SLT SecuritiesLendingTimes

ISSUE156
19.07.2016 TUESDAY
securitieslendingtimes.com

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South Africa makes leap to T+3

South Africa's capital market has initiated its long-anticipated settlement reform by shortening its standard cycle to T+3 from T+5.

The revised market cycle went live on Sunday 10 July and the first trades were successfully settled with no fails on 14 July, according to the Johannesburg Stock Exchange (JSE).

A faster settlement cycle represents a significant opportunity for South Africa's securities lending market, which the JSE highlighted as central to minimising fails in the new environment.

At the same time, the move will boost the market's limited liquidity levels.

Leila Fourie, executive director at the JSE, commented: "Based on the average daily figure of trading to the value of ZAR 25 billion (USD 1.74 billion), this is expected to create a release of ZAR 50 billion (USD 3.48 billion) into circulation."

"Experience from other international exchanges indicated that we could potentially be looking at a 7 percent to 10 percent increase in liquidity, depending on current markets and other macroeconomic factors," Fourie explained.

South Africa is now in line with the US settlement cycle until Q3 2017, when the US in turn will cut its settlement cycle down to match the EU's T+2 system.

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Consob bans short selling of Italian bank shares

Italian financial services regulator Consob has been forced to impose multiple short selling bans on the shares of the country's banks this week after the financial sector suffered fierce market turbulence.

A three-month ban on short sales was imposed for shares in Banca MPS, the country's third largest lender, after its share price dropped from 30 cents (euro) to 27 cents in the first two hours of trading of 7 July.

The ban was initially set to run for a single day on 6 July but it was subsequently extended to run until 5 October.

In Consob's statement on the decision, the regulator specified that the prohibition on net short positions bans both short selling on Banca MPS shares and short positions taken though single stock derivatives.

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Short sellers Diglett Nintendo

The gaming phenomenon Pokémon Go has helped Nintendo's share price to soar by 93 percent in the past week, but FIS Astec Analytics data has revealed that speculative short sellers are also gathering.

Borrow volume in Nintendo grew by 73 percent in the past week, although, as FIS noted, this remains some way below the 12-month peak borrow volume seen last March. David Lewis, senior vice president and FIS Astec Analytics, commented: 'It [the rise in borrow volume] is a move that cannot be ignored any more than you can ignore the hordes walking the streets attacking virtual monsters with their smartphones."

Pokémon Go gained more than 65 million users in the US alone within seven days of its launch.

South Africa makes the leap to T+3

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"This is a major milestone for our country and our capital markets. The alignment with global standards will increase interest from global investors who constitute more than a third of our equity market volumes," added Fourie.

"Coupled with this, the move to a shorter T+3 settlement cycle will significantly reduce the number of unsettled trades at any given point, substantially reducing the potential risks and losses between trading parties and enhancing investor protection."

The JSE anticipates between 5 percent and 10 percent rolling of trades in the new environment, but is aiming to maintain a target of less than 5 percent, which is consistent with global best practice.

It is also working with market participants to minimise this percentage even further by improving the availability of securities for lending and borrowing activity and also by actively encouraging behaviour changes where required.

The reform was described by Brett Kotze, head of operations for clearing and settlement at the JSE, as one of the largest projects in South Africa since early 2000.

The T+3 project was initiated in 2013 and has since been through a three-step implementation process, which took place at national level and involved multiple test runs with all market participants. The move was spearheaded by the JSE in close collaboration with the South African Reserve Bank, National Treasury, Financial Services Board and numerous other stakeholders.

Italy bans short selling of banks

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The ban does not apply to transactions in index-related instruments, taking into account the marginal weight of Banca MPS shares in financial indices.

The decision to extend the ban was endorsed by the European Securities Markets Authority, which stated: "The current circumstances related to Banca MPS constitute adverse events or developments which constitute a serious threat to market confidence in Italy and that the proposed measure is appropriate and proportionate to address the threat to Italian financial markets."

Consob was also forced to enact a one-day shorting ban on share of communications provider Telecom Italia and Credito Valtellinese, an Italian co-operative bank on 7 July.

Hermes Investment Management said of the country's troubles in a research note: "In the short-term, Italian banks find themselves in an increasingly difficult situation regarding their ongoing non-performing loans, which are equivalent to around 22 percent of the country's GDP."

It continued: "[We] heard rumours of the Italian government bailing out the banks, but this would contravene EU rules which stipulate bail-in of equity and bond-holders prior to such a rescue."

"Italy is less keen on this option, given that many of those that would be 'bailed-in' are retail investors (more than 50 percent in some cases). In the meantime, Italian bank shares continue to plunge and capital positions remain light."

ETFs offering tasty returns

European and Asian exchange-traded funds (ETFs) are currently offering particularly attractive lending returns in their equity securities lending rates, according to Clearstream chair Jeffrey Tessler.

Demand for ETFs is steadily growing but challenges around settlement and realignment

Contents

within the fragmented European market are stifling further potential for growth, according to Tessler.

The ETF market is worth more than €450 billion, with more than 2,200 products registered in at least 20 countries, according to Clearstream.

Clearstream provides ETF issuers with global access to investors in over 50 markets as well as settlement in over 40 currencies, which can be utilised for securities lending and collateral management through its Global Liquidity Hub.

