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Limitless opportunities

The Asia Pacific has been described as a land of myriad possibilities in terms of the growth of its securities lending markets. In 2019, lending revenue was down 5 percent from the year prior, but this was still better than the Americas and EMEA, which both reported drop-offs of 19 percent and 22 percent respectively, according to DataLend. This may not seem impressive but it's worth noting that 2018 was a bumper year for revenue and other relevant metrics within these pages paint a rosier picture.

Regardless, several major agent lenders and service providers have highlighted expansion in APAC as a central pillar of their plans for the future.

The hierarchy of the region's securities lending markets has not changed in recent years with Japan and Hong Kong among those leading the pack, but this should not distract from the diligent work being done the regulators of smaller markets to develop their rules frameworks and encourage industry stakeholders. Even in Japan, there are unplumbed depths of liquidity yet to be explored, with many beneficial owners still not claimed by an agent lender.

In this context, SLT is proud to bring you its 2020 Asia handbook which explores the patchwork quilt that is the region's securities lending markets with analysis, primers and explainers on the top trends of the moment.

In our panel discussion, we hear from regional experts on what to expect from APAC in 2020 and beyond, and other articles will impart key insights into the state-of-play across the region.

Elsewhere, this handbook provides an easy-to-digest data snapshot for each of the main securities lending markets.

Finally, the inevitable topic of the COVID-19 pandemic is everpresent in these pages but the mood of contributors is overtly bullish that markets will continue to develop and grow in the medium term.

My sincere thanks go to the contributors and data providers that made this handbook an invaluable tool for all those looking to expand their understanding of the region, which from SLT's understanding is most of you.

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IHS Markit to publish index-tracking lending revenue reports

IHS Markit has launched a "first-of-its-kind" monthly performance benchmarking reports that measure securities lending returns in six MSCI global equity indices.

The reports aim to help lenders, particularly asset managers and pension funds, to better analyse the value of their portfolio across markets and assets. The report focuses on the past five years of historical lending returns on constituents of each index.

The reports track the MSCI World Index, MSCI USA Index, MSCI Europe Index, MSCI AC Asia Pacific ex Japan Index, MSCI Japan Index and MSCI Emerging Markets Index.

For each index, insight is provided on monthly, quarterly and annual returns, index short interest levels, contribution by securities lending fee categories and top-performing sectors by revenue and nation, IHS Markit says.

"These pioneering monthly reports bring high-level performance metrics to the securities lending community, enabling firms to identify new opportunities and optimise returns," said Paul Wilson, managing director and global head of securities finance at IHS Markit. "Readers will gain innovative, index-based reference points powered from our comprehensive universe of securities finance data, which covers more than $25 trillion of lendable inventory and $2.5 trillion of loan balances."

Commenting on the introduction of these reports, Andy Dyson, CEO of the International Securities Lending Association (ISLA) added: "ISLA welcomes the public availability of broad returns data which helps bring greater visibility to the role securities lending plays in financial markets.

"It also helps bridge the understanding between the securities lending market and investor communities."

Key findings from the first set of reports include:

- The MSCI World Index returned 1.3bps to 2.3bps over the 12 months ending in March, with US contributing 43 percent of the total revenue.
- From April 2019 to March, the MSCI Emerging Markets Index produced the highest securities lending return with a range of 6.9 bps to 12.9 bps, more than 75 percent contributed by special stocks. Year-to-date returns in 2020 have declined in comparison to the same period last year.
- All six indices showed a lower level of securities lending returns for Q1 2020 compared to Q1 2019, however, global equity utilisation increased sharply in March.
- Healthcare equipment and services was the top-performing sector in the MSCI World index in March 2020, contributing 24 percent of securities lending revenue. It was also the most prominent sector in MSCI USA where it contributed around 50 percent of the securities lending revenue for the month.

Eurex expands OTC clearing services to Japan

Eurex's central counterparty (CCP) is now able to offer its clearing services in Japan, after gaining a licence from the country's Financial Services Agency.

Eurex Clearing can now operate as a 'foreign financial instruments clearing organisation' and allow Japanese financial institutions to directly access its swaps clearing services and combine their listed and over-the-counter (OTC) euro yield curve business in one single place.

The service extension into one of the largest fixed income markets is driven by client demand and will support the momentum of the CCP's EU-based liquidity pool for euro Swaps, Eurex said.

The service is already available throughout the EU and US.

