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Eurex Clearing strips Maple Bank of its membership following ban

Maple Bank has been forced to cease all transactions through Eurex Clearing's services, including its securities lending central counterparty, due to the ban on its German branch.

BaFin, Germany's financial regulator, issued a ban of sales and payments, known as a moratorium, on 6 February due to the threat of balance sheet over-indebtedness.

The German branch of Canada-based Maple Financial Group is currently closed for business to all customers except to accept payments meant to go toward paying off its outstanding debts.

A spokesperson for Eurex Clearing said: "The executive board of Eurex Clearing terminated the clearing membership of Maple Bank."

"The ordering of the moratorium by BaFin caused a material admission prerequisite for a clearing membership with Eurex Clearing to be no longer satisfied such that a termination event pursuant to Chapter 1 Part 1 Number 7.2.1 (7) of the Clearing Conditions occurred."

"All open proprietary positions of Maple Bank will be liquidated in due course within the defined default management process."

The deposits of Maple Bank's customers are protected under the German Deposit Guarantee Act.

The bank belongs to the Compensation Scheme of German Banks. The statutory conditions for compensation of up to €100,000 per depositor are met when BaFin has determined that compensation is payable.

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CCP repo is on the rise, says ICMA

A shift towards centrally cleared repo transactions and the building regulatory strain on global systemically important financial institutions (G-SIFIs) were cited as key developments in the European repo market in a new study.

The results of the European Repo and Collateral Council (ERCC) and the International Capital Market Association's (ICMA) European repo market survey also showed fractional growth of outstandings from the June 2015 result.

The survey calculated the amount of repo business outstanding on 9 December 2015 from the returns of 72 offices of 68 financial groups and set the baseline figure for market size at approximately €5.61 trillion, largely the same as the figure seen in June.

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Taiwan Stock Exchange to allow unlimited day trading

The Taiwan Stock Exchange is now allowing unlimited day trading for all securities eligible for margin trading and short selling, covering almost all listed stocks, exchange-traded funds and warrants.

The relaxation follows the implementation of the Taiwan Financial Supervisory Committee's amendments, in a bid to stimulate more trading volume and provide investors with hedging instruments.

The move expands on the earlier removal of day-trading restrictions on constituent stocks of the Taiwan 50 and Mid-Cap 100 indices.

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Eurex Clearing strips Maple Bank of its membership following ban

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BaFin stressed in a statement: "Maple Bank is not systemically important and thus poses no threat to financial stability."

On 4 February 2016, the balance sheet total of Maple Bank stood at roughly €5 billion with liabilities towards institutional customers of close to €2.6 billion—liabilities to retail customers only make up a negligible share of the liabilities.

Following the German branch closure, the National Bank of Canada, which owns almost 25 percent of Maple Bank's parent company, agreed to take an investment writedown of $165 million in Maple Financial Group, representing 100 percent of its investment carrying value.

Shortly afterwards, the Canadian banking regulator, the Office of the Superintendent of Financial Institutions, took permanent control of the assets of the Canadian branch of Maple Bank.

The regulator also requested that Canada's attorney general enact a winding-up order with respect to the lender's Canadian assets.

Maple Bank is not a member of the Canada Deposit Insurance Corporation and therefore its deposits are not covered.

Maple Bank's troubles first started to show in September 2015 when its offices were raided by German prosecutors in a probe over serious tax evasion and money laundering following accusations of dividend stripping.

The bank was cited as the largest target in a crackdown on financial misconduct, with unpaid taxes by the bank valued at roughly €450 million.

National Bank of Canada said in a statement: "None of National Bank of Canada and its employees were involved in these [allegedly illegal] trading activities, nor to our knowledge is National Bank of Canada or any of our employees the subject of these investigations."

"National Bank has advised the German authorities that if it is determined portions of dividends received from Maple Financial Group could be reasonably attributable to tax fraud by Maple Bank, arrangements will be made to repay those amounts to the relevant authority."

"If any repayments are required they are not expected to be material to National Bank."

CCP repo is on the rise, says ICMA

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ICMA put the relative stability of outstandings between the two surveys down to the expansion of non-EU banks' European repo books.

Meanwhile, the study noted a decline in the activity of G-SIFI banks, which are most intensely affected by new regulation.

The share of all government bonds within the pool of EU-originated fixed income collateral reported in the survey recovered.

This change was driven by German and UK government securities.

It remains difficult to unravel the net impact of quantitative easing by European central banks, according to ICMA.

The study stated that the reduction in repo activity from its pre-crisis highs can be widely attributed to the impact of new regulation such as the net stable funding ratio (NSFR) and the mandatory collateraliseation of over-the-counter (OTC) derivatives.

The mandatory collateralisation of OTC derivatives was also cited as a primary driver behind the growing shift from unsecured markets, which in turn is bringing in banks that previously had no reason to use repo, as well as non-bank financial institutions.

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The share of triparty repo recovered to 11 percent from 10 percent but some of this increase may have been due to improvements in reporting by several banks, stated the study.

Godfried De Vidts, chair of ICMA's ERCC, said: "This thirtieth European repo market survey is a continuation of ICMA ERCC's commitment to providing authoritative data on secured repo and triparty markets."

"Given this long experience in collecting and interpreting data, we recommend caution with the forthcoming EU Securities Financing Transaction Regulation."

He explained: "The authorities would be wise to start with carefully designed, clear and simple data requests."

"Inappropriate interpretations of data could result in mistaken policy interventions, so care is needed to evolve robust processes based on practical experience."

"We will continue our data collection, given the wealth of historical data captured in this 15 year survey series."

Taiwan Stock Exchange to allow unlimited day trading

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This also applies to publicly listed ETFs and stock warrants announced by the TFSC in June last year.

As of the beginning of February, the total number of securities listed on TWSE that are eligible for day trading rose to 907, up from 250 securities at the end of 2015, accounting for approximately 98.75 percent of the value of total market transactions and 99.7 percent of market value.

TWSE has also amended its operational rules governing day trades to allow borrowed securities to be used as collateral for any shortfalls arising from day trading.

Overstock and Merrill Lynch settle naked shorting case for $20 million

Overstock.com has ended its long legal battle with a group of broker-dealers after securing a $20 million settlement from the remaining defendant.

Merrill Lynch Professional Clearing Corporation was the last defendant standing in the litigation over allegations of naked short selling, which were first brought in 2007. Merrill Lynch agreed to pay $20 million to Overstock and co-plaintiffs on 28 January to settle the claims, without admitting any liability.

Overstock CEO Patrick Byrne and a group of shareholders brought the litigation against 11 broker-dealers in California, claiming they engaged in naked short selling that drove down the retailer's share price and hindered capital raising efforts.

The retailer settled with all of the defendants, except Goldman Sachs and Merrill Lynch.

The case against Goldman Sachs was eventually dismissed due to a lack of jurisdiction, but Overstock filed a fresh case in New Jersey, making racketeer influenced and corrupt organisation (RICO) allegations and accusing the bank of securities fraud.

Goldman Sachs agreed to settle the new action out of court, admitting no liability.

The financial terms of that deal were not disclosed, although Goldman Sachs did pay $15 million to settle with the Securities and Exchange Commission in January this year over allegations, which it did not admit, that its broker-dealer improperly provided locates for short selling.

Announcing Overstock's $20 million settlement with Merrill Lynch, Byrne commented: "Though I am under no obligation to say so, I want to make clear that Bank of America had nothing to do with the behaviour documented in this case."

He added: "Even with Merrill Lynch, the individuals at issue are no longer employed there. I do not feel like bayonetting any more of Wall Street's wounded today."

Bank of America, on behalf of Merrill Lynch, and Goldman Sachs declined to comment on their settlements with Overstock.

ESMA gives exemption to certain securities financing transactions

Securities financing participants have successfully obtained an exemption from the mandatory buy-in regime of the Central Securities Depository Regulation (CSDR) for certain transactions.

The European Securities and Markets Authority (ESMA) released its final technical standards for settlement disciplines under the CSDR on 1 February, applying a mandatory buy-in exemption for transactions not exceeding 30 days.

ESMA was due to deliver the final technical standards in September, but the European agency delayed from doing so after securities financing participants raised concerns that the penalties imposed may be disruptive to normal market activity.

Buy-ins act as additional security for the buyer of securities in a trade.

If the counterparty fails to deliver the securities agreed, the buyer has the right to appoint an agent to purchase the securities at market value for guaranteed delivery.

The buyer will still purchase the securities for the agreed price, and the seller must make up the difference. This is conducted on a discretionary basis, and occurs fairly infrequently, but under the new CSDR rules, buy-ins will become mandatory if instruments are not delivered within a specified timeframe.

ESMA initially held that whenever the intended settlement date of the second leg of the transaction was before or on the day when

the timeframe for the delivery of the financial instruments would have elapsed, the buy-in addressing the fail of the first leg of the transaction would have been ineffective.

But during the consultation process on ESMA's final technical standards, some securities financing participants argued that the proposed approach "would create very different demand and supply skews depending on the fixed terms of the transactions".

According to ESMA: "They thought that lenders would no longer be incentivised to lend securities where there is even the remote possibility of being bought in and that intermediaries/repo desks would adjust their price for fixed terms that are in the scope of buy-in rules as in a low margin business, participants are extremely sensitive to any increase in their costs."

"They also stressed the impact on Basel III net stable funding ratio, which seeks to reduce financial institutions reliance on short term sources of finance such as term repo."

To overcome these issues, they suggested excluding all transactions with terms of 30 days or less, and all of those in bonds, from mandatory buy-ins, which ESMA has taken on board.

"Given that the settlement instruction does not contain information on whether it relates to the first or second leg of the securities financing transaction, in view of the difficulties to implement and enforce the rule as well as the estimated impacts of the previous proposal, ESMA has revised its approach."