“Currently, ETFs enjoy the highest equity securities lending rates, with European and Asian ETFs offering particularly attractive lending returns,” Tessler said.

According to a recent PwC survey, the global ETF market is gearing up for a growth spurt. The survey report noted that ETFs saw a record $351 billion in global flows in 2015, while ETF assets under management have increased from $1.46 trillion in December 2010 to $2.96 trillion in December 2015.

Among Asian firms that responded to the survey, the Hong Kong-Shanghai Stock Connect was named the biggest growth accelerator, highlighted by about 80 percent of respondents. This was closely followed by availability of new distribution platforms and better investment education.

Also in Asia, the majority of respondents, about 70 percent, said insurance companies will be the main drivers for demand of ETFs. This was followed by ETF strategists, noted by about 60 percent, and financial advisors, named by about 50 percent.

European respondents, meanwhile, named investor education as an important growth indicator. This was followed by lower distribution costs and availability of new distribution platforms.

The survey covered more than 80 percent of the world’s ETF assets, according to PwC.

BoE keeps interest rates the same

The Bank of England has declined to raise interest rates in the face of increasing economic uncertainty following the UK’s decision to leave the EU, but warned that volatility in property prices might require action in the future.

Monetary policy committee members voted eight to one in favour of keeping the UK’s interest rate at 0.5 percent, despite a majority of market commentators expecting a cut to 0.25 percent.

They also voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion.

A Bank of England statement said: “Committee members made initial assessments of the impact of the vote to leave the EU on demand, supply and the exchange rate. In the absence of a further worsening in the trade-off between supporting growth and returning inflation to target on a sustainable basis, most members of the committee expect monetary policy to be loosened in August.”

But the outlook for the UK is less than rosy, with survey data suggesting that the housing market will suffer a “significant weakening in expected activity” thanks to the uncertainty brought about the 52 percent vote to leave the EU in June.

“There are preliminary signs that the result has affected sentiment among households and companies, with sharp falls in some measures of business and consumer confidence.”

"Early indications from surveys and from contacts of the bank's agents suggest that some businesses are beginning to delay investment projects and postpone recruitment decisions."

"Taken together, these indicators suggest economic activity is likely to weaken in the near term."

Commenting, Darren Ruane, head of fixed interest at Investec Wealth & Investment, said: "It is likely that markets will comprehensively price in the likelihood of a rate reduction in August."

"The immediate reaction in markets is that UK government bond yields are higher, the FTSE 100 has fallen back by around 70 points (1 percent) to overnight levels and sterling has rallied against both the US dollar and euro."

State Street joins margin settlement pilot programme

Euroclear and the Depository Trust & Clearing Corporation (DTCC) have secured State Street as a participant in a pilot programme to test their joint venture's margin settlement messaging service. The joint project, known as GlobalCollateral, will begin testing its new add-on after receiving authorisation from the Financial Conduct Authority to operate its margin transit utility (MTU) technology on 31 March.

The latest addition to GlobalCollateral, a collateral processing platform first launched in 2014, is aimed to provide straight-through-processing for the settlement of margin obligations. According to a Euroclear statement on the pilot programme, State Street, as a participant, hopes to further streamline its margin call processes, increase transparency through automated collateral settlement tracking, enhance client service, and improve custodian communications.

State Street will initially pilot the MTU functionality with select client portfolios to evaluate how the technology could be leveraged more broadly.

"We look forward to participating in this programme," said Dick Taggart, executive vice president and head of State Street's investment manager services business.

"Industry collaboration and a community-based model for margin call management can decrease risk, drive standardisation and increase efficiency for our clients. As we enhance our collateral management services, we are focused on streamlining and scaling the margin call process, improving settlement certainty and increasing transparency."

ESMA proposes two-year extension for OTC central clearing rule

The European Market Infrastructure Regulation (EMIR) requirement to centrally clear over-the-counter (OTC) derivatives may be pushed back by two-years for 'small' counterparties.

The European Securities and Markets Authority (ESMA) has published a consultation paper proposing a delay to EMIR's phase-in period for category three counterparties with a limited volume of OTC derivative business.

The extended phase-in period will allow affected counterparties more time to meet the minimum volume and cost requirements of becoming a direct clearing member of a central counterparty (CCP), according to ESMA

The regulator also cited challenges for some counterparties around infrastructure needs, adequate resources and minimum capital requirements, along with risks, such as mutualisation of default fund resources, as its reasons to propose the delay. The consultation window closes on 5 September and ESMA will publish its final report by the end of the year.

Spanish trading heats up in June

Equity trading on BME Clearing's exchange has recorded a 25 percent drop off in volume between January and June this year compared to the same period in 2015.

BME Clearing's equity volume for the first half of the year hit €389.7 billion, down from €519.6 billion in H1 the year before.

However, a rebound may be on the horizon as the exchange saw a 36.2 percent uptick in its equity trading volume for June, compared to the month before.

The same trend can be seen in the exchange traded fund (ETF) volumes, with H1 volume falling by 41.7 percent from the same period in 2015, but monthly volume for June soared by 115.8 percent, compared to the May.

ETF volume in the first half of 2016 totalled €3.7 billion, with €653.9 million of that coming in June alone. In the derivatives market, volume was up by 3.2 percent in June reaching 5.8 million contracts, compared the same month in 2015.

