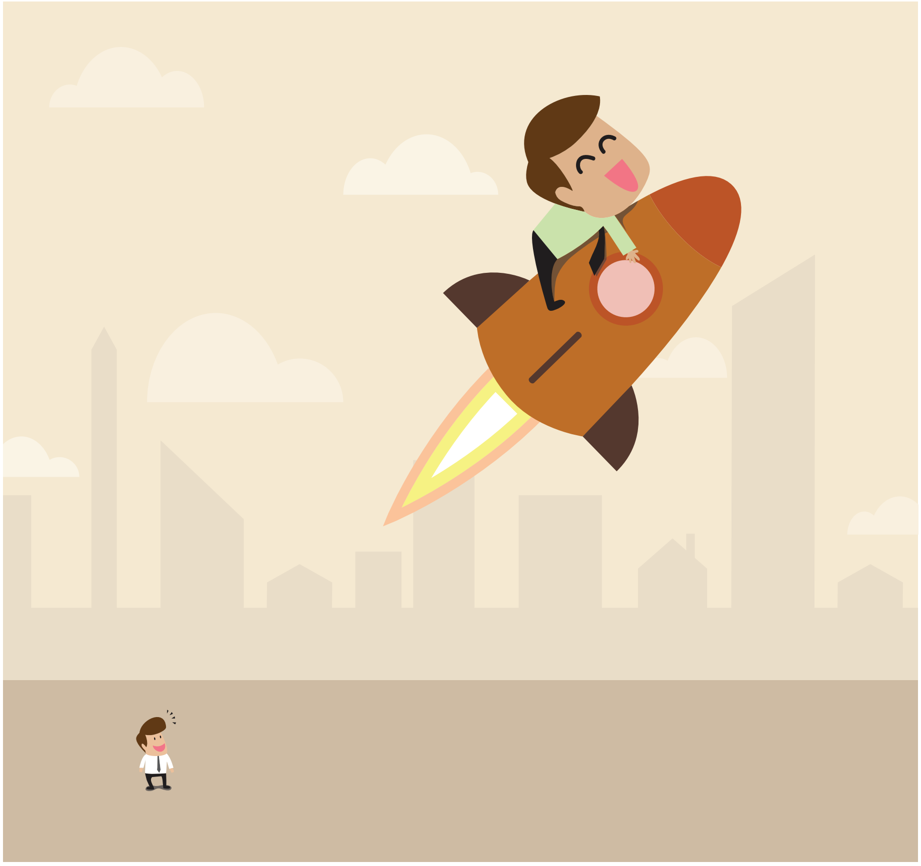
He added: "On top of that, there's reputational risk if fund structures that have to meet daily capital calls find themselves in a stress scenario with diminished ability to attract new assets and, in a tail scenario, to deliver fund proceeds."

According to the report, concerns around the bond market have been largely driven by regulations designed to reduce banks' leverage, which have limited their propriety trading and market-making activities.

As corporate bond exposures have shifted from the banking sector towards asset management, the associated risks have been passed to both institutional and retail investors. The report showed that mutual funds and exchange-traded funds currently hold about a quarter of the US corporate bonds outstanding, compared to the pre-crisis figure of 13 percent.

Pinto also noted the more recent market volatility. He said: "During the market plunge at the end of the summer, we saw irregular price-setting in the ETF market which spooked investors."

"Increased volatility in the bond market could renew those concerns and lead to anxiety about the performance of funds invested in illiquid asset categories, especially bank loans and high yield corporate bonds."



Despite this, however, the report suggested that US financial institutions are prepared to cope with secondary market disruptions. In the Federal Reserve's Comprehensive Capital Analysis and Review 'severely adverse' distress scenario, trading and counterparty losses for the five largest banks were between 4 and 5 percent of their gross market value.

NSE to launch ETF products to boost liquidity

The Nairobi Securities Exchange (NSE) is preparing to launch with exchange-traded fund (ETF) and derivatives add-ons.

The move aims to improve market liquidity and allow more local investors to play a bigger part in the market.

Currently, 70 percent of trading on NSE is done by foreign investors.

NSE will become only the second exchange in sub-Saharan Africa, after Johannesburg, to allow ETFs to be traded.

The new services expansion comes less than a month after the NSE announced plans to offer a securities lending facility to allow short selling on the exchange.

