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Regulations are radically altering repo

Uncoordinated regulations are radically altering the short-term secured financing market, argues a new study.

The new study from the European Repo Council (ERC) of the International Capital Market Association (ICMA) shows increasing concerns that the cumulative impact of various prudential and market regulations, along with extraordinary monetary policy, could be affecting the ability of the European repo market to function efficiently and effectively.

The qualitative assessment of the current state and future evolution of the European repo market is based on interviews with bank repo desks, fund managers, inter-dealer brokers, electronic trading platform providers, agency lenders and triparty agents.

The study, Perspectives From The Eye of The Storm: The Current State and Future Evolution of The European Repo Market, argues that Basel III, which mandates risk capital requirements and ratios for leverage, liquidity and net stable funding, is the single greatest regulatory driver of change.

Each of its four components impact the repo market in different, yet cumulative ways, significantly adding to the cost of capital required to run a repo trading book.

The leverage ratio, with the supplementary leverage ratio for larger US banks, is having the most profound impact on the repo market, “to the point where repo is becoming unprofitable as a traded product”, explained the ICMA-ERC in a briefing document summarising the results of the study.

Adding to the regulatory pressure on the repo market is European Central Bank monetary policy, which has resulted in excess bank reserves, negative interest rates and a reduction in the stock of high quality collateral, and upcoming changes, including mandatory buy-ins and resolution stays.

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FSB finalises SFT proposals

The Financial Stability Board (FSB) has finalised its recommendations on increasing data reporting requirements for securities financing transactions (SFTs).

The Standards and Processes for Global Securities Financing Data Collection and Aggregation report states that the extra reporting requirements will serve a wide range of market participants and improve market transparency.

The newly finalised standards define the data elements for repo, securities lending and margin lending that national and regional authorities will be asked to report as aggregates to the FSB.

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BlackRock eases collateral levels for equity loans

BlackRock has lowered its over-collateralisation level for equity loans using equity collateral to between 5 and 12 percent.

The asset manager previously required between 10 to 12 percent, however, the new figure is still considered to be conservative for the wider market.

The additional flexibility is designed to enable BlackRock’s clients to earn additional securities lending returns in funds where there is more borrowing demand, while maintaining a conservative approach to securities lending and rigorous risk management processes, according to BlackRock.

This adjustment is the result of ongoing reviews to ensure that collateral requirements for loans are appropriate in view of evolving market factors such as volatility and liquidity, and taking normal and stress scenarios into consideration.

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Regulations are radically altering repo

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Most banks have already restructured or are restructuring their business models, according to the study, through de-risking, deleveraging, changing from a profit-centre to a cost-centre, reducing head-count, and the merging of repo desks with other funding functions to create centralised liquidity and collateral management hubs.

Many banks now even provide repo liquidity to preferred clients as a loss-leader to support other, more profitable businesses and services, according to the study.

The ICMA-ERC interviews discovered a sense among repo market stakeholders that regulators do not fully appreciate how the repo market operates, and that this is apparent in a number of regulatory initiatives, both directly and indirectly related to the repo market.

There is also concern about the cumulative burden of regulation and its cost.

"There are still many unknowns arising from both regulation and monetary policy making predicting the future evolution of the European market difficult," the ICMA-ERC summarised in its briefing document.

"The consensus views are: an expected reduction in the size of the market; an increase in the diversity of participants; a general widening of bid-ask spreads; and the ongoing merging of banks funding and collateral management functions."

"The overriding concern among market participants is that in future, although they expect the repo market to continue in some form, it may be unable to function as effectively and efficiently as it has in the past in providing liquidity and collateral fluidity to the financial system, with potential negative consequences both for markets and the broader global economy."

Godfried De Vidts, chair of the ICMA-ERC, said: "The ERC has highlighted the value of the repo market for decades and was swift to recognise the need for regulatory reform in the aftermath of the financial crisis, but this latest study clearly shows that uncoordinated measures [from] legislators, regulators and prudential authorities are radically altering the short-term secured financing market and may even compromise the success of regulatory measures such as EMIR, which depend on the fluidity and availability of collateral."

FSB finalises SFT proposals

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The FSB argue a greater detail of data reporting on SFTs is needed to detect market instability. The final standards are based on the FSB's previous August 2013 report.

The FSB's Data Experts Group developed the standards and processes for global data collection and aggregation on SFTs for financial stability monitoring and policy responses.

These standards and processes would allow the FSB to collect periodically (at least monthly) from national and regional authorities aggregated data on securities lending, repos, and margin lending.

They would also include recommendations for data collection procedures for national and regional authorities that should help minimise potential problems in global aggregates, such as double-counting.

The standards also tie into the implementation of the FSB's regulatory proposals on haircuts on non-centrally cleared SFTs.