Citigroup admits blue sheet violation

Citigroup Global Markets has admitted wrongdoing and agreed to a $7 million penalty to settle charges that it provided incomplete blue sheet information to the US Securities and Exchange Commission (SEC) over a 15-year period.

The SEC found that a computer coding error caused Citigroup to omit certain trade information requested in the blue sheet data by the SEC. This data included time of trades, volumes traded, prices, and other customer-identifying information. In total, the SEC alleged that Citigroup failed to report 26,810 securities transactions across more than 2,300 blue sheet requests, between May 1999 and April 2014.

The resulting $7 million penalty is the largest ever issued for blue sheet violations, and, according to the SEC, reflects the significant length of time that the error went unchecked. The SEC also found that, once it discovered the coding error, Citigroup failed to report the incident to the SEC. Citigroup then took no steps to produce the omitted data until nine months later.

Robert Cohen, co-chief of the SEC enforcement division's market abuse unit, said: "Broker-dealers have a core responsibility to promptly provide the SEC with accurate and complete trading data for us to analyse during

enforcement investigations. Citigroup did not live up to that responsibility for an inexcusably long period of time, and it must pay the largest penalty to date for blue sheet violations."

A Citigroup spokesperson said: "We are pleased to have resolved this matter."

The case follows several other high-profile penalties paid for violations around blue sheet information.

In September 2015, Credit Suisse Securities admitted that technological and human errors led to the omission of more that 550,000 reportable trades from blue sheet responses over two years, paying a $4.25 million penalty.

In June 2015, OZ Management LP paid a $4.25 million penalty for similar offences over almost six years, and in January 2014 Scottrade paid $2.5 million for submitting incomplete blue sheet responses for more than six years.

Banks on track with T2S project, says Clearstream

The vast majority of banks are confident that they're prepared for implementation of Target2-Securities (T2S), according to a survey by Clearstream and Accenture.

Of the banks surveyed, 90 percent said they are ready for T2S, with half of these indicating that their preparations are part of a wider strategy. Only 10 percent said they are not ready for implementation. The survey suggested that this could be because they have not identified specific risks during the impact assessments, or because they believe they are flexible enough to manage the change.

Although there are various access models to T2S up for discussion, the survey identified a trend towards using either a single point of access or a model with few points of access. The most popular option was connecting through an investor central securities depository, selected by 40 percent of respondents.

A fifth said they will connect through a custodian and an investor's CSD, 10 percent said they will use an investor CSD and an international CSD, and 10 percent said they would use a custodian and an international CSD.

The remaining 20 percent said they will connect through all three.

The survey also found that a majority, 65 percent, are not planning any connectivity rationalisation or optimisation, either before implementation of T2S or alongside it. The report said this suggests that these activities and the related costs are being pushed back to later stages.

It said 25 percent of respondents plan to manage connectivity rationalisation and optimisation at the same time as connecting to T2S, thereby "leveraging resource synergies", while the remaining 10 percent plan to do this before connecting to T2S.

The report said: "T2S has, to a certain extent, served as a business and technology operating model accelerator for banks, particularly in certain geographies where market reforms have been significant."

Clearstream's CSDs in Germany and Luxembourg will migrate to the platform in wave four in February 2017.

Eurex Repo's lower growth continues

Eurex Repo's outstanding volumes have now been lower than last year for six consecutive months, with average outstanding volume at the end of 2015 down €26.7 billion.

The Deutsche Börse subsidiary had an outstanding average of €172.8 billion last year, down from €199.5 billion in 2014.

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More recently, in June 2016, Eurex Repo saw a 23.7 percent fall in all markets, compared to the same time last year.

The average outstanding volume fell by €43.4 billion to achieve €139.8 billion last month, compared to €183.2 billion in June 2015.

Eurex Repo has consistently cited that "this negative development was mainly due to the quantitative easing policy of the European Central Bank" as the main driver of its negative results. It did not wish to comment further.

The persistent market headwinds come in spite of several market initiatives launched by the company to boost business this year.

These include an expansion of Eurex Repo's inter-bank markets by customising buy-side trading licences that offer bilateral trading in February.

Eurex Exchange also launched a US dollar-denominated futures on the Euro STOXX 50 index in March, which aimed to allows investors to participate in the performance of the index without being subject to currency fluctuations between euro and US dollar.

In April, Eurex Repo launched a service to allow its clients to trade pound sterling (GBP) against debt securities of the UK government-denominated in GBP and is available in the UK gilt basket.

OCC boasts strong June volumes

The Options Clearing Corporation (OCC) enjoyed a 39 percent boost to its securities lending new loans volume through its central counterparty in June, compared to the same month in 2015.

January to June stock loan activity was also up 45 percent from 2015.

OCC's average cleared daily loan value for June reached $1.45 billion.

The Chicago-based clearinghouse also achieved its highest ever volume for cleared futures in a month, with a 79 percent jump, compared to June 2015.

OCC's average daily cleared futures volume for 2016 so far is up 68 percent with 386,756 contracts in 2016.

"OCC has seen increased clearance and settlement activity in our core equity options clearing business attributable to recently elevated levels of equity market volatility," said Craig Donohue, OCC executive chair.

"We also continue to experience strong growth in our futures and stock loan clearing businesses."