Kenya's economy has struggled this year in an environment of global market disruption.

The list of new products is part of a NSE initiative to restore investor confidence, which has dropped 17 percent since the start of the year.

State Street sees securities finance revenue fall in Q3

State Street's securities finance revenue fell 27.1 percent in Q3, although it did beat the previous year's results.

Revenue fell by $42 million to $113 million in total, representing a 27.1 percent drop-off on its Q2 figures. The bank blamed the results on "second quarter seasonality".

State Street's latest results also showed a 14.1 percent increase on Q3 2014's figures, "due to new business from enhanced custody, our principal securities lending service for custody clients", according to State Street.

Bank of England calls on ISLA to help OTC market

The Bank of England has invited the International Securities Lending Association (ISLA) to participate in a sub-group to assist with the implementation of the new term deliver-by-value (DBV) mechanism into the over-the counter market.

ISLA, as part of the committee, will help to address market concerns and participants adopt the new product. DBV is a settlement mechanism for members of the Certificateless Registry for Electronic Share Transfer (CREST).

Users can deliver a specific basket of securities to the required value from a defined set, such as conventional UK gilts or FTSE 100 equities, to a counterparty. This tool mitigates the need to detail the quantities of each individual security to be delivered.

In a statement on the appointment, ISLA stated: "The product is considered helpful in reducing systemic risk in the UK settlement system."

ISLA has requested that its members voice any concerns about the implementation. A committee term of reference will also soon be published on the ISLA website.

BCBS faces challenge over leverage ratio

A group of 13 derivatives exchanges and clearing members have signed a letter to the Basel Committee on Banking Supervision (BCBS) urging the committee to address the unintended consequences of the leverage ratio using the current exposure method (CEM).

The group includes the Options Clearing Corporation, ABN AMRO Clearing Bank, the Intercontinental Exchange, and NASDAQ, and expressed "grave concern" over the calculation for exchange-traded derivatives exposure.

The letter suggested that the application of the leverage ratio as it stands will lead to increased capital requirements for general clearing members, as well as their underlying clients.

This will threaten these business models, and affect the liquidity and stability of the European and global markets.

It argued that the standardised approach for measuring counterparty credit risk exposures (SA-CCR) would be a more appropriate was of calculating exposures for exchange-traded derivatives.

The letter argued that: "Market makers and liquidity providers perform essential services to facilitate efficient price discovery in the global markets using their own proprietary capital."

It also pointed out that these players account for anything between 25 to 40 percent of turnover on the global markets, and that they predominantly generate liquidity, rather than consuming it.

The group accepted that the BCBS leverage ratio framework and disclosure requirements intend to provide simple, transparent, non-risk based, and more credible capital calculations.

However, the letter pointed out that global regulation is leading to a over-the-counter (OTC) derivatives market that is more standardised, more transparent and more focused on mitigating systemic risk.

This has led to widespread adoption of the G20's global central clearing obligations.

The letter said: "The G20 commitments are at odds with the impact of the liquidity ratio for general clearing members and their clients, mainly as a result of the 'one-size-fits-all' approach for exchange-traded derivatives and OTC derivative products."

If BCBS stick to the current CEM, this is likely to prompt more general clearing members to exit the exchange-traded derivatives space.

The letter urged BCBS to "address the unintended consequences and shortcomings of the CEM methodology for CCP exposures by allowing the SA-CCR method as a replacement for CEM in the leverage calculation for ETD exposure," adding that the latter method provides more adequate differentiation between margined and un-margined trades, plus more recognition of netting benefits and more transparency.

It also asked BCBS to conduct more analysis in to the proportionality of the leverage ratio requirements, and to adopt a more tailored approach to different institutions and business models, saying this "would contribute to a better application and effectiveness of the leverage ratio requirements."

US interest rate hike will come in December

The first US interest rate hike is expected in December, according to the Securities Industry and Financial Markets Association's (SIFMA) Quarterly Issuance Survey results.

The survey saw 80 percent of respondents predict the Federal Reserve will raise the target rate by the end of 2015.

The remaining 20 percent suggested March 2016 was a more likely date.

Total net treasury bill, note, and bond issuance are expected to hit $166 billion in Q4 2015, according to the survey.

The target will represent 24.9 percent growth on the $132.9 billion issued in Q3 2015.