The report sets out six recommendations to ensure the consistency and usefulness of the data collected by authorities.

The potential uses of the aggregated data are discussed and the next steps for the completion of the initiative, including a timeline for the implementation of the standards and processes, are outlined.

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The FSB has started working on the detailed operational arrangements with a view to initiating the official global data collection and aggregation at the end of 2018.

In a separate report presented to ministers at the latest G-20 Summit, the FSB valued the shadow banking industry at $80 trillion in 2014, up from $78 trillion in 2013.

The new figures were collated from data from 20 jurisdictions and the eurozone area.

While researching for this report, the FSB introduced a new activity-based ‘economic function’ approach in its annual monitoring this year.

This narrowed the focus to those parts of the non-bank financial sector where shadow banking policy changes may be needed to mitigate risks.

The first results of this approach highlight that the new activity-based, narrow measure of shadow banking grew by $1.1 trillion since 2013 to total $36 trillion in 2014.

This is equivalent to about 30 percent of the overall non-bank financial sector assets and 60 percent of the GDP of the 26 participating jurisdictions.

The FSB’s finding were presented to the G-20 Summit as part of its role as advisor on banking reform.

Mark Carney, chair of the FSB, said: “Non-bank financing is a welcome additional source of credit to the real economy. The FSB’s efforts to transform shadow banking into resilient market-based finance, through enhanced vigilance and mitigating financial stability risks, will help facilitate sustainable economic growth.”

BlackRock eases collateral levels for equity loans

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A BlackRock spokesperson said: “BlackRock’s priority in managing our clients’ assets is to act as a fiduciary, and in line with this we have adjusted the permissible range of collateral requirements for all BlackRock funds domiciled in Europe that lend securities.”

BlackRock has also removed a 50 percent utilisation limit in Europe for each fund’s net asset value, following recent client feedback.

For the vast majority of funds, removing the utilisation limit is unlikely to affect the value of securities on loan, according to BlackRock.

For iShares exchange-traded funds domiciled in Europe, the average amount lent has been less than 10 percent in the year ending 31 March 2015.

Hedge funds’ sec lending trends for October

Deutsche Bank has published its analysis of hedge funds’ securities lending trends for October.

In the US, equities rallied as funds began to unwind their positions.

Deutsche Bank specifically saw its short selling exposure decrease by 10.5 percent over the month.

The materials, energy and IT sectors saw the greatest monthly drop in short exposure.

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Aluminum, BNY Mellon and Morgan Stanley saw the greatest net addition to short exposure.

In Europe, Volkswagen's emissions scandal continued to cause waves in the market.

The vehicle manufacturer announced further cuts to Capex, which brought the attention of short sellers to Capex-dependent automotive suppliers, such as Kuka and Duerr.

M&A activity also had a major impact on the European market.

ABI Inbev concluded one of the largest acquisitions in history when it took on SABMiller and Potash Corp dropped its €41 per share offer to acquire K+S, which in particular regained a lot of its shorting interest once the acquisition deal fell through. At the same time, a number of companies that missed their Q3 earnings targets or issued profit warnings also endured significant stock decline and increased shorting attention.

In China and Hong Kong, Great Wall Motors repeatedly made headlines as its borrow rates soared to over 7.5 percent and shorting interest peaked at over 50 percent.

In conjunction with this theme, borrow interest for other automakers, such as Byd Co, Brilliance China Automotive, Geely Automobile Holdings, and CAR Inc.

Regionally in Asia, short flow was quiet around South Korea and Taiwan, although borrow returns remained in the Samsung group names.

In Japan, the Nikkei also rallied after a difficult September to finish around 10 percent up in October.

The Bank of Japan maintained its monetary policy at its meeting as Governor Kuroda bet that expanding the monetary base at an annual pace of JPY 80 trillion ($650.8 billion) will be enough to meet the 2 percent inflation target.

Taiwan reforms lending and collateral rules

The Taiwan Stock Exchange (TSWE) has amended its operating rules to make more financial products available for lending.

The reformed 'Operating Rules for Securities Business Money Lending by Securities Firms' will mean more products can be loaned by brokers to investors and also expands the types of collateral that can be accepted as part of these loans.

The new amendments came into force at the end of November.

Brokers are currently able to loan securities and commodities products such as TWSE-listed securities, general stocks listed on the Taipei Exchange (TPEx) and government bonds.

Under the new amendments, brokers will be able to lend open-end funds, futures funds, applications for shares in companies scheduled to list as an initial public offerings (IPO) or secondary public offerings (SPO) on TWSE or TPEx, municipal bonds, corporate bonds, financial bonds and spot gold products.

All of these products will also able to be used as collateral for loans except for the financing

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of IPO and SPO subscriptions for companies scheduled to list on TWSE or TPEx.

