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EBA finalises shadow banking and NSFR proposals for the EU

The European Banking Authority (EBA) has finalised its guidelines on shadow banking entity exposure limits and recommended introducing the net-stable funding ratio (NSFR) in the EU.

The shadow banking guidelines, which come into force on 1 January 2017, centre on the decision to allow EU institutions to set internal limits for their exposures to shadow banking entities.

The EBA hopes this approach will address, in a proportionate way, the risks that these exposures pose to the EU banking sector.

The guidelines will support institutions and banking supervisors across the EU in minimising the risks arising from exposures to entities that carry out bank-like activities outside regulated frameworks, according to the EBA.

For those institutions that do not have sufficient information on their exposures to shadow banking counterparties, the EBA will require a 'fallback approach' involving a fixed limit to all or some of these aggregate exposures.

The EBA has focused the guidelines on entities that it considers to pose the greatest risks in terms of both the direct exposures institutions face and also the risk of credit intermediation outside the regulated framework.

Shadow banking entities are defined by the EBA as entities that carry out credit intermediation activities (ie, bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities) without falling within the scope of consolidated supervision (or equivalent third-country legal frameworks).

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Markit's most shorted stocks throughout 2015

The current 20 most shorted companies saw shorts increase by 50 percent over 2015, according to Markit.

Gamestop was the most shorted company globally with 47 percent of its shares out on loan. The game retailer saw consistently high shorting interest throughout 2015, with borrowing demand only up a modest 3 percent since the start of last year.

Singapore-listed supply chain Noble Group saw the biggest proportional change in short interest over the year, which grew 120-fold over the past 12 months.

This massive jump makes the company the eleventh most shorted in Asia with 14.5 percent of its shares now out on loan.

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OCC issuing $39m refund to clearing members

The Options Clearing Corporation (OCC) will implement its approved capital plan this year, issuing a $39 million refund to clearing members and a dividend of $17 million to stockholder exchanges, and a new fee schedule marking a 19-percent drop in cost.

Both the refund and dividend will be paid in Q1 2016, following OCC's financial statements. The new fee schedule will take effect from 1 March. Shareholders' equity will increase from $25 million to $247 million.

The announcement comes after the US Securities and Exchange Commission approved the capital plan.

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EBA finalises shadow banking and NSFR proposals for the EU

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In addition, ‘excluded undertakings’, which are subject to an appropriate and sufficiently robust prudential framework, will not be considered as shadow banking entities.

Isabelle Vaillant, director of regulation at the EBA, stated: “Shadow banking has the potential of putting the stability of the financial system at risk.”

“Recent global financial crises have revealed fault lines which were previously unknown, but can transfer risks from the unregulated to the regulated banking system.”

The EBA also recommended the introduction of the NSFR in the EU to ensure stable funding structures.

In its report on the regional study, the EBA stated: “The analysis did not find strong statistical evidence of significant negative impacts of the NSFR on bank lending, financial assets markets or trading book positions.”

The EBA went on to clarify that, while the Basel NSFR standard is seen as fitting well within the EU banking framework, certain EU specificities should be taken into account such as trade finance, pass-through models, central counterparties, centralised regulating savings and residential guaranteed loans.

Markit’s most shorted stocks throughout 2015

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The 60 most shorted companies across the world had an average of 14 percent of their shares out on loan at the start of 2015. This subsequently climbed to 22.6 percent.

At the same time, short sellers seem to have given up on real estate developer China Vanke group as its short interest has halved year to date, according to Markit.

While the company still makes it on to the most shorted list, a growing number of short sellers look to be closing out their positions given that its shares have continued to climb in the last six months.

China Vanke is still the exception to the norm, however, as only seven of the 60 most shorted companies globally have seen short covering over 2015.

Markit’s data on most shorted sectors showed the favourite targets of short sellers heading into 2016 were clustered around the capital goods and energy firms.

These two sectors make up a third of the 60 firms that saw the most interest.

While these sectors were no stranger to short sellers at the start of 2015, the ongoing China slowdown and commodities headwinds have added to short sellers’ resolve given that both sectors have seen a large jump in demand to borrow in the past 12 months.

On the energy side, the most shorted firms were Noble Group, Rex Energy and Tidewater, while the favourite capital goods shorts were irrigation provider Lindsay Corp and construction firm Carillion.

OCC issuing $39m refund to clearing members

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In September 2015, the SEC issued an order to stop a delay to the plan, which was put in place automatically because of various petitions filed against it by options competitors.

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The plan allows OCC to refund about $72 million in 2015 clearing fees, on top of the $33.3 million to be returned from 2014. These figures are based on pre-tax net incomes that exceeded OCC's target revenues, including a 25 percent risk buffer.

Payment for these refunds will be made in 2016 "as soon as practicable", according to OCC. The exact date will depend on the determination that the refunds will not lead to OCC's capital base falling below its resource requirements, which currently stand at $247 million.

When the SEC ordered the end of the stay on the plan, the regulator said the capitalisation of OCC is in the public interest, and that the concerns raised by competitors did not warrant putting a stop to the plan.

Craig Donohue, executive chairman of OCC, said: "Our actions taken under the approved capital plan are consistent with the operative fee, refund, and dividend policies approved by the SEC and align with regulatory expectations under the approval order."

He added: "It will also ensure OCC has the amount of capital needed to comply with existing and proposed capital requirements."

ISC releases T+2 guide

The T+2 Industry Steering Committee (ISC) has published an Implementation Playbook to help market participants in their transition to a T+2 settlement cycle.

The playbook, developed in partnership with Deloitte Advisory, offers a detailed timeline, milestones and dependencies that market participants should consider in order to migrate to a T+2 settlement for US equities, corporate and municipal bonds, and unit investment trust trades.

The implementation period is set to be completed by Q4 2017.

The playbook was developed in response to a request by Securities and Exchange Commission (SEC) chair Mary Jo White for a more detailed implementation plan.

The playbook builds upon the white paper that was published by the T+2 ISC and outlined the high-level industry requirements and a high-level timeline for shortening the settlement cycle.

"Moving to a two-day settlement is a transformational change for the securities industry, which will also yield long-term benefits and help reduce risk for investors," said Bob Walley, principal, Deloitte & Touche LLP, in the finance and operations practice, who spearheaded the development of the playbook for Deloitte Advisory.

Tom Price, co-chair of the T+2 ISC, said: "The industry's work with Deloitte Advisory to develop the Implementation Playbook is a critical next step to help ensure that all market participants have the tools and knowledge they need to prepare their individual firms to be T+2 ready."

4sight and Pirum expand their existing partnership

Technology providers 4sight and Pirum have created a new interface between their securities lending platforms.

The latest collaboration allows users of 4sight's securities lending product to integrate with Pirum's real time post-trade automation services.

The interface is an expansion on the existing 4sight-Pirum modules, which already provides connectivity to Pirum's contract and billing compare services.

The interface is used to process various parts of the securities finance post-trade lifecycle in real time, including bilateral and triparty collateral management and for connectivity to central clearing counterparties, according to 4sight.

Martin Seagroatt, 4sight's marketing director, said: "The enhanced connectivity between 4sight securities finance and Pirum's real time service is a major step forward in increasing the automation and straight-through processing we offer to our shared clients."

"As regulatory cost pressures continue to impact the securities finance industry, reducing manual effort and operational risk through the use of technology is becoming a key way for market participants to maintain profitability."

Mark Schilling, global head of sales at Pirum, added: "While our clients are continually challenged with a combination of regulatory hurdles and pressure to reduce operational overhead and risk, they're increasingly looking for automated real time solutions to facilitate these processes."

"Working with 4sight to create a standardised interface between ourselves allows our mutual clients to access the benefits of our real time services while reducing the burden on their own IT resources."

Fed finally raises interest rates

The Federal Reserve's board has voted unanimously to raise interest rates from 0.25 to 0.5 percent for the first time since 2006.

As part of its policy decision, the Federal Reserve Bank of New York was authorised to execute overnight reverse repurchase operations at an offering rate of 0.25 percent.

The amounts available for these transactions will reflect the value of treasury securities held outright in the System Open Market Account by a per-counterparty limit of $30 billion per day.

Several industry observers noted the significance of the much anticipated rake hike but also reiterated that this was just the beginning of the next phase of the market's recovery from the latest crisis.

"We expect two further rate hikes, but Fed watching will become much more thrilling than in previous years," commented Stefan Kreuzkamp, chief investment officer at Deutsche Asset & Wealth Management.

"The Fed now controls two levers for its monetary policy: the federal funds rate and the speed by which it changes its policy of reinvesting proceeds from maturing bonds."

Kreuzkamp added that the real test for the Federal Reserve will come in 2016 and that, due to the sluggish speed of economic growth, it's not obvious when the next rate hike will come.

"Investors may well have to learn to live with greater uncertainty about the path of monetary policy. Having squeezed volatility in recent years, at least the US monetary policy is likely to have the opposite effect in the months to come."

"The Fed is clearly entering unchartered territory as it has never embarked on a hiking path in an environment with such low growth rates and never with such a bloated balance sheet."

"The fact that reserve balances of financial institutions at the central bank have grown from $15 billion in 2007 to now $2.5 trillion makes the Fed's task more difficult."

He added: "We expect no shrinkage of the Fed's balance sheet until after the first few rate hikes."

Clearstream opens CSD link in Georgia

Clearstream will open a domestic link in Georgia, becoming the first international central securities depository to do so with the country.

The link will open on 11 January 2016 and is part of a strategy to increase access to the Caucasus region and the Commonwealth of Independent States (CIS) for international investors.

It also means Clearstream will be able to offer Georgian government bonds and superannuation bonds through its partner, Bank of Georgia, which will act as local custodian and cash correspondent bank. A separate entity, the National Bank of Georgia, will be the CSD for government bonds.

The new offering will include internal free-of and against-payment settlement in all eligible currencies, including the Georgian lari (GEL). Other services include external free-of-payment settlement, custody and reconciliation, and asset servicing.

Berthold Kracke, head of business management at Clearstream and a member of the executive board, said: "The new link to Georgia is an important milestone as it marks another step in Clearstream's strategic aim to increase access for our global customer base to the Caucasus and CIS region."

