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School of stock loan: Rehypo off the hook but reuse told to see the FSB after class

There is no immediate need to harmonise regulatory approaches toward collateral rehypothecation, but reuse needs to be monitored on a global level, according to two new reports from the Financial Stability Board (FSB).

The FSB's reports, released at the end of last month, assessed the potential risks of collateral rehypothecation and reuse to the financial system.

The rehypothecation report revealed that all of the regulatory approaches that the FSB assessed are designed to protect rehypothecated client assets within their jurisdictions, while market participants such as prime brokers have significantly strengthened their risk management practices.

While there is no immediate need to harmonise regulatory approaches, the FSB proposed implementing Recommendation 7 from its 2013 shadow banking risks in securities lending and repo policy framework.

Under the recommendation, regulatory authorities should ensure that financial intermediaries provide sufficient disclosure to clients in relation to rehypothecation of assets so that they can understand their exposures in the event of a failure of the intermediary.

Also, when client assets are rehypothecated for the purpose of financing client long positions and covering short positions, they should not be rehypothecated for the purpose of financing the own-account activities of the intermediary. Finally, only entities subject to adequate regulation of liquidity risk should be allowed to engage in the rehypothecation of client assets.

The FSB's report on collateral reuse was more critical, with regulators lacking a clear understanding of global collateral reuse activities in the securities financing markets. "The FSB considers that appropriately monitoring collateral reuse at the global level will be an important step towards obtaining a clearer understanding," according to its statement on the reports.

This "reaffirms the importance" of implementing the FSB's standards and processes for global securities financing data collection and aggregation, which were published in November 2015. "[They] will now include data elements related to a non-cash collateral reuse measure and to some associated indicators."

Data collection and aggregation will be restricted to collateral received and subsequently reused in securities finance transactions. The FSB explained: "Most comments received from market participants shared the view that this is a meaningful basis for measuring collateral reuse."

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‘An estimate of an estimate’

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The FSB said: “The scope of collateral reuse being measured is therefore restricted to collateral received and subsequently reused in securities finance transactions. However, authorities are encouraged to consider monitoring collateral reuse activities beyond securities financing transactions as appropriate.”

An approximate measure will be used to gather collateral reuse data, as “market practice is generally aligned with the assumptions behind [it]”.

“Market participants do not generally distinguish between own securities or securities originating from another collateralised transaction when posting collateral,” the FSB explained in its collateral reuse report.

“Respondents also highlighted that it would be extremely difficult to extract the information needed to compute the exact measure and indicated that the indirect approximate measure may lead to over-estimating collateral reuse.”

In response to the FSB’s consultation on measuring collateral reuse, Amundi Asset Management was highly critical of the now disregarded option of indirect approximation.

“We strongly oppose any measurement that would constantly and largely overstate the proportion of collateral re-used, as would the proposed third option called indirect approximation of re-use,” Amundi Asset Management explained.

“We know that any regulatory approach based on approximate data is misleading and generally leads to inappropriate analysis and wrong policy decisions.”

Metrics will include collateral reuse at the jurisdiction and global level, reuse rate, the share of reused collateral, the concentration of reuse activities, the collateral circulation length, and the collateral multiplier, which constitutes a measure of velocity, but that will be at the global level only.

Collateral circulation length, which is used to approximate the contribution of re-use of collateral to interconnectedness, could be inaccurate “given the aggregated and fungible nature of securities”, the International Securities Lending Association (ISLA) warned in its response to the consultation.

“It is not possible to link the transactions in any meaningful manner as the security posted as collateral may represent ‘own assets’ or collateral. Assets held in a collateral pool cannot be distinguished in this manner. Making an assumption about the linking of the two transactions in this way will lead to overstating the levels of interconnectedness in the collateral market.”

ISLA added: “It should be recognised that because the calculation is based on the reuse calculation, which in itself is an estimate, the results of this calculation will be an estimate based on an estimate and so may lead to unrepresentative results.”

The FSB has started work on the detailed operational arrangements to initiate the official data collection and aggregation at the end of 2018. Data related to collateral reuse will be transmitted to the FSB for global aggregation from January 2020.

Inside securities lending times

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NSD plans repo collateral service

Russia’s National Settlement Depository (NSD), in partnership with Bloomberg, is preparing to launch a new collateral management service for over-the-counter repo transactions.

The platform, which is scheduled for release in March, began testing in December. It promises to expand the number of users of NSD’s collateral service and allow new repo transactions to be processed “in a similar way to the functionality available for repos with the Bank of Russia and the Federal Treasury”.

NSD’s existing system currently services 192 participants.

Emerging exchanges need SBL

London | Reporter: Mark Dugdale

A securities lending function is an important enabler for boosting liquidity in emerging exchanges, heard participants of a recent World Federal of Exchange (WFE) roundtable in London.

The roundtable, hosted in partnership with consultancy Oliver Wyman at the end of January, discussed the results of a joint report on how exchanges and the buy side can boost liquidity in emerging markets.

WFE and Oliver Wyman's report and roundtable, which featured international buy-side firms, as well as representatives from exchanges in both emerging and developed markets including Bermuda, Brazil, India and Japan, identified the development of a diverse investor base, increasing the pool of available securities, and creating an enabling market environment, as three key areas that exchanges and regulators can focus on to increase liquidity.

Daniela Peterhoff, partner and global head of market infrastructure at Oliver Wyman, said of the issues: "Buy-side participants can act as a catalyst for growth of the overall capital markets ecosystem. Bringing them closer to emerging markets by offering dedicated solutions is crucial to enhance liquidity."