As the foundation for secure markets, OCC is committed to providing industry-leading clearance, settlement and risk management services while fostering the continued growth of our business."

Linear teams up with RSRCHXchange for compliant research

Linear Investments has partnered with RSRCHXchange, an online marketplace for institutional research, to offer its hedge fund clients to access to research in compliance with the second Markets in Financial Instruments Directive (MiFID II).

The partnership allows Linear direct access to alpha-generating institutional research from over 140 providers on the RSRCHX platform, as well as the ability to track research procurement and consumption in real time, via the integrated dashboard.

Jerry Lees, chair of Linear Investments, said: "The RSRCHX platform is a pivotal addition to Linear's offering, permitting our hedge funds, family offices and asset managers to easily access, procure and pay for MiFID II compliant and unbundled research."

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Jeremy Davies, co-founder of RSRCHXchange, commented: "We are thrilled to be working with Linear Investments to enable their hedge fund clients to access institutional research via our platform."

OneChicago sees keen interest in OCX.NoDivRisk for June

Chicago saw its open interest fall by 41 percent for June, compared to the same time last year.

The securities finance exchange's open interest reached 473,876 contracts at the close-of-market on 30 June, with the 75 percent of the month's contracts in the exchange's flagship OCX.NoDivRisk product.

Monthly volume fell by 22 percent compared to June 2015, but year-to-date volume is actually outpacing 2015's figures by 13 percent. Last month also saw the announcement that OneChicago is launching a new no dividend risk cash settled single stock futures on 1 August 2016.

Brexit: the day after tomorrow

The UK's financial services firms were the biggest targets for short sellers after the Brexit vote, according to DataLend.

DataLend saw fees for financials jump 52 percent in the days immediately after the EU referendum result was confirmed on 24 June.

UK banks and real estate companies garnered the most attention, with fees to borrow rising from 40 basis points (bps) to 61 bps between 23 June and 28 June.

DataLend also noted that, in contrast to the fast-changing environment in the UK, EU borrow fees and utilisation of financial services firms remained largely the same. Borrow fees for UK bank stocks soared by 200 percent from an average of 25 bps on 23 June to a high of 75 bps on 28 June.

Borrow fees for UK real estate firms "showed a similar pattern" to that of bank shares, with fees increasing from 38 bps on 23 June to 52 bps by 30 June, representing a 36 percent increase.

Utilisation rose from 7.2 percent to 8.7 percent during the same timeframe.

"Compared to hotter industries such as UK information technology (currently trading at 390 bps), these fees may not seem particularly incendiary; however, they still represent a significant change in demand to borrow the UK financial services sector."

"We will continue to monitor fees in UK financials, particularly in light of the Bank of England's announcement on 5 July to ease special capital requirements for banks."

Greek bonds rejoin collateral pool as ECB reinstates waiver

Greek government bonds are once again available for use as collateral, as of 29 June, after the European Central Bank (ECB) reinstated a waiver on its minimum credit rating requirements.

The usual credit rating threshold for using government bonds as collateral in Eurosystem monetary policy operations was suspended by the ECB's Governing Council but will be subject to special haircuts that will be specified in the relevant legal act.

In a statement on the ruling, the council noted that it "acknowledges the commitment of the Greek government to implementing current European Stability Mechanism programme and expects continued compliance with its conditionality".

The ruling will remain until further notice and applies to all outstanding and new marketable debt instruments issued or guaranteed by Greece.

The ECB's council confirmed that purchases of Greek bonds under the public sector purchase program will be examined at a later stage, taking into account the progress made in the analysis and reinforcement of Greece's debt sustainability, as well as other risk management considerations.

BCBS addresses NSFR questions

Collateral must be considered encumbered for the term of the transaction, regardless of maturity date, when calculating the net stable funding ratio (NSFR), according to Basel Committee on Banking Supervision (BCBS).

In its latest response note to industry queries about Basel III's NSFR, the BCBS explained in a newly updated FAQ document that any collateral pledged under a transaction maturing beyond one year should be subject to a required stable fund factor of 100 percent.

In a separate question, the BCBS clarified that securities finance transactions can only be reported on a net basis in the NSFR when the transactions have a single counterparty and all the netting conditions set out in Paragraph 33(i) of the Basel III leverage ratio framework and disclosure requirements document are met.

In all other instances, the amounts receivable and payable through securities financing transactions should be reported on a gross basis.

When dealing with partially secured securities transactions in the context of calculating the NSFR, the BCBS said that the secured and unsecured portions of a loan should each be treated according to its characteristics and assigned the corresponding required stable fund factor.

The BCBS added that if it is not possible to draw the distinction between the secured and unsecured part of the loan, the higher required stable fund factor should apply to the whole loan.

Finally, the BCBS addressed industry concerns regarding open reverse repo transactions, explaining that, when determining the maturity of an instrument, investors should be assumed to exercise any option to extend maturity.

For assets with options exercisable at the bank's discretion, supervisors should take into account reputational factors that may limit a bank's ability not to exercise the option.

A focus on regulation

Everything has changed but remains the same following the 'Brexit' vote in June

The UK's decision to leave the EU following the referendum vote on the 23 June has left the financial services industry facing an uncertain future. The result poses more questions than answers on what it will mean for financial regulation in the post-Brexit era.