SIFMA's forecast for the Q4 issuance of net marketable debt is much lower than the Treasury's August debt issuance $270 billion estimate.

When asked about main risks on the downside (lower-than-expected yields), responses included US and global economic deterioration, strengthening US dollar, and persisting low oil prices.

Retail channels see ETF growth

There was a 7.4 percent growth in exchange-traded funds (ETFs) assets from January to 30 September, according to the Broadridge Financial Solutions Fund Distribution Intelligence.

ETF assets increased by $144 billion due to retail channels, according to Broadridge's data. Long-term mutual fund assets from third party distributors dropped by 2 percent ($156 billion), during the same period. Retail channels now represent 63 percent of all ETF assets.

The continuing collateral conundrum

The cash versus non-cash collateral debate has raged for several years with both sides repeatedly shifting position. David Lewis of SunGard's Astec Analytics examines where the debate currently stands

There has been a debate surrounding cash versus non-cash collateral for securities lending transactions for many decades. The European and Canadian models have favoured non-cash collateral while the US model was built on the premise of a highly developed cash collateral reinvestment technique—and never the twain shall meet.

Over the past few years, this geographically based twin positioning has been challenged as a result of market disruption, cash reinvestment issues and regulatory scrutiny. Furthermore, given the fact that the words 'intrinsic value' are la phrase du jour, applying it to the non-cash collateral side as well has spawned all sorts of creative approaches.

Historically, the rationale behind these divergent methodologies was quirky and driven by local nuances. For example, lending against cash in the UK until the 90s created a taxable event on any rebate paid and thus was not beneficial for any party. In the US, employment law, insurance company and mutual fund legislation and the Employee Retirement Income Security Act pushed participants more towards taking US dollar than any other form of collateral.

Consequently, it is no wonder that each method was and is still pushed and driven to find innovative ways to create additional returns either by collateral upgrading or cash reinvestment.

It's not such a common event now, but back then, every Federal Reserve interest rate change in the cash reinvestment world resulted in a day or two of frenetic activity and number crunching among borrowers—no doubt the dust was being blown off the calculators in mid-September when it was rumoured that there might be a change. It was likely a dry run for the near certainty of that happening in the short term.

That all changed in 2008. Many chickens came home to roost for cash collateral, and regulators around the world woke up to the fact that there was a whole industry based around the investment of cash collateral and the movement and malleability of certain types of securities—and they knew next to nothing about it.

Since then, the creation or use of collateral arising from securities lending transactions has undergone a wholesale change, with stakeholders in both camps, but mostly on the cash collateral side, reviewing other methods and systems. Figures 1 to 3 show how even over the past three years, there has been a global movement towards the taking of cash and/or non-cash collateral.

A point to note is that a few years ago, it was argued that just as those in the US were becoming more enamored with non-cash, so the Europeans were looking to move into cash collateral more aggressively than they had before. The data would appear to show the opposite is the case.

This change has led to the growth of a whole new industry dynamic of participants looking to outperform their rivals and peers by looking at new forms of non-cash collateral in order to argue the case that it can be used as 'good' collateral for securities lending transactions.

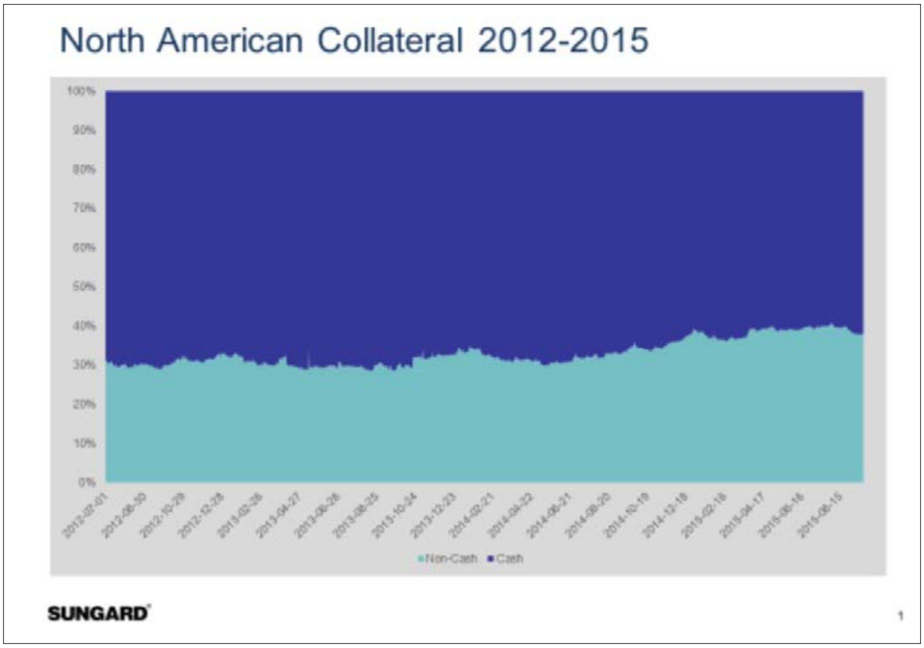
A current example of this would be the ongoing discussion surrounding the use of exchange-traded funds (ETFs) as collateral. Some argue that they are simply another form of collateral that can be used and valued by looking at the underlying securities they represent. Others argue that this has the potential for turning into another crisis of trust for the industry if something goes wrong and that the collateral is only as good as one of its individual constituents.