One such solution put forward was the implementation of a securities lending function in emerging exchanges.

"Securities lending and borrowing is an important enabler for the successful introduction of short selling, as well as market-making programmes, and the introduction of products such as equity derivatives and exchange-traded funds," WFE and Oliver Wyman's report explained.

"As markets mature and as they seek to attract international investors, they look to gradually enable short selling and/or securities lending and borrowing."

The report did warn that exchanges looking to implement a securities lending function must focus on creating a well-managed and safe environment for the business.

"There are several risks associated with securities lending and borrowing that may have systemic implications. These include counterparty credit risk, operational risk, collateral risk, settlement risk, and market risk. There is no one-size-fits-all approach to implementing securities lending and borrowing."

Nandini Sukumar, CEO of WFE, commented: "Institutional investors are crucial in the creation of market liquidity. They create information flows and contribute to market efficiency, positively influencing liquidity. This, as our report shows, is particularly important in emerging markets."

In a statement on the launch, NSD described its role as keeping general collateral certificates (GCCs) and basic assets, as well as providing collateral management services to automatically select clients' securities for the pool on the basis of selected parameters and for margin calls.

The aggregate value of repo transactions serviced by the NSD increased nominally in 2016, to sit at RUB 47.3 trillion (USD 797.5 billion), up from RUB 46.3 trillion (USD 780.6 billion) in 2015.

The annual value of repo transactions with the Federal Treasury through NSD doubled between 2015 and 2016, to value more than RUB 37.4 trillion (USD 630.6 billion).

Transaction volumes also increased to more than 2,200, up from 1,200 the year before.

The value of repo transactions with the Bank of Russia fell steeply to RUB 9.9 trillion (USD 166.9 billion) in 2016, down from RUB 30.8 trillion (USD 519.3 billion).

Bloomberg recently launched the MARS Collateral Management solution and secured HSBC Private Bank and more than a dozen corporations and financial institutions as clients.

The MARS solution targets the new variation margin requirements for non-centrally cleared OTC derivatives for banks, investment firms and corporations, promising to facilitate the collateral management and reconciliation processes that are needed to adhere to these new requirements.

"These rules are intended to reduce systemic risk, but present costly operational challenges to investors who will need to calculate and post initial and variation margins for all non-cleared trades, classify eligible collateral to post and deal with an increase in margin calls and daily calculations," said Bloomberg.

Record peso IRS activity

Derivatives marketplace CME Group achieved a record-breaking January trading day by clearing more than MXN 1 trillion (USD 45.53 billion) interest rate swaps (IRS) in a single session.

CME Group's cleared notional on 12 January surpassed the previous record of MXN 659 billion (USD 30 billion) set on 16 December.

It began offering Mexican peso IRS clearing in 2013. To date, nearly 120 participants have cleared MXN swaps at CME, with a cleared notional of over MXN 57 trillion (USD 2.59 trillion).

CME offers over-the-counter (OTC) clearing for IRS products in 19 currencies.

Sean Tully, global head of financial and OTC products at CME Group, said: "We are pleased that global market participants continue to turn to our OTC cleared swaps solution as their preferred venue to clear Mexican peso TIIE swaps. We continue to strive to provide efficiencies to this important marketplace, including the first cleared Mexican peso compression cycle through TriOptima TriReduce, which removed more than 33,000 line items and reduced gross notional by MXN 6.23 trillion (USD 283 billion) on market participants' balance sheets."

Malaysian PB picks Protrader

Prime broker Maybank Kim Eng Securities has signed up with multi-asset brokerage and trading provider PFSOFT to give its prime services clients access to global equity and derivatives markets using Protrader.

Maybank Kim Eng clients will be able to use PFSOFT's Protrader to execute a range of instruments, including equities, equity contracts for difference/swaps, fixed income, futures and foreign exchange.

Andrew Gee, head of institutional sales for prime services in London at Maybank Kim Eng, said: "The integration with Protrader demonstrates Maybank Kim Eng's commitment to providing our broker-dealer and fund clients the freedom to choose and use best-of-breed platforms when accessing our prime brokerage services."

Roman Nalivayko, global head of business development at PFSOFT, added: "It's well known execution is one of the key elements of a multi-asset business. With this integration all of our existing clients as well as those who plan to implement Protrader can now access all of the major equity and derivatives markets including the US, Europe and Asia using one single and trusted counterparty."

SZ-HK Stock Connect reroutes

Value Partners Ireland, an Irish UCITS funds umbrella, has become the first to receive Central Bank of Ireland (CBI) approval to start investing in China A-shares through the new Shenzhen-Hong Kong Stock Connect.

Value Partners was supported by HSBC, which, the bank said, has been working closely with the CBI around approvals for UCITS funds for the Shenzhen-Hong Kong Stock Connect programme, as it did when the original Shanghai-Hong Kong Stock Connect launched in 2014.

The new programme began operations on 5 December 2016. On 16 December, the CBI started to accept invitations from Irish UCITS funds to invest through the platform.

Ciara Houlihan, head of trustee and fiduciary services at HSBC Institutional Trust Services in Ireland, which acts as depository to Value Partners Ireland, said: "We understand that this is the first Irish UCITS funds to be approved to invest in the Shenzhen-Hong Kong Stock Connect. HSBC has a long track record of engagement and connectivity in Asian markets and is exceptionally well placed to enable Irish regulated funds to access this latest programme."

Goldman Sachs funds begin lending

New York | Reporter: Drew Nicol

Three of Goldman Sachs's emerging market equity funds are now able to lend up to a third of their total assets.