In the immediate aftermath of the Brexit vote, we can expect a business as usual approach to regulatory compliance. At the beginning of 2016, Kay Swinburne, Conservative MEP and member of the European Parliament's economics and monetary affairs committee, warned that in the event of the UK voting to leave the EU, firms would still need to comply with European financial services legislation. This view was reiterated by the UK Financial Conduct Authority in its referendum result statement. It advised that firms continue with their obligations under UK and EU law, including implementation plans for legislation that is still to come into effect.

The UK government has yet to announce when it intends to invoke Article 50 of the Treaty on the EU, which will trigger the official start of the UK's withdrawal process from the union. Regardless of when Article 50 is invoked, most institutions will hope to suffer as little disruption as possible over the forthcoming years as the UK exits the EU. Many analysts believe it will take at least two years for the withdrawal process to be completed and during that time the UK will remain subject to EU law.

Financial services is already a highly regulated industry and this will not change as a consequence of Brexit. Many EU regulations already stem from international directives from the G20 and the Basel Committee on Banking Supervision, of which the UK is a party. The long term future of financial regulation within the UK will depend largely on the type of relationship it intends to seek with the EU. The UK could adopt a similar line to Norway (by becoming a member of the European economic area and European Free Trade Association). Alternatively, it could become the new Switzerland by accessing the EU through bilateral agreements.

Brexit should see no immediate effects to financial regulation but the UK will undoubtedly lose its influence and ability to negotiate, change and challenge future regulations set by the EU. Until that point, the British wartime slogan 'Keep Calm and Carry On' would appear an apt description on how institutions should approach post-Brexit financial regulation.

Jeremy Taylor
Head of business consulting
GFT

Bears sightings increase in London real estate, SAYS IHS Markit

Short sellers are moving into the UK real estate sector in greater numbers as investor sentiment sours after the referendum, according to IHS Markit.

Although shorting interest in the sector has been increasing since the start of the year, it leapt by a further 43 percent once 'Brexit' was announced.

Bearish activity in UK real estate market, specifically commercial property, first began to gain momentum in the weeks as skittish investors reacted to polls showing the increasing likelihood of a 'Leave' vote.

Since the 23 June referendum, average short interest across the UK real estate sector, which includes 63 firms, has surged by 28 percent, rising to 1.3 percent as of 13 July.

Intu Properties, a shopping centre operator, became the most shorted firm.

It recorded a massive 141 percent jump in short interest, with 10.3 percent of shares outstanding on loan.

Do you have a story we should cover?

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Under pressure: financial services turns the screw

The BCBS has been taken to task over its latest leverage ratio framework proposal, with commentators claiming it may unbalance global markets and damage the business model of clearinghouses

The latest iteration of the Basel Committee on Banking Supervision's (BCBS) Basel III leverage ratio framework has galvanised the global financial services industry into action to ensure that the final proposal, which is due by the end of 2016, is a viable addition to the post-financial crisis regulatory framework.

The BCBS presented its new proposal, which already includes several revisions from its original version, in April and offered financial services a final opportunity to provide feedback—and the response was damning.

One comment letter, signed by 30 exchanges and clearinghouses, along with other stakeholders, said the leverage ratio, in its current form, fundamentally threatens their business model and could affect financial market stability.

In total, 53 comment letters were sent to the BCBS during the three-month consultation. The full list of industry comment letters is available to read on the Bank for International Settlement's website.

The revisions

The revised framework revealed a number of proposals for amendments that may be made to the framework, based on previous issues raised by financial services. These included:

- The use a modified version of the standardised approach for measuring counterparty credit risk exposures (SA-CCR) instead of the current exposure method (CEM) to measure derivative exposures;
- Two options for the treatment of regular-way purchases and sales of financial assets to ensure consistency across accounting standards;
- A clarification on the treatment of provisions and prudential valuation adjustments for less liquid positions to avoid double-counting; and
- An alignment of the credit conversion factors for off-balance sheet items, with those proposed for the standardised approach to credit risk under the risk-based framework

Get your clearinghouse in order

The clearinghouse and exchange-backed letter boasted several signatories, including ABN AMRO Clearing Bank, Eurex Clearing, the Options Clearing Corporation (OCC) and Nasdaq, making it one of the most significant comment letters in the long list of respondents.

Beyond its initial stark warning, the letter's signatories positively acknowledged the progress that the framework has already made from its initial form. They reiterated their encouragement that further progress can be made thanks to the BCBS's willingness to continue respecting the various concerns of financial services. But they also didn't shy away from the fact that significant work is still needed before the final proposal is published.

The letter's signatories took particular issue with the CEM, arguing that the SA-CCR offers a better alternative to calculating leverage for exchange-traded derivative (ETD) exposures.

The letter states: "[With the CEM] the application of the leverage ratio will result in vastly increased capital requirements for general clearing members offering clearing services to market makers and liquidity providers.The leverage ratio does not take the different characteristics and risks of ETD and OTC instruments into account. For ETD, we believe that a different treatment compared to over-the-counter (OTC) derivatives would be warranted recognising the applicable netting rules and CCP clearing processes."

The letter was also one of many that drew attention to a number of unintended consequences that the current leverage ratio framework threatens to impose.

"We note that a number of general clearing members (GCMs) have already ceased their operations while others are re-assessing their business models. Data from the US Commodity Futures Trading Commission shows a steady decrease in the number of futures commission merchants, while at the same time the number of total cleared client assets has increased significantly driven by new clearing mandates since 2009."