"Therefore, in consideration of the length of time of the extension period, the delivery period, the ability to defer the buy-in, ESMA proposes a global approach whereby buy-in would be ineffective for those securities financing transactions concluded for a maximum of 30 business days."

On bonds, ESMA added: "ESMA's mandate relates to the determination of the timeframe that renders buy in ineffective for certain types of transactions and ESMA has no mandate on the scope of application of the exemption related to the categories of financial instruments."

"As a result, ESMA cannot consider for the draft [technical standards] any provision aiming at excluding the securities financing transactions in bonds from the scope of the buy-in rules."

Giles Kenwright, head of the investment banking regulatory practice at financial markets consultancy Delta Capita, commented: "ESMA is understandably concerned about the number of settlement fails and the risk that these pose to individual market participants and the broader financial system. Historically, the buyer of a security has carried the risk of failed settlement, but with mandatory buy-in, this risk transfers to the seller."

He added: "This should incentivise sellers not trade in securities that have not settled and in the long run reduce the number of fails across the market. The concern was that this would discourage securities financing transactions, where penalties could outweigh the commercial gain."

OCC enjoys a bumper January

OCC's stock loan programme reported strong volume numbers in January, with year-to-date activity up 29 percent.

Securities lending central counterparty activities saw a 29 percent increase in new loans with 136,772 transactions last month.

The average daily loan value at OCC in January reached more than $145.5 billion.

Exchange-listed options volume reached more than 364.6 million contracts in January, up 3 percent from the previous year, while equity options volume surpassed 326.3 million contracts, increasing 2 percent over the same period.

OCC also achieved total cleared futures volume of almost 7.2 million contracts, a 41 percent increase from January 2015.

US and EU tackle CCP continuity

European and US central counterparties (CCPs) will soon be able to operate in both markets with full regulatory compliance after a common approach was agreed.

The agreement will allow US CCPs to continue to provide services in the EU while complying with Commodity Futures Trading Commission (CFTC) requirements. EU CCPs will be able to provide services to US clearing members and clients while complying with certain corresponding EU requirements.

European commissioner for financial stability, the financial services and capital markets union, Jonathan Hill, said: "This is an important step forward for global regulatory convergence."

"It means that European CCPs will be able to do business in the US more easily and that US CCPs can continue to provide services to EU companies.

"It has taken a long time, but it is good news that after more than three years of discussion, we are now able to provide certainty for the marketplace. I am grateful to chairman Timothy Massad and his team for all their work in helping us get to this point."

Massad added: "Our agreement is critical to ensuring that our global derivatives markets remain robust, while keeping our financial system as stable and resilient as possible."

"It is a significant milestone in harmonising regulation of these markets. I thank commissioner Hill for working in a constructive and collaborative manner to resolve this issue."

In addition, the European Commission is set to adopt equivalence rules under the European Market Infrastructure Regulation (EMIR) to ensure US trading venues are equivalent to regulated EU markets.

The move aims to provide a level playing field between EU and US trading venues for the purposes of the Markets in Financial Instruments Directive I framework.

EU member state authorities must vote before an equivalence decision is adopted.

On the US side, the CFTC will provide a basis for both EU CCPs already registered with the CFTC as derivatives clearing organisations and those seeking registration to meet certain CFTC requirements by complying with the corresponding EMIR requirements.

Both sides also showed further willingness to expand the range of the agreement in the future.

In particular, the Committee on Payment and Market Infrastructures and the International Organization of Securities Commissions work on CCP resilience was cited as an area of interest where the standards contained in Principles for Financial Market Infrastructures for initial margin methodologies could be made more granular and robust.

European banks struggle on with low interest rates

Low to negative interest rates are causing a slump in European banking share prices but are failing to stimulate bearish attitudes towards them, according to Markit.

The decline of financials has "accelerated at nearly twice the pace that is seen in across the broader European market", as gauged by the iShares Stoxx 600 Europe Banks, which is down by "a staggering 20 percent year to date, twice that of its broader full index peer", according to Markit's analysis.

The 73 financial exchange-traded funds (ETF) listed in Europe have seen major outflows since the start of the year, with net withdraws approaching the $1 billion mark year-to-date.

Assets under management from these ETF funds have shrunk by over $2 billion—more than 15 percent of 2015's year-end total, according to Markit.

Despite poor market performance, short selling interest in Europe has stayed below the wider market average.

On average, banks have just 1.5 percent of shares out on loan, one-third less of that of the average for Stoxx 600 constituents, which stands at 2.6 percent.

Markit's data highlights that this gap shows no signs of closing as demand to borrow the stocks of banks in Europe has increased by 9 percent in the past 12 months, while the rest of the market has seen a 33 percent increase in short interest.

The low shorting demand revolved around periphery banks such as Italian, Portuguese and Spanish banks. Only three European banks currently have short interest of more than 5 percent of shares outstanding.

Triad partners with Wedbush

Triad Securities has added Wedbush Securities to its roster of clearers, further boosting the firm's prime brokerage services.

The partnership with Wedbush through a new clearing agreement gives its clients a choice of multiple custodians, "providing greater flexibility", as well as greater access to securities lending programmes, according to Triad.

Scott Daspin, director of prime brokerage sales, said his firm is always looking for new ways to alleviate the complexities of multiple primes.

"In the wake of Basel III, concerns about counterparty risk continue to rise and hedge funds are finding it more difficult to custody their assets in an environment of increased rules and regulation. Triad understands and addresses those concerns by providing a choice of multiple custodians."

Triad has also joined the Airex Market Partner (AMP) programme to give its clients access to financial applications, information and reports.

Daspin commented: "Triad is a global source for prime brokerage services, as well as for information on IPO and secondary offerings. As an AMP, Triad continues to enhance the way customers gain knowledge in these and other areas through our superior state-of-the art technology."

"Our new partnership with Airex is in keeping with that philosophy and allows our team and our clients to instantly find and purchase unique financial information and products."

Costs affecting IRS clearing decision

Costs are playing a major role in where buy-side firms are choosing to clear their interest rate swaps, according to a new report.

TABB Group's report, Global Clearing: Navigating Liquidity and Pricing Pools, reviews the shifts that major clearinghouses are seeing in market share and how cost analysis on clearing has become a major factor.

Author Radi Khasawneh found that many asset management firms in the US and Europe are attempting to retain banks as intermediaries for large trading flows by voluntarily clearing many derivatives, particularly interest rate swaps.

According to TABB, the majority of interest rate swaps are now centrally cleared in the US market with Depository Trust & Clearing Corporation data showing a year-on-year 10 percent increase between November 2014 and 2015.

Asset managers and hedge funds understand that trading choices will have a recognised impact on the back end, said Khasawneh, with clearing choices also making a difference for these firms in terms of their priority status for dealer intermediaries.

The regional phasing-in process for derivatives clearing reform under the European Market Infrastructure Regulation has given firms the ability to analyse and act on data gathered from changes in trading behaviour as each region finalises its approach. As this process comes to an end, global dealers and buy-side traders are now faced with choosing the best way to react and position themselves in a largely cleared, but more fragmented market, according to Khasawneh.

"Regional fragmentation, particularly in the US and euro-denominated interest rate swaps, has helped clearing clients get clearing and compliance certainty thus far. They have paid for that certainty by actively restricting their clearing and counterparty choices geographically," commented Khasawneh.

"A reversal of this trend may emerge if the expected regulatory harmonisation between the US and Europe spurs cross-regional differentiation," said Khasawneh.

Eurex Repo expands inter-bank markets for the buy side

Eurex Repo has expanded its inter-bank markets to address buy-side clients.

The Frankfurt-based service provider is seeking to separate itself from the anonymous inter-bank markets with customised buy-side trading licences that offer bilateral trading.

Banks and their buy-side clients will be able to continue their existing business relationships under the expanded service.

The first of two new products, Select Invest, will act as net cash providers to banks and the second, Select Finance, will provide access to secured funding and securities financing in one single trading and clearing permission.

Select Invest will operate by signing an agreement with a clearing agent who will provide transaction, cash and collateral management services.

Select Finance clients will have direct access to Eurex Clearing and will therefore need to fulfill all admission requirements.

If a bank concludes a cleared repo transaction with a corporate, the bank lowers its capital costs significantly by decreased risk weighted assets. The risk weighting can drop from between 20 and 100 percent to just 2 percent.

Both products are joint initiatives of Eurex Repo and Eurex Clearing.

Broadridge acquires Anetics

Broadridge has acquired Massachusetts-based tech firm Anetics, adding to its arsenal of securities finance tools.

The new relationship advances Broadridge's strategy to expand its securities finance suite of offerings, according to the tech solutions provider, which already includes FinancePro.

Jerry Friedhoff, managing director of securities finance and collateral management at Broadridge, commented: "The Anetics solution is an advanced securities lending tool that will allow us to provide additional capabilities across different asset classes to this important market.

"We are excited to have Rob Sammons and his talented team as a part of Broadridge."

Rob Sammons, senior director of securities finance at Broadridge and former CEO of Anetics, added: "Broadridge's global presence, financial strength and expertise at delivering technology solutions to capital markets firms will enable new service opportunities. We find the Broadridge culture to be consistent with our own and expect this to be beneficial to our existing customers."

T2S delay confirmed for Clearstream

Clearstream has confirmed that its German and Luxembourgish central securities depositories (CSDs) will migrate to the T2S platform with wave four in February 2017, rather than in wave three, as originally planned.

Confirmation from the T2S CSD Steering Group comes after successful tests of wave-three participants on 30 and 31 January. Clearstream will also take part in wave-four testing in July, which it anticipates will run equally smoothly.