The collateral parameters of the the Goldman Sachs Asia Equity Fund, Emerging Markets Equity Fund and N-11 Equity Fund have been adjusted to allow for cash, cash equivalents, US government bonds or letters of credit equal to the market value of the loaned securities. Any cash collateral can be reinvested in short-term investments, including registered and unregistered investment pools.

The decision to adjust the funds' investment strategies was agreed in a vote by the Goldman Sachs Trust board of trustees in June last year and included in its 2016 prospectus, which became public in January.

All of the funds' programmes will be managed by an in-house agent lender, which exists under the umbrella of Goldman Sachs Asset Management International.

It also acts as the funds' investment adviser.

The prospectus stipulates that the funds are able to lend to broker-dealers, including Goldman Sachs, within the confines of the rules laid down by the US Securities and Exchange Commission.

OneChicago starts with strong volume

OneChicago's volume for the first month of 2017 fell 9 percent year over year.

The securities finance exchange recorded 780,990 transactions in January, down from 2016's volume of 862,488.

OneChicago's December 2016 volume did reach 1.3 million transactions.

Last year was a record-breaking one for OneChicago in terms of volumes. The exchange beat its 2015 target by 6 percent. Overall, OneChicago's Q4 data remained positive with a 15 percent increase on 2015's figures.

US and HK recommit to sharing

The US Securities and Exchange Commission has renewed its ties with the Hong Kong Securities and Futures Commission (SFC) to further strengthen oversight of entities operating in both markets.

The new agreement builds on a foundation agreement signed in 1995 and will allow for easier data sharing on the activities of their market's constituents, such as investment advisers, broker-dealers, securities exchanges, vendors, and credit rating agencies.

The original agreement was limited to investment managers.

Paul Leder, director of the SEC's international affairs office, commented: "By creating a formal channel for exchanging supervisory information with the SFC, this new arrangement will enhance the SEC's ability to supervise firms on a cross-border basis."

OCC hits the ground running

OCC members began 2016 with a bang, completing 180,624 transactions last month.

The transactions, which marked a 32 percent increase over January 2016, had an average daily of more than $146.6 billion.

The central clearer's 2016 ended on a similar high, with 177,826 stock loan transactions recorded in December.

January to December 2016 securities lending activity was also up 37 percent with almost two million new loan transactions.

OCC's average daily loan value was $153 billion in December.

Meanwhile, the central clearer's total cleared futures volume in January was approximately 9.7 million contracts, a 35 percent increase from January 2016.

Repo could ‘shut down’

The repo market could “shut down” under stress conditions with pension funds most at risk, according to a new Northern Trust whitepaper.

Pension funds are caught between sustained low interest rates and “the unintended consequences of a variety of market regulations,” explained authors Mark Austin and Steve Irwin.

“In times of market stress, the repo market could shut down, or a bank may not be able to provide an investor with direct cash,” the paper continued.

Funds must diversify their portfolios’ liquidity sources in order to gain the “strongest protection” against future market turbulence.

According to the whitepaper, some pension schemes are increasing their allocation to cash to as much as 7 percent of their portfolios.

In previous environments, investors could earn as much as 2 to 3 percent by holding cash, but, today, they must settle for no returns, or even suffer negative rates. “Cash has gone from being a benign by-product of investing to arguably the essential facet of a lot of investment strategies.”

Turning to regulation, Irwin and Austin cited the US Dodd-Frank Act, the European Markets Infrastructure Regulation and the EU’s Solvency II Directive as all bringing unintended consequences through their liquidity requirements.

A separate report by the Dutch asset manager APG and the Dutch pension fund provider PGGM, two of Europe’s largest pension funds, along with the Insight Investment and MN, estimated that if European pension funds were required to centrally clear derivatives trades and post cash for variation margin, the total collateral required for a 1 percent rate shift would range from €205 billion to €255 billion. In more stressed scenarios, it could reach €420 billion.

“If interest rates in the current market environment move by a quarter of a percent—which some industry participants argue would not be uncommon—then, collectively, European pension funds would be required to post intra-day margins of approximately €55 billion,” stated Northern Trust’s whitepaper. “So, while more central clearing has de-risked the market, it has unintentionally given investors new kinds of liquidity challenges.”

By way of possible solutions to what the paper describes as the “liquidity conundrum”, funds should identify “unusual sources of liquidity”, such as securities available for repo activities or securities lending.

Funds should also maintain a liquidity ladder to forecast needs and match them with known cash flows, while modelling the asset liquidity profile and stress testing it to understand the true benefit and cost of embedded funding costs, as well as margin requirements on derivatives positions.

Pakistan review SBL lists

The National Clearing Company of Pakistan (NCC) has revised its list of securities eligible for lending activities.

Three securities will be added to the list, while 10 will be removed, effective 17 February.

Service Fabircs, TPL Properties and Loads will all be open to lending.

At the same time, Brothers Textile Mills, Kasb Corporation and Associated Services, among others, will be removed.

NCC also specified that shares of Hinopak Motors will be removed from the list of securities available for short selling as of 6 February.

Dutch regulator admits short error

Amsterdam | Reporter: Mark Dugdale

The Dutch financial services regulator accidentally published the wrong daily short positions on its website in January.

The AFM "inadvertently" published a list of net short positions on its website on 24 January that included positions of less than 0.5 percent. Some of these reportedly included short positions in the shares of Dutch banks.

Under the EU Regulation on Short Selling, national financial services regulators are required to issue notifications of net short positions of 0.5 percent or higher on a daily basis, while short sellers that hold a net short position of 0.2 percent or higher in a listed company's issued capital must tell the relevant regulator.