"We fear that a further reduction of GCMs will result in an undesirable lack of choice for end-users and decrease available (global) balance sheet capacity for clearing of derivatives transactions, including those that are anticipated to become subject to mandatory clearing."

John Fennell, OCC executive vice president of financial risk management, expanded upon the issues it raised, pointing out that options in particular are treated incorrectly.

He said: "[The leverage ratio] creates the real potential to move liquidity away from the listed and centrally cleared markets and ultimately back to the opaque bilateral OTC markets. This is counter to the global mandate by regulators to bring more OTC volume into centrally cleared solutions mitigating systemic risk."

"The issue with the leverage ratio, and specifically the CEM, is that it neglects to recognise the risk limiting effects associated with being long and short options of different strikes on the same underlying instrument. Hedging option risk using other options is the most effective and relied upon way option market makers mitigate the risks assumed as they fulfill their vital role of providing committed liquidity to the cleared markets."

"Our desire is that the regulators adopt SA-CCR as quickly as possible, which does not have the same shortcomings of CEM, or provide an exemption for options market makers, given the vital role they fill in providing committed liquidity to these markets."

Another noteworthy response included the views of five financial industry associations, including the International Swaps and Derivatives Association (ICMA), which joined forces to express their strong concern about the implications of including central bank cash balances within the leverage ratio framework.

The associations noted and echoed the sentiments of the Bank of England's Financial Policy Committee, which raised its the same concern with the leverage ratio framework in its review on 5 July.

All five associations reiterated their support for the BCBS's broad aims to mitigate market risk and boost transparency, but also highlighted the need to expand the scope of the BCBS's review and "carefully consider the way cash and unencumbered cash equivalent assets are treated in the leverage ratio".

They said they share the Financial Policy Committee's concerns that including central bank deposits in the leverage ratio could affect the ability of the banking system to cushion shocks.

Kenneth Bentsen, CEO of the Global Financial Markets Association, a trade group that joined ICMA in submitting to the consultation, explained: "Even client transactions that are designed to reduce risk will require broker-dealers to expand their balance sheets. Regulations should not impair clients' ability to conduct risk-reducing transactions in cases where these transactions do not add risk to banks' balance sheets."

"By excluding cash and cash equivalents from the exposure measure of the leverage ratio, regulators could alleviate the constraints on these important market activities, especially in distressed markets."

Scott O'Malia, ISDA's CEO, added: "The leverage ratio as it stands makes the economics of client clearing extremely difficult for clearing members, which runs counter to the objective set by the G20 nations to encourage central clearing."

"We welcome the decision by the BCBS to collect data to study the impact of the leverage ratio on client clearing, but we are disappointed it has not taken the opportunity to consult on the recognition of initial margin more widely."

The associations also noted that the BCBS did not resolve the issue of whether to recognise collateral posted by counterparties on derivatives trades more broadly. Additionally, the lack of recognition of high-quality liquid assets as variation margin will potentially limit the access to derivatives of pension funds and other end users that rely on the ability to post securities collateral.

The associations added in their joint statement: "The BCBS should consider how other cash equivalent securities, such as US Treasuries and other high-quality government bonds, are treated in the leverage ratio and the broader Basel framework."

"These securities underpin the soundness of the financial system and are used as collateral by most market participants for central clearing and as liquidity reserves by all banks and other market participants. If banks are bound by the leverage ratio, they cannot provide financing, even against such high-quality assets, and this may significantly reduce risk warehousing capacity on a system-wide level."

Over the Hill

The leverage ratio also attracted criticism from departing UK representative in the European Commission, Jonathan Hill, who spearheaded financial services reform. Hill resigned following the UK's referendum on its EU membership, which kicked off the so-called Brexit, and couldn't resist a parting blow in his final speech before the European Parliament on 13 July.

Hill said: "In the banking sector, we need to be sure that measures being considered by the Basel Committee—like the leverage ratio, the net stable funding ratio, and the fundamental review of the trading book—work for Europe."

"Many people who replied to the call for evidence said they worried about the impact of those measures and how they interacted with existing rules. They are also worried about the impact of future measures on areas like trade finance, market liquidity and on access to clearing services."

He added: "Trade finance loans are typically less risky than standard corporate loans. But people have told us that this is not recognised properly by the Basel measures being developed. They worry that neither the leverage ratio nor the NSFR will recognise the specific nature of trade finance."

"So we need to look at whether these measures can be adjusted and see whether we can lower the NSFR required stable funding factor and exempt trade financing altogether from the leverage ratio calculation."

Hill did express confidence that the BCBS would continue to work closely with financial services to ensure the final result is acceptable to all parties. "That [banking reform] is of course no longer up to me. It will now be up to my colleague Valdis Dombrovskis to take it forward with you. I could not be leaving the [leverage ratio's] call for evidence in better hands," Hill concluded. **SLT**

The longest week

The UK is the volatile epicentre of fast-paced economic and political change that is playing havoc with EU markets and the aftershocks are still coming thick and fast. FIS Astec Analytics senior vice president David Lewis reports

Working at a gilt edged market maker in the 1990s, my life was very binary. Some bad news came in, the cry of “sell everything” would go out and when good news was around, the opposite shouts were heard. How things have changed, not only technologically, but regulatory and, of course, politically. They say a week is a long time in politics, and each and every week since the 23 June referendum vote to leave the EU has certainly lived up to that maxim. The UK has endured the Brexit vote, the resignation of a prime minister, a leadership contest, too many resignations to count, an opposition leadership challenge, and then, two months earlier than expected, a new prime minister.