It is certainly the case that activity in lending ETFs has grown at a significant rate as Figure 4 shows, but their use as collateral does attract a disparate range of views. The main problem remains that if something does go wrong, there will be a large number of detractors who will be able to say "I told you so". However, this is not the case when it comes to government debt.

Lending equities against a piece of paper representing a whole bunch of other equities is not a new process. The UK money broker lending was built around participants providing a certificate representing a basket of securities to cover any daylight exposure with the market makers. This worked very well until someone asked: "By the way, how do we actually cash these things in if we need to?"

Some of the discussions around the table at the then embryonic International Securities Lending Association meetings were, looking back, exciting to say the least. The system was never the same again. We learned that we should use caution when piling layer upon layer of wrapping like a game of pass the parcel.

Figure 1



It might be good to reflect that we should be driven not so much by what we can do but rather more by what we should do. This may be corny and trite, but it does not make it any less true.

Maximising the efficient use of collateral is, of course, a necessary function, and there are a plethora of systems available to undertake this important activity. This has become even more important given the regulatory requirements for certain margins and quality of collateral to be used in differing trading situations. This means there will be a growing demand for better quality collateral in an environment where there is less to go around—hence the push to validate new forms of securities as collateral.

Furthermore, correlation of collateral to the security being lent is now argued as being the best way forward, despite years of successful and no-loss lending of equities against government bonds. This would appear to offer a good way of using in-house available securities efficiently.

Indeed, lending equities against another equity of the same country or industry with a margin would appear a logical move if it were the case that the risks of default by a counterparty were the same whether markets as a whole are rising or falling.

However, I am not aware of too many major failures occurring in a rising market situation. Certainly, a bubble can expand but it is only when it bursts that the fallout would appear to be truly threatening. To that end, it may not be so wise to have your collateral too closely correlated to the lent securities, from the beneficial owner's perspective.

Another area of difference that is underestimated by many non-cash newcomers is the necessity to monitor the collateral being held to ensure that by holding it over certain event dates, for example. You don't want to end up owing dividends or tax that would not be received by you as opposed to the collateral lodger.

There are many causes célèbres around the difficulties arising from holding Italian bonds, as an example, over record date by non-Italians. There are just as many pitfalls to holding non-cash collateral as opposed to the more sophisticated or dynamic cash collateral reinvestment system.

The history of collateral, both cash and non-cash, worldwide in respect of the securities lending industry has been one of a teetering edifice perched at the top of the rock of securities lending.

The conundrum for all, but especially for those contemplating the change from cash to non-cash collateral, is how to generate the extra income enjoyed from reinvesting cash collateral from other forms that have no intrinsic additional revenue generation capabilities. The answer would appear to be a resounding: "You don't." **SLT**