According to TSWE, the changes will enable brokers to offer more diverse services to investors who have been asking for more channels to access capital to invest in Taiwan's financial markets.

It will also increase the global competitiveness of Taiwan's brokers and support the development of Taiwan's capital markets and economy.

Short sellers surge to three-year high

Recent volatility in Asian markets is driving massive growth in demand for securities lending, according to Markit.

Interest in borrowing is up by a fifth since the start of the year, but short sellers have slightly begun to cover positions as the summer's turmoil settles down.

The financial information provider noted that short interest across Asia grew by 18 percent this year, reaching 2.7 percent of free float.

The rise of the Asian short seller is primarily driven by China's market volatility, which paved the way for short sellers to build positions in every global market.

Analyst Simon Colvin explained: "The Asian market's long-short ratio, a measure of the value of long positions sitting in lending programs to short positions, fell to a three year low during the worst of the recent volatility in late September."

"Over this low there were eight dollars of long positions to cover every short position, down from 12 at the start of the year."

"While the trend has fallen back somewhat in the last few weeks, the long-short ratio still indicates that the overall demand to sell the region's shares is very much at an elevated state."

Australia was the most shorted country thanks to its consumer sector. In contrast, Japanese short selling has seen almost no growth since the start of the year.

Hedge fund diversity grows

The virtue of hedge fund diversification has been highlighted in a new report from the Alternative Investment Management Associations (AIMA) and the Chartered Alternative Investment Analyst Association.

The Portfolio Transformers: Examining the Role of Hedge Funds as Substitutes and Diversifiers in an Investor Portfolio report outlines the specific qualities that different types of hedge funds offer to institutional investors, the main source of capital managed by the hedge fund industry today.

The report's finding are based on a 'cluster' analysis of the risk and return characteristics of the main hedge fund investment strategies.

"Some of the most experienced investors in alternative investments no longer see hedge funds as a standalone allocation but rather as substitutes for investments in equities and bonds or as investments that bring particular diversification benefits," according to AIMA.

The new analysis identifies 'substitute' strategies that could replace a long-only allocation to stocks, bonds and other asset classes as long/short equity, long/short credit, event-driven, fixed income arbitrage, convertible arbitrage and emerging markets.

'Diversifier' strategies, which are those that are particularly uncorrelated to the underlying asset class, include global macro, managed futures and equity market-neutral, according to the research. AIMA CEO Jack Inglis said: "This new paper underlines the heterogeneity of hedge funds today."

"For every type of fund, there are just as many solutions to investors' particular requirements."

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"The paper also makes it clear that the old distinctions that have underpinned portfolio construction for the last 25 years are disappearing."

He added: "Pensions, endowments, foundations, insurers and family offices are different entities, with different challenges and divergent investment aims."

"But what many of them have in common is a wish to see hedge funds as another method of investing in equities, bonds and other asset classes, rather than as a separate asset class."

Healthy growth in UK AUM

UK assets under management reached a record figure of £6.8 trillion at the end of 2014, marking the sixth successive year of growth, according to a report from TheCityUK.

The figure represents a 9.7 percent increase on the end of 2013, and a 60 percent increase on the pre-crisis peak.

Funds managed on behalf of international clients increased by 14 percent year-on-year to £2.5 trillion at the end of 2014.

The report also estimated that funds managed in the UK in the first half of 2015 increase by 4 to 5 percent year-on-year to an estimated 7.1 trillion, while the figure for the full year is expected to increase by 9 percent.

TheCityUK also reported an increase in institutional clients in the UK such as insurance funds, pension funds, local authority and pension funds, which now account for two thirds of assets under management.

Assets of retail clients accounted for £1.1 trillion, while private clients accounted for £705 billion and alternative funds, such as hedge funds, property funds and private equity funds, accounted for £700 billion.

CEO of TheCityUK Chris Cummings said: "The UK fund management industry is diverse and sophisticated, respected globally and has seen a remarkable recovery post-crisis."

He added: "We welcomed the re-launch of the Financial Services Trade and Investment Board earlier this year, and would like to see the fund management industry remain a priority area of focus for the new government."

"We look forward to continuing our work with the government and wider industry to extend the promotion of the fund management sector overseas and further strengthen the UK's position as an attractive location for international fund management."

SocGen selects SmartStream for reconciliation

Societe Generale Prime Services has chosen SmartStream's transaction lifecycle management (TLM) Reconciliations Premium solution for its exchange-traded derivatives (ETD) reconciliations and internal and external brokerage.

The Reconciliations Premium solution will be used across various departments in a bid to deliver additional risk and control points.