"The AFM corrected this mistake and posted the correct list of net short positions of 0.5 percent and higher on the morning of Wednesday, 25 January. We regret this error," the Dutch financial services regulator said in a statement.

The EU Regulation on Short Selling has been in effect since 2012. It was enacted to increase the transparency of short positions in Europe, particularly in times of market stress.

BNY Mellon ends 2016 on a high

BNY Mellon posted its strongest securities lending revenue of the year in Q4 2016.

The bank raked in $44 million during the final quarter, up from the $42 million achieved in each of the first three quarters.

Q4's securities lending performance also outdid the bank's results during the same period in 2015 by 5 percent.

BNY Mellon's clearing services fees hit $355 million in Q4, representing an increase of 2 percent on its Q3 2016 results and 5 percent on the Q4 2015 results.

SDR takes dim view of lending

Asset managers must provide annual reports on their securities lending policy under the proposed EU Shareholder Rights Directive (SRD) because it "can cause controversy in the area of shareholder engagement".

In its current form, the SRD text, published 13 December, decrees that "it is therefore important that the asset manager reports on its policy on securities lending and how it is applied to fulfil its engagement activities, particularly at the time of the general meeting of the investee companies."

The SRD is still subject to legal-linguistic revisions and a final vote in the European Parliament before it enters into force.

The directive does not currently require public disclosure of asset managers' reports.

But it does include a clause that promises to review this particular element in three years.

According to the International Securities Lending Association (ISLA), the new directive is expected to come into effect "within this quarter".

Under such a timeline, the review into public disclosure would occur after the UK had formally left the EU.

It is currently unclear how such provisions may then affect UK-based asset managers.

Commenting on the SRD, ISLA lamented that, "despite the progress we have seen, there are still perception issues around securities lending in areas where it is not the primary focus".

ISLA also reaffirmed its commitment to continue to monitor progress and seek to comment if appropriate.

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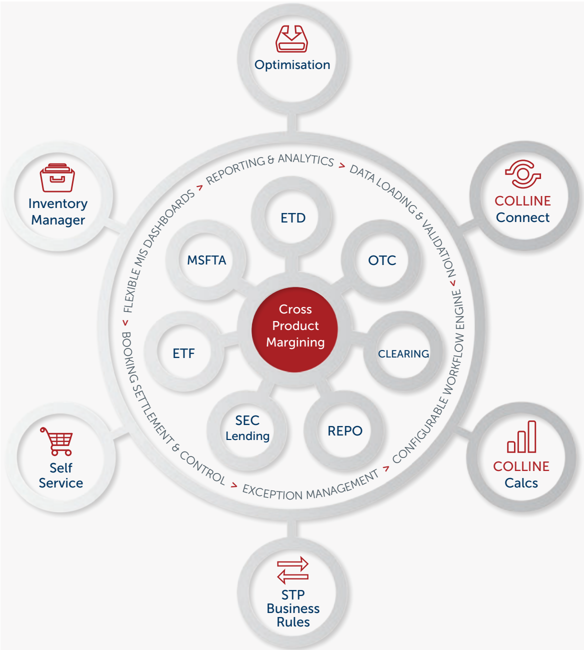

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Pirum links up with ColleX

London | Reporter: Mark Dugdale

Pirum Systems has linked its real-time straight-through processing services for the securities finance industry to ColleX, a platform for collateral trading.

The BGC Brokers-owned platform, which launched in Q3 2016, is multi-product and asset-class to promote collateral mobility in all its forms.

The collaboration between the two firms will enable clients to leverage ColleX's expertise in electronic trading, combined with Pirum's ability to manage the post-trade lifecycle, which includes regulatory reporting.

Rajen Sheth, CEO of Pirum, said: "We are excited to be working with ColleX to create this trading marketplace."

"Market connectivity and trade lifecycle management is core to Pirum's product offering. Our ability to streamline the post-trade process by transacting on ColleX will increase liquidity in this marketplace."

Philip Norton, executive managing director of ecommerce at BGC Partners, which owns BGC Brokers, said the need to tackle market-wide collateral latency and mobility "makes Pirum's straight-through processing connectivity and post-trade infrastructure key to the financing universe".

"Linking ColleX to Pirum's suite of products addresses frictional costs, which is a benefit to our clients. Furthermore, we are excited to grow this joint effort across BGC's global brands."

BrokerTec eyes up e-MID

BrokerTec is on track to acquire a controlling majority stake in e-MID SIM, the first Italian electronic central limit order book platform for inter-bank deposits and overnight indexed swaps.

BrokerTec will integrate e-MID into its architecture to offer additional eurozone repo and government bond products.

e-MID will become a subsidiary of BrokerTec Europe, which is NEX Group's global electronic fixed income trading platform.

Brexit whitepaper hints at status

The UK could adopt 'third-country' status in financial services upon its exit from the EU, according to the Brexit whitepaper.

The whitepaper described but did not discuss in detail "a range of provisions across many different pieces of EU financial regulation" that allow firms in member states "to provide financial services across the EU under a common set of rules and a single authorisation from their regulator".

"Both UK and EU firms benefit from [passports]", the whitepaper affirmed, pointing out that "there are over 5,000 UK firms that utilise passports to provide services across the rest of the EU, but around 8,000 European firms that use passports to provide services into the UK".

The whitepaper said, without a firm commitment: "There are provisions that allow firms from 'third countries' to provide services across the EU, provided that their relevant domestic regulations have been deemed equivalent to those of the EU."

"In our new strategic partnership agreement we will be aiming for the freest possible trade in financial services between the UK and EU member states."