David Lewis
Senior vice president, Astec Analytics
SunGard

Figure 3

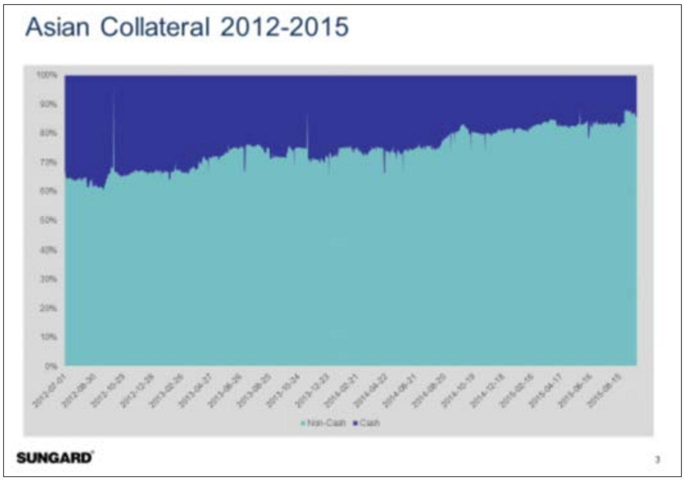


Figure 2

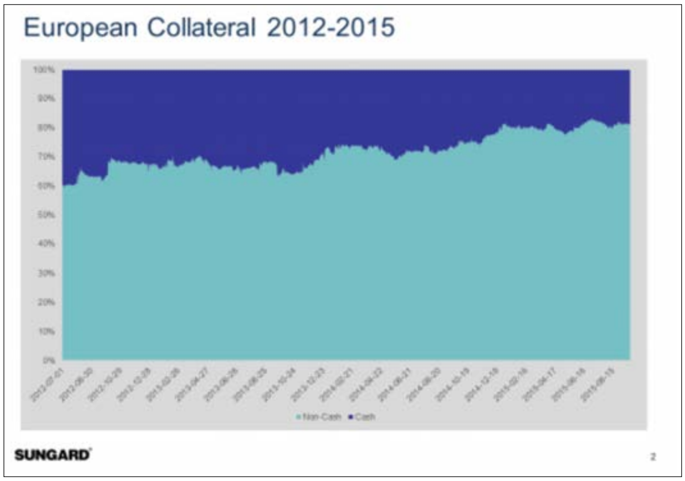


Figure 5

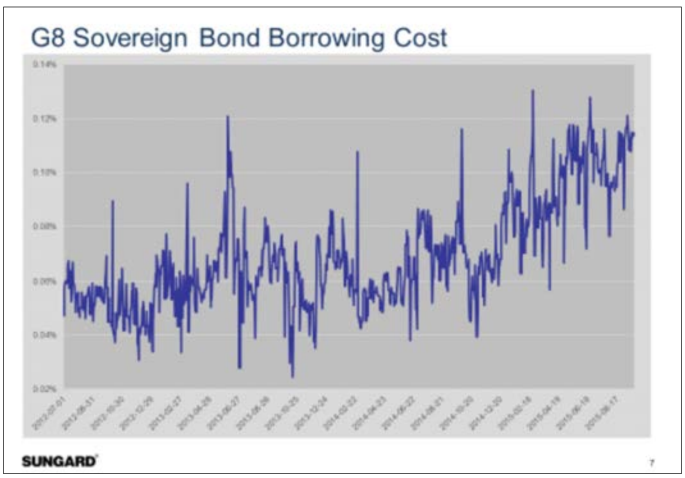
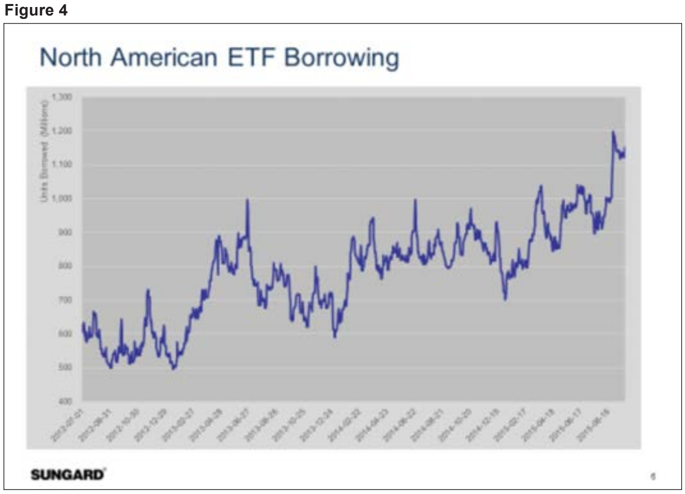


Figure 4



Between a rock and a hard place

Scott Olson of the Risk Management Association explains the Securities and Exchange Commission's reporting modernisation initiative

DREW NICOL REPORTS

What are the main drivers behind the SEC's push for investor disclosure?