In the US, Eurex operates under the associated legally segregated, operationally commingled (LSOC) model. Since it first set out its stall in the US in February 2019, Eurex says it has onboarded more than 20 clients with over 3,500 registered funds.

In a statement on the new licence, Eurex explained that access to the Japanese market is "a logical next step" to expand its liquidity pool.

Japanese institutions are very active in European fixed income futures on Eurex and also have significant exposure in the euro swap market. Japan is one of the largest exchange-traded derivatives and OTC derivatives markets globally.

Christopher Perkins, global head of OTC clearing and foreign exchange prime brokerage at Citi, said: "Citi is very pleased to extend our unique and differentiated cleared swap connectivity on Eurex to the Japanese market. We look forward to working with Eurex to onboard new clients in Japan."

According to Eurex Clearing, it has developed a strong liquidity pool for clearing euro-denominated interest rate derivatives, mainly through its partnership programme launched in early 2018.

This market-led initiative is designed to further accelerate the development of a liquid, EU-based alternative for the clearing of OTC interest rate derivatives.

It benefits clients and the broader market place through greater choice and competition, improved price transparency as well as reduced concentration risk, said Eurex.

Total notional outstanding of over €18 trillion (as of the end of February) keeps Eurex's overall market share at about 18 percent.

Bank of Japan shines new light on securities financing markets

The Bank of Japan (BoJ) has undertaken new initiatives to increase securities financing market transparency by collecting and publishing monthly transaction data in a new, more granular way.

The country's central bank said it wishes to contribute to the global effort to shine a light on securities finance markets following the 2008 financial crisis, which has also produced the EU's Securities Financing Transactions Regulation.

The BoJ first published its new statistics in January, which covered Japanese securities finance transactions (SFTs) between December 2018 to November 2019.

Until now, transparency into Japan's securities financing markets was offered via the central bank's annual 'Tokyo Money Market Survey', along with the Japan Securities Dealers Association's monthly report 'Balance of Bond Transactions with Repurchase Agreements'.

The BoJ noted in a research paper on its first data release that these existing formats lack the necessary granularity or offer an accurate reading of key figures such as monthly outstanding balances.

The bank said that the key difference is that the new reports collect data on individual transactions, which will allow it to compile and release data on other areas, such as outstanding balances of transactions where the cash leg is denominated in a foreign currency.

Other new statistics include information about counterparty jurisdiction, original maturity, which is calculated as the difference between the ending date and the starting date of the transactions, and daily data on repo transactions.

December 2018 to November 2019 market data

The BoJ's data for the period shows that for cash lending, the average month-end outstanding balance in securities financing markets in Japan was JPY164 trillion (US$1.52 trillion).

Of that total outstanding balance of SFTs, the outstanding balance of transactions denominated was JPY148 trillion ($1.37 trillion) (approximately 90 percent of the total outstanding balance), indicating that, unsurprisingly, transactions in Japanese yen make up the bulk of SFTs in Japan.

Of the transactions denominated in Japanese yen, the average month-end outstanding balance was JPY89 trillion ($823.52 billion) for repo transactions with Japanese government securities, and JPY45 trillion ($416.4 billion) for securities lending transactions with Japanese government bonds (JGBs) (accounting for approximately 60 percent and 30 percent, respectively). This indicates that transactions with JGBs make up the majority of SFTs where the cash leg is denominated in Japanese yen.

Elsewhere, the new reports for the first time collect data on counterparty jurisdiction under the headings of 'US', 'Europe', and 'Other' for transactions where counterparties are residents outside Japan.

Over the same one-year period, reporting financial institutions borrowed an equivalent of JPY130 trillion ($1.2 trillion) from residents in Japan, and an equivalent of JPY72 trillion ($666.2 billion) from residents outside Japan.

Borrowing from Europe accounts for 44 percent of all foreign currencies borrowed. BoJ noted that this is mainly because financial institutions headquartered in Europe conduct many transactions between their Japanese offices and those located overseas.

Central banks to offer US dollar funding via daily swap lines

The Bank of Japan (BoJ) was among several central banks seeking to double down on cross-border efforts to ensure their local markets have enough liquidity to minimise disruption amid the coronavirus outbreak.

The US Federal Reserve, the European Central Bank, and the Bank of England, the Bank of Canada, the Swiss National Bank, along with BoJ,

J.P.Morgan

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signed up to coordinated action to enhance the provision of liquidity via the standing US dollar liquidity swap line arrangements.