"It also demonstrates Clearstream's commitment to support efforts made by the Georgian authorities and market participants to align their domestic market infrastructure and legal framework with international standards."

Murtaz Kikoria, CEO of Bank of Georgia, commented: "I am pleased that Bank of Georgia becomes the local custodian and cash correspondent bank for Clearstream and am excited about our prospects of

partnering with Clearstream in expanding its international coverage by opening a new link to Georgia."

"It is an important step forward in terms of market coverage for Clearstream and another major boost for Bank of Georgia to be at the forefront of the capital market development in Georgia."

Giorgi Kadagidze, governor of the Bank of Georgia, added: "The enabling of the Georgian link by Clearstream is a major milestone for capital market development in our country.

"It will work as a platform for European and international investors helping them to discover the Georgian market, which already features a liberal tax regime, ease of entry and exit and a leading market infrastructure."

"This was a long anticipated event and we hope to see increased activity of international investors following this announcement. We look forward to continuing cooperation with Clearstream in other areas aimed at developing the local capital market, which will bring mutually beneficial results."

OFR: threat to financial system on the rise

The level of threat to financial stability in the US has increased during 2015, according to the Office of Financial Research (OFR).

In its first annual financial stability report, the OFR revealed that credit risks are rising for US non-financial businesses and in many emerging markets.

Non-financial business debt is growing rapidly, boosting leverage and, in relation to gross domestic product, it is at elevated levels, according to the OFR.

At the same time, persistently low interest rates and suppressed risk premiums in US fixed income markets contribute to excessive risk-taking and borrowing that could pose financial stability risks.

The report noted that the financial system is significantly more resilient than it was in 2007, but it is uneven.

Vulnerabilities persist and some new ones have emerged. Financial activity and risks have migrated outside the regulatory perimeter, market liquidity appears to have become more fragile in recent years, and connections between financial firms and markets are evolving in ways that are not yet fully understood.

Central clearing of derivatives has benefits for risk management, but concentrates risk in central counterparties and may transmit or amplify stress in new ways.

Derivatives data reported to registered swap data repositories still have significant room for improvement. Further development of the framework to standardise and validate data is essential to improve data quality, according to the OFR.

Enhanced capital and leverage requirements have made banks more resilient, but they can also have unintended consequences.

The OFR's analysis shows areas where these requirements may increase incentives for risk-taking by large, complex banking firms.

The report supplements and precedes the 2015 annual report to US Congress, which the OFR will publish soon.

"Overall, threats to US financial stability remain moderate, in other words, in a medium range, but they edged higher within that range over the past year," said OFR director Richard Berner.

"We see elevated and rising credit risks in US non-financial business and in emerging-market economies, the continued reach for yield in a climate of persistently low interest rates, and the uneven resilience of the financial system."

BBH launches industry first STP interface for CME Clearing

Brown Brothers Harriman (BBH) has unveiled the industry's first straight-through processing (STP) interface to CME Clearing's collateral connect messaging protocol.

The BBH-Cleared Derivatives Collateral Management platform (BBH-CDCM) enables participants to optimise the customer collateral selection process and efficiently process collateral transfers to and from CME Clearing.

This solution expands the established collateral management services for futures commission merchants (FCMs), asset managers, and other market participants, according to BBH.

"Now more than ever, our FCM clients have expressed a need for new solutions to help them navigate new regulations and changing market dynamics, all while being responsive to increased demand for high-quality collateral, reduced costs and improved risk management controls," said Frank Perrone, head of the BBH FCM and derivatives settlement banking group.

"BBH-CDCM will help our FCM clients remain competitive with cost effective technology options that offer STP, aid in risk management, and accommodate evolving regulatory reporting practices."

Sunil Cutinho, president of CME Clearing, added: "We are pleased to work with BBH

to provide greater collateral efficiencies to the marketplace.

"BBH-CDCM provides access to CME's Collateral Connect API, which is available for all CME Clearing and CME Clearing Europe clearing firms and their custody banks, supports continued automation of collateral transaction processing, and makes it easier and faster for FCMs to substitute collateral for their clients."

Hedge fund assets up a third

Hedge fund assets under management (AUM) have increased by 34 percent in three years, according to an International Organization of Securities Commissions (IOSCO) survey.

The value of hedge fund AUM has shot up to $2.6 trillion from $1.7 trillion since the last survey was taken in 2012.

Most of this growth can be attributed to changes in asset values, net inflows and fund structures.

Some of this growth also reflects more widespread and accurate reporting across participating jurisdictions, according to IOSCO's survey.

The third IOSCO hedge fund survey captured data from 1,486 qualifying funds, an increase of 42 percent from the 1,044 funds that participated in the previous survey.

The latest survey is part of IOSCO's efforts to support the G20 initiative to mitigate risk associated with hedge funds.

The survey also highlighted other features of the hedge fund industry such as the Cayman Islands continuing to be the tax domicile of choice.

It also noted that equity-based strategies remain the most popular among hedge funds.

SEC sets new asset segregation rule for repo and short selling

The US Securities and Exchange Commission (SEC) has approved a new rule that will require funds to segregate certain assets for repo and short selling transactions.

The latest proposal will compliment existing regulation on the use of derivatives by registered investment companies, including mutual funds, exchange-traded funds (ETFs) and closed-end funds, as well as business development companies.

Funds would be limited in their use of derivatives and be required to put risk management measures in place, which would result in better investor protections.

"Today's proposal is designed to modernise the regulation of funds' use of derivatives and safeguard both investors and our financial system," said SEC chair Mary Jo White.

"Derivatives can raise risks for a fund, including risks related to leverage, so it is important to require funds to monitor and manage derivatives-related risks and to provide limits on their use."

The Investment Company Act limits the ability of funds to engage in transactions that involve potential future payment obligations, including derivatives such as forwards, futures, swaps and written options.

Funds can enter into these derivatives transactions, provided that they comply with one of two alternative portfolio limitations designed to limit the amount of leverage the fund may obtain through derivatives and certain other transactions, according to the SEC.

A fund would also have to manage the risks associated with their derivatives transactions by segregating certain assets in an amount

designed to enable the fund to meet its obligations, including under stressed conditions. A fund that engages in more than a limited amount of derivatives transactions or that uses complex derivatives would be required to establish a formalised derivatives risk management programme.

DTCC and SimCorp to deliver repo central matching service

The Depository Trust & Clearing Corporation's (DTCC) Omgeo subsidiary and SimCorp have successfully completed the first automatic live repo trade in SimCorp Dimension and Omgeo Central Trade.

The trade was between Kammarkollegiet and Nordea Bank and marks a significant milestone in DTCC's ongoing partnership with SimCorp to deliver straight-through processing to the marketplace.

Current processing for repo is largely manual. Operational efficiencies and service levels decrease as manual processes are employed, while the absence of a repo system for electronic confirmation, allocation and central matching creates an inherent risk within the post-trade environment, according to DTCC.

DTCC's Omgeo has been working with the European Repo and Collateral Council, the industry representative body and is part of the International Capital Market Association, to address these various challenges.

Matthew Nelson, managing director of global product and strategy at DTCC's Omgeo, said: "Given today's challenging economic environment, trade participants have never been under greater pressure to further mitigate risk, reduce costs and enhance operating efficiencies."

Fredrik Waesterberg, who is global head of settlement at Nordea Bank, said: "With Omgeo CTM, we can match trade fundamentals with our trade counterparties, such as Kammarkollegiet, for the open and close legs of our repo agreements on trade date using a single trade ticket, ensuring terms of the deal are clear to both of us."

"Furthermore, Omgeo CTM keeps open repo trades available for re-matching, which allows us to make subsequent changes to our repo trades."

"DTCC Omgeo and SimCorp are active voices in this particular field, and we look forward to working with them on this and future projects."

SEC approves new post-trade matching service for the US

SS&C Technologies Holdings has received approval from the Securities and Exchange Commission (SEC) to bring a post-trade matching service to the US market.

SSCNet is a cloud-based product that aims to offer an alternatives service for investment firms in the US as they prepare for moves to a T+2 settlement cycle, according to SS&C.

It will provide a real-time interface for transmission of matched institutional trades from SSCNet directly into Depository Trust & Clearing Corporation (DTCC) for clearing and settlement.

Bob Shaw, director of SSCNet, said: "T+2 strategies can't be developed in isolation, and it's essential to have interoperability between countries."

"With direct access to DTCC and the Canadian Depository for Securities, SSCNet will offer market participants a giant leap forward towards T+2 settlement for all eligible equities and fixed income trades," added Shaw.

Adapt to thrive

Clearstream's global head of GSF sales and relationships, Pascal Morosini, explains what the Clearstream GSF Summit will offer attendees this year

This year is the twentieth Clearstream Global Securities Finance Summit. How are you marking the occasion?

As it's the twentieth event, we're going to shape the agenda a bit differently to celebrate the anniversary. The first session, 'Milestones and Memories', will highlight some key points from when the summit first started and will recall the beginning of the repo market. We want to look at the golden years of booming activity between 2000 and 2007, before the sub-prime crisis, as well as what has happened since. In this opening session, I will be welcoming nine industry experts to talk about these different periods. It will be interesting to hear about market experiences in the words of people who worked back then. We are not publishing the names of these panellists, but they're all people who have been in the securities finance industry for a long time

What else can the delegates expect from this year's agenda?

We aim to give a deeper analysis into what is to come for those in the securities finance industry. At Clearstream, we do not rule out that there could be a disruptive time ahead as we are facing big changes to our current environment while still absorbing the aftershocks of the last crash.

Following our opening session, we have a European regulator who will discuss all the regulatory changes that have occurred in 2015 and that will hopefully lead to a discussion about their effectiveness. Of course, much of the agenda reflects the context of the regulatory timeline that our industry faces in 2016 and we will pose a question around whether we have achieved our goals with regard to regulation, or whether we need to go further.

We will also show what the entire Deutsche Börse Group can offer the industry through the many entities and business areas it now has under its umbrella. Representatives of 360T, which the group recently acquired, Eurex Repo and Eurex Clearing will join Clearstream staff on stage to explain how we are much stronger together.