UK members of parliament voted on 2 February in favour of triggering Article 50, which must happen before exit negotiations with the EU can begin.

The UK plans to formally announce its intention to leave the EU in March. Negotiations on the manner of its exit must be completed within two years.

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Collateral correction

The market effects of monetary policy and regulation were outlined at the Deutsche Börse Global Funding and Financing Summit in Luxembourg

Liquidity, or the lack of it, was the hot topic at the newly re-branded Deutsche Börse Global Funding and Financing Summit in Luxembourg.

Conference panellist Roelof Van der Struik of PGGM, an active play in the reverse repo space, outlined concerns that month-end liquidity pools are drying up and pension funds are most at risk.

Speaking in a panel alongside a representative from the European Central Bank (ECB), Van der Struik revealed that he had found it more difficult balance the books each month in the second half of 2016, due to a lack of market liquidity caused, in part, by ECB monetary policy.

He added that the current month-end drop offs were already the worst he had witnessed during his career and that the problem was amplified significantly at year's end.

"It's [month-end liquidity] getting worse," Van der Struik explained. "On average, liquidity is okay but we had some serious problems [at year's end]."

"I really hope that some liquidity comes back to the bilateral repo market, which is being disproportionately affected. We will need this market in the future."

The recently extended ECB public sector purchase programme was accused of being a major factor behind the repeated droughts.

When explaining its decision to extend its asset purchase programme in December, the central bank stated: "From April 2017, the net asset purchases are intended to continue at a monthly pace of €60 billion until the end of December 2017, or beyond, if necessary."

Panellists and audience members all highlighted that a programme of this scope and duration was inevitably going to affect overall market liquidity of the high-quality liquid assets that are essential to the health of many markets, including as securities finance.

Stifling reporting requirements and unfair risk mitigation rules are also contributory factors according to conference attendees.

Data analysis from the International Securities Lending Association appears to reinforce the theory that the ECB's prolific hoarding of government bonds, with only a limited lending programme, is a contributing factor to dwindling liquidity, according to the panel.

The ECB representative on the panel acknowledged a nominal drop in average liquidity but denied that it had sunk to dangerous levels. It was also clarified that the asset purchase programme was devolved to national central banks at an operational level, and that there was some disparity in their commitment to the programme, of which the ECB was not responsible.

"We have the feeling that the securities lending programme has been well received by the market," explained the ECB panellist.

"We monitor our repo and securities lending programme very closely. The market needs to adapt and be innovative to survive in these difficult times."

The ECB recently revised its lending rules for eurosystem central banks to allow for cash collateral to be reinvested more liberally, as of 15 December.

The central banks of Europe, Germany, Ireland, France and Belgium have all since opened their lending programmes to cash collateral, along with Spain and the Netherlands. The ECB set the overall limit for lending against cash collateral at €50 billion.

In a statement on the revised rules, the ECB said: "To avoid unduly curtailing normal repo market activity, the cash collateral option will be offered at a rate equal to the lower of the rate of the deposit facility, minus 30 basis points (bps), currently -70 bps, and the prevailing market repo rate."

Turning to the regulations that are putting downward pressure on overall liquidity, the panel cited the US Federal Reserve-backed single counterparty credit limits, which are built upon the initial rules laid down in the Dodd-Frank Act. A global systemically important bank must now apply a 15-percent cap to its tier-one exposure to any other similar ranked bank, and a 25-percent cap on its tier-one exposure to other counterparties.

Several panellists noted that the limited number of counterparties in the securities lending market means that this rule disproportionately penalises their area of the market. The burdensome reporting requirements of the Securities Financing Transaction Regulation (SFTR), among other frameworks, were also held up as forces driving participants out of the market by making the cost of lending uneconomical.

Don't shoot the messenger

The appearance of several representatives from policymakers and central banks was a welcome addition to this year's summit that allowed for robust and frank public debate on real challenges facing the industry.

ECB board member Yves Mersch attempted to ease the concerns of the repo industry over the central bank's controversial monetary policy during his keynote speech on the second day.

Mersch acknowledged the negative effects of the central bank's "unconventional monetary policy", but argued that the European repo market, by its very nature, is procyclical and so will continue to suffer for as long as it takes for the overall economy to recover, regardless of ECB policy.

"The ECB has one mandate, which is to ensure price stability," Mersch explained.

"Elevated risks to its goal have made unconventional measures necessary on an unprecedented scale and on a temporary basis. And they prove successful. Although we try to minimise negative side effects, any of these considerations are without prejudice to the obligation to honour our mandate."

Mersch went on to explain that, once inflation rates are back to normal in Europe, the ECB's policies can also normalise. This includes its uncharacteristic suppression of interest rates and persistent asset purchase programme, which is now ongoing until March.

In response to concerns raised by these policies in earlier panels, Mersch echoed points raised by his colleague from the previous day's session, who stated that, although unfortunate for some summit attendees, the ECB has to consider the wider markets when drafting policy.

"Although the asset purchase programme might have some negative side effects on the functioning of the repo market as compared to the pre-crisis levels, other more potent factors were at work. To reduce spillover effects the ECB has also introduced several mitigation measures.

Mersch, without offering a specific timeline, implied that the recovery is well underway and the end is in sight.

Hoping for a Hail Mary

The first keynote of the summit, Andreas Zubrod, member of Union Asset Management's executive board, opened by celebrating the fact that, for the first time in years, the event would not be dominated by discussions around regulations. That didn't turn out to be entirely true.

In a subsequent panel, when discussing the looming 1 March deadline for fresh margin rules under the European Market Infrastructure Regulation (EMIR), speakers were in agreement that a second delay is needed.