As with much of the regulatory environment post-2008, the main driver here is increased transparency into registered investment companies' (mutual funds or funds) holdings and activities for the benefit of both the US Securities and Exchange Commission (SEC) and fund investors. Obviously, the thinking for fund investors, if the disclosures are properly designed, is that better insight into the mutual funds' investments, expenses, credit exposures and so on will help investors with their investment decisions.

What is it hoping to achieve and what is the timeline?

In addition to providing investors with more detailed fund information, the SEC also made it clear at its 20 May open meeting (at which the proposals were announced) that this enhanced insight into increasingly complex mutual funds will help the SEC with its regulatory oversight and policy making.

As you know, funds today report their portfolio investments but offer little insight into their derivatives and securities lending activities, which are the subject of the SEC's proposal.

As far as a timeline, as is the case with many proposed regulations or proposals, we can only guess. Assuming the SEC does not re-propose the new or amended rules and forms, we could see a final regulation in the middle of or late 2016 with an effective date perhaps 60 days after publication in the Federal Register, and a reporting compliance date a specified number of months thereafter.

The SEC's guidelines will not be mandatory, but do you predict market pressure will make them hard to ignore?

Actually, the SEC has proposed specific amendments to both rules and forms under the Investment Company Act of 1940 (often referred to as the '40 Act). Specifically, Regulation S-X under the '40 Act is amended, along with a new Form N-PORT and new Form N-CEN (along with certain other amended rules and forms).

There is, however, a new Rule 30e-3 that would permit, but not require, funds to transmit periodic reports to investors via a website.

How does the SEC's push for transparency tie in with the FSB's proposals for greater data collection? Are they similar?

That's a great question and one that has been posed to SEC officials. There is no specific tie, as the SEC's proposal is limited to mutual funds (not the shadow banking community in general) on one hand and is broader than the Financial Stability Board's (FSB) recommendations around securities lending and repo on the other.

That said, both go to data collection by regulators and we have urged consistency to both bodies. A related question is how does this SEC proposal relate to Dodd-Frank's 984(b) mandate that the SEC "promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities"?

Interestingly enough, the SEC does acknowledge DFA 984(b) in footnote 73 of the proposal and simply states that this proposal accomplishes some of the requirements for such transparency.

What sort of new pressure will this put on those affected?

Another good question and one that was addressed, I would think, in most of the comment letters submitted to the SEC. There are a number of considerations here. First, most if not all of the information proposed to be reported or disclosed is in the hands of the agent lenders today, with much of it reported to the beneficial owners or lending funds.

The reporting onus is on the mutual funds themselves (ie, the fund complexes' staff) and will require potentially significant resources in order to comply. To that end, in our Risk Management Association (RMA) securities lending committee comment letter, we urged the SEC to: (i) not require detailed loan information at the loan or Committee on Uniform Security Identification Procedures (CUSIP) level, which would effectively be voluminous and mostly useless data; (ii) narrow the definition of reportable borrower defaults (for example, don't include delays in the return of borrowed securities, or technical defaults); and (iii) to limit aggregate loan information to the top five or 10 counterparties, which would comprise the majority of the funds' exposure.

Do you feel that those affected fully appreciate the implications of the SEC and FSB's guidelines?

We certainly are aware of the implication, though the ultimate impact on us won't be known until both proposals are finalised. This is even more true with respect to the upcoming FSB's reporting and disclosure recommendations that are still being sorted out by the FSB's data expert group.

One of the biggest challenges in regards to the FSB proposals will be the consistency, or lack thereof, of the implementation by local regulators. Currently, the European regulators have proposed transactional data, whereas others such as the US seem to be leaning more to position level data.

As far as mutual funds go, the SEC's proposal certainly made them focus on the implications, but it is probably fair to say that most beneficial owners in agency lending programmes aren't at the same stage with regard to the FSB's recommendations and perhaps don't have to be if the reporting onus is placed on the agent lenders. **SLT**

Scott Olson
Senior managing director and head of industry and regulatory affairs, State Street
Trust chair of securities lending legal, tax and regulatory sub-committee, RMA

Putting the brakes on ABS for special purpose vehicles

Short sellers have not been slow to capitalise on Volkswagen's recent woes, says David Lewis of SunGard's Astec Analytics

Contagion. The interdependent nature of the financial markets. Investor risk. Unforeseen losses. I suspect that these are all things that keep regulators awake into the wee small hours, always wondering what new and potentially unexpected financial structure or special purpose vehicle pops up to ruin some poor unsuspecting investors. Looking back to the start of the financial crisis, few expected AAA-rated securitised mortgages and collateralised debt obligations to go bad when market stresses overwhelmed them.