Technology is another major driver of the changes happening now and, going forward, it will to continue to impact the way we do things. Therefore, it's appropriate that we will have our first ever session on how technology is affecting the securities finance business specifically. New innovations, such as blockchain, are good examples of the disruptive technology that we must explore because it will affect how we have traditionally conducted our business.

New technological developments require that we constantly review our model—although it has been very robust so far, including through the financial crisis. But resting on our laurels isn't enough.

There will also be an opportunity for the panellists to discuss how a depressed repo market will operate in the future and outline their predictions on where the market is headed.

Is there anything you're personally interested in being discussed at this year's conference?

I'm eager to hear how my colleagues think the securities finance industry is going to evolve because, as I mentioned, the level of disruption we have to deal with is only increasing. In particular, the industry is facing a number of qualitative easing initiatives being implemented by central banks throughout the world and these are having an enormous impact on global securities finance markets.

I would also like to see an end to the ongoing debate on the collateral cliff, or shortage, that has concerned some people in our sector, because I do not see this as a problem for the market.

The European Market Infrastructure Regulation for uncleared over-the-counter derivatives comes into force in September 2016 and I believe there will be enough liquidity in the system to support it.

On top of this, there are more people than ever before who, if the price is right, are now prepared to unlock the potential of the collateral they have been sitting on. And, of course, I will be very interested to see how our securities finance industry will develop in order to provide the services the financial industry needs.

Will there be an opportunity to discuss how Europe fits into a wider picture of the global securities finance market?

Yes, our markets are interlinked and many of our customers work for companies in multiple jurisdictions, so we are always conscious of the global scope of the securities finance market.

On the second day we have an economist who will be speaking in depth on the interlinked nature of the markets and that will allow us to touch upon other regions.

Additionally, we will again be running the same format of conference in Hong Kong and Singapore in April with an Asian focus so that allows us to leverage the agenda of our summit in Luxembourg.

What do you mean by disruptive technology and regulation?

We must all continue to develop and adapt for our industry to remain profitable. We do not have the luxury any more to continue with the same recipe of doing the same transactions with the same counterparties.

Many trades have lost their value and we need to re-evaluate which counterparties we are working with. For example, if we need to adapt from trading with banks to corporates, then we have to figure that out and make the necessary changes soon.

Regulation is disruptive because people experience it every day as part of their business and it means that they can't do certain transactions with traditional counterparties any longer. But if they are creative they may be able to transact in a similar way with new counterparties.

Technology is also disruptive because, more than ever, we are confronted with an industry that has to embrace new tech in order to remain competitive. In short, it's disrupting the normal day-to-day business.

However, it can only bring a lot of disruption if the industry doesn't adapt to it. Now is the time for the securities finance industry to consider whether we can realistically resist the likes of blockchain. Instead, should we master it?

It should not become a source of fear because it's not necessarily a bad thing, but many people will certainly have to make changes. In some cases, the core of our products may be able to stay the same but we will have to change who we market them to and who we work with to make them viable.

I see a bright future for our industry if we can tackle the challenges of the current market. **SLT**

Regulation is disruptive because it means people can't do certain transactions with traditional counterparties any longer. But if they are creative they may be able to transact in a similar way with new counterparties

Pascal Morosini, global head of GSF sales and relationships, Clearstream

FTT to miss latest target

The industry will be pleased to hear that the little regulation that shouldn't has stalled

The European financial transaction tax (FTT), which could affect 65 percent of the European securities lending market, has been kicked into the long grass for yet another year, despite some progress being made over 2015 in confirming new details.

The participating member states have missed multiple deadlines for agreeing the terms of the tax but are now aiming to reach a final agreement by the middle of 2016.

The FTT, when it is finally realised, is aimed at recovering some of the taxpayer's money used to support struggling banks, while also restraining risky trading and go some way to streamlining the various existing charges already in place in several EU member states. However, the existing terms of the tax have the potential to inadvertently cripple auxiliary finance industries such as securities financing, according to several figures within the industry.

This year has seen a number of key developments in the FTT's development, including a proposal to introduce exemptions for repo trades, government bonds and market makers, along with a lessening of the tax's impact on pension funds.

The FTT continues to garner significant controversy from different camps within the EU who claim that the nature of the tax threatens to negatively effect different EU states.

The International Securities Lending Association (ISLA) commented in September 2015 on the lack of a definitive exemption for securities lending, stating: "Applying an FTT to securities lending transactions would result in a large reduction in securities lending activity in the countries affected as the economics of these short term, low risk and return transactions, would be dwarfed by the tax. This would have very negative implications for the functioning of the wider financial markets, and for the successful delivery of a European capital markets union."

Institutional investors in Europe earned approximately €3 billion of revenue from lending their securities in 2013. It is estimated that €2 billion of revenue would be seriously at risk if the FTT is implemented on securities lending transactions, according to ISLA.

Last year's controversy came to a head in December when Estonia refused to sign up to the latest terms of the tax and eventually pulled out of the initiative altogether, claiming the tax would do more harm than good for its economy.

The latest update came on 8 December with a provisional version of the tax was produced—notably the confirmation or dismissal of any exemptions remained elusive. Although the EU Council did concede that, in order to sustain liquidity in illiquid market configurations, a narrow market-making exemption might be required.

In its report on the meeting, the EU Council stated: "In its proposal, the commission did not foresee an exemption for market making activities. However, from the start of the negotiations in council the need to include such an exemption in the future FTT was raised and extensively discussed."

"In its meeting on 25 November 2015, the working party focused on the definition of market-making activities that could potentially be exempted. Should such an exemption be part of a final compromise on the FTT, a suitable and operational definition would have to be designed, which would not hinder efficient administration and collection of the FTT."

"For example, it could be considered, whether it is technically feasible to foresee that such a specific exemption, designed solely for FTT purposes, could be narrowed down to, for example, illiquid markets."

Regarding shares, the parties agreed that all transactions including intra-day should be taxed and all transactions in the chain should be taxed, except agents and clearing members (when acting as facilitators). It was agreed that the territorial scope of the tax should follow the European Commission's proposal for both derivatives and shares transactions. However, it was not confirmed whether it is more sensible to start taxation with only shares issued in the member states participating in 'enhanced cooperation'.

The taxation for derivatives should be based on the principle of the widest possible base and low rates and it should not impact on the cost of sovereign borrowing, according to the EU Council, while, for option-type derivatives, the tax base should preferably be based on the option premium.

Despite noteworthy progress being made, the negotiations between 11 EU member states temporarily stalled in early December when Estonia refused to sign the latest version of the FTT. Estonian representatives claimed that the current terms of the FTT would actually disadvantage their economy by incentivising traders to leave the country while bringing in very little revenue due to the fact very little of its trades would be eligible for tax by the Estonian regulator.

The remaining 10 member states—Germany, France, Italy, Austria, Belgium, Greece, Portugal, Slovakia, Slovenia and Spain—have since signed up to the 8 December agreement and made further progress.

"Following Estonia's withdrawal, 10 member states are currently participating in the enhanced cooperation procedure on the proposed directive, with all member states participating in the discussion," reported the Luxembourg government, which held the EU Council presidency.

Valdis Dombrovskis, vice president for the euro and social dialogue at the European Commission, stated: "The ministers of the 10 member states had reached an agreement in principle and I believe that the details should be addressed before the summer."

"The commission will offer its support in order to translate this agreement into legislative terms and will ensure that the text complies with EU and international law, in particular with regard to the rights of member states not participating in the FTT."

Dombrovskis also stressed that the future FTT must comply with measures at a European level, particularly the banking union.

There are still several key aspects of the FTT that need to be addressed if even the revised 2016 deadline is to be met. The issue such as whether the 'issuance' and 'residence' principles could be combined in defining the scope of the future FTT has already been subject of an extensive exchange of views at the EU Council.

There have also been concerns raised by non-participating EU members that the FTT should not "go against the interests of non-participating member states". **SLT**

The opposing forces are strong with this one

France's institutional investors establishing discretionary securities lending programmes are benefitting from increased levels of control and flexibility

It's been topsy-turvy year for securities lending in France, with regulations unbalancing balance sheets, low interest rates skewing seasonal trends and pan-European issues from tax to Target2-Securities (T2S) making waves throughout the continent.

According to DataLend, France has seen a significant drop in securities lending revenues over the last 12 months, with a particularly poor start to the year. Q1 saw a 45 percent drop in revenues year-on-year, while Q2 registered a drop of 38 percent.

Despite an 11 percent uptick in Q3, towards the end of Q4 things were looking less promising, with DataLend predicting another dip of at least double-digits at the time of writing.

The data provider did note that this is not out of line with the rest of Europe. Spain, Portugal, Belgium, the Netherlands and Greece all experienced similar downward spirals. In Europe, as of mid-December, securities lending revenues were down 19 percent, reaching $2.61 billion in 2015, compared to $3.23 billion at the same time in 2014.

David Lewis, Europe, Middle East and Africa head of Astec Analytics at FIS, doesn't see anything unusual in the year's activities, saying instead that the trends have "perhaps confirmed expectations for France and indeed other European nations".

He adds: "Equities have followed a very typical pattern, seeing the European dividend season boost between April and June with the well-known September late-paying stocks adding their own blip later in the year."

John Arnesen, global head of agency lending at BNP Paribas Securities Services, adds that, along with most European markets, securities lending in France has been affected by various opposing forces. He says: "Due to the prolonged period of low interest rates in Europe, asset owners have been focusing more than ever on investment solutions that generate incremental revenues on their assets, and securities lending continues to offer a balanced risk-reward solution for generating investment alpha."

According to Arnesen, an increase in loan balances has been driven mainly by a demand to borrow fixed income securities, particularly French government bonds, which are categorised as top-tier high-quality liquid assets (HQLAs) under Basel III. As HQLAs, they're in demand among those banks and broker-dealers looking to satisfy their regulatory obligations.

And this will only increase in 2016 as liquidity requirements come in to effect under Basel III, mandating that banks must hold enough unencumbered HQLAs in stock to cover their net outflows in case of any 30-day stress period.

Arnesen predicts an increase in the number of asset owners looking to securities lending as a means of generating additional income on their assets. Equally, asset managers will gradually enter back into the market as they adapt their strategies to comply with the new requirements. He says: "Asset owners are looking at securities lending as a means of generating additional incremental income on their assets, due to the continuation of the low interest rate environment in Europe."