New non-cleared, over-the-counter derivatives margin rules under EMIR are aimed at reducing counterparty and credit risk. Once implemented, all new derivatives trades will need to be backed by collateral in the form of initial and variation margin to cover the risk of a counterparty default.

A snap poll of the conference hall compounded the delay prediction as only 17.3 percent claimed to be ready for the deadline. A further 35 percent said they are still putting their agreements into place, but had already completed their operational changes. Another bank representative panellist agreed with the claim that a delay was needed and stated that the 17.3 percent result was a surprisingly positive figure.

Despite the lack of industry preparation, many audience members and panellists were not hopeful that a delay is coming. The rules were originally intended to rollout throughout the EU back in September, but a delay pushed that back to the March. The US, Canada and Japan all managed to meet the initial deadline and went live in September.

The Financial Stability Board first warned of the global market's inability to meet the deadline in August 2016, as part of its review of 24 markets' progress. The review found that 10 countries were unlikely to be ready for implementation in the first half of 2017, while eight would not reach completion within the year.

Easy as CCP

The mantra, "it's a marathon, not a sprint", has never been truer than when describing the introduction of central clearing to securities lending, but the finish line appears to be at hand.

Another audience poll revealed that 43 percent of those in attendance who had considered alternative routes to market had looked into using a central counterparty (CCP).

The significance of this was emphasised by panellist Susan O'Flynn of Morgan Stanley, who notes that pro-CCP responses to this question had been around 20 percent in previous years.

Speaking after the panel, Marcel Naas, global head of funding and financing at Deutsche Börse Group, added: "[The] poll result is a positive affirmation that Deutsche Börse's continuous strive to deliver industry standard solutions has been well received by the securities lending community. We will continue our endeavours to become a leading provider of services that understands and fulfils clients' needs."

Another Eurex representative, when also commenting on the poll, noted that, in a wider context, if just under half of a market which boasts €1.9 trillion of securities on-loan, as of 30 June 2016, are considering utilising a CCP solution, it represents a significant opportunity for Eurex and its partners.

G20 and counting

Godfried De Vidts, chair of the International Capital Market Association European Repo and Collateral Council captured the mood of the day in his closing remarks.

"After the Lehman Brothers event, it was clear that regulation of the secured markets was necessary, hence the overall direction of travel is not a problem for market participants," he said.

He called on market participants and regulators alike to work together to ensure that at appropriate regulatory framework is constructed to avoid repeating the events of 2008.

"However, more work is needed to make sure that the repo and collateral market can deliver what is intended of it. Hence, several calibrations of current initiatives are urgently needed, for example to alter net stable funding ratio asymmetries; the Central Securities Depositories Regulation mandatory buy-in; Markets in Financial Instruments Directive best execution (which should be shifted to SFTR, where market participants are working hard to develop usable reporting); use of collateral for CCP and bilateral clearing; and to further refine the lending programme under qualitative easing."

De Vidts continued: "Particularly after the year end turmoil, that will continue albeit to a less punitive extent, it is important that the fluidity of collateral–the flow of cash and collateral in the system–is at the service of both sell- and buy-side market participants. The negative impact on the real economy is now plain to see. We owe it to all, and see it as our duty, to make sure that collateral flows, mainly through the repo market, are put back on track, so the ultimately goal of the G20, to avoid yet another crisis, can be best realised." **SLT**

Show, dont tell

Charl Bruyns of Standard Bank lays out the challenges of bringing securities lending products to the emerging markets of Africa

What's the biggest challenge when entering emerging markets in Africa?

When Standard Bank moved into the Nigerian market, for example, the first question we needed to answer was, where do I get my portfolio from? We've had an active securities lending market in South Africa for roughly 20 years and sometimes we still have issues with liquidity there, so imagine what that's like in places such as Nigeria—it's hard. Standard Bank is still in the process of securing that portfolio and we've done some trading to make sure the infrastructure is in place.

At the same time, in a wider financial perspective, countries such as Nigeria have had a tough time with their overall economies. Nigeria has been an oil producing nation for more than 60 years and with the price of oil basically being cut in half it has been a very difficult period. It is also competing against all the other oil producers in the world, and is therefore vulnerable to seemingly unconnected events such as the lifting of economic sanctions in Iran (another oil dependent economy) last year, which has allowed it to compete in the global market again.

Despite the headwinds, Nigeria opened up its currency market in June last year and traded about $2 billion in two days, which was positive. However, there are still not enough US dollars in the market and as long as you can't ensure that investors will be able to withdraw their funds when they need them, any capital market growth will be slow.

Are there any other African markets that are building their securities lending infrastructure?

We recently participated in creating Kenya's securities lending regulation with the Kenyan Capital Market Authority. So far that's proven to be very promising. Securities lending is such a key product in Africa because it can boost essential liquidity and allow participants to hedge risk when they are long.

What is Standard Bank looking to do in those markets?

Currently we have an investor services business in 14 African markets, where we have a physical local presence with offices and staff.

At the moment we are in the middle of launching a derivatives clearing business in Kenya. We have our licence and we will be the first clearing facility in that market. Our systems are in place and are currently being tested. The pressure is always on the derivatives market to manage risk through margining, so that's kept us busy. We expect to go live with this product in Q1 or Q2 later this year. The regulators are very keen for us to launch and that provides us with good motivation to keep moving forward.

How closely do potential foreign investors and the regulators from these markets cooperate?