The change to migration date follows Euroclear's announcement that its Settlement of Euronext-zone Securities (ESES) CSDs for Belgium, France and the Netherlands would not be ready to migrate with the second wave, as scheduled. These CSDs were re-scheduled to migrate with wave three in September 2016.

Under the new schedule, Euroclear will go live in wave three, alongside VP Securities in Denmark and VP Lux in Luxembourg.

The Clearstream CSDs in Germany and Luxembourg will be part of wave four, with the Hungarian, Slovenian, Slovakian and Austrian CSDs.

Wave two now includes only Interbolsa in Portugal and NBB-SSS in Belgium, which will migrate on 28 March. The first migration wave took place in June 2015, with the CSDs of Greece, Malta, Romania and Switzerland moving to the T2S network successfully.

Monte Titoli, the Italian CSD, migrated on 31 August 2015.

The final composition of migration waves is expected to be confirmed by the middle of March.

Convergex builds on its securities lending offering

Convergex Prime Services has enhanced its securities lending offerings by adding fully-paid for lending capabilities to allow investors to potentially generate additional income.

By integrating with Convergex's Global Clearing, Convergex Prime Services can offer an improved securities lending service to its larger hedge fund clients and third-party institutional investors.

Convergex Prime Services has also confirmed a clearing agreement with INTL FCStone Financial that enables Convergex to offer its clients access to FCStone's futures execution capabilities and prime brokerage platform.

With FCStone, Convergex Prime Services claims to be able to offer its clients 24-hour trading access and full portfolio and risk reporting features traditionally only available to larger hedge fund managers.

"At Convergex, our securities lending professionals seek to ensure that every client receives the maximum value for their securities loaned," said Doug Nelson, Convergex executive managing director and head of global clearing and prime services. "In addition to monitoring our client positions throughout the day, all loans are fully collateralized and marked to market."

Pershing launches new big data analytics service

BNY Mellon subsidiary Pershing has upgraded its big data analytics service to aid clients' securities lending programmes.

Users can use the upgraded service to identify fully paid securities lending income opportunities for qualified investors on a daily basis and match them for consideration against every position across all qualified clients.

The new data analytics capabilities are available through Pershing's NetX360 platform and will enable advisors to proactively manage risk and opportunities for investors.

According to BNY Mellon, Pershing's big data analytics platform will capture, store, analyse and use evidenced-based decision making to maximise client's growth and productivity. The solution automates and streamlines what had been a manual and time-consuming process with a single click.

"We've seen big data being put to work in other industries in ways that help businesses better understand their clients and improve business outcomes," said Patrick Yip, director of advisory market technology strategy at Pershing.

"Big data doesn't just allow us to see more, it allows us to see things better and differently."

"We continue to invest in big data to deliver innovative solutions to help our clients be more productive in running their business and more effective in servicing their clients."

CFTC opens US door for South Korean futures

The Commodity Futures Trading Commission (CFTC) has allowed certain Korean Exchange (KRX) members to trade futures directly with in the US market.

South Korean derivative dealers will now be able to deal in products, such as KOSPI 200 futures, with their US counterparts without registering as futures commission merchants (FCM).

KRX expects US investors to increase trading in the KRX futures market as South Korean member firms are able to solicit and provide information and infrastructure to US investors.

According to KRX, it will start administrative procedures for qualified member firms soon.

The petition to exempt KRX member firms from FCM registration was first lodged in January 2009.

The South Korean Financial Services Commission then sent a representation letter on information sharing to the CFTC.

The exchange now plans to allow its index options product tp become legally accessible to US investors through relief by the Securities and Exchange Commission.

Clearsteam sees global securities financing dip in January

The monthly average outstanding in Clearstream's global securities financing services fell by 14 percent year-over-year for January.

The combined services, which includes securities lending, triparty repo and collateral management, collectively reached €519.8 billion, down from €602.5 billion in January 2015.

Assets under custody held on behalf of customers registered a year-to-year increase of 1 percent for January.

Clearstream's assets under custody now sit at €13 trillion, up from €12.8 trillion in January 2015.

SEC signs off on OCC capital plan after competitors' petitions fail

The US Securities and Exchange Commission (SEC) has finally approved the OCC's capital plan, following an independent review.

The SEC's final approval means OCC can press ahead with the capital plan unabated.

OCC will issue a $39 million refund to clearing members and a dividend of $17 million to stockholder exchanges.

It also plans to implement 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, and the new fee schedule will begin on 1 March.

Shareholders' equity will increase from $25 million to $247 million.

OCC initially received approval for its capital plan in H1 2015, but industry competitors BATS Global Markets, BOX Options Exchange, KCG Holdings, Miami International Securities Exchange and Susquehanna International Group filed petitions contesting approval, citing policy and competition concerns.

The petitions triggered an automatic stay of the approval, which OCC disputed in April last year.

The SEC accepted OCC's motion to lift the stay in September 2015, while simultaneously granting the petitions to review approval of the capital plan.

Dismissing the petitions on 11 February, the SEC said "given OCC's critical clearing functions and its systemic importance, the commission agrees that having OCC increase its capitalisation is appropriate and in the public interest".

"The capital plan does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the [Exchange] Act."

Craig Donohue, OCC executive chairman, commented: "We are pleased that the SEC has granted final approval of OCC's capital plan."

He added: "Through this action, the SEC has confirmed that strengthening OCC's capitalisation is a compelling public interest and has acknowledged OCC's importance to the US financial markets as a systemically important financial market utility."

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Time to collateralise a bucket or two

Non-cash collateral, indemnification, central counterparties and fees were the main talking points at IMN's 22nd Beneficial Owners' International Securities Lending & Collateral Management Conference in Arizona

IMN's 22nd Beneficial Owners' International Securities Lending & Collateral Management Conference in Arizona saw DataLend's Chris Benedict note a significant swing in the percentage of US and Canadian transactions using non-cash collateral last year.

He also predicted that this might even reach a 50-50 split by the end of 2016.

Staying on collateral, the pros and cons of beneficial owners accepting equities as collateral were heavily debated, along with the possibility of this option being opened up to them in the US.

Some beneficial owners in attendance suggested that the greater risk of equities, compared to cash collateral, could be offset by the better comparability between the security lent and collateral offered.

Others stated they couldn't see any eventuality where their mandate from their investors would allow them to accept equities.

The conversation inevitably shifted to the Securities and Exchange Commission's (SEC) 15c3-3 rule, which currently prohibits certain funds from accepting equities as collateral in the US securities lending market.

Agent lenders and broker-dealers were notably more optimistic about the advantages of a revision of this rule, often citing the greater flexibility of the European model as evidence.

"We are waiting [for equities to be allowed]. The reason for doing this is that equities have huge liquidity," said one panellist.

"Because of the lack of flexibility of the US market the US securities lending market has suffered."

Another panellist was more hesitant, stating that if the market sees another interest rate hike this year, cash collateral will suddenly look more attractive to US beneficial owners as a collateral option.

The conversation turned to the future of indemnification, with David Martocci of Citi describing the practice of indemnifying the beneficial owner as the elephant in the room.

The panel agreed unanimously that indemnification, as it currently exists, is unsustainable and must change, given the pressure on spreads and increasingly onerous capital requirements.

"Going un-indemnified is a small but growing proportion of our clients," shared Gino Timperio of State Street.

The growth of term trades was one example given as to why blanket indemnification, currently enjoyed by some beneficial owners, is becoming an unfeasible service for agent lenders—the cost and risk versus the reward are bordering on unacceptable.

"Not all trades are born equal," summarised one panellist.

A snap poll of the audience found that 100 percent of the buy side in attendance would be willing to negotiate different cost levels to borrow securities based on the risk weighting of beneficial owners.

For beneficial owners in the room, 31.3 percent said they would be willing to lend without indemnification.

Martocci gave context to this figure, stating that if that question was posed even up until a year ago, he would expect the percentage willing to do so to be around 5 percent.

At the same time, however, only 38.9 percent of beneficial owners said they would be willing to adjust their fee splits to include an indemnification feature.

This suggests there is a small group of beneficial owners who are not willing to lend without an indemnity but are also unwilling to negotiate less favourable fee splits to pay for the service.

As beneficial owners come to terms to a possible life without indemnification, central counterparties (CCPs) continue to be a consideration—or at least they would, if the conversation could get past the lack of netting benefits.

A conference audience poll found that 63.9 percent of attendees believe that CCPs will account for just 5 percent of securities lending transactions by 2017.

The poll found that the remaining audience members believe the market share would be between 5 to 20 percent (33.3 percent) or 20 to 50 percent (2.8 percent). The higher percentages didn't receive any votes.

"We are six or seven years on [from the start of the CCP debate] and we haven't had a viable option," summarised Mark Skowron of Northern Trust.

"There is an attractiveness to the model but the right model hasn't been built yet."

Peter Economou of eSecLending added: "There are benefits for the agent lender and the borrower but until you can go to the beneficial owner and show them there are benefits."

"CCPs will struggle to gather steam," added Economou.

Skowron offered a possible solution, stating: "Maybe general collateral should be priced more aggressively to help the beneficial owner see a benefit to the CCP."

Phillip Todd of BlackRock came out in favour of the CCP model during a later panel, claiming: "There is a lot more meat being put on the bones of CCPs and a lot will be finalised in 2016."

BlackRock and Morgan Stanley, meanwhile, have invested heavily in exploring the CCP model and their representatives on the panel were sure that their use in the securities lending marketplace would increase.

Another panellist also raised the point that, as counterparty risk weighting becomes a more prominent consideration in securities lending, the use of CCPs by borrowers may mitigate this potential issue and make the borrower more attractive to a beneficial owner. **SLT**

We've been here Basel IV

Basel III is still a work in progress, and Basel IV might be just around the corner

Basel III's overhaul of liquidity standards is still being felt on both sides of the securities financing transaction, with prime brokers and agent lenders having to adjust their business models to address the direct and indirect impacts of the sweeping regulation.