According to Arnesen, although European trends and regulations will have an effect on the French securities lending market, the impact will not necessarily be a negative one. Instead, he points to France's relatively liquid capital markets business, saying: "Securities lending activity is important to the continued liquidity that is key to market participants."

He explains: "Although we are witnessing a continuing trend towards tax harmonisation across European markets, institutional investors establishing discretionary securities lending programmes are benefitting from the increased level of control and flexibility they have over their programmes, while at the same time tailoring their programmes to deliver upside revenue potential from all available trade opportunities."

At the same time, Lewis points out that, as of 2014, France was the third largest economy in Europe, only smaller than Germany and the UK. Therefore, he argues, France is more likely to affect trends in the rest of the continent, rather than the other way around. He says, however: "Having said that, the profiles of both fixed income and equity activity in France are similar to those we have seen in Germany through 2015."

There are several regulations on the not-so-distant horizon, both in France and EU-wide. As Lewis notes: "All market participants need to be cognisant of them".

He highlights the Markets in Financial Instruments Directive (MiFID) II, with its best execution and reporting obligations, and the Securities Financing Transaction Regulation (SFTR), with its trade reporting and transparency rules.

"Exact details of who should report what remain unclear." says Lewis. "There are many other regulations that directly and indirectly affect the securities finance market, but as a data, analytics and reporting provider, MiFID II and SFTR naturally bubble to the top of our interest list."

For BNP Paribas, Arnesen says, 2016 will be about fine-tuning its lending offering for asset managers in France, "to help them reach their lending objectives while becoming compliant with [financial markets regulator] AMF's regulation". He adds that BNP Paribas will "continue to invest in [its] technology infrastructure and expand [its] reporting capabilities in line with varying client requirements".

But Lewis suggests a change in trading strategies across the board. He predicts efficiency will be "the name of the game", with large-volume, low-value trades becoming more automated and higher-value trades remaining on the more manual side. "However, the ability to customise a trade to suit ever more specific needs does not preclude the need for extensive technology and automation, quite the opposite."

To structure a trade, Lewis says, whether through a total return swap, a stock loan or repo, market players will have to manage their data and analytics more efficiently than they manage trading desks today, and therein lays the challenge. He says: "2016 and beyond will bring the need for multiple trade disciplines with balance sheet and collateral management all working together in real-time. This will be a significant challenge for our industry." **SLT**

The centralisation game

Experts discuss the progress that has been made in collateral optimisation

Should securities lenders and borrowers be making more effort to optimise their collateral?

Paul Wilson: The approach by lenders and borrowers will likely have different starting points and potentially different objectives, but will be built upon the same principles. Lenders are generally looking for the highest quality collateral, with decent haircuts and high degrees of liquidity so that it can be readily liquidated in a stress situation. Traditional lenders seldom re-use collateral from securities lending transactions. Thus, there tends to be a greater emphasis on collateral eligibility. On the other hand, borrowers view the provision of collateral as an expense and are therefore generally focused on minimising that cost and optimising assets.

A collateral management provider can help lenders and borrowers more efficiently and effectively manage their collateral requirements. This highly complex business requires sophisticated optimisation capabilities and a custody agnostic solution to be truly effective. J.P. Morgan has built its collateral management business based on these principles. Our global model allows an entity to incorporate a broad spectrum of assets to be used as collateral, alongside its obligations, across markets.

Gerard Denham: All securities lending participants should be looking to optimise their collateral in the current and future market conditions given the drive towards more effective use of capital and greater efficiency. Lenders need to analyse their existing collateral schedules, their collateral management systems and processes to determine if the collateral is being allocated and used in the most efficient and effective way.

Borrowers, in addition, to re-examining all internal systems and cost parameters need to analyse their downstream processes and service providers such as triparty agents, central counterparties (CCPs), account structures and vendor solutions in order to determine how their collateral usage is optimised to reduce costs and improve efficiency while satisfying their clients' requirements.

Martin Seagroatt: There is a measurable return-on-investment in pledging cheaper to deliver collateral and also in operational risk considerations. It is important to start with the basics—centralising inventory and exposures, electronically mapping legal agreements and assigning a cost to collateral assets. From there it is then possible to pledge cheapest to deliver collateral. This offers many of the easy to achieve benefits of optimisation, and from there a decision can be made on whether implementing more advanced algorithms is worth the investment in additional spend on IT and resources.

Bill Foley: Collateral optimisation can offer many benefits to all market participants and I'm sure that a number of borrowers and lenders consider that they are already making optimal use of collateral. That may be determining what collateral is acceptable to them and what, if anything, they are able to do with it, or ensuring that when they are posting collateral they do say in the most efficient way.

I think it is vital, though, to expand this thinking beyond just securities lending activity and capture the many other ways in which assets if all kinds can be utilised across an organisation in an optimal way. Taking a holistic view across an organisation's collateral and financing needs, understanding the value of all the inventory available to best meet those needs, and then appraising all the opportunities available to further utilise that inventory, can improve liquidity, reduce risk, reduce costs, generate revenue and help avoid the inefficiencies created by taking a more siloed approach.

Helen Nicol: Today's constantly changing regulatory environment creates demands on collateral across all business lines. As a result, organisations need to review their collateral strategies and look to maximise efficiencies, reduce costs and automate end-to-end processes.

Securities lending is widely recognised as playing a vital function in today's global capital markets by improving market efficiency and liquidity. By reducing fragmentation through the consolidation of inventory across all positions, improved access to liquidity sources and collateral pools can be achieved.

> ***There tends to be a greater emphasis on collateral eligibility***
>
> **Paul Wilson**, managing director and global head of agent lending product and portfolio advisory, J.P. Morgan

Lenders need to realise the full potential of their portfolios, benefit from securities that are re-callable immediately, obtain close-to-market cash rates, maximise income, and maintain controls. Borrowers are striving to reduce the risk of failures and ensure securities coverage, efficiency and quality are maintained.

Good collateral is not necessarily always the cheapest—availability, opportunity cost, eligibility and sufficiency also need to be taken into account. Active portfolio management is therefore critical for optimisation.

Karl Wyborn: Most institutions would accept that they are nearer the beginning than the end of their 'optimisation journey'. This said, it is axiomatic that the benefits of optimisation are governed by the law of diminishing returns. For any given portfolio, the maximum benefit will be constrained in somewhat by the size of the collateral pool and the range of acceptable collateral. The amount of effort that is 'appropriate' is therefore correlated to the variables. Simply being able to view all available collateral in one location and have the flexibility to switch between cash and securities where necessary would represent a good first step for many institutions.

Etienne Ravex: Securities lending plays a key role in financial markets by providing liquidity for trading and settlement as well as enabling firms to meet their collateralised trading activities requirements. In this respect, it is a business that is crucial to enable firms to get the required access, liquidity, and velocity in terms of high-quality liquid assets (HQLAs) and meeting regulatory ratios.

In addition, the securities lending and repo business lines are themselves under regulatory and reporting scrutiny, which could foster the growth of new execution models such as cleared repo. Developments such as these may help to solve a difficult equation, whereby market participants must cope with greater transparency and more stable balance sheets, while needing to meet different demands and expectations across the market.

From this perspective, we may consider that the question is not really if one should optimise, but rather assume that with the overall increase in market demand for collateral and HQLAs, buy- and sell-side firms need to adjust their business models. Optimisation for all participants is key to achieving greater market efficiency, liquidity and lower costs.

Michael Airey: Securities lenders and borrowers are already actively looking at ways to more efficiently manage and optimise their collateral pools. Some have made more advancements than others in the process, but the way forward is taking shape. Firms are evolving from utilising collateral to meet specific obligations (ie, financing or margin-related activity), to managing collateral by value, cost and balance sheet components, both pre- and post-trade.

To achieve this, firms can use various methods, but ideally it all starts with the aggregation of data into a centralised collateral hub, removing information silos as a result of fragmented architecture and product silos. This gives a more holistic view that highlights the quality and location of collateral in real-time, allowing firms to start reaping the benefits of allocating and optimising collateral more effectively.

> ***More efficient collateral usage is one area where there is a great deal of low hanging fruit in terms of cost reduction***
>
> **Martin Seagroatt**, marketing director, 4sight Financial Software

What are the main drivers for this?

Foley: For most borrowers this has been their approach for many years and many will justifiably consider that they have done a good job of this so far. However, the need to manage collateral in a more efficient way has never been greater. As managing the usage, cost and level of return on balance sheet and capital becomes ever more important, it is no longer acceptable to use these vital business resources inefficiently. For lenders, the challenges created by new regulation and the ability to use assets varies depending on the type of participant. However, the buy side recognises that there are a number of ways to make use of the assets that create efficiencies. Securities lending is one of these and a very successful one at that, but I think we will see more buy-side participants looking to use their inventory in more diverse ways.

Kelly Mathieson: The primary driver is regulatory change, both in terms of derivatives and securities transactions. An increasingly broad range of transactions require collateralisation as a result of regulatory requirements, often applied in a more prescriptive way. New, or recently enhanced, capital requirements are really driving the focus on collateral now. This manifests itself in driving up cost and operating complexity for lenders and borrowers, creating increased demand for specialist collateral management solutions to help mitigate these issues.

Seagroatt: Optimisation is becoming more important as various regulatory changes start to drive collateral demand and promote disintermediation in the marketplace. Costs are increasing from these actions, reflected in growing spreads and restricting access to the market for some while creating profitable opportunities for others. More efficient collateral usage is one area where there is a great deal of low hanging fruit in terms of cost reduction.

Denham: The main drivers for increasing optimisation of collateral are many. They include regulatory directives such as Basel III and the US Dodd-Frank Act, the mandatory regulations enforcing over-the-counter (OTC) derivatives to be centrally cleared, minimum margin collateral requirements being set for non-cleared derivatives and securities finance transactions, CCP collateral guidelines, as well as a greater awareness of the risk profiles of all trading counterparties, trading venues and end users.