Asset-backed securities (ABS), quickly went from near-cash liquid, high-quality securities to become one of the car wrecks of the financial crisis. They recovered, however, as memories fade and new issuance under new regulations return such assets to the near cash quality they used to have. But is there a new storm beginning to gather, where previously rock solid investments backed by assets that could be readily seized and sold should the debtors default?

The recent trials of Volkswagen and the damage suffered by the brand have been well documented and it would seem that the ramifications of the emission-cheating software debacle will roll on for some time to come. VW has very publicly paid the price of course, both in share price and on the sales forecourt. But what other horrors may be lurking under the bonnet? Less obvious to many is that Volkswagen Financial Services is the largest issuer of automotive ABS and the second largest issuer of ABS of any type in Europe.

Volkswagen Financial Services is a so-called 'captive bank'. Its purpose is to raise cash by issuing bonds to investors and lending that cash to buyers of Volkswagen cars so that those owners can finance their new vehicles. Yields on such bonds have been very low, historically, partly because the debt is secured on an underlying asset that can be taken back from the debtor and sold should they cease to pay. What helped VW in this area has been the solid re-sale values of their cars giving a relatively predictable recovery rate. Such a reliance on the value of the underlying asset effectively providing insurance against the owner's default is somewhat similar to sub-prime mortgages of a few years ago.

The numbers involved are equally eye-watering. The day after the emission scandal broke, VW sold more than €800 million of ABS backed by Spanish car loans. At the end of 2014, approximately €21 billion of VW's funding was generated by automotive ABS. VW has stated, as part of the disclosures regarding the scandal and the resulting vehicle recalls, that around €2.6 billion worth of finance contracts are linked to vehicles affected by the issue. Unsurprisingly, spreads on VW ABS have risen dramatically as risk premiums associated with them drive market concerns.

While the adverse publicity and reputational damage to VW had an immediate effect, the ABS issue is evolving like a slow moving car crash. Ironic given ABS is also the acronym for anti-lock-brakes, a significant development in vehicle safety. At the end of the driver's finance deal there is an option for a final payment to be made (often called the balloon payment) enabling the debtor to then own the car. The alternative is to hand the keys back and walk away, leaving VW with an asset to sell generating cash to pay back the holder of the ABS.

Such balloon payments and the resale value of the car are mathematically linked to the debt owing to the bond holder, who expects to be paid. It is perfectly possible that the recovered assets will be worth less than the debts owing, and if this is the case, how many owners will be opting to pay that balloon payment exceeding the car's worth? Bondholders will expect to be repaid and Volkswagen Financial Services may well be held to account for the shortfall.

This tail risk will continue to threaten VW for years to come as multi-year finance deals mature. Even if the cars are recalled and fixed, it is not certain that re-sale values will be what they were before. Short sellers have not been slow to capitalise on VW's woes. Borrow volumes in VW shares have risen dramatically, reaching a peak earlier in October in excess of twice the annual yield enhancement volume (see Figure 1).

But what of the ABS securities? Taken as a whole, borrow volumes in the various ABS assets issued by VW have risen more than 38 percent over the last 30 days (to October 23). Compare this with the global issuance across the automotive sector where, over the same period, borrow volumes have risen 8.75 percent, and it suggests that short sellers are targeting every angle of VW.

There is certainly a long road ahead for VW. While the initial shock of the emission scandal sent the shares skidding down more than 30 percent, there has been a levelling off and more recently, some elements of a recovery. However, few such issues are as simple as they seem at first, and much like the wider second hand car market, hidden problems may await the unwary investor/buyer and will keep regulators alert for the risks of further contagion in the ABS market overall. **SLT**

Figure 1: Borrow volume Volkswagen shares—January to October 2015 (indexed from January)

David Lewis
Senior vice president
SunGard's Astec Analytics

Industry Jobs

Liquidity and Collateral Management Associate

Recruiter: Bruin
Location: London
Salary: Competitive
Date: 26 October 2015

Follow the link to apply for an exceptional role opportunity with a top tier Investment Bank. To join our client as Liquidity and Collateral Management Associate, you must have strong Securities Lending experience from a comparable background.