An Alternative Investment Management Association (AIMA) and S3 Partners joint survey found in January that the majority of responding hedge fund managers had revised their relationships with prime brokers in order to better tackle new regulatory challenges.

Basel III has already caused 75 percent of the survey's respondents to rethink how they do business with their prime brokers and more than 67 percent have had to cut the levels of cash kept on their prime brokers' balance sheets. The survey also found that most alternative asset managers either maintained or increased the number of prime brokers over the last two years—with four becoming the average.

It was also revealed that only 20 percent of managers have a clear understanding of how their prime brokers calculate their worth in terms of the revenue they provide relative to balance sheet impact. Fewer still have the data necessary to calculate this themselves.

On the other side of the transaction, Kristin Missil, head of financial analysis and reporting for global securities lending at Northern Trust, sees similar pressures on the mainstay between agent lenders and beneficial owners that is indemnification.

She says: "Regulatory capital and large exposures will most affect agent lenders directly. The current US capital rules are punitive for indemnified lending transactions. Indirectly, the business is affected by changes in demand due to a much broader set of regulations applicable to principals of the transactions, specifically, the borrowers."

The Basel Committee on Banking Supervision's regulatory work is far from done, with 2019 set as the completion date for implementation of the liquidity standards. Missil adds: "The year 2019 is not necessarily viewed as the only finish line. Our expectation is that the regulatory environment will continue to evolve and the banks will respond to the requirements as necessary."

"There are key aspects of regulations that are already effective and impacting agent lenders, such as regulatory capital, but other rules, like the treatment of securities lending transactions within large exposure, have not been finalised at the Basel level. Local regulators are still working to issue rules on the implementation of Basel standards within their jurisdiction that could have an effect on securities lending transactions."

"Even rules that have been finalised may be re-evaluated as appropriate, as evidenced by the recent Basel proposal on revisions to the standardised approach in December of last year."

The trilogy becomes a quadrilogy

Jonathan Berryman, senior vice president of risk strategy at FIS, warned in a recent whitepaper, Basel IV: Coming If You're Ready or Not, that the Basel regulators are far from done with their rulemaking. "The ink may barely be dry on Basel III, but the Basel Committee on Banking Supervision seems intent on making fundamental changes to standard risk weights across the majority of risk types."

"Analysed separately, each revision could be seen as an incremental shift, just the start of the journey towards a new Basel Accord. When viewed in combination, however, a bigger picture starts to emerge—building a clear and compelling case for the imminent coming of Basel IV."

There are as many as seven different pieces of rulemaking under consultation or due to be implemented in the next few years, across credit, market, operational and counterparty credit risk, as well as interest rate risk in the banking book and capital floors, that could be fairly described as the next coming of Basel.

Berryman comments: "Nearly every element of the risk-weighted asset (RWA) calculation is going to change in the next two to three years. The icing on the cake is the capital floors, which have the potential to fundamentally change the philosophy of RWA—particularly in the larger banks where the RWA calculation (since Basel II) has moved towards a risk-sensitive, internal management view of the risk, rather than a regulatory prescribed formulaic one-size-fits-all view."

Missil concludes: "Some key rules affecting securities lending transactions have not yet been finalised, such that the requirements for implementation are not yet defined. We continue to partner with our custody bank peers and other agent lenders in the Risk Management Association on this topic. The organisations are actively engaged with government agencies on regulatory developments to provide relevant context and input to inform final rulemaking."

"In addition to managing purely the compliance aspect of regulations, a real issue is how organisations adjust their business models in response to the changing regulatory landscape."

"The cumulative effects (including both the intended and unintended consequences) of the new rules are far from being understood." **SLT**

Orders out of chaos

A difficult end to 2015 has not deterred securities borrowers and lenders in Asia, where certain markets enjoyed significant growth and offered new opportunities

The Asian market had a volatile year in 2015. How has the securities lending industry fared?

Madalin Prout: Based on data from FIS's Astec Analytics, 2015 was a particularly flat year for securities lending in the majority of the Asian markets, despite the market volatility. The majority of developed markets finished the year with volumes on loan either flat or slightly down on where they started, with Japan and Singapore being the exceptions. Three names stand out as notable trades in 2015—Hanergy Thin Film Power Group, Samsung C&T and Celltrion Inc—together accounting for nearly 20 percent of the 2015 securities lending revenues generated from Asian securities.

Andrew McCardle: The first half of the year was a good year for Asia with there being a lot of profit to be made in a few securities in particular. The year started with the outlook for China being very positive, and the PASLA conference in Shanghai was very informative. Then, in the middle of the year with markets moving as they did, China was no longer as far forward as it had looked. One particular revenue-driving security, 566 HK, also hit a difficult patch as the stock was suspended by the Hong Kong exchange.

David Raccat: The securities lending industry did well, and better than other regions in terms of growth. According to Markit data, revenues from securities lending activity in Asia were up 21 percent year on year to a record $672 million in fees. That number is small when compared to other markets such as the US ($4.2 billion), but when you look at growth and then further potential, the Asian region is key. Hong Kong continues to be a strong performer with continued corporate activity, but South Korea has again returned to the top of the table and we have noticed a strong increase in this market.

Dane Fannin: The Asian securities lending market still appears to dominate others in the region. In particular, the Hong Kong equity lending market continued to be an important revenue stream for clients, given exposure to China via the dual listed H-shares listed on the Hang Seng index, which created arbitrage opportunities.

Over time, there has been a shift in risk appetite with the market volatility caused by uncertainty over the Chinese economy, lowering demand for these securities. However, these Hong Kong equity lending market impacts were offset by increased demand in other jurisdictions, notably South Korea. The South Korean securities lending market has seen an increase in directional strategies and increases in revenue to clients that hold such securities.

The Asian hedge fund industry continues to thrive, and this has also helped increase volumes across the board.

Ariel Winiger: 2015 was generally a good year for the securities lending industry. According to Markit, outstanding securities lending balances on Asian equities have increased by about 30 percent year on year while the average securities lending fees across Asia Pacific are above 1 percent.

The average fee level has been volatile throughout the year and reached 1.5 percent in March and April, mainly driven by China related demand in the Hong Kong market where average fees peaked at 3 percent.

Paul Solway: Asia has nine active markets open to securities lending—ranging from Japan to New Zealand—with no two markets being the same in terms of liquidity, structure, flows or industry dependence. Whether consumer or producer, the primary or downstream drivers of investment activities across each of the markets always makes lending in Asia fairly dynamic.

During the first half of 2015, securities lending fared well across the region, and indeed most of the year's revenue was generated during the first six months of 2015. Hong Kong and Japan somewhat dominated in

Asia with Hong Kong being the primary driver of 2015 lending revenue as it continued to be the main link into corporate issues coming out of China, which currently does not allow foreign investors to engage in securities lending. Japan was not as volatile as Hong Kong, but its size in terms of loan balances drove significant revenue.

Volatility also helped boost securities lending activity in a number of the smaller Asian markets. As money flowed out of the emerging markets and into the US during the summer months, there was a significant uptick of borrowing in South Korea, Malaysia, Singapore and Thailand.

Paul York: The volatility we witnessed throughout Asia in 2015 certainly proved beneficial in terms of promoting strong returns within our securities lending programme. From a purely State Street Asian perspective, there were positive like-for-like annual returns in every single country that we operate in, bar one, which was extremely pleasing. From a macro client perspective, we continue to see new entrants into Asian markets, which are both highly encouraging and beneficial in terms of adding new liquidity to core and emerging market supply. It's these markets in particular where we can generate strong income streams on behalf of our customers.

Order flow last year was extremely buoyant in high revenue generative markets such as Hong Kong and Japan. Here we witnessed a good eclectic mix of demand side strategies, particularly in the quantitative, long/short and event-driven space. It was also encouraging to see resurgence in markets that had arguably been underperforming in 2014, namely Australia, South Korea, Singapore and Thailand.

Darren Measures: There was volatility in the Asian markets in 2015—as much, if not more than, the rest of the globe. However, the demand and interest in securities lending has held up well across both developed and emerging markets across the region. On the demand side, Hong Kong has had a very positive year and South Korea and Taiwan were also very strong. In Japan, demand for dividend names was positive as always and we saw directional interest from the technology sector in particular.

On the supply side, international lender sentiment towards Asian markets represents one of the strongest areas of revenue generation with many lenders seeking ways to capture additional earnings even in the more hands-on markets of Taiwan and Malaysia. For Asia-based lenders, our emphasis on education and building long term relationships has been very positive. We saw new lenders bringing assets to market, existing lenders modifying their parameters, and strong desire for third party (non-custody) programmes.

Asian-based lenders have been quite adept at looking at opportunities arising from the new environment and have used this to capture additional returns from structured and term trades.

"2015 was generally a good year for the securities lending industry"

Ariel Winiger, Head of securities finance services, Asia Pacific, Societe Generale Securities Services

Francois Maury: The securities lending business has been relatively lacklustre during the past year. We see a few main trends having a material impact. The overall compression of margins in a world of high liquidity is not favourable, while the hedge fund world appears to have struggled in the second half of 2015, particularly smaller funds that strive to differentiate themselves to keep the interests of investors.

"It was encouraging to see resurgence in markets that had arguably been underperforming in 2014, namely Australia, South Korea, Singapore and Thailand"

Paul York, Managing director, securities finance, head of Asia trading, State Street

The second part of the year, however, provided opportunities on very select names and exchange-traded funds (ETFs), especially on those tracking China. However, most clients remained on one side only and unwinding/de-risking was the mood.

Has there been any notable difference in the development of the securities lending industry in each of the Asian countries? Were you surprised by which countries did best or struggled?