Wyborn: The purpose of optimisation is clearly to reduce expense

> ***Most institutions would accept they are nearer the beginning than the end of their 'optimisation journey'***
>
> **Karl Wyborn**, managing director and global head of sales, CloudMargin

(cheapest to deliver) and reduce risk (replacement cost). While different institutions will be sensitive to those two metrics to varying degrees, now more than ever, all would acknowledge these dual goals. Historically, large banks have really been the only real champions of collateral optimisation. But as the use of collateral becomes more ubiquitous and the values of collateral grow the remainder of the industry is now far more sensitive to those opportunities that may be won or lost through collateral optimisation.

Nicol: The need for greater transparency in terms of eligibility, availability and allocation, combined with the desire for an improved understanding of the inherent risks involved and the scarcity of high grade collateral due to global market initiatives and regulatory requirements, means that organisations are seeking ways to access cross-asset, cross-business line optimisation.

Optimisation can assist organisations in accessing sources of collateral that can enable them to make well-informed decisions with regard to availability, collateral usage and cost. The optimisation platforms available to the marketplace provide multiple algorithms that can take into account differing haircuts, eligibility requirements, volumes, collateral costs, liquidity constraints and client strategies and provide scenario analysis according to pre-defined rules for best asset selection.

Airey: Collectively, the key driver has been the multiple challenges imposed by the enormous financial regulatory overhaul that has evolved post-crisis. Through various regulations, a heightened awareness of a firm's sources, its use of collateral and any adjacent activities has emerged.

Regulators now want to know how much collateral a firm holds at any point, where it's located, whether or not it's segregated, how it reacts under stressed scenarios, and more, with the intent of promoting future stability in financial markets. Regulatory challenges continue as financial firms across the sell and buy sides struggle in the face of timelines that are rapidly approaching.

Could a more centralised optimisation team lead to better efficiency throughout?

Airey: There will always be debate among financial firms about the best way to structure a firm-wide collateral optimisation effort. Historically, most firms have practiced collateral optimisation within the specific business line, largely due to the product and information silos that existed. As firms evolve collateral practices, they begin adopting a hybrid style, implementing a coordinated effort across business lines to more effectively manage collateral. Ideally, this leads to a more holistic approach that spans business lines and geographies in sourcing and allocating the optimal collateral firm-wide.

> ***Firms are seeking ways to access cross-asset, cross-business line optimisation***
>
> **Helen Nicol**, director, Colline collateral, clearing and optimisation, Lombard Risk

However, questions continually arise as to where this effort should reside. Is it best suited as a part of a firm's treasury unit given the links to liquidity and regulatory reporting? Should it be a part of the funding desks' efforts given the market intelligence needed with respect to collateral financing rates? Or should it be carved out as a standalone business unit with a joint form of governance?

In reality, firms will choose the model that best suits their organisational structure and understand that it will require efforts across multiple parts of the organisation to collaborate and gain efficiencies in achieving collateral optimisation. Transformation of a firm's collateral structure, systems, processes and people will be at the forefront of its decision process, mitigating risk and obtaining compliance with forthcoming regulatory demands.

Nicol: Most certainly and here at Lombard Risk, we are seeing a number of clients move towards this structure with specific focus on the front office driving the programme forward.

Collateral is now more expensive and less readily available. Within a collateral programme, there is an increasing pressure to make the best use of what collateral is available, calculate the cost and maximise the cost savings. Credit risk and control teams are operating at heightened levels of awareness, and treasury and front-office functions are becoming increasingly involved or are primarily responsible for collateral inventory and selection of assets to be posted as margin.

Therefore, the need for centralisation of these functions becomes increasingly important in order to provide a consolidated view so that well-informed decisions across business lines can be executed.

Denham: There are many banks and financial institutions that have implemented a centralised function to manage the increased demand for collateral optimisation and many more are undergoing the analysis required to implement such strategies. This involves combining many different business lines, such as treasury, repo, securities lending, prime brokerage and global custody, as well as existing collateral management, network management and IT units.

In addition, these financial institutions also need to be aware and make use of external services that already provide tailored solutions. Deutsche Börse, for instance, already has established services in place to meet the demands of the modern day collateral manager, through Clearstream, Eurex Repo and Eurex Clearing. These enable the optimisation of all collateral across the cash markets, listed and OTC derivatives, and repo and securities lending transactions, all supported by robust and superior risk and collateral management systems that are flexible for multiple client types and trading activities.

Wilson: A centralised team could work. However, it could be hard to create or staff such a team as, in our opinion, there tends to be a shortage of collateral expertise in the market. Using a collateral agent provides lenders and borrowers access to a single source that combines expertise

> ***Many have implemented a centralised function to manage the increased demand for optimisation***
>
> **Gerard Denham**, senior vice president, clients and markets, securities lending, Eurex Clearing

with a scalable and efficient solution, while reducing implementation timeframes, expense and the need for ongoing technology investment.

Using a third-party collateral agent allows lenders and borrowers to outsource complex and potentially expensive functions such as optimisation, eligibility management and settlements whilst retaining oversight so they can dedicate more resources to other important business matters and elements of risk management.

Seagroatt: Consolidation of previously siloed desks allows for a more holistic approach to pledging collateral.

> ***We should not assume that there is a one-size-fits-all model for collateral optimisation***
>
> **Etienne Ravex**, collateral management product manager, Murex

This then facilitates the matching of firm-wide views on exposures to available collateral flows.

Single system technology solutions help to support this centralised function by reducing operational burdens and risks. They also provide a backbone of functionality from which additional benefits such as process automation and the deployment of more advanced optimisation algorithms can be achieved.

Wyborn: It's hard to argue that, where optimisation is concerned, decentralisation is preferable. For many, one of the first steps towards optimisation is the consolidation of your collateral in a single location. That 'location' may very well be a single platform that takes feeds from multiple custodians, trading desks and so on. Clearly, it is nonsensical to suggest therefore a decentralised optimisation team is best aligned to the operation of this single location.

Foley: Most organisations operate a central treasury function and can see the benefits of this. To be trying to balance your books at the end of the day, unaware of what someone elsewhere in the organisation is doing with your cash, would be unacceptable. I think the same is true of centrally managing your inventory and again many will already be doing so.

In order to take a holistic view of all assets, all draws on those assets and all potential opportunities to utilise those assets, then yes, centralisation and the ability to see all the moving parts is important, otherwise arriving at the optimal scenario would be very difficult.

> ***Centralisation and the ability to see all the moving parts is important***
>
> **Bill Foley**, director, Foley-O'Neill

Ravex: While there is a definite trend towards centralisation, and in some cases organisations even evolving to create central or global desks, we should not assume there is a one-size-fits-all model. Rather, we need to understand the underlying reasons behind the change.

Firms are looking at solving four different problems when optimising balance sheet resources: minimising balance sheet usage, ensuring efficient usage of available capital, investing excess liquidity and securing liquidity ratios.

At a minimum, to solve these problems, firms require access to timely centralised data. To enable better management of a firm's inventory of assets, all stakeholders require accurate and settlement-aware information.

The next step is to push the model further and create a servicing unit that would consolidate and match internal owner and borrower requirements. By acting as as the firm's internal broker, such a unit would be in a favourable position to manage collateral supply and demand at the enterprise level. It would be able to identify idle resources, price and allocate collateral usage, and ultimately deliver indicators for enhanced inventory management. A clear and transparent pricing mechanism is required to make this model successful.

How big a part does technology play in optimising collateral?

Mathieson: The importance of technology cannot be overstated. Over the past five years, we've seen optimisation move from managing collateral using highly manual processes (such as spreadsheets), to focusing on managing collateral via more comprehensive eligibility criteria, to a widening need for tools that could incorporate multiple considerations—such as the eligibility of different asset classes and the need to meet collateral obligations across various counterparty types, clearing brokers and custodians.

As previously noted, given the focus on capital efficiency, lenders and borrowers increasingly seek to employ very sophisticated algorithms to manage their collateral against their own capital needs—beyond simply meeting their contractual obligations to their counterparty. This creates an increasingly important role for technology in the collateral optimisation field.

Our solutions continue to evolve accordingly. For example, J.P. Morgan is finalising a user-defined allocation tool that will allow our clients to assess a proposed collateral allocation, fine tune it in-house to meet their own criteria, and then return it to us for retesting against eligibility requirements. This gives the client substantial flexibility in how they deploy their collateral. Finally, the importance of technology in supporting a client's risk management programme should not be overlooked. As an industry, we need to make sure that risk management remains a primary focus.

Airey: The task to deliver a more efficient, cost-effective collateral optimisation platform remains a daunting one for financial firms. As a result, a significant amount of time, effort and money has already been invested from a technology standpoint across the financial community. Examples of this are as follows:

- Central Securities depositories that have been tasked to streamline efforts in the global mobilisation of collateral;
- Custodians that continually seek out ways to more effectively transform collateral holdings for their clients;
- Solution providers that look to mutualise associated costs while remaining compliant with regulatory change in servicing their clients; and

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Collateral Management

COLLINE: Consolidated end-to-end cross-product (OTC derivatives, repo, securities lending and ETFs) collateral management, clearing, inventory aggregation and optimisation.

Mitigating exposure risk while satisfying the growing demand for multiple/global entities, margining, master netting, dispute management and electronic messaging.

- COLLINE OTC has market-leading functionality including a legal agreement repository supporting CSA, SCSA and umbrella agreements, **flexible margin calculation and configurable workflow, reporting and reconciliation.**
- COLLINE REPO and SEC LENDING supports front-to-back margin operations for an institution's repo and securities lending agreements, including optional **mark-to-market calculation and exposure profiling.**
- COLLINE CCP/CLEARING **workflow supporting both** house and client clearing requirements. Validation of **CCP and broker calculations with configurable margin process definition and cash flow management to support** multiple clearing house models on a single platform.
- COLLINE OPTIMISATION **offers a highly configurable** solution to enable real-time algorithmic calculations, **according to user-defined rules, goals and evolving** priorities, to ensure optimal use of assets.
- COLLINE ETF organises, manages and tracks the creation and redemption process of an ETF (Exchange-Traded Fund) – improving an **organisation's operational efficiencies.**
- COLLINE ELECTRONIC MESSAGING - automates **the interaction between financial institutions on** their margining requirements (margin calls, partial **and full dispute notification, real-time visibility of** counterparty actions, interest statements, and collateral substitutions) thus reducing operational risk.