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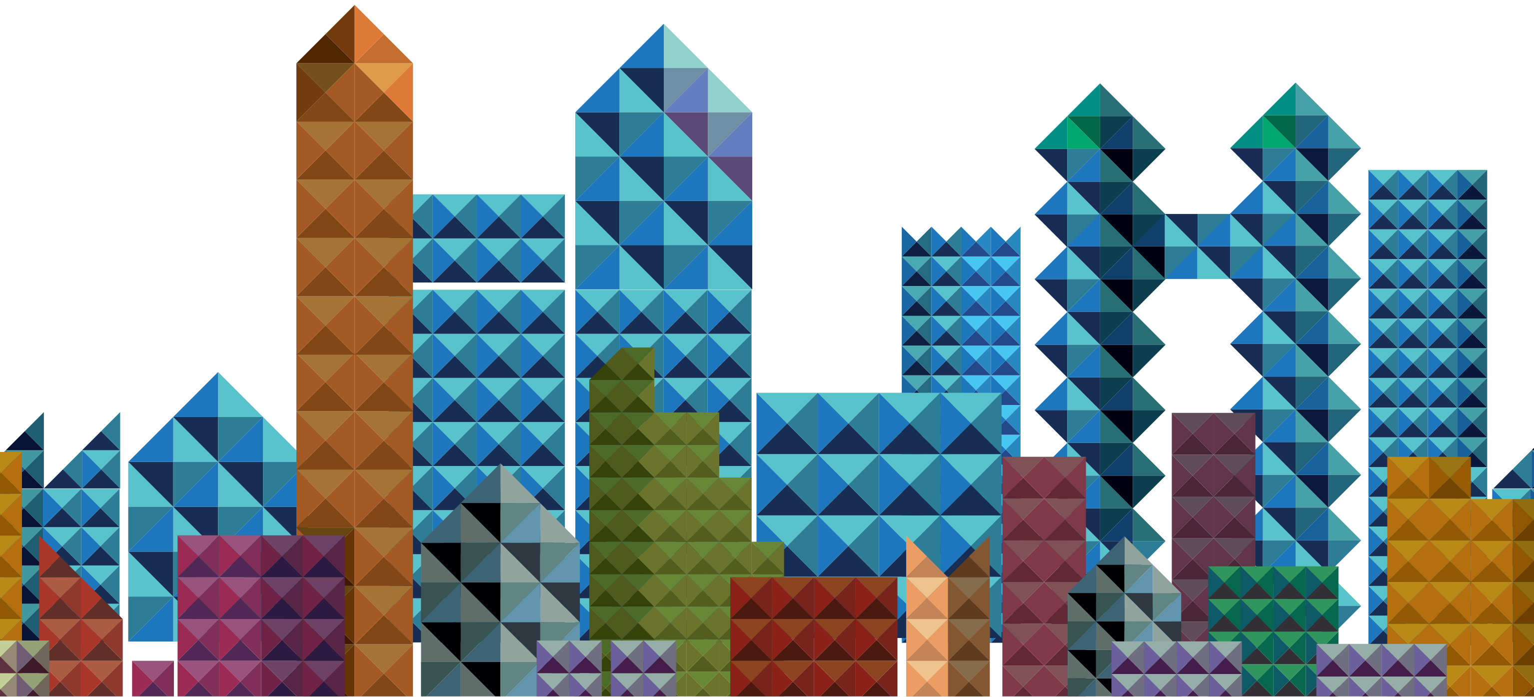

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It will be provided using a business process outsourcing (BPO) service, issued through SmartStream's Centre of Excellence.

Societe Generale will be able to directly on-board reconciliations, using SmartStream's TLM SmartRecs to make the process as fast and efficient as possible.

Mark Taylor, sales director for Asia Pacific at SmartStream, said: "Societe Generale required an easy-to-use solution with the shortest time-to-market. Following a comprehensive internal and external review, TLM Reconciliations Premium and TLM SmartRecs were selected as the optimum solutions."

Clearstream suffers GSF loss

Clearstream's global securities financing (GSF) figures for October show a 10 percent drop-off on last year's figures.

GSF, which covers triparty repo, securities lending and collateral management, reached €571.1 billion in October, compared to €636.7 billion in October 2014.

The monthly average outstanding grew by 1 percent in year-to-date October figures (€609 billion) on last year's figure for the same time period (€605.2 billion).

CUSIP requests jump a fifth

CUSIP Global Services saw a sharp increase in requests for new security identifiers in October, suggesting that there could be a surge in new corporate and municipal bond issuances over the next few weeks.

The report tracks requests for, and issuances of, new security identifiers, and acts as an early indicator for debt and capital markets activity.

October saw a total of 1,111 requests, 20 percent more than in September, and 22.2 percent more than October 2014. The jump follows five months of steady decline. Municipal bond issuers in Texas, New York and California requested the highest volume of new CUSIP identifiers in October, collectively accounting for 30 percent of all municipal bond activity.

Requests for new US and Canadian corporate equity and debt also increased by 3 percent on September, with a total of 1,755 new identifiers requested.