McCardle: I think everyone was a little taken aback about how China suddenly became much less important in the securities finance industry in the second half of 2016. Obviously, everyone is still very keen to see China truly emerge. In the first few months of 2015, it seemed that this might be the year for China, but now it is less certain as to when it will become a market for securities borrowing and lending.

Another noteworthy issue in the region in 2015 was when the Indonesian market announced that it would be instituting a requirement for securities borrowing and lending to be collateralised in the Indonesian rupiah, which meant that there may be less interest in this market from securities finance participants than was hoped for. It was a good year in Japan, Hong Kong and South Korea, with these making up the lion's share of revenue.

Solway: In 2015, Hong Kong and Japan dominated the securities lending market in Asia, which was consistent with 2014 trends. One notable and pleasant surprise was South Korea returning to its number three spot in the Asian securities lending marketplace, according to our data. South Korean regulators eased the daily bandwidth in which stocks could move intra-day while refraining from any other restrictive measures. As a result, investor confidence returned, demonstrated by decent South Korean quant flow throughout the year, combined with some deep special plays in sectors such as pharmaceuticals, shipping and chemicals, and South Korea produced balances and returns that were stronger in 2015 than they were in the previous year.

The nascent but usually subdued Malaysian securities lending market also did very well in 2015 compared to 2014. We began to see activity and significant returns from the middle of the year, and this was driven by emerging market macro demand, for example, US dollar strength, emerging market exit, falling oil prices and political uncertainty. Between the beginning of 2015 and year-end, Malaysian loan volumes grew by a factor of five and returns grew by a factor of 3.5, according to Markit.

Measures: Generally across the emerging market countries, the supply of securities has increased, leading to greater liquidity in the market while spreads have held up. In the developed market countries, the spreads have come under pressure as supply has increased. The countries that have historically been strong performers in the last few years—Hong Kong, Taiwan and South Korea—continued to generate excellent returns in 2015. As we look at the outbound flow of investments from the emerging market countries, we see a greater accumulation of international equities coupled with a desire to capture additional returns from lending.

Raccat: The Hong Kong market is very much linked to what has happened in China and has become the third biggest market worldwide. Directional demand (all sectors affected) keeps increasing significantly whereas liquidity can vanish very quickly. Hong Kong ETFs are extremely popular and have generated impressive revenues for some of them. Scrip arbitrage has also been very active in 2015 with more and more companies offering this optional dividend programme. South Korea's shipping industry has suffered quite a lot. Some names (like in Hong Kong) have been trading specials for years. All industries linked to oil are massively targeted by short sellers.

There is still an impressive list of Japanese companies raising cash. It's probably the most active market in terms of flow.

Fannin: The most notable advancement in development was the Shanghai-Hong Kong Stock Connect scheme, offering offshore investors a means to invest directly in designated Chinese shares. However, the securities lending rules within the framework create some challenges for offshore participants, but they are nonetheless an important milestone in the development of the Chinese securities lending market. We believe market participants remain optimistic that progressive development of the Shanghai-Hong Kong Stock Connect scheme could open up a significant opportunity for securities lending, and result in incremental revenue streams for clients.

In other Asian jurisdictions, development of securities lending markets has been relatively muted. In Taiwan for example, a number of punitive rules pertaining to settlement and execution of trades that continue to constrain some securities lending activity, not the least of which is the daily quota applied to short selling volume. However, overall market development in Taiwan and other jurisdictions nonetheless remains encouraging.

> *It was a good year in Japan, Hong Kong and South Korea, with these making up the lion's share of revenue*
>
> **Andrew McCardle,** Head of EquiLend Asia

Maury: The widely anticipated opening of China's stock lending market didn't materialise in 2015. To a lesser extent, we could say the same about Taiwan's efforts. We believe, however, that the positive direction towards a more open environment is making significant inroads and hope to see further progress in 2016. Japan is resisting to a certain extent in this volatile environment and, indeed, we find that clients occasionally forget that it is still a tremendously big, albeit not 'exciting' market.

Prout: Despite starting from a low base in terms of volumes on loan, the Malaysian securities lending market looks to be firmly on a growth trajectory with volumes more than doubling from the start of the year. This growth is being noticed by local firms, many of whom are looking to enter the market or expand their securities lending activity.

In Hong Kong, there is a clear trend of the local entities of Chinese securities houses entering the securities lending space. They bring new sources of inventory to this established market, often holding securities that are hard to find elsewhere.

Winiger: The most noticeable change we observed was in the demand for South Korean equities where the overall securities lending market balances reaching $10 billion for the first time in July 2015, with a high average fee level of 3.25 percent, according to Markit.

Nevertheless, Taiwanese equity lending balances are also doing well with more international supply coming to market. Balances stood below $7 billion at the start of 2015, reaching almost $10 billion in the summer before ending the year at about $8 billion. Fees have reduced though because of the increased supply over the last few years. They are still at an attractive 1.8 percent, but down from the 3.9 percent of three years ago.

The main country to mention is Hong Kong. With fee levels going up in the first half of the year, comparable with the high demand seen in 2012, lenders were pleased to see their revenues soaring compared to 2014. Some of the Hong Kong-listed ETFs also traded at very high levels. CSOP's FTSE China A50 ETF, 2822 HK, traded at an average of 13 percent in 2015 and was, together with China AMC's CSI300 ETF, 3188 HK, and BlackRock's iShare FTSE China A50 ETF, 2823 HK, among the most actively sought after ETFs in Hong Kong.

Which of these would you still consider to be 'emerging' and which are now developed? Are there any new Asian countries likely to develop a securities lending industry?

Measures: There are obviously many ways to categorise the divisions between emerging and developed market, but one safe proxy is the MSCI index definitions. These would put Japan, Australia, New Zealand, Hong Kong and Singapore in the developed bucket, and Taiwan, South Korea and Malaysia in the emerging bucket. Indonesia, Philippines and Vietnam are markets on our watch list for the creation of a non-domestic stock borrow loan model, with perhaps Indonesia the one closest. China and India have securities borrowing and lending activities but these are either limited to domestic entities and/or have challenges that are inhibitive for non-domestic lenders.

Maury: As does the overall economy of Asia, the future of securities borrowing and lending in the region relies heavily on China. Indeed, the pressing question is whether we are going to see the emergence of a securities borrowing and lending market on the mainland.

Furthermore, clients are looking at Thailand, Indonesia and Malaysia. We believe interest for those Southeast Asian economies will

progressively deepen as the various foreign exchange regulations loosen. However, we anticipate this to be a slow evolution.

Meanwhile, enthusiasm for Taiwan seems to be wavering as the securities borrowing and lending market failed to materialise in 2015, as many clients expected.

Winiger: I would categorise the region as follows. First, you have the established countries of Japan, Hong Kong, Australia, Singapore and New Zealand. The second category contains the two big emerging markets that have been operating for many years now and are becoming more mainstream, South Korea and Taiwan. Then you have two smaller emerging markets in Thailand and Malaysia. The latter revised its rules only a few years ago to accommodate securities lending flows better and has shown good balance growth over the past year.

Then you have two markets that officially offer a securities lending market, the Stock Connect and India, but in reality the rules are not practical and there has been little to no volumes. The next Asian securities lending market to open up is supposed to be Indonesia, which is expected to go live as early as this year.

Raccat: Thailand, Malaysia and Indonesia are still emerging. We all hope to see a proper mechanism in place on the Chinese onshore market. The current set up via the Shanghai-Hong Kong Stock Connect doesn't work. But for the moment, Japan, Hong Kong, Australia, Taiwan and South Korea will be the key markets for many more years to come.

York: I suppose it depends on how you define 'developed' versus 'emerging' but I think with so many idiosyncrasies within multiple jurisdictions throughout Asia, it's imperative for any country wishing to gain 'developed' status to incorporate a fluid working capital markets framework that offers high levels of liquidity and encompasses meaningful regulatory bodies. In Asia, it's not uncommon to have a 'workable' structure for securities lending, but it's certainly not as liquid or fluid as participants would perhaps like them to be. Taiwan, South Korea and Malaysia, for example, are all viable and working structures, but they are not arguably as fluid as, say, Japan, Hong Kong or Australia.

Obviously, all eyes are on China right now in terms of how looks to develop its securities lending capability. As it currently stands, the model is simply unworkable from an offshore agency perspective and, until that changes, China will remain stifled in terms of both market participation and liquidity.

> ***The pressing question is whether we are going to see the emergence of a securities borrowing and lending market on the mainland***

Francois Maury, Head of equity finance Asia, Natixis

That said, through organisations such as PASLA, the industry had some excellent dialogue with both the Shanghai Stock Exchange and Hong Kong Stock Exchange last year. Participants remain positive in their commitment to working closely with them in order to help formulate a more workable framework that will better serve Chinese market and foreign institutional investors going forward.

McCardle: The emerging and developed markets have not really changed in 2015. Some people see South Korea becoming more developed, with the focus and level of trading in the market, but I still believe that it is more likely to have three levels of market development in Asia. South Korea and Taiwan can be seen as developing, somewhat ahead of emerging, but not fully developed yet.

> ***Tax legislation needs to keep pace with market evolution so that loan transactions are not treated as sales activity***

Darren Measures, Executive director and agent lending product manager for Asia Pacific, J.P. Morgan

Fannin: Asia continues to boast an impressive landscape of untapped emerging markets that offer attractive return profiles for securities lending participants. Most notably, the industry is acutely focused on developments pertaining to the Shanghai-Hong Kong Stock Connect initiative in respect of the ability to lend and borrow Chinese inventory. The launch of a Shenzhen-Hong Kong Stock Connect platform is also widely anticipated and it is thought that this would be an important milestone for index providers to include China in various global indices at some point. This would ultimately serve as a critical source of supply for the purposes of securities borrowing and lending via the Stock Connect schemes. Other jurisdictions such as Indonesia continue to progress developments of their offshore securities lending frameworks. Indonesia, having previously engaged its counterparts in South Korea to facilitate creating a robust securities and lending offshore market, is hopefully anticipating a model that will closely resemble the successful one established in South Korea. From a demand perspective, Indonesia promises an attractive demand profile, given its changing economic backdrop.