If you are trying to trade the markets while all this is going on, you are probably working a long way from pure fundamental style analysis. Sentiment is the market driver at present and sentiment is fickle at best.

It would appear that almost everyone was caught out by the result of the Brexit vote, not least of which, those actually leading the Brexit campaign. Polling analysts, bookies, business leaders and short sellers all seemed to be expecting a ‘remain’ result, even if not by a significant margin. It is fair to say that the whole of the UK was in a state of shock directly after the vote, irrespective of which way people actually voted.

Looking at the short selling activity before and after the vote tells an interesting, if not conclusive story. Conclusions can be difficult when considering time series data. Having considered the extent of short selling data at my disposal, it is possible to say that short interest was relatively low or high around the vote, depending on the dates that data point is compared with. For simplicity, Figure 1 shows data three weeks before and two weeks after the vote, from which your own conclusions can be drawn.

What the data does indicate, however, is that short sellers in Italy and the UK were reducing their positions ahead of the vote, suggesting that the expectation of a market boost following a remain result was on the way. Short selling in French shares was actually up just over 4 percent by 23 June, compared with 9 June. By contrast, short selling in German shares jumped up in terms of borrow volumes for one week before joining their British and Italian counterparts in reducing their short exposure going into the vote.

Then came the vote and the market impacts were felt across the eurozone and much further afield. The DAX, CAC, FTSE 100 and MIB indexes were all on the rise leading up to the vote, so it is perhaps unsurprising that short sellers were getting nervous and reducing their exposures.

However, like many other observers, analysts, pollsters and pundits, they got it wrong. On 24 June, the FTSE 100 fell more than 3 percent, the DAX almost 7 percent, the CAC 8 percent and the MIB an eye-watering 12 percent. By 27 June, having added the loss of a prime minister to the mix, the same indices extended those losses to 5.6, 9.6, 11 and 16 percent, respectively.

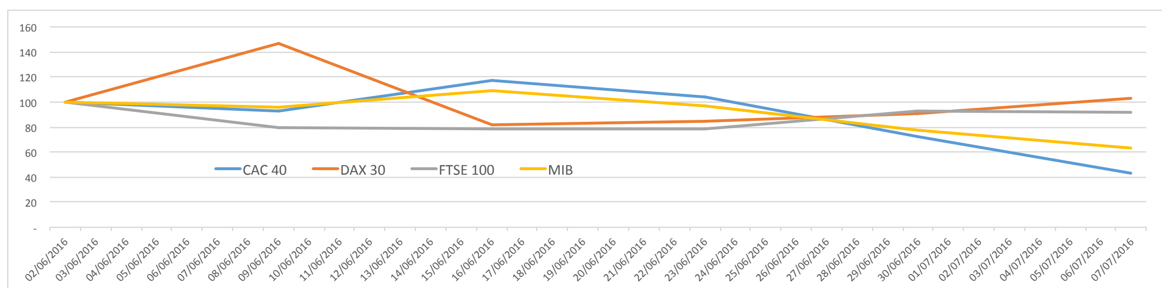
Short selling strategies were diverging across national lines too. In the week following the vote, borrow volumes in France and Italy reduced by some 30 and 18 points respectively, while in Germany and the UK, balances were up by 6 and 15 points respectively. All four indices remained below the borrow volumes recorded at the start of June. Across all four indices, losses were narrowing and the initial panic following the Brexit vote appeared to be fading. The FTSE 100 was already back in positive territory, up 2.6 percent compared with 23 June and losses in the DAX had narrowed from almost 10 percent down to 5.6 percent.

Jump forward to the latest data available at the time of writing (11 July) and the FTSE 100 is up 5.4 percent, compared with 23 June and, at 6,682 is only 114 points below its 12-month high of the 6,796 seen last August. The DAX, CAC and MIB remain down 4, 4.5 percent and 7.8 percent respectively, suggesting that post-Brexit market pessimism is greater in those countries than in the UK.

Brexit is not the only factor of course. Political unrest in several European countries is increasing the threat to the stability of the eurozone, including the political right groups in France and the nationalist movements in Italy. Last week, Italy imposed short selling bans on a list of financial institutions as they struggled to cope with non-performing loans (what were previously known widely as ‘bad debts’), which, in total, are equivalent to 20 percent of the country’s GDP. With slowing economic growth, falling tax receipts, the second largest government debt in Europe after Greece and unemployment levels of 11 percent, the Italian government is considering a bank bailout to support its domestic economy, despite this being in contravention of strict EU bank bailout rules.