Director – Regulatory Change – Securities Lending – Global Bank

Recruiter: Alexander Ash
Location: London
Salary: Competitive
Date: 02 November 2015

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Compliance Advisory Oficer

Recruiter: Bruin
Location: London
Salary: Competitive
Date: 02 November 2015

A leading custodian is looking for a Compliance Advisor to support the Head of Compliance and the rest of the Advisory team to assist in the risk-based compliance programmes across the business.

Graduate Software Developer

Recruiter: 4sight
Location: Edinburgh
Salary: Competitive
Date: 23 October 2015

4sight is looking for a graduate software developer to join our Application Development Group.

This position offers an excellent opportunity with an innovative and fast growing financial services technology provider, as well as experience in financial markets and business processes.

Industry appointments

Pirum has snapped up **David Sanderson** as its newest business and client support specialist.

Sanderson is a seasoned securities finance professional with more than 15 years of experience in both the lender and borrower sides of the industry.

He most recently worked in collateral management at Citigroup.

LCH.Clearnet Group has appointed **Christine Cumming** to its board of directors.

Cumming, previously first vice president of Federal Reserve Bank of New York, will join the global clearinghouse's US-based entity as independent non-executive director, effective immediately.

She will also serve as a member of the risk committee.

Prior to her appointment, Cumming held a number of leadership positions over her 35-year tenure at the Federal Reserve Bank of New York.

Jill Considine, chairman of LCH.Clearnet LLC, said: "Cumming has had a distinguished career at the Federal Reserve Bank of New York, often leading and participating in the work of a number of international financial policy committees."

"Her experience will undoubtedly be an asset to LCH.Clearnet LLC and I am delighted to welcome Cumming to the board."

The International Securities Lending Association (ISLA) has appointed two extra board members to balance industry representation.

Jonathan Lombardo of Eurex and **Matt McDermott** of Goldman Sachs were invited to join the board to better represent the needs of ISLA members.

ISLA CEO Andy Dyson said: "We are of course delighted to welcome Jonathan Lombardo and Matt McDermott to the ISLA board and feel that their different perspectives will add greatly to the new ISLA board."

The decision followed news that new ISLA board had been elected for a new two-year tenure.

Andy Krangel will remain the board's chairmen for a second term.

State Street's **Alex Lawton** was also newly elected to the board during the initial election process.

Other board members for the new term include: Aviva's Mick Chadwick, Barclay's Mark Newton, BlackRock's Stefan Kaiser, BNP Paribas's David Racca and J.P. Morgan's Duncan Wilson.

PGGM's Roelof van de Struik, Morgan Stanley's Martina Szameitatand and Unicredit's Arne Theia were also re-elected.

The Securities and Exchange Commission (SEC) has appointed two new associate directors to its clearing and settlement office.

Wenchi Hu and **Christian Sabella** will join the SEC as associate directors for risk and supervision and regulation, respectively.

Hu will oversee supervision of registered clearing agencies, which has expanded to include firms that clear securities-based swaps.

Hu, who joined the SEC in 2011, has worked in various departments, including the office of compliance inspections and examinations, and the office of derivatives policy.

Sabella will lead a team that develops recommendations for commission policy and rulemaking regarding clearing agencies, transfer agents, security-based swap data repositories and a variety of other financial market infrastructure.

Sabella also joined the SEC in 2011 as a branch chief in the trading practices and was a special counsel to the trading and markets division director from July 2013 to April 2015.

Tred McIntire will retire from Goldman Sachs in February 2016, and will be succeeded by **Mark Whipple** and **Chris Bodner**.

Whipple and Bodner will share responsibility of the Goldman Sachs agency lending programme as co-heads.

Industry heavyweight McIntire will leave the investment bank after 17 years as managing director of agency lending at Goldman Sachs.

He has been with the bank for 31 years.

Whipple, who is relocating to Boston from London, is currently vice president in the agency securities lending group.

Bodner is vice president in the agency securities lending group and is based in Boston. **SLT**

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