Prout: Although still making changes to their operating models to support securities borrowing and lending activity, South Korea and Taiwan can broadly be considered emerged markets in Asia. Malaysia is a key emerging market in the region that appears to be gaining momentum with both local and international players. Other markets that have signalled an intention to develop securities lending activity include Indonesia, the Philippines and Vietnam, but any development in these markets is likely to be cautious and gradual.

Solway: One could consider markets open for 10 or more years to be developed or mature by nature, depending on local regulations that may restrict access and therefore liquidity. In Asia, this would include Hong Kong, Japan, South Korea, Singapore, Australia, New Zealand and Thailand. Taiwan continues to lag a number of markets due to


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regulations that constrain the freedom of investment that is enjoyed elsewhere. Malaysia, which opened up three years ago, continues to grow both in terms of supply and demand. Both of these markets are still considered by many as still emerging.

As to new countries developing a securities lending industry, all eyes are on China. Currently, foreign investors are not allowed to engage in securities lending in China and instead use the Hong Kong securities lending market as a proxy, where able. If China opens up securities lending to foreign investors, this will no doubt have a huge impact on the securities lending market in Asia.

How important is an active equity market to Asia's securities lending industry?

Fannin: Generally, an active market would imply a strong supply of liquidity and large daily average trading volumes, which all are critical components to the level of securities lending demand. In the absence of sufficient liquidity, investors are unable to benefit from the advantages brought by securities lending through the various trading strategies. This is increasingly important as the various markets continue to grow.

York: Securities lending plays a pivotal role in providing both liquidity and settlement, not just in Asia but on a global basis. Furthermore, it reduces volatility and creates greater price discovery on exchanges and in bilateral markets. An active equity market is clearly a prerequisite to encouraging investment within any particular country, therefore creating a more fluid securities lending product offering. This in turn is likely to promote multiple investor strategies from which all market participants can benefit and engage.

Maury: The equity market's health is essential to the securities borrowing and lending business. We need end-user clients, such as hedge funds and asset managers, to be active and successful in their trading to be the catalyst for securities lending markets. Furthermore, a lack of liquidity and light volumes do not favour the securities borrowing and lending markets We also believe that unhealthy market valuations are not conductive to the long term development of our businesses. Beyond liquidity, depth and market valuation, the securities borrowing and lending business requires healthy legal, regulatory and fiscal environments. There are complex legal environments in Asia, while stamp duties are another form of unfortunate restrictions to the business.

Measures: The two things go in lockstep: one of the hallmarks of an active market is a vibrant lending (short selling) market. The foundation of any successful securities lending market is the ease of conducting international investments, sufficient liquid stocks to trade in, securities borrowing and lending rules that can are viable for the international borrower community, and limited restrictions on short selling. Importantly, tax legislation needs to keep pace with market evolution so that loan transactions are not treated as sales activity. The more constrained and restricted a market, the less attractive it is for securities lending, which in itself limits liquidity in the equity/bond markets and makes the market more expensive for capital investments.

Winiger: An active equity market is very important. Securities lending is only a secondary market and depends on an equity market flows to generate the demand for short selling and hedging needs.

> ***South Korea and Taiwan may not be as liquid as some other markets, but their securities lending platforms are among the most transparent of all markets globally***
>
> **Paul Solway,** Regional head of securities finance, Asia Pacific, BNY Mellon

Solway: An active equity market is extremely important because consistent activity drives securities lending returns. The active and volatile equity market in 2015 demonstrated this relationship, as volatility drove earnings up significantly during the first half of the year.

The equity market's volume, liquidity and transparency are also key considerations. Japan and Hong Kong are strong markets in terms of volume and liquidity, with the remaining markets perhaps less so.

Before participating in securities lending in Asia, investors need to be aware of the breadth and depth of the Asian equity market and know any nuances or limitations that may prevent them from completing their investment strategies during their desired time-frame.

With specific regard to transparency, Asia does very well. South Korea and Taiwan may not be as liquid as some other markets, but their securities lending platforms are among the most transparent of all markets globally.

Overall, the Asian equity market is very active, volatile and driven by fundamentals—all good characteristics for generating securities lending revenue.

Raccat: The cash equity market is the driving force of our securities lending industry. The ability to short sell a stock has a direct impact on our activity.

In Asia, many stocks in Hong Kong or Taiwan cannot be short sold at all, which can limit the utilisation rate of a long portfolio. Regular bans on short selling occur when stock markets tumble. Securities lending continues to suffer from a bad reputation.

> ***The cash equity market is the driving force of our securities lending industry***
>
> **David Raccat,** Head of market and financing services Asia Pacific, BNP Paribas Securities Services

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Have the close ties that smaller Asian economies have to China been an advantage or disadvantage for securities lending participants and short sellers? Is this likely to change?

McCardle: In the first half of the year the economies linked heavily with China did see an advantage, but in the second half of the year, as China slowed, those countries also saw the downside to the relationship.

Fannin: Asia's regional economies are directly or indirectly exposed to the health of the Chinese economy (as are most global economies). This may benefit or equally hinder the securities lending industry. With a slowing growth rate in China, directional demand has manifested in some jurisdictions most exposed to this theme, particularly those who maintain China as a key export trading partner (for example, within Australia, Singapore and South Korea).

The volatility of regional exchange rates and the pursuit for export-led economies to remain competitive in this regard has also presented opportunities for revenue to be generated for clients who participate in securities lending.

Prout: Following the significant market volatility in the Chinese stock markets in the second half of 2015 and the public condemnation of short selling by the Chinese government, many short sellers, especially those in Hong Kong, scaled back their activities in the latter part of the year. This has clearly been a disadvantage for the prime brokers servicing these clients in the region as lower levels of demand from short sellers hit their bottom lines.

On the other hand, the close links with China seem to be working well for the local Chinese-owned brokers in Hong Kong. Their access to wealthy Chinese investors is allowing them to take advantage of the opportunities created by the investors' demand to short international markets and the access to attractive inventories for their emerging securities lending programmes.

Raccat: One of the key challenge for securities lending participants is to offer stable inventory to the sell side. Demand is there and keeps increasing but thin liquidity available for short selling can refrain from entering into a deal. This is unlikely to change anytime soon. For example, many stocks in Hong Kong are held by investment vehicles not part of any securities lending programme. On top of that, it is fairly usual to see some funds pulling out temporarily from lending programmes in case of high volatility in the market.

Solway: In 2015, all of Asia's securities lending markets felt the effects of the market volatility caused by China as it continues to open up its market to the rest of the world. Currently, foreign investors cannot participate in securities lending in China, but instead must use other Asian markets as proxies. Technology focused economies, such as Taiwan, South Korea and Japan, can serve as proxies for China as does Hong Kong, especially with the Shanghai-Hong Kong Stock Connect platform now in place.

China's slow transformation from a production to a consumption economy, combined with is relative slowdown in GDP, has had impact on a number of sectors with commodities being hardest hit. An obvious market that in turn has been affected is Australia, where many mining companies, both large and small, saw earnings slump in 2015.

There is certainly potential for change. In Taiwan, the pro-Chinese KMT political party was recently replaced by the pro-independence DPP, party which may affect trade relations between China and Taiwan with potential knock-on effects for the rest of Asia. Such change and uncertainty ultimately attracts speculation both at the macro and micro level.

Maury: It is a relative disadvantage as non-Asian investors and clients often lack the breadth to focus on smaller economies, where we believe there could be interesting opportunities for them. Also, the flows are massively macro-driven with monetary policies playing a major role and somehow swamping more local factors.

If we dig further into the question, we can observe a pattern; local investors are focused on their own markets but very few are going into other Asian markets. Asia, in that respect, displays very little unity.

The link to China benefits the small number of sophisticated cross-border sellers in Asia (outside of Japan) because most of the sectors are somehow linked to the Chinese economy. This explains the short selling of sectors across Asia, such as the recent action in the commodities markets. In other words, excluding Japan, many Asia Pacific markets have benefitted from the Chinese market. Australia is a clear example.

The link does not favour autonomous development of smaller Asian markets, and sometimes penalises local long-term investors. From our perspective, this is not a positive environment and it is unlikely to change rapidly. One rebalancing factor for the longer term could be the expansion of India.

York: Naturally, one would expect both countries and companies alike with deeply integrated supply chains with China such as Hong Kong, Japan and South Korea to be more affected in terms of short side demand. In Europe, Germany is arguably most at risk as a producer of capital goods to China and large commodity exporters such as Australia also find themselves in the firing line, especially within the mining sectors and such like.

One way to amplify the trade effects would be through a massive depreciation of the currency in an attempt to revive Chinese export-led growth and that is what we have been witnessing over the last few months. That said policy makers have strengthened the yuan rate since early January. However, in doing so, the central bank has burned through more than $400 billion in foreign reserves to prop up the yuan since the surprise August devaluation, raising concern that the cash stockpile may soon fall below adequate levels.

Measures: The volatility in the local economies in Asia are always, to some extent, going to take their lead from how the dominant economies in the region are faring, especially China and Japan. However, each country has its own dynamic around balance and composition of trade, exposure to foreign exchange and trade reserves. Exposures

> ***The volatility of regional exchange rates and the pursuit for export-led economies to remain competitive has presented opportunities for revenue***
>
> **Dane Fannin,** Head of securities lending, Asia Pacific, Northern Trust

to global pressures such as commodity prices and internal political pressures will affect how each country deals with the reverberations from changes in those economies. For example, an economy such as Malaysia is more likely to be driven by the price of oil and foreign exchange devaluations than by events in China, whereas Hong Kong will be materially more affected.