Overall, in October corporate CUSIP requests reached the highest monthly volume seen in 2015 so far, which was largely attributed to growth in federal agency program offerings. Year-on-year, however, corporate CUSIP request volumes still fell by 8.3 percent.

Both international debt and CUSIP international numbers declined in October, by 4 percent and 22 percent, respectively.

Gerard Faulkner, director of operations at CUSIP Global Services, said: "Several factors have driven the turn-around in new CUSIP request volume this month, including the start of the Q4 and a new fiscal year for municipal issuers."

He added: "Guidance from the Federal Reserve has also played a role, giving issuers a clearer window of opportunity to issue new debt while interest rates remain low."

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Richard Peterson, senior director of global markets intelligence at S&P Capital IQ, which manages CUSIP Global Services on behalf of the American Bankers' Association, said: "What we're seeing in the current CUSIP issuance numbers is a 'dash for debt' among US corporate and municipal issuers who are looking to raise fund ahead of an interest rate increase from the Federal Reserve."

He added: "CUSIP request volumes will be instructive as we draw closer to a rate rise, offering us an early look at how capital markets might respond in a rising rate environment."

IRS CMFs open to US firms

The Commodity Futures Trading Commission (CFTC) has approved the Global Markets Exchange Group's request to offer its products to US-based firms.

Interest rate swap constant maturity futures (IRS CMF) are now available to US firms with immediate effect directly though the GMEX Exchange. Trade confirmation and clearing of the GMEX IRS CMF takes place at Eurex, the derivatives marketplace of Deutsche Börse.

Transactions will be processed via the Eurex Trade Entry Service, which has been made available to US-based exchange participants. GMEX Exchange has signed a number of firms, including Bank of America Merrill Lynch, Societe Generale and R.J. O'Brien, to trade the contract.

Hirander Misra, CEO and co-founder of GMEX Exchange, commented: "This is an important part of our growth strategy as it enables a wider range of buy and sell-side participants to gain access to our innovative products to facilitate effective hedging of their interest rate exposure."

Kyobo Securities signs up to SunGard

South Korean securities firm Kyobo Securities has chosen SunGard's connectivity and market data solutions to help boost its global trading reach.

Kyobo aims to provide its clients with trading and execution services across multiple asset classes and exchanges worldwide, including seven major global futures exchanges.

SunGard's connectivity via the SunGard Global Network for real time market data feeds will help support Kyobo's derivatives trading by complying with the exchanges' redistribution licence policies.

Brokers in South Korea are increasingly seeking to expand their reach in global equities and derivatives markets as they have become crucial for hedging, direct trading and risk mitigation through portfolio diversification in the face of low interest rates.

Nasser Khodri, managing director, head of capital markets for Asia Pacific at SunGard, said: "To be competitive in today's trading environment, firms need to quickly find new market opportunities and be able to cost-effectively execute trades across multiple platforms, instruments and geographies."

"Our solutions provide agile technology and reliable global connectivity across asset classes and exchanges worldwide, and we are pleased to provide Kyobo Securities with the level of sophistication, flexibility and stability it needs to reach various local and global markets and help it expand opportunity for its brokers."

Brazil CCP sees boom

Brazil's BM&FBovespa reported a 48.2 percent jump in securities lending volumes for Q3 2015 compared to Q3 last year.

Securities lending reached BRL 28.2 million ($7.5 million) in 3Q 2015, representing a 4.3 percent growth in total revenues on last year's figures.

BM&FBovespa pointed to a combination of a 31.1 percent increase in the average value of

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open interest positions, and the removal of rebates (since January) that were offered to some groups of clients.

The average value of open interest positions in the securities lending platform reached BRL 40.7 billion ($10.9 billion) in 3Q 2015, a 31.1 percent increase on 2014.

BM&FBovespa has also reformed its pricing and incentives policies for its securities lending services.

Rebates were removed in the securities lending service. There was also a rebalancing of prices charged on interest rates in BRL contracts, adjustment in depository service prices and a review of prices for mini futures contracts and in 3Q, new commercial policy for market data and changes to the OTC derivatives pricing policy.

SunGard's hottest stocks

SunGard's Astec Analytics has compiled its list of the most desirable stocks for securities lending for the week beginning 16 November.

Zalando SE is a new entry that has taken the top spot in the Astec Analytics hot stocks data for Europe, the Middle East and Africa.

The German online fashion retailer saw its share price drop 13 percent after it published weak Q3 results and revised its full-year results. The company blamed rapid expansion and additional staffing costs for the poor results, which went some way to sooth investors concerns.

However, Astec Analytics noted some bearish activity from short sellers with the number of borrowed shares doubling in the past month.

Transocean once again came in second place after Seaport Global Securities downgraded from 'neutral' to 'reduce'.