Looking across Europe, uncertainty seems to be a relative factor. The UK is facing unprecedented changes, but with a new prime minister quickly, almost ruthlessly installed, a political opposition in disarray, the UK, when compared with France, Italy and even Germany, which are separately facing impending elections, industrial and economic issues, does not seem to be in too bad a shape. However, a week is indeed a long time in politics and markets. Who knows what next week might bring? **SLT**

Figure 1: Main index borrow volumes indexed to 100 at 2 June 2016



Industry **Events**

IMN European Beneficial Owners' Securities Lending Conference

Date: **22-23 September**
Location: London

The IMN European Beneficial Owners' Securities Lending Conference will cover the 2017 macroeconomic outlook and implications for securities lending programmes; the economics of collateral optimisation; structuring and enhancing lending programmes to increase revenue; the business implications of regulation on lending and collateral management programmes; alternative routes to market; effective benchmarking and performance; sell and buy-side perspectives on doing business today; and perspectives on the future direction of the industry.

10th Annual Collateral Management Forum

Date: **21 October**
Location: Amsterdam

The 10th edition of the annual Collateral Management Forum in Amsterdam is looking to offer an overview of the most crucial topics in the field today. In a shifting regulatory enivornment, with the margin requirements soon to come into play, the call for advanced tools of collateral management is as loud as ever.

For more events visit securitieslendingtimes.com/events/events.php

Industry Recruitment

Securities Lending Trading (Associate/Vice President)

Recruiter: BlackRock
Location: London

BlackRock is one of the world's preeminent asset management firms and a premier provider of global investment management, risk management and advisory services to institutional, intermediary and individual investors around the world. BlackRock offers a range of solutions—from rigorous fundamental and quantitative activemanagement approaches aimed at maximising outperformance to highly efficient indexing strategies designed to gain broad exposure to the world's capital markets.

Systems Analyst

Recruiter: EquiLend
Location: London

EquiLend is seeking a systems analyst for the London office to work closely with the EquiLend product owners and scrum team to execute projects from inception through production release.

Senior Software Engineer

Recruiter: EquiLend
Location: New York

EquiLend is seeking a senior software engineer to participate in all stages of development for several applications within the enterprise.

Business Analyst, Prime Finance

Recruiter: Citi
Location: Dublin

Investor services is a business line within markets and securities services, it includes products across prime finance, delta one, futures, OTC clearing, collateral management, global custody, fund administration, and agency lending.

CloudMargin and Tradding Apps make management changes

CloudMargin has appointed David Little as non-executive director, effective immediately.

Little brings 20 years of experience in investment, business development and marketing focusing on securities finance and collateral management within the capital markets arena.

Previously, Little held various roles including managing director of strategy and business development for Calypso Technology, where he was responsible for the development of collateral and securities finance as a strategic business area of focus.

This appointment is the latest in a number of recent hires for the financial technology provider in 2016.

Little said: “I’m very excited to join and invest in CloudMargin. Collateral management is now a key function for financial firms, and so it is vitally important to have access to a cutting edge solution at an affordable price.”

“Spreadsheets simply won’t do and traditionally installed products are too costly and time consuming for most firms. CloudMargin’s SaaS solution is quick to deploy, easy to use and affordable by all.”

“CloudMargin is well funded, has a user base that is growing fast and has an exciting future.”

Prior to Little’s appointment, CloudMargin brought on Stuart Abrahams, formerly of Commerzbank, as European head of sales, Steven Husk as executive chair of the board and Karl Wyborn as global head of sales who joined CloudMargin after 20 years at J.P. Morgan.

Husk added: “We are really pleased to have David Little join the CloudMargin team, where undoubtedly his knowledge and expertise in the collateral field will prove invaluable to CloudMargin’s future success.”

“David brings with him a wealth of experience from the collateral technology space and has a track record of supporting innovation.”

Trading Apps has reshuffled its roster with the appointment Andrew Malpass as non-executive director.

Malpass has over 30 years of experience in the software industry and served as the CFO of Fidessa group (formerly Royalblue Group) from 1995 to February 2016.

He is also a fellow of the Chartered Institute of Management Accountants.

Malpass commented: “I am delighted to join Trading Apps as non-executive director. Trading Apps is at a similar position to when I first joined Fidessa and helped grow the company to be worth $1 billion listed on the FTSE. I hope to be able to bring my wealth of experience in financial software to the Trading Apps management.”

Trading Apps has also seen its co-founder Jean-Paul Musicco shift from his role as managing director for North America to become non-executive director as well.

Matthew Harrison, CEO of Trading Apps, said: “I am delighted that Andy Malpass will be joining us as a non-executive of the board and that Jean-Paul Musicco has agreed to continue being involved in an advisory role.”

Prior to founding Trading Apps, Musicco worked for SAC Capital Advisors managing the financing for the various asset classes in numerous jurisdictions.

Musicco said: “My role as non-executive of the board is to assist the executive team in continuing the growth journey and vision that the original founders established over five years ago.”

“In particular, my role is to continue to bring my global experience with securities finance on both the sell and buy sides.” **SLT**

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SecuritiesLendingTimes

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

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

Reporter: Drew Nicol
drewnicol@securitieslendingtimes.com
+44 (0)203 750 6022

Contributors: Becky Butcher

Marketing Director: Steven Lafferty
design@securitieslendingtimes.com
+44 (0)203 750 6028

Designer: James Hickman
jameshickman@blackknightmedialtd.com
+44 (0)203 750 6028

Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6028

Recruitment Manager: Chris Lafferty
chris@assetservicingtimes.com
+44 (0)203 750 6020

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

Office fax: +44 (0)20 8711 5985

Published by Black Knight Media Ltd