China has already experienced its first wobble of 2016, which automatically affects all of the Asia Pacific and even global markets. What are your predictions for the next 12 months?

McCardle: I think that people will continue to concentrate on Japan, Hong Kong and South Korea as the revenue drivers in 2016, but, as always, if there are opportunities in markets such as Malaysia, Taiwan or others, there will be activity there also. Asia is a region that is hard to predict, as we saw in 2015. Last year in particular showed that there are many influences in this region compared to others, as the regulatory environment is less aligned and, as we have seen, things such as elections have large impacts on the markets.

Prout: Since the beginning of 2016, FIS's Astec Analytics has observed a 10 percent reduction in the available supply of Asian securities for lending. This is particularly notable in the Hong Kong market, which has seen the largest decrease of over 12 percent. The well documented sell off among long investors is likely to account for this, at least in part, and while this does result in supply constraints, the prolonged market volatility does create opportunities for the short side of the market.

Looking more broadly, the much discussed regulatory changes will continue to shape market activities in 2016, with further increases in the use of synthetic financing options likely as prime brokers seek to maximise their balance sheet efficiency. From a technology perspective, at FIS we are already seeing the effects of this as banks seek to optimise their IT infrastructure with multi-asset solutions that can simplify their IT footprint. Coinciding with this is a clear industry move towards hosted and managed services for their platforms, driven by firms seeking to take advantage of the expertise of their technology providers and benefit from operational efficiencies. We see both of these technology trends continuing throughout 2016 and beyond.

Raccat: Volatility will continue, consistent and stable supply will become more critical and in regards to China, we shall see. The regulators have surprised us in the past with their speed and pace of market change, but this may be slowed down in line with the economic environment. But you never know, the regulators may see securities lending for what it is—a market facilitator—and surprise us by reviewing market rules to attract more market participants.

> *Regulatory changes will continue to shape market activities in 2016, with further increases in the use of synthetic financing options likely*
>
> **Madalin Prout,** Head of relationship management, securities finance APJ, FIS

Solway: Over the next 12 months, we believe market volatility will undoubtedly continue, fueling the type of activity that provides opportunities to lend securities. There is still a great deal of uncertainty in the market regarding regulation, currencies, commodities, and monetary and fiscal policy.

Similar to 2015, Hong Kong and Japan will continue to generate good returns, and macro trends (for example, the U.S. political situation) will likely influence the market. Currencies have a huge influence on markets and so drive volatility. It's also worth remembering that weaker emerging market currencies will suppress securities lending earnings in US dollar terms.

On a country-specific level, I see the following. South Korea returned to the third spot in the Asian securities lending space in 2015, according to our data, and these high levels of activity are set to continue into 2016. In Malaysia, loan volumes grew five-fold above their 2014 levels throughout 2015, according to Markit, so in 2016 spreads may compress as additional new supply is added during the year. In Thailand, given that average borrow rates remain healthy due to limited supply, any new entrants to lending will likely see good returns in 2016.

Japan spreads were compressed due to broader supply being available in 2015, and this trend will likely continue in 2016, albeit on a healthy volume base. Negative interest rates are already a reality—the impacts of which are yet fully to be seen.

York: Being the second largest market in the world, China is always going to be a major cause for concern across all global markets if it continues to go through a period of correction. With ongoing weakening economic data, a devaluation of the yuan, falling commodity prices and growing concerns over aggressive credit expansion and the potential for bad loans—all of these issues weigh heavily on market sentiment.

A plethora of attempts have been made by the central bank to intervene within the capital markets in a bid to buoy mainland indices and artificially introduce restrictive selling practices, particularly on major shareholders. If this trend continues throughout the year, it will only serve as a selling proxy for China in markets such as Hong Kong, where investors look to bypass the ongoing intervention. This in turn is highly likely to induce further securities lending activity.

Hong Kong has long benefited from a unique blend of Chinese growth and a well-established currency peg to the US dollar. If China continues to slow down and the US Federal Reserve stays on the current path of raising rates, Hong Kong may face the possibility of a property and equity market downturn, again which would culminate in specific strong sector shorts for the securities lending market.

Maury: Overall, global equity markets have been expensive. Indeed, equities are very much in a bull market, so it is therefore not surprising to see it undergo a correction. However, given the steep losses so far, it will take some time to recover, so I expect some volatility in the first half of 2016 and improvements later in the year.

We need further transparency before the uncertainty will subside, including on US Federal Reserve interest rate decisions, the Bank of Japan's path to reach its inflation target, and Chinese growth. As decisions unfold and clarity sets in, a relief rally in the second part of the year is a plausible scenario. **SLT**

Asian markets continued growth trend in 2015

Chris Benedict of DataLend drills deeper into Asian market trends to review the areas that are driving revenue growth in the region

The securities lending markets experienced mixed results from a revenue perspective in 2015. Securities lending revenue generated by Asian markets rose from approximately $1 billion in 2014 to more than $1.4 billion in 2015. North American revenue also experienced positive growth in 2015 as gross revenue grew by 21 percent. At the same time, European securities lending revenue was down approximately 12 percent year over year. DataLend drilled deeper into these trends in the Asian markets to review the areas driving the revenue growth in the region.

Japan has long been an established market in securities finance and had a substantial average daily on-loan balance of $66 billion for 2015. However, annual average fees for the market were approximately 47 basis points (bps), which were fairly cool relative to the region. The Japanese lending market consists of both equities (average of $49.04 billion) and fixed income (average of $17.29 billion) on loan. Two of the top performers in Japan were electronics firm Sharp and specialty retailer Sanrio. Combined, these two names produced approximately $35 million in gross revenue in 2015. We wait to see what impact, if any, the Bank of Japan's recent move to negative interest rates will have on the market.

Australia was also a fairly substantial market in terms of size with an average on-loan balance of just under $26 billion last year. Fees

Figure 1: South Korea On-Loan Value

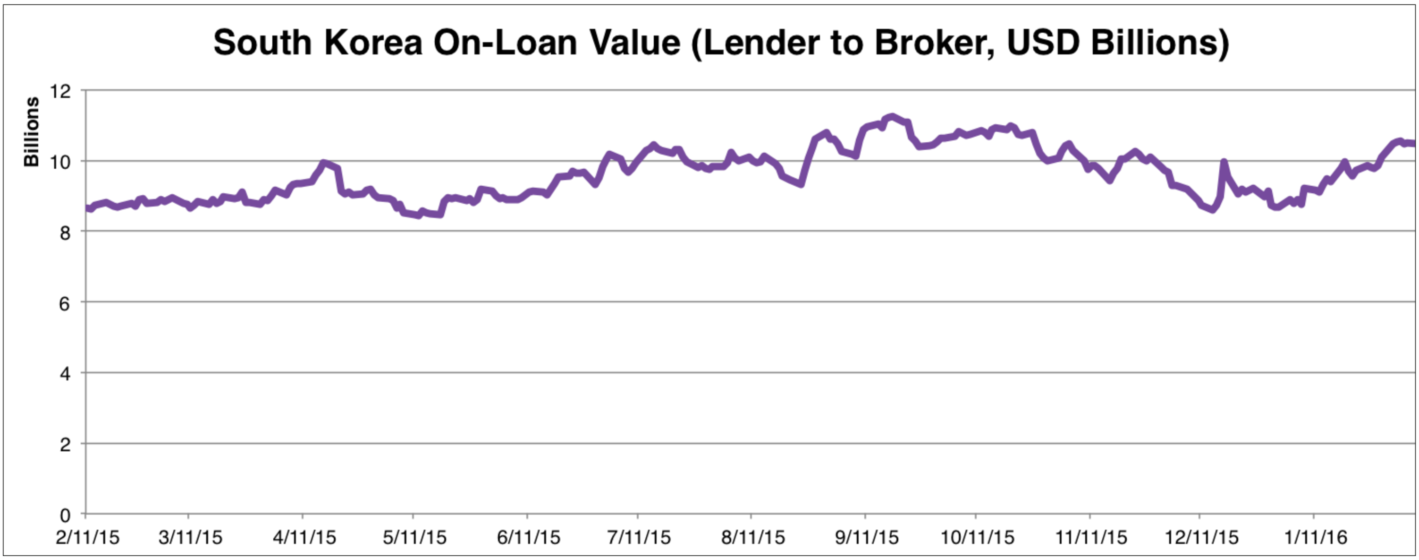


Figure 2: Most Profitable Names in Asian Securities Finance 2015

	Security	Sector	Country
1	HANERGY TFP	Semiconductors	Hong Kong
2	CELLTRION	Pharmaceuticals	South Korea
3	EVERGRANDE	Real Estate	Hong Kong
4	DAUM KAKAO	Software and Services	South Korea
5	HUISHAN DAIRY	Food, Beverage & Tobacco	Hong Kong
6	FORTESCUE METALS GROUP	Metals and Mining	Australia
7	SHARP	Consumer Durables & Apparel	Japan
8	SANRIO	Retailing	Japan
9	MIXI	Software and Services	Japan
10	CRRC	Capital Goods	Hong Kong

to borrow Australian assets were among the lowest in the region, averaging around 35 bps for the year. Mining company Fortescue Metals Group was the largest securities lending earner for Australia in 2015, grossing revenues of a little over $20 million.

Hong Kong had another great year in the securities lending market. Loan balances grew from a little over $26 billion in January to a peak of $37 billion in May of 2015. Fees to borrow Hong Kong equities averaged a very warm 182 bps for the year, hitting a high of 284 bps in early April.