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- In-house technology teams tasked to link legacy platforms in a real-time environment.

Keeping up with the challenges of effective collateral management and optimisation has only intensified as regulatory timelines draw near and it will be the advancements in technology that drives change in the way firms look at the sources, uses and needs of their collateral requirements in the future.

Seagroatt: While re-organising people and processes is a key part of running a more efficient collateral management program, technology is also a fundamental building block in optimising.

Due to the increase in margin calls and heavier operational burden now involved in managing collateral, automation is increasingly vital. While experienced collateral managers may know their books and available collateral, a well-integrated and centralised system allows them to focus on tactical and strategic issues rather than wading through the operational burden on a daily basis. Exactly what part technology should play depends greatly on the individual firm. For some, simply providing centralised inventory and exposures provides the key information to allow collateral managers to make the necessary decisions accurately but also with some degree of flexibility.

For others, the sheer volume of exposures and collateral movements requires a heavier reliance on more advanced functionality. This ensures the collateral manager can easily sort and allocate inventory and keeps the time spent per exposure to a minimum.

Wyborn: Optimising collateral is, for all but the smallest/simplest collateral pools, all about technology. This does, however, talk to the diminishing returns argument. For many institutions, a centralised view of collateral along with the flexibility to choose one asset over another would achieve a significant percentage of the available benefit.

To develop beyond this position by, for example, employing algorithms to manage optimisation will be beyond the needs of many institutions.

Nicol: Technology has always played a significant role in bringing new products to market. Over the years, as financial services firms have expanded, most have either bought or built in-house systems to meet each department's unique requirements as they arise. In this ever-evolving market, access to accurate, real-time data—particularly linked to requirements, pricing and disputes—is essential for lenders. Access to cross-product data enables differing optimisation criteria to be utilised for varying algorithmic optimisation scenarios therefore enabling front-office trading decisions to be achieved on a real-time basis.

Therefore, platforms that provide flexibility for differing strategies and offer opportunities to leverage process synergies can create a substantial competitive advantage and provide granularity and agility within today's complex market.

Denham: The greater use and advancement of technology solutions has been rapid in recent years. Many institutions, including CCPs such as Eurex Clearing, are now able to provide users within multiple business units and IT operating systems a more flexible and customised way than ever before, whether it be enhanced front-ends, fully integrated systems on a real-time basis, advanced margin simulators or more flexible reporting, the CCP's role as an efficient and more effective provider of solutions towards capital and collateral cost reduction is an opportunity that all financial institutions need to consider as part of any collateral optimisation programme.

As an industry, we need to make sure that risk management remains a primary focus

Kelly Mathieson, managing director and global head of collateral management, J.P. Morgan

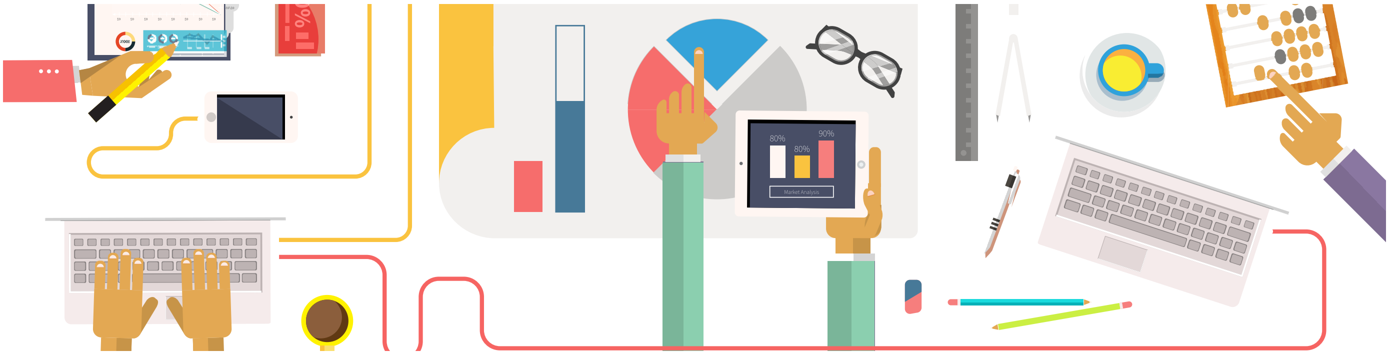
Ravex: Technology has a fundamental but complex part to play in optimising collateral. Firstly, technology should be a leverage for change. We can observe an evolution of the target operating model of the securities finance function towards a more centralised and service-oriented setup. Besides these challenges, firms will be able to rely on technology to roll these new models, which most often imply important IT system changes. Secondly, technology is the enabler to centralise assets and make resources available for optimisation. The first challenge is to break traditional silos and create a global book of records that is available in real-time. Once available, additional and new inventory management functionalities such as optimiser engines need to build. Component and service-oriented architecture are best placed to answer these challenges.

Firms do not need to physically centralise the data (positions, static or market data), but build virtual inventory accessing classified and mapped data. The challenge is actually not to have a data warehouse but to build an integrating solution, enabling a reduction of the footprint within the firm while providing unique and centralised access to data. Finally, optimisation as an analytical service enables firms to determine cheapest-to-deliver assets, although there there is a requirement for strong data access and computational resources to determine the target assets, along with efficient and reliable operational capabilities to process the outcome.

Foley: Technology has a big part to play in collateral optimisation as it does in all aspects of financial markets and clearly, the right technology can help an organisation to better manage its assets and asset deployment. However, it is important to understand exactly what your requirements are, what benefits a system can bring and whether they are the right platform for you. If you are looking at one aspect of your business, such as collateralising your lending activity, then establishing the optimal way to do this in line with your counterparties' collateral parameters and your available assets is easily managed by most securities lending platforms, and also by triparty collateral managers. If you are looking at a more varied range of factors across a number of products and routes to market, then your need for technology is even greater as you are asking for something quite different of your technology provider. **SLT**

It will be the advancements in technology that drives change in the future

Michael Airey, vice president, strategic solutions, capital markets, Broadridge



Techniques for post-trade collateral optimisation

Ted Allen of FIS and Thomas Schiebe of Sapient Global Markets discuss the techniques that firms are employing to optimise the allocation of collateral

Collateral optimisation is a buzzword used to describe a variety of techniques that aim to reduce the cost of collateral supporting trading activity. This is important for all sell-side and buy-side market participants given the various regulatory changes that increase the amount of collateral required to support trading activity, the increasing number of collateral movements to be processed and the additional strain on liquidity from regulatory capital changes. The goals of collateral optimisation differ by firm, geography and sector but at their core translate into a number of common problems.

In a previous paper written jointly by FIS and Sapient Global Markets, we discussed the collateral optimisation value chain and the tools that can help firms minimise the impact of increased collateral requirements. The collateral optimisation lifecycle consists of three distinct phases:

- Pre-trade optimisation to minimise the margin requirement of a given new deal by identifying the optimal broker, central counterparty or bilateral counterparty;
- Ongoing optimisation that seeks to minimise the amount of collateral required to support a given portfolio through cross-margining, trade compression and back loading of trades to clearing; and
- Optimised post-trade collateral allocation to minimise the funding or opportunity cost of the collateral deployed.

In a new whitepaper due to be released this month, we provide an in-depth analysis of the techniques for optimised post-trade collateral allocation. Here is a taster of some of the key highlights.

Purpose of optimised collateral allocation

The optimisation of each step of any financial institution's processes is more important than ever. Collateralisation of business activities has increased post-crisis due to regulation, market standards and a wider adoption of credit risk mitigation techniques. The available collateral within every typical financial institution is limited and there are conflicting demands for the use of high quality assets, hence a mechanism is needed to ensure these are optimally allocated.

By optimising the allocation of collateral, firms are essentially minimising the cost of use of collateral assets. In addition to minimising cost of use, another goal of collateral optimisation can be to maximise the value of the assets that are retained. This two-step approach of minimised cost and maximised retained value requires active management of collateral allocation as part of a front-office trading or treasury management function. The growth in the number and complexity of collateral agreements and the amount of collateral required make the optimisation problem both large and complex. The paper discusses why a waterfall approach to allocating assets against requirements based on preference ranking cannot lead to optimal results, highlights other techniques that may be employed and provides examples of savings that are achievable in a typical collateral programme.

Requirements

Collateral inventory optimisation can identify how to rebalance the collateral inventory by posting the overall cheapest-to-deliver collateral while considering funding capacity and liquidity ratios. The most advanced algorithms identify what collateral should be substituted, what assets should be posted against new requirements and what assets should be retained in order to minimise overall costs and maximise potential liquidity from a given inventory. Both of these goals can be achieved in a single process.

Recent studies performed by both Sapient Global Markets and FIS demonstrate that significant, quantifiable savings can be achieved by the optimal allocation of available collateral. They have also shown that improved performance in the range of three to 12 basis points can be attained on a typical portfolio of a bank's collateral requirements and inventory by implementing a collateral optimisation programme.

The benefits of collateral optimisation techniques go beyond simply minimising the cost of posted collateral. They can also maximise the liquidity potential of the available inventory. This is important for banks that will be subject to the liquidity coverage ratio and the net-stable funding ratio. These are binding constraints on short-term and medium- to long-term liquidity that force banks to set aside more assets. Collateral optimisation can mobilise more liquidity and enable more business.

The four key goals of optimised collateral allocation are:

- Minimise the cost of collateral;
- Maximise liquidity or funding capacity of the retained inventory;
- Minimise funding costs by identifying the optimal funding venue for the inventory; and
- Automate the allocation process.

> ***Collateral optimisation techniques are relevant now and will evolve as the market and regulations change***

Ted Allen, collateral product manager, FIS

Common strategies

Two strategies for post-trade collateral optimisation are typically considered: collateral rebalancing and inventory optimisation. In practice, both can be performed continuously, but for illustration purposes, it is meaningful to assume a two-step approach. Both strategies are applied in the post-trade world where collateral has already been exchanged. The core principle of post-trade optimisation techniques is to restructure the collateral portfolio by analysing current collateral requirements, collateral that has already been posted, and the assets available to the firm, and then proposing substitutions and new allocations in order to achieve an economic benefit.