Astec Analytics data suggests that short sellers in fact took somewhat of a counter position after the news, reducing their positions as borrowing volumes fell about 10 percent in the week.

In the Americas it was Canada's Valeant Pharmaceuticals that unsurprisingly took first place after several investigations were launched into its drug pricing methods.

The news immediately took 9 percent off share prices, although most of that was recovered shortly afterwards.

At the same time, short sellers have continued to build their positions with borrowing volumes up 60 percent in the past month.

Chesapeake Energy Corp, another hot stocks favourite, was downgraded by Standard & Poor's in November, causing further concern from the market. However, once again short sellers showed caution and borrowing has in fact fallen by 10 percent since the start of October.

The Asia Pacific hot stocks list was dominated by Chinese and Japanese companies.

China Mobile, GungHo Online Entertainment and Great Wall Motor Company took the top three spots respectively.

China Mobile came under the spotlight again with the news that it will be joining with the country's two other top three telecommunication operators to pool about $36 billion worth of assets to improve efficiency.

GungHo continued to gain market favour from its pending partnership with Nintendo.

But SunGard's Astec Analytics did find that short sellers have begun to take a more cynical view, with borrowing up 23 percent in the past two weeks.

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Dressed to impress

Ben Munyan, researcher for the US Treasury's Office of Financial Research and author of the report, Regulatory Arbitrage in Repo Markets, discusses his findings on the non-US repo market

DREW NICOL REPORTS

Your report focuses on how banks use repo to strategically 'window-dress' their balance sheets during certain times of the year. What do you mean by 'window dressing'?

By window dressing, I mean a pattern of adjusting behaviour to appear safer and more conservative around a regular reporting date, specifically where the dealer affiliate of a non-US bank may choose to unwind repo transactions and reduce leverage around a quarter-end reporting date, then resume normal (higher) repo activity and leverage when the new quarter begins.

What does your data reveal about the difference between US and European banks?

I don't find evidence of US banks window dressing, but there is evidence that dealers with non-US bank parents are reducing their repo borrowing in a way that's consistent with window dressing.

By combining multiple datasets, this study was able to rule out some other potential explanations for this behaviour, such as a lack of available cash or an unwillingness to lend to dealer affiliates of banks at the quarter-end.

Why don't US banks window dress?

Dealer affiliates of US banks don't have an incentive to window dress at the quarter-end because their parent bank has to report not just the quarter-end but also the quarter-average balance sheet. A sudden change in repo activity would affect the quarter-end report, but not the quarter-average.

How do the LCR and NSFR affect banks and their use of repo?

Because I observed this quarter-end pattern since July 2008, it is unlikely that the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) are driving this phenomenon.

Under the Basel framework, the LCR may be affected by a bank's judicious use of reverse repo transactions, and that may in the future complicate a bank's repo book management. In contrast, the companies achieve a quarter-end leverage ratio reduction throughout the period studied.

Why is leverage reduction an important driver for non-US banks to window dress?

Dealer affiliates of non-US banks report at quarter-end but not their quarter-average. Therefore, by reducing repo activity at the end of a quarter, a dealer can improve the appearance of the parent bank's consolidated balance sheet for the reporting date and then resume normal activity once the new quarter begins.

In the report, why do you conclude that the 'decline in repo is caused by the non-US bank dealers—not their repo lenders'?

I use a variety of tests to rule out repo lenders as the cause of this decline. In one, I use daily figures from iMoneyNet for assets under management in the US money market fund (MMF) industry to show that the magnitude of cash leaving MMFs is an order smaller than the decline in repo, so it doesn't appear to be driven by outflows from MMFs and therefore an inability to lend. If the decline in repo was caused by an unobserved (non-MMF) repo cash lender withdrawing from the market at quarter-end, we would expect dealers to rely even more heavily on MMFs for cash financing.

In another, I use monthly disclosures of MMF portfolios from the Securities and Exchange Commission's (SEC) form N-MFP to show that this does not seem to be the case. MMFs' un-invested cash holdings are actually higher at quarter-end than a typical month-end (until the introduction of reverse repo agreements, which provides an alternative overnight repo investment for MMFs).

It might alternatively be the case that the network of triparty repo lending happens to be such that only the repo lenders that provide cash to dealers with non-US parent banks are the ones that have outflows or are constrained from lending at quarter-end. This would mean that by looking at the MMF industry in aggregate I am missing out on this driving force. To test this, I use a within-investor specification to control for any investor/MMF-specific shocks that I might otherwise miss. My findings show that an individual investor's repo lending doesn't change across the board at the end of a quarter (the regression coefficient called 'Last Day of a Quarter' is statistically insignificant), it only significantly declines for dealers with a European bank parent (the coefficient for lending to dealers with a Japanese bank parent is also negative, but they are a much smaller fraction of the market than US and European bank dealers and there may be a sample size issue reducing the power of this test on those dealers).