Three of the highest revenue generating securities in Asia came from Hong Kong: renewable energy company Hanergy, property developer Evergrande and farming company Huishan Dairy. These three companies were responsible for almost $234 million worth of securities lending revenue last year.

South Korea also saw solid growth last year with on-loan balances starting 2015 at $8.1 billion and hitting a peak of $11 billion in September, averaging around $9.5 billion for the year. Fees for the market also saw significant growth, starting the year at 220 bps to hit a peak of 334 bps in July with a yearly average of 292 bps, putting it among the hottest in the region.

Notable South Korean revenue earners included pharmaceutical company Celltrion and software firm Daum Kakao. These two names alone made approximately $98 million in securities lending revenue in 2015.

Singapore also experienced solid overall growth in 2015 as balances rose from $2.6 billion early last year to approximately $4.1 billion in early 2016. Fees to borrow Singaporean assets averaged around 107 bps, hitting a high of 149 bps in November. Singapore shipping company Sembcorp Marine was actively traded last year, with lending revenues coming in at $11.6 million.

On-loan balances for Taiwan continued the growth trend exhibited by much of the region as balances increased from a little under $7 billion to $8.4 billion at the end of December 2015. Fees to borrow Taiwanese assets averaged 169 bps for the year. Hardware and electronic components company Acer was the most profitable security on loan for Taiwan last year, generating revenue of $8.16 million.

The remaining countries in Asia saw a combined average daily on-loan balance of $4.77 billion last year, with fees averaging around 122 bps. Securities lending activity in Asia continues to contribute a significant percentage of revenue to a global lending programme.

We look forward to continuing to monitor growth in Asia as new markets are explored. **SLT**

"Securities lending activity in Asia continues to contribute a significant percentage of revenue to a global lending programme"

Chris Benedict, Director, DataLend

Consumers services feel the January cold

Consumer spending has remained downbeat, with services firms coming at the bottom of the inaugural Markit US Sector PMI. Simon Colvin reports

Consumer spending represented two thirds of US GDP as of latest count, and with other sectors of the economy coming unstuck by global volatility, market watchers have increasingly looked to US consumers to pick up the growth slack. But this faith in US consumers is looking increasingly misplaced, as overall consumer spending over the crucial December 2015 holiday shopping window was flat on the previous month.

The new year brought a wave of negative indicators regarding the health of US consumers. Services firms came in at the bottom of the pile of the newly released Markit Economics US Sector PMI.

These firms had previously led all sectors in terms of output growth over last year, but momentum has faltered over the last two months and firms reported a slowdown in output over January for the first time in two years.

In fact, the consumer services sector was the only sector to see a slowdown in output over the month, putting it behind even basic materials firms, which have been the vanguard of the recent market slowdown.

Investors shifting positions

The recent weakness looks to have been seized upon by short sellers as demand to borrow consumer services' shares has increased to new highs in recent weeks.

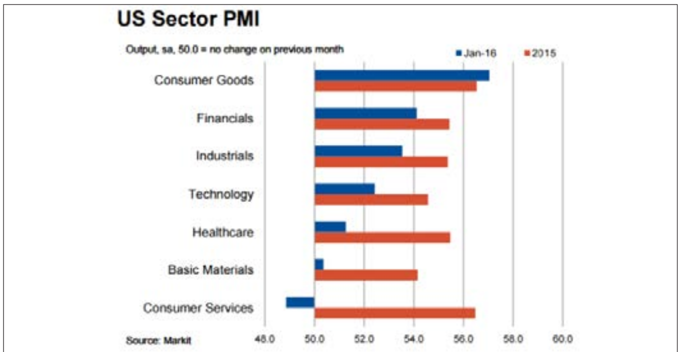
The current average demand to borrow shares in the sector has crossed the 4.5 percent, making it the third most shorted sector behind oil and gas and basic materials firms.

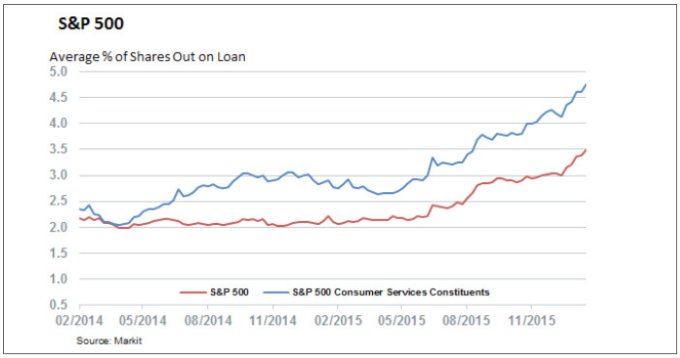
Retailers, which stand to feel the brunt of the anaemic consumer spending, have been the most targeted by short sellers as the industry makes up six of the 10 most shorted S&P 500 retail constituents. Videogame retailer Gamestop comes in as the most shorted of the lot with 40 percent of the firm's shares now on loan as its stocks hit new multi-year lows after its earnings came in below analyst estimates.

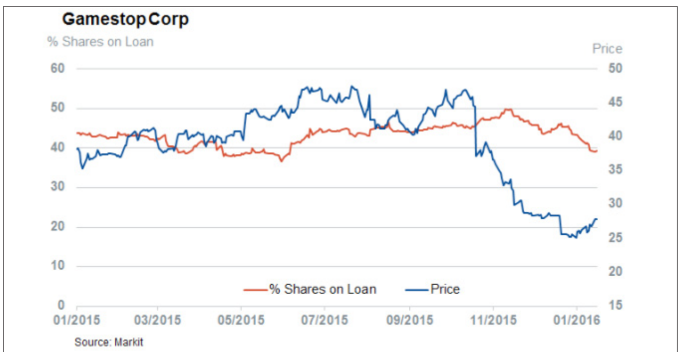
The consumer services sector was the only sector to see a slowdown in output over the month, putting it behind even basic materials firms

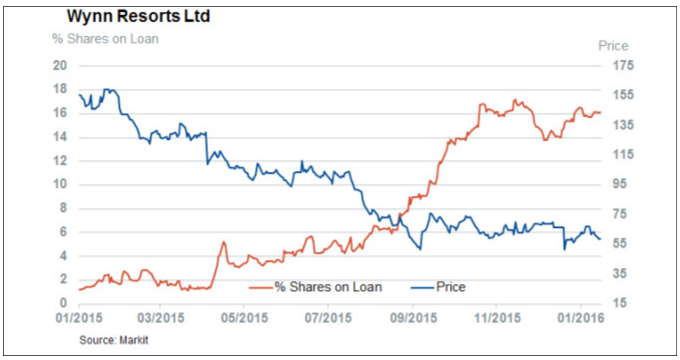
Other retailers favoured by short sellers are Carmax, Nordstrom and Gap, all of which see more than 12 percent of their shares now out on loan.

Outside of retailers, short sellers have been loading up on Discovery Communication and casino operator Wynn Resort. The latter of the two has seen short sellers circle as its shares tumbled by over 80 percent from their highs in 2014. **SLT**









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Industry **Events**

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Date: 01-03 March 2016
Location: Singapore
http://landing.rmahq.org/pasla/conference-87MH-1804IY.html

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- Debate with your peers the changing role of collateral and how we do more with less
- Hear how the buy side view the role of securities financing and their service providers evolving to reflect these new norms

Comings and goings at at J.P. Morgan, RBC I&TS and more

J.P. Morgan's global head of agency clearing and collateral management, **Emily Portney**, has left the bank.

Portney was with the bank for more than 20 years, having joined straight out of college.

She took on a variety of roles during her two-decade tenure within the bank's prime finance, equities and futures clearing desks, and took on her latest role in 2012.

Portney also served on the US Commodity Futures Trading Commission's market risk advisory board, the executive committee of the Futures Industry Association, and CME Group's risk committee.

J.P. Morgan has yet to announce Portney's replacement.

Don D'Eramo will assume responsibility for managing the securities finance business globally at RBC Investor & Treasury Services following the departure of **Kelly Bateman**.

Following Bateman's decision to leave RBC, D'Eramo, based in Toronto, will report to managing director Elaine Skinner-Reid.

Don D'Eramo previously served as a regional head of securities finance at State Street

D'Eramo joined the Canadian bank in August last year as head of securities finance distribution and product development for its treasury and market services activity.

He previously served as a regional head of securities finance at State Street.

Credit Suisse co-head of prime services in Europe, **Dougal Brech**, will leave the bank at the end of February.

A replacement has not yet been named but the position will be based in London.

The Swiss bank recently moved part of its prime services to Dublin under a significant re-structuring process.

The new hub for Credit Suisse's prime services business in Europe will house 100 members of staff, including 40 trading, risk and capital professionals, and 60 support personnel.

The Dublin operation will handle trading, capital and risk management for the business, while the salespeople and relationship managers will remain in London due to client proximity, according to Credit Suisse.

HM Treasury has appointed **Andrew Bailey** as the new CEO of the Financial Conduct Authority (FCA).

Bailey is currently deputy governor for prudential regulation at the Bank of England and CEO of the Prudential Regulation Authority (PRA). He will take up his new role once a suitable successor is found at the PRA, expected to be around July.

Serving a five-year term, Bailey will replace Tracey McDermott, who has been interim CEO since Martin Wheatley stepped down from the role in September 2015.

John Griffith-Jones, chair of the FCA said: "I am delighted that Andrew Bailey has been appointed as the new chief executive.

"He brings unrivalled regulatory experience, a proven track record and an excellent reputation in the UK and internationally.

"Having been an FCA board member since 2013 he has been fully engaged with all the regulatory issues that we have faced in recent years and in setting our strategy for the future."

He added: "I would also like to thank Tracey McDermott for the excellent job she has been doing as the Acting CEO and for agreeing to remain in post until Andrew starts." **SLT**

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