Although the target function of post-trade optimisation methods may vary by firm or market situation, collateral rebalancing and inventory optimisation target the goal of minimising the cost of funding. Other goals of collateral optimisation are to minimise the balance sheet impact of collateral, maximise liquidity through haircut optimisation or simply to automate the recall of posted collateral that has gone special. The optimisation procedure is independent of the target function and always follows the same pattern, regardless of the function to be maximised.

The whitepaper provides a detailed commentary on the approach and realisable benefits of these optimisation techniques, including:

- Techniques for measuring the cost of use of inventory positions;
- Constraints to be considered in the optimisation process;
- Allocation methodologies;
- Inventory optimisation objectives and methodology; and
- How to measure and quantify the benefits.

Outlook

Collateral optimisation techniques are relevant now and will evolve as the market and regulations change. Various collateral approaches can have different impacts on the leverage ratio, so impacts on the leverage ratio will equate to impacts on the optimisation problem.

The inclusion of mandatory bilateral margining of non-centrally cleared derivatives can be easily mapped into the approach that we have outlined in the whitepaper. Indeed, the broader eligibility buckets under the regulatory proposals compared to the often narrow eligibility sets in legacy credit support annexes will enhance the potential savings from optimisation.

However, it is important to note that theoretical funding costs and realised funding costs differ. This also implies that 'xVA', and funding valuation adjustment (FVA) costs in particular, differ when calculated pre-deal based on optimal availabilities of assets and ex-post.

The solution to this emerging field is the establishment of collateral transfer pricing. The development of this pricing mechanism is best owned by a collateral trading desk and best realised in an enterprise collateral management IT solution. **SLT**

To request a copy of the full whitepaper co-published by FIS and Sapient Global Markets, please contact apexcollateral@sungard.com

> ***The solution to this emerging field is the establishment of collateral transfer pricing***

Thomas Schiebe, senior associate, Sapient Global Markets

An app-titude for securities finance

Getting the right technology solutions in place for today's securities financing participant is paramount. Matthew Harrison of Trading Apps explains why

The securities finance market is undergoing a fundamental change, which can be seen in the increased focus on the net revenue generated on a trade-by-trade basis. This change is most prevalent in the general collateral market where broker-dealers are looking for alternative sources of borrowing as beneficial owners and agent lenders introduce hurdle rates to protect their return on equity. To counter this, market participants are looking for more complex technology solutions both internally and from securities finance vendors.

The increased cost for agent lenders to trade general collateral business means market participants must redefine their models to retain current revenues. The lender that can quickly and correctly differentiate between a general collateral and intrinsic value stock, and direct them to the appropriate beneficial owner in terms of risk-weighted asset (RWA) charges, trade collateral, and so on, will have a more attractive proposition for broker-dealers. There is a continued focus for broker-dealers to achieve an appropriate level of return on equity, and in order to do so, traders require the ability to calculate an implied cost of trade prior to execution.

Trading Apps believes that the market will transition rapidly in the way it uses technology in order for the participants to maintain market share and profitability. The need to execute, track and measure trades as regulation becomes prevalent and the increasing demands of profitability and transparency are pushed upon the organisation have never been stronger. This can be seen with the market's continuing adoption of EquiLend's Next Generation Trading (NGT) and the decommissioning of schedule-based AutoBorrow trading.

NGT aims to automate not only the general collateral space but also the warm and hot stocks. The absence of schedules causes another dimension—no longer will orders be approved or rejected, but rates will need to be either validated against thresholds or manually approved/negotiated via a front-end screen. The Trading Apps pricing engine gives the capability for straight-through processing and allows for the countering of a given rate, speeding up the lender's capability to filter stocks, which will increase fill ratios and the lender's market share. Trading Apps gives the ability to centrally manage your locates, create push lists for your long positions, easily view and cover your short positions, and optimise collateral through multiple sources, including NGT or Bloomberg messaging.

The Borrower App provides a single point for locates, relieving the trading desk of the manual requirements of monitoring responses from numerous sources, and more importantly, allowing the trader to identify the best offers based upon the implied cost of trade.

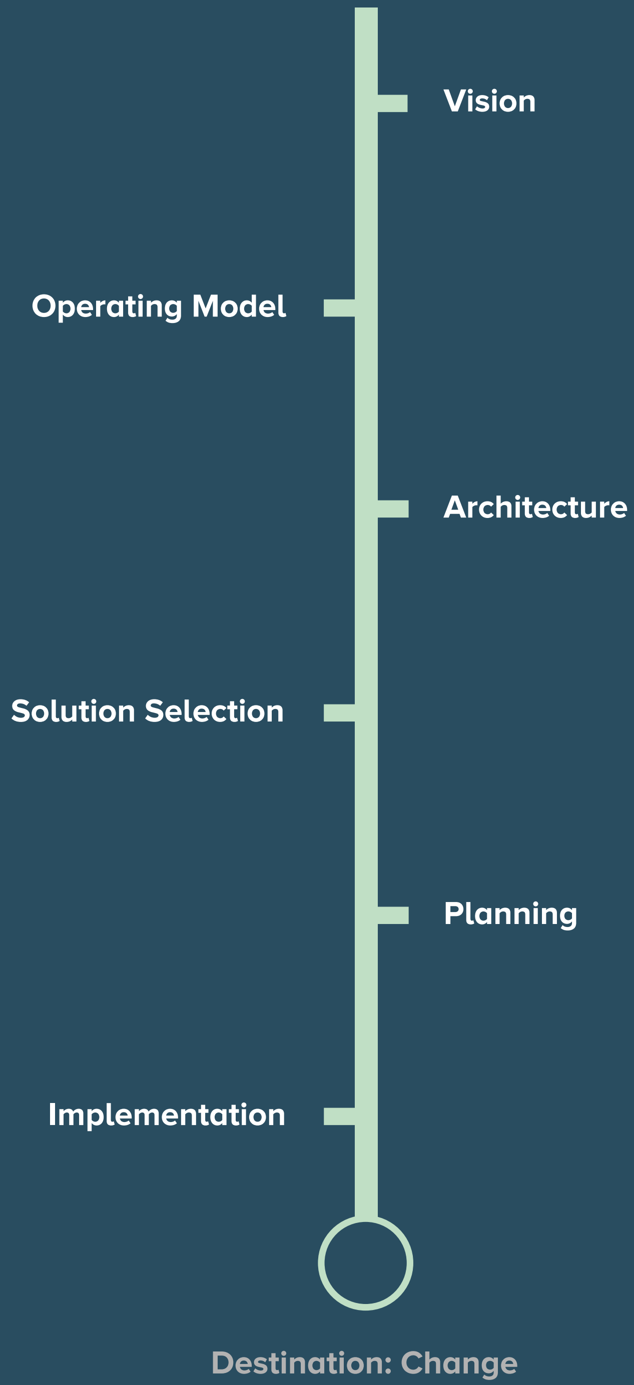
The Lender App can solve for the day-to-day locate, determine the category of locate, be it general collateral, warm or hot, and using its unique algorithm tool, direct the borrow request to afford the lowest implied cost of trade, thus making it RWA efficient. Our technology streamlines the process, without the firm dictating to the market the format to receive the requests, eliminating flashing Bloomberg messages going unanswered or NGT orders being timed out. With Trading Apps, the ability to negotiate your trades in a single system instead of switching back and forth between Bloomberg and your trading screens is a reality.

In summary, getting the right technology solutions in place for today's securities financing participant is paramount. As market regulation continues to evolve and makes itself increasingly prevalent in your business, the requirement for technological solutions through integration and automation becomes inevitable. Trading Apps offers solutions that create interaction with multiple systems and information that satisfy the regulatory requirements and enhance the business and its revenues. **SLT**

The increased cost for agent lenders to trade general collateral business means market participants must redefine their model to retain current revenues

Matthew Harrison, CEO,
Trading Apps

Helping you find the quickest route to change



www.thefieldeffect.co.uk
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THE FIELD EFFECT

The Clearing & Collateral Specialists

Data, data, everywhere

Welcome to the new world of securities lending, where data is king. David Lewis,EMEA head of Astec Analytics at FIS, explains

We live in an increasingly digital- and data-driven society, be that in our professional or private lives. Every expression of interest we show results in targeted pop-ups, emails and offers. You don't even need to buy anything anymore for online retailers to bombard you with suggested items that are similar or compliment that product or service you looked up. Everything is tracked and that is almost impossible to avoid.

To outperform, or even just to stay in the race, retailers need to maximise every selling opportunity and the data trail you leave behind in your daily life is increasingly the tool of choice helping them to empty your pockets more effectively. No industry is excluded. Even what some view as the arcane industry of securities lending is being affected and the market is being changed forever right across the transaction chain.

Beneficial owners want more information to help them manage their funds and get the most from their programmes. Their agents, whether custodial or not, need to understand their clients' increasingly specific and bespoke needs more than ever before. The brokers and borrowers are scrutinising the organisations they borrow from more acutely and arguably much more selectively than previously, while the end users are investigating other solutions for their servicing and asset management needs, looking at ever more disruptive business models. Sitting on top of all this, the regulators, partly at the behest of the Financial Stability Board (FSB), want every market participant—under the European Securities and Markets Authority (ESMA) rulings—to report to them exactly what they are doing and with whom.

If the years between the financial crisis and now have been all about resetting the market, installing new rules, restrictions and safeguards, then it seems that 2016 forward is going to be all about implementation and adaptation. Without adequate management of data, and its distillation into decision-supporting actionable information, some organisations may well become the also-rans of the financial world—the WM Morrison of the supermarket giants, if you will.

Looking at the elements of our market transaction chain in reverse—reporting to ESMA and then to the FSB will be a new overhead to meet and a new exposure to regulatory changes. Given the current wording and expectations regarding the data requirements, it is likely that ESMA will be the organisation with the bigger problems compared to those it is looking to monitor. At the risk of utilising an over-used metaphor, there will be a tsunami of data heading its way it persists in choosing transactional level details from every participant. Laugh at its impending self-inflicted plight if you wish, but it is ESMA's task to make sense of the data it gathers and potentially raise new regulations on the back of it, so it is incumbent on all of us to help ESMA get it right.