Could it not be the case that MMFs simply don't want to lend to non-US bank dealers at the end of a quarter?

If this were the case, I would expect non-US bank dealers' cost of funding to either stay the same or increase. However, my findings show that among MMFs (again using their complete monthly portfolio disclosures), lending declines, but so does the cost of lending/borrowing, given by the repo rate.

I'll note here that for dealers with Japanese bank parents, there is no significance on the quantity of lending they get from MMFs, but a positive coefficient in the rate they receive, however, that coefficient when combined with the 'quarter-end' industry-wide coefficient still means an overall decline in cost of borrowing.

These analyses, when taken together, seem to rule out most explanations for this quarter-end decline from the side of repo lenders. That being said, I'm always interested in exploring another testable hypothesis for this quarter-end phenomenon. My hope with this research is that regulators and market participants can use the identification strategies in this paper to more effectively monitor the safety and smooth functioning of this market whenever they encounter a new phenomenon, and act appropriately. **SLT**

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The business of energy

Short sellers have made their views about the energy market abundantly clear, according to David Lewis of SunGard's Astec Analytics

There can be few products in the world for which you can say with a very high degree of certainty that demand will rise exponentially. While many products and machines, from light bulbs to cars and the smartphone in your pocket, are becoming more efficient in their consumption of energy compared to what they can achieve, there is an ever-increasing amount of them. Our net energy consumption continues to grow, largely unabated. For a producer, that must be a great industry to be in then—something everyone will always need and in ever increasing amounts. Well, perhaps not great for every producer as it depends how you go about producing that product.

The UK, along with many other countries, is having to balance the conflicting needs of a power-hungry and growing population against a dwindling capacity to produce the power it needs. We are already somewhat dependent on importing energy through gas and oil imports to feed our domestic electricity generation, as well as importing electricity itself from our closest geographic neighbours—Ireland, France, the Netherlands and the Nordics—when we have shortfalls to meet peak demands.

Getting supply from elsewhere when you cannot meet demand with your own capacity, or simply because someone else can do it cheaper than you can at that time, makes perfect sense in almost any industry, not just power production, even though the fear of energy insecurity can adversely affect a country's view of such alliances. But what if, on top of energy security issues, falling capacity and increasing demand, your own government decides to outlaw your production methods?

This is effectively what has just happened to Drax Group PLC Selby (DRX.L). Drax Group is a company of two halves: the first sources fuel and generates energy, and the second acts as the retailer selling that energy to retail and corporate clients. Drax's generation, however, relies heavily on burning coal to generate electricity, which is comparatively polluting, especially when compared with certain renewable and nuclear power generation methods. With the need to meet impending targets for reducing the levels of carbon produced across the country getting increasingly close, the UK's secretary of state for energy and climate change, Amber Rudd, recently announced that the UK's coal power stations would close by 2025. These closures form part of the strategy aimed at meeting EU emissions targets and clean air quality standards.

The announcement had an unsurprising effect on the share price of Drax Group. Losing £40 million off its market capital within 30 minutes of the announcement from Rudd reflects the fact that a significant part of the company's value had just been effectively outlawed. With reductions in subsidies for solar and other forms of renewable energy dominating the energy market headlines for the last couple of years, perhaps Rudd was looking for some positive news in announcing a strategy for greener energy in the future.

The devil, as always, is in the detail, though. This new announcement is not as earth-shattering as it might appear at first—the writing has been on the wall for dirty power generation for years, and as such coal fired power stations, with their trademark massive cooling towers, have been living on borrowed time already. Furthermore, plans already in the public domain had stated that coal-fired power would account for only 1 percent of the UK's energy demands in 2025, which may well account for the drop in Drax shares not being worse.

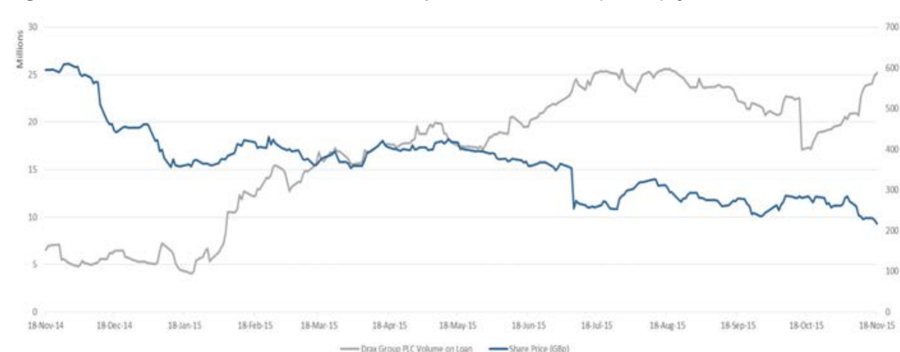
Drax has also defended itself by suggesting that it is already moving towards renewables and cleaner energy, such as using biomass as an energy source. But with the country's energy policy seemingly in disarray and a now dashed hope that coal-fired energy production would get a reprieve, it seems that this part of the industry is in terminal decline.