The fact that South Africa has a fairly developed securities lending market is hugely helpful. It allows us to host other regional regulators in our offices there and talk them through securities lending as a product. It creates a positive environment to discuss how it can help their own markets, with the South African market as the perfect example.

It's always tough to be first, but when you're in Nigeria or Kenya and you can point to a relatively local neighbour that does securities lending it's a lot easier to have that conversation. It's much easier to bring people on board with an existing African model than if we had to compare them to the European or North American markets.

Launching a fully developed securities lending product is, at a minimum, a two-to-three year project, but we are moving forward in several African markets. There are many legal frameworks that have to be in place domestically in areas such as insolvency, tax and reporting standards. It's also essential to have the central securities depository on your side or it can be a much longer process. Overall, these markets are expanding, new products are going live and the regulators are supporting those who wish to invest.

Are you finding there's specific model of lending that is easiest to bring to a new market?

When launching in a new market our credit risk appetite is conservative. From a collateral perspective, we start with cash, to settle the product, before moving on to other forms. It's all about learning to walk before you can run. The basic product is scrip versus cash, because it can be executed very quickly. Scrip lent out also needs to be liquid in order to facilitate recalls.

Once you've secured a portfolio of local assets, the next major step is crafting your own internal processes, which largely relates to risk management. You have to know to what extent you are going to open the book. The answer to that has a lot to do with understanding the liquidity profile of the securities in question.

Even in South Africa there's still lots to do when it comes to collateral. We've had a lot of success when dealing with the regulator in areas where new rules have inadvertently but negatively affected securities lending. We've been able to make tweaks to ensure that's fixed.

If I looked at my book two years ago, then about 60 percent would be collateralised with cash, with the rest divided between bonds and equities. Today, cash is 20 percent.

Where the work needs to be done is in cross-currency collateral trades. Many people will have dollar accounts in South Africa but you can't currently have collateral sitting in London for a borrow in South Africa, for example. The conversations that need to happen to add this level of sophistication are already underway.

In markets such as South Africa, where yields are relatively high, cash is an expensive form of collateral. Traders know what they need to do but there are also infrastructure changes required to make it happen and to adapt the methodology.

A lot of these steps involve the use of market data. How do you source data in developing markets?

We rely on our brokerage businesses, which trade actively on the market every day, to help give us a clear image of what that environment is like. We also rely on the exchanges. Once we collect that data we can then set our models to be as conservative as it needs to be.

There are a number of emerging securities lending markets around the globe. Is Africa sometimes overlooked?

Yes, and it's up to us to create visibility for Africa. The South African equities market is 40 percent foreign owned and many of the banks and hedge funds that have African exposure do their trading indirectly via platforms in places like London. We are working to educate the wider market about the possibility of opening desks in South Africa, as the most developed African market, because there is a lot of yield opportunity.

We see the demand is there once we've shown people all that's there already, and we're growing. **SLT**

Where the work needs to be done is in cross-currency collateral trades

Charl Bruyns, Head of investor services
Standard Bank

The Trump bump

Can the new US president resurrect the American dream? David Lewis, senior vice president at FIS Astec Analytics, sees what the short sellers are saying

The US is on the brink of great change. Whether you think that change is good or bad depends very much on who you are, and indeed, where you live. On the campaign trail, the then presidential candidate, Donald Trump, pronounced the American dream to be dead. The 'American dream' was adopted as a phrase to epitomise the prospect of personal economic advancement in the land of opportunity many years ago. It is, in fact, a literary reference attributed to James Truslow Adams in his book The Epic of America (published in 1931), but some economists measure it in the advancement of one generation compared to the last. Just a few decades ago, in the 1970s, 92 percent of 30-year olds earned more than their parents had done at the same age, adjusted for inflation. Last year, it was 50 percent. By extension, of course, that means the other 50 percent earnt the same or less than their parents did. Can this be fixed, or turned around?

Much has been trumpeted about the reestablishment of industry and manufacturing in America. Looking at the effect on the Dow Jones Industrial Average (DJIA) over the last six months, it would seem that many investors are buying into that very promise. The week beginning 20 January saw the DJIA surpass the 20,000 mark for the first time ever, having been as low as 6,000 in 2009 and only 16,400 12 months ago (see Figure 1). Having peaked at 20,100 on 26 January, further political turmoil, this time regarding the partial ban on refugee travel, the index fell back slightly, ending the month around 19,800. This still represents a rise of around 2,000 points, or 11 percent, since the start of November. For completeness, over the same period, the S&P 500 and the Russell 2000 have risen 9 percent and 17 percent respectively.

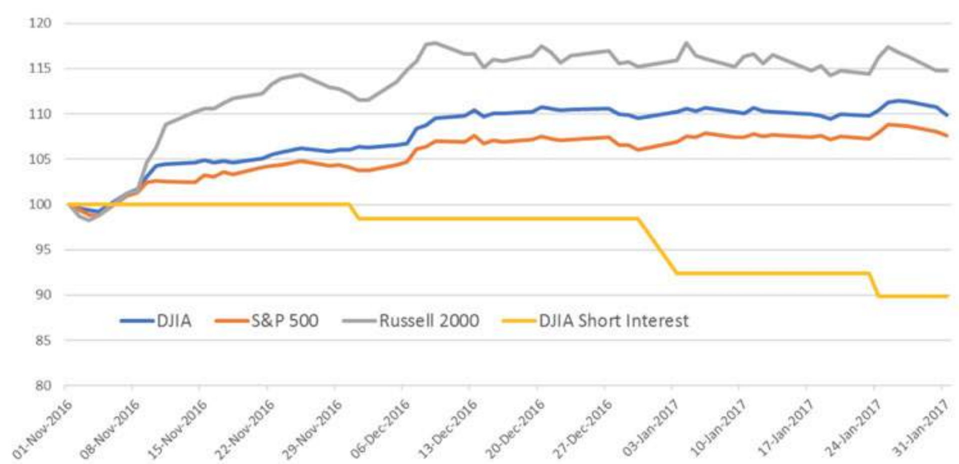
Will those great industrial manufacturing companies lying in the doldrums recover and join some of those in the DJIA? With a couple of notable exceptions, the DJIA is made up of high-value producers, such as Boeing, Pfizer, Intel and Apple. Such companies use highly-skilled, highly-paid employees and automation on a huge scale. Competitors such as Mexico and China have grown on the high volume, relatively lower-skilled, lower-cost items that are more dependent on significant supplies of low-cost workers. On that basis, it can be argued that it is unlikely that the jobs that have been offshored already will ever come back to the Rust Belt regions of the US. It is not all bad news as a proportion of the imported items brought into the US are components used in US industries, building products at lower costs for either domestic consumption, or indeed to be re-exported.