Hedge funds have always been more data driven than many organisations as well as being more agile than their larger trading counterparts. As such, it is not surprising to learn that they are commonly first in line when considering more disruptive technologies and inventive solutions to their needs. Larger funds with stronger balance sheets are said to be already lending and borrowing assets directly, circumventing the whole securities lending transaction chain. While this activity may be small so far, and the availability within this group will struggle to match what is available from more traditional sources, it would be remiss to ignore such a trend. 'Enhanced custody' was a disruptive phrase five-plus years ago, perhaps more, and it is now an increasingly common model for custodians to grow their businesses efficiently while disintermediating some players.

Prime brokers and borrowers have their own challenges of course, and balance sheet management is high on the list of their priorities. Increasing pressure on regulated entities may be driving innovation efforts away from banks as borrower types, be that through a central counterparty (CCP) or otherwise. Lenders are under the same kinds of pressure and together they are looking harder at pre-trade analytics so the right decision is made up front. No longer is the fair allocation algorithm the only decision process participants need to worry about.

The days of the homogenous pool of lender funds are long gone. Post-financial crisis, it was all about market education and understanding, which led to much greater involvement of lenders in the design and management of their programmes. This drew a great deal of data out of the system to support such changes, particularly where borrower approval and collateral schedule design was concerned.

Now that requirement has moved along the chain, lenders have to segment their lendable pools at increasingly granular levels. As the market has moved from a divergent, and dare I say somewhat disconnected, set of disciplines, such as securities lending, repo, collateral management and financing derivatives, which were all managed separately, into an emerging securities financing and collateral management unit, the need to organise these once divergent businesses has become more complex.

When a securities financing transaction or, to use a recurring regulatory phrase, a transaction of equivalent economic effect, is undertaken between a lender and a borrower now, there are more facets and considerations to manage than ever before. What is the trade type going to be? What is the acceptable collateral like, and at what margin? Can the trade be netted, at least in that borrower's opinion? What is the term of the deal and will I have sufficient rights of substitution or buffer left over? Will it help me meet my near-, medium- and long-term liquidity needs? Finally, how will all these moving parts determine the right price for the cost of capital that I will put behind this indemnified or un-indemnified trade, each of which will pay me a different split?

In the late 1990s, the European head of the bank I worked for at the time suggested that the future of our business lay with scientists, computer specialists and those who can manage data. His views were not universally applauded or understood, but he was way ahead of the game. Indeed, the previous job of one of our arbitrage traders at that time was as an engineer designing wings for Airbus. It would seem that the future of our business, along with other financial and non-financial trades, lies with those market participants that can convert more data into actionable information, faster and more effectively than their competitors can. Welcome to the new world of securities lending. **SLT**

Industry **Events**

20th Clearstream GSF Summit

Date: 26 - 28 January 2016

Location: Luxembourg

www.clearstream-events.com

Clearstream's Global Securities Financing Summit will celebrate its 20th anniversary in 2016. This edition will be held on 27 and 28 January 2016 in Luxembourg. Visit the website for more information.

IMN's 22nd Annual Beneficial Owners' International Securities Lending & Collateral Management Conference

Date: 03 - 05 February 2016

Location: Arizona

www.imn.org

In such a dynamic market, beneficial owners need to fully understand where the industry is heading, the implications for their securities lending programmes, and what it is that they need to be doing to position themselves for continued success in the new world order.

Comings and goings at Citi, Natixis, Jefferies & Co and more

Jemma Finglas has taken on a new role at Citi following her resignation from BNP Paribas in September last year.

Finglas took up the role of head of business development for asset financing for Europe, the Middle East and Africa in November.

She resigned from BNP Paribas in September after 10 years with the French bank, where she had spent the past eight years as global head of business development for asset financing and repo. Finglas will continue to be based in London.

Matthew Baldassano has left his post as managing director of Jefferies & Company, according to multiple sources.

Baldassano joined Jefferies in 2007 as co-head of securities finance having previously been with Lehman Brothers until a year before its collapse in 2008.

He boasts nearly 30 years of securities lending experience and is based in New York.

Romuald Orange, formally of Credit Agricole, has been snapped up by Natixis after going on gardening leave in November 2015.

Orange accepted the position of product specialist within the equity finance business unit in December.

He previously spent five years at Credit Agricole, most recently as the bank's head of structured products strategy for its global markets division. With nearly 20 years of experience in the equity finance and delta one space, Orange has held senior roles in Europe and Asia at Credit Agricole CIB, HSBC and BNP Paribas.

Orange will continue to be based in Paris and will report directly to Regis Lavergne locally and Dennis Shikar globally.

Delta Capita has appointed **Julieann Hall** as global head of business development.

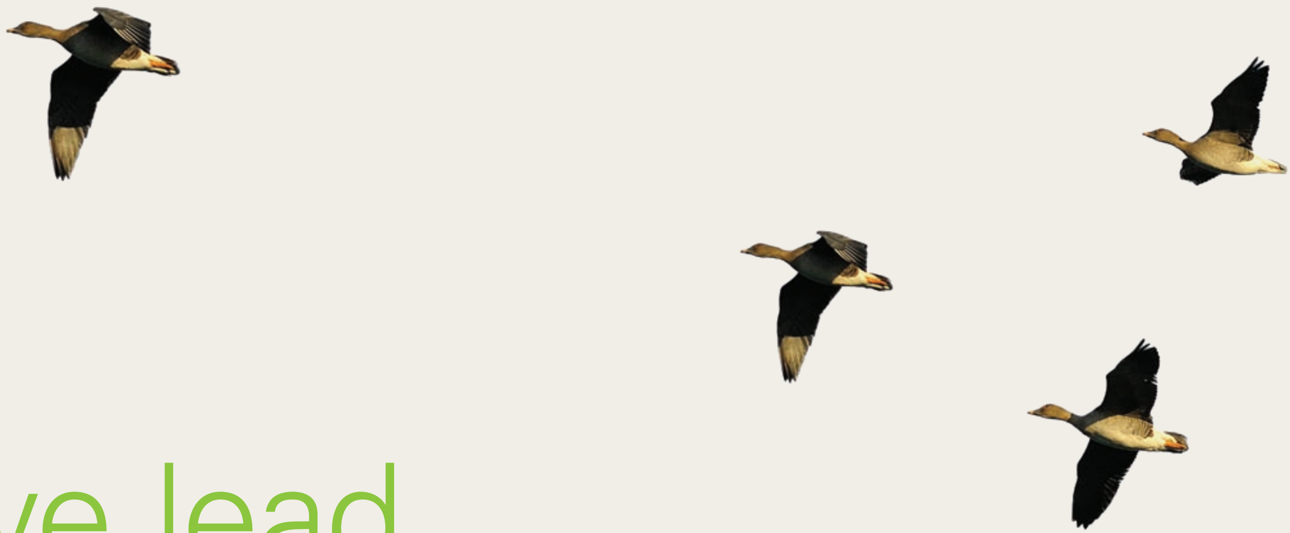
Hall will be based in London and responsible for increasing Delta Capita's global client base, with an immediate focus on identifying new business opportunities across London and Asia.

A key part of her remit will be developing new consortia projects, bringing together market participants and technology providers to develop new services to the industry.

Hall was previously managing director at financial services consultancy JDX for three years, where she was a founder member and helped to grow the business to over 250 full-time employees.

In a career spanning two decades, she has held positions at established banks and companies including J.P. Morgan and SunGard and gained a wealth of experience working for various technology and group and company start-ups.

Hall said: "At a time when the financial services industry continues to face a number of competitive and regulatory challenges,



consortia projects provide an opportunity to mutualise cost and improve capability."

"Delta Capita is leading the charge in this area and challenging the established consulting business model. I look forward to making a big contribution to Delta Capita's growth by broadening its client reach internationally."

Joe Channer, CEO of Delta Capita, added: "Julieann Hall's expertise in building relationships, coupled with her proven track record of achieving business growth, made her the clear choice to support our global expansion."

"We are focused on developing long-term partnerships across the financial sector, and Julieann's background will enable her to play a critical role in this."

Jonathan Cooper is the new director of 4sight's sales team in New York.

Cooper will be responsible for the growth of 4sight's North American customer base as the company builds on a series of recent US and Canadian client wins on both the buy side and sell side.

He has more than 30 years of capital markets experience including previous roles as a senior consultant at Finadium and managing director at BNP Paribas Securities Services.

Cooper said: "I am very excited to join 4sight's growing business. The company has a unique, focused and forward looking approach to collateral management and securities financing."

"The massive re-tooling of the securities financing business, driven primarily by regulatory initiatives, has profoundly impacted buy and sell side alike. The need for the kind of integrated technology solutions that 4Sight offers has never been greater."

Antonio Neri, 4sight's executive director, added: "We are delighted to welcome Jonathan Cooper to our team and look forward to the many years of experience and depth of market knowledge he will bring to 4sight. Jonathan Cooper is well known in the North American securities finance and collateral management business and is a recognised industry thought leader."

"His appointment will further strengthen the consultative approach we offer to both customers and prospects as they realign their business models and technology needs in response to a high volume of regulatory change."

SLT SecuritiesLendingTimes

Editor: Mark Dugdale
editor@securitieslendingtimes.com
+44 (0)203 750 6022

Deputy Editor: Stephanie Palmer
stephaniepalmer@blackknightmedialtd.com
+44 (0)203 750 6019

Reporter: Drew Nicol
drewnicol@securitieslendingtimes.com
+44 (0)20 8663 9621

Contributors: Becky Butcher and Tammy Facey
editor@securitieslendingtimes.com

Marketing Director: Steven Lafferty
design@securitieslendingtimes.com

Marketing Executive: Ayla Uzunhasan
ayla@blackknightmedialtd.com
+44 (0)203 750 6020

Designer: John Savage
design@securitieslendingtimes.com
+44 (0)203 750 6021

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6019

Recruitment Manager: Chris Lafferty
chris@assetservicingtimes.com
+44 (0)208 663 9624

Office Manager: Chelsea Bowles
accounts@securitieslendingtimes.com
+44 (0)203 750 6020

Office fax: +44 (0)20 8711 5985

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