The action included an agreement by the group to introduce daily swap lines for dollar funding for seven-day maturity operations. Until now operations have been available on a weekly basis.

The daily operations began on 23 March.

The central banks also continues to hold weekly 84-day maturity operations.

In a joint statement, the banks said the increased frequency in seven-day maturity operations was aimed at improving the effectiveness of swap lines in getting funding to financial institutions and serve as an important liquidity backstop to ease strains in global funding markets.

The plans for daily operations built upon the coordinated action by the same banks earlier in March which saw them agree to lower the pricing on the standing US dollar liquidity swap arrangements by 25bps.

This meant the new rate is the US dollar overnight index swap rate plus 25bps.

World's largest pension fund scraps securities lending programme

Japan's public pension fund will no longer lend out its foreign equity assets as it considers the practice to be too opaque and incompatible with its responsibilities as a long-term investor.

The Government Pension Investment Fund (GPIF) has around $1,452.5 billion in assets under management, of which $381 billion are foreign equities (as of March 2019), making it the world's largest pension fund.

The fund will continue to lend its government debt assets.

In a statement on the decision, GPIF said that the fact that securities lending includes a title transfer element effectively creates a gap in the period in which the stock is held by GPIF, which "can be considered to be inconsistent with the fulfilment of the stewardship responsibilities of a long-term investor".

Moreover, the fund expressed concerns that its programme lacked the transparency required to know who the ultimate borrower was what they were doing with the assets. The fund did not directly highlight a desire to deprive short sellers of its assets but this is understood to be one of the drivers behind the decision.

As a result, the fund confirmed today that its lending programme would be suspended until further notice, adding that it would reconsider the move "if improvements are made to enhance transparency and address the inconsistencies".

The decision is understood to be part of GPIF's aim of being a market leader in environmental, social and corporate governance (ESG) financing.

In September 2015, GPIF signed the Principles for Responsible Investment introduced by the United Nations, as part of GPIF's efforts to enhance ESG implementation. The fund has since taken further steps to ensure ESG is put front-and-centre in policy decisions as well as contributing to several initiatives to launch green and social bonds.

Although GPIF is a heavyweight in the funds space the move is not expected to have a significant impact on global borrowing prices as its foreign equities holdings does not represent an overly significant portion of the global lending pool.

Nonetheless, the decision represents a negative development for the global securities lending market which has been actively attempting to incorporate ESG into the market infrastructure in recent years.

The move drew criticism and praise in equal measure from various financial market participants with much speculation as to whether it will cause others to consider short selling as non-ESG friendly and cause a domino effect of funds pulling out of the lending market.

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The Philippines first to shut down financial markets

The Philippine Stock Exchange (PSE) was the first to close its $188 billion financial markets in response to the widening coronavirus pandemic.

The PSE ceased trading activity across its equity, currency and bond markets on in early March following President Rodrigo Duterte's decision to widen a month-long lockdown of the capital region to cover the country's main Luzon island.

Philippine equities have fell more than 30 percent between January and March, which was among the biggest declines in Asia, as stocks around the world plunged amid fears of global recession due to the on-going coronavirus-fuelled market sell-off.

The exchange said it would not resume trading until it could guarantee the safety of its employees and traders due to the escalating COVID-19 outbreak.

The official count at the time put the number of infected in the Philippines at 202 with 17 deaths.

The Asian market's closures came amid a torrid period for global markets that have caused widespread losses not seen since the 2008 finance crisis.

In Europe, the Italian main index (the FTSE MIB) fell from 20,799 to 14,894 between 6-12 March, representing an overall decrease of 28.39 percent.

Meanwhile, the French main index (the CAC 40) decreased by 27.2 percent between 2-16 March.

Despite this, the Federation of European Securities Exchanges (FESE), which represents EU trading venues, today vowed that its members would keep their doors open.

Regulated stock markets play a key role in social and economic functions, these functions have been put to the test in the past, for example during the financial crisis - when other sources of liquidity dried - despite this the exchange markets remained operational, the FESE explained in a statement.

Moreover, the association warned that closing markets would remove transparency of investor sentiment and reduce investors' access to their money; all of which would compound current market anxiety and would result in a negative decline in investor outcomes.

Philippines SEC approves guidelines on lending and short selling

The Philippines Securities and Exchange Commission (SEC) has approved new guidelines on securities lending and short selling in a bid to boost market activity. The framework will now be implemented by the Capital Markets Integrity Corp (CMIC), the independent