Looking at the borrow volumes of Drax over the last 12 months, taken here as a proxy for short interest, it would appear that the negative sentiment towards this segment of the industry is not a new phenomenon and has, in fact, been validated by the announcement from the energy and climate change secretary.

Figure 1 shows the volume on loan for Drax for the 12 months to mid-November 2015, demonstrating the quadrupling of shares borrowed over that period. Alongside this is the Drax share price. Twelve months ago, Drax peaked at £610 but closed after the announcement from the UK government at less than £220, representing a 65 percent drop over the period.

The short side of the market has made its view abundantly clear, with a renewed uptick in borrow volume over the past month, yet the outlook for this company and its future value appears to have confused other parts of the market. An analyst report published the same day as the announcement from the energy and climate change secretary gave a target price for Drax some 72 percent above its current level. In the last month, three other analysts have predicted further falls of 6.8 percent, 28.4 percent, and an upside of 20.8 percent, respectively. If I remember my physics lessons correctly, energy cannot be made or destroyed—it can only be changed. One thing is for certain, the market for it is not easily understood. **SLT**

Figure 1: Volume of shares on loan and share price for Drax PLC (DRX.L), year to November 2015



Source: SunGard's Astec Analytics

David Lewis
Senior vice president
SunGard's Astec Analytics

Industry appointments

Rob Ferguson has stepped down as president of the Canadian Securities Lending Association (CASLA).

Don D'Eramo, head of distribution and product development for securities finance at the Royal Bank of Canada (RBC), will take over the role.

Ferguson has chosen to retire as president because his primary role as senior vice president at CIBC Mellon has changed.

As well as his current responsibilities for capital markets, he has taken the helm of business development and relationship management throughout CIBC Mellon, following the retirement of David Linds.

Ferguson will remain the CASLA representative for CIBC Mellon but Phil Zywot of BNY Mellon will take his place on the board, in addition to D'Eramo taking over as president.

D'Eramo replaces Arthur Kolodziejczyk, also of RBC, on the board.

In additional, Paul Larkin from CIBC World Markets replaces Nathalie Bockler, of Societe Generale, on the board and takes over from Don Lim as CIBC World Markets's representative.

Ferguson said: "I want to thank Arthur Kolodziejczyk, Nathalie Bockler and Don Lim for their service and to welcome Phil Zywot, Paul Larkin and Don D'Eramo to the board."

"Don D'Eramo is an excellent choice for president and I believe he and CASLA will continue to represent the interests of the Canadian market participants."

Commissioner **Luis Aguilar** is set to leave the US Securities and Exchange Commission (SEC) in December.

Aguilar, who joined the SEC in 2008, served for two terms, which ended on 5 June, but agreed to stay in office until a suitable replacement was found.

A successor has now been nominated and Aguilar will formally step down no later than 5 December.

In a formal resignation letter to President Barack Obama, Aguilar expressed his deep respect for his colleagues and the commission.

He stated: "[SEC rulemakings] have involved novel and complex matters, such as securities-based swaps and other derivatives, asset-backed securities, credit rating agencies, money market fund reform, and crowdfunding, to name just a few."

"There is undoubtedly more work to be done, but much progress has been made to protect investors and strengthen our capital markets."

Aguilar is the eighth longest-serving commissioner out of 94 individuals and is one of only three commissioners to be nominated by two different presidents from two different political parties.

Global Prime Partners has appointed **Sean Capstick** as head of prime brokerage.

Capstick joins from RWC Partners where he was a member of the management committee and head of new markets. Capstick was responsible for the entire RWC Partners client business outside of Europe.

Prior to this, Capstick was European head of prime brokerage at Bank of America Merrill Lynch.

Deutsche Bank has named a new head of equities trading and two global co-heads of prime finance as part of its leadership restructuring process.

The bank has confirmed that **Rick Saunders** has expanded his remit from European head of equities to become global head of equities trading. Rob Ebert will remain head of equities for Asia.

Ashley Wilson and **Greg Bunn** were appointed co-heads of the prime finance business.

The pair will be responsible for managing hedge fund clients' trades and securities lending, as well as providing services to asset managers.

Deutsche Bank also recently named **Thomas Patrick** to run the equities business globally.

He was previously head of North American equities, which is now overseen by Brad Kurtzman, and managed equity derivatives globally, until the promotion in November.

Patrick takes over the post from Garth Ritchie, who also moved up the ladder in October to oversee all of the bank's markets businesses. **SLT**

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