This will continue to aid high-tech organisations, which are less reliant on labour, but will it help reverse the decline of the American dream? That certainly remains to be seen. If borrowing patterns supporting short selling can be taken as an indicator, it would certainly seem that hedge funds are not prepared to bet against the rising DJIA. Figure 1 shows DJIA member share volumes borrowed over the last three months, decreasing a net 10 percent up to 30 January. The turnaround seen as the index retreated from its historic peak has not created a sudden new surge of borrowing in the expectation that the so-called 'Trump bump' is looking shaky.

The promised bonfire of regulations will no doubt help many industries, most notably the extractive industries such as oil and coal, but will it help the basic manufacturing industries that have been promised a renaissance? By way of example, a regular member of the FIS Astec Analytics hot stocks list is Cliffs Natural Resources, a $2 billion iron ore mining and steel producing company. Cliffs has seen its share price rise some 478 percent over the last 12 months, from a little over $1.50 to over $9 at the time of writing. While this represents a significant recovery, almost half of which occurring since last November, it must be viewed in context. In 2012, shares in Cliffs were worth more than $75. This is one example of many but it is illustrative of the relative value of old industries compared to the newer ones, dominated by organisations that need fewer but higher skilled employees.

Economies do not turn around overnight, or on the change of one policy, so there is far to go yet. However, it does appear clear that the benefits of the recovery may not be as evenly spread as some might expect. One economist's measure of the American dream is the proportion of people born into the poorest 20 percent of society in the 1980s that have now progressed to the top 20 percent. In the US at present, this ratio is around 7.5 percent. In Canada, it is 13 percent. **SLT**

Figure 1: DJIA, S&P 500, Russell 2000 and DJIA short interest, indexed to 1 November 2016



Source: FIS Astec Analytics and Thomson Reuters

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Comings and goings at EquiLend, Cowen, EIP Broadridge and DTCC

EquiLend has hired Ann-Marie Pearce as associate director of sales in North America.

Pearce, who is based in New York, is responsible for account management across all EquiLend products in North America, as well as new business in the region.

She joins from the surveillance and investigation department of Intercontinental Exchange, where she was a regulation consultant.

Previously, Pearce worked at Jefferies Global Securities Finance, Fortis Securities Global Finance and ING Financial Markets.

Ross Levin has joined Cowen Group to build a brand new securities finance and equity trading and clearing business.

Levin has taken on the role of director of global securities finance.

He previously worked at New York-based technology firm Pleeco, where he was in charge of business and product development.

He has more than 20 years of experience, having held multiple positions at Itau, RBS, ABN AMRO and ING, including, head of equities IT, head of product development, and, most recently, head of business architecture for the Itau prime services division.

Levin joins Matt Baldassano at Cowen, who arrived last year from Jefferies as head of securities finance.

Stephen Howard is stepping down from his head of trading role at Enhanced Investment Products (EIP) in Hong Kong.

Howard will leave on 27 February after two years at the asset management firm, which launched in 2002.

In his capacity as head of trading at EIP, Howard led the hedge, exchange-traded and mutual fund trading platform.

Howard has previously worked at RBS, ABN AMRO and J.P. Morgan, and has spent much of his career in Hong Kong.

Broadridge has expanded its securities finance team with the addition of Wells Fargo's Peter Abric and FIS's Thomas Price in New York.

Abric has taken on the role of vice president of securities finance product sales for Broadridge's North America unit, including its latest acquisitions of 4sight and Anetics, which have been rebranded in Broadridge colours.

Previously, Abric ran Wells Fargo's equity finance desk for more than 15 years.

Price has become vice president of relationship management for the securities finance business line. He previously worked at Sungard (now FIS), where he was North American head of securities finance relationship management.

The Depository Trust & Clearing Corporation (DTCC) has appointed Ann Shuman as general counsel, as her predecessor Larry Thompson steps down to focus full-time on his vice chair position.

Thompson has been with DTCC since 1981, when he joined as associate counsel. He became general counsel in 2005, and has also held his vice chair position since 2015.

Focusing on his vice chair responsibilities full-time, Thompson will lead public policy engagement with regulators and lawmakers, while also acting as a senior adviser to the firm and chief spokesperson.

Shuman was previously managing director and deputy general counsel, a position that she has held since she joined the clearinghouse in 2014.

Taking over the general counsel role, she will advise senior management and the board of directors in legal and regulatory matters.

Shuman will also join the management committee, and continue to oversee the global legal team.

Both appointments became effective on 1 February. **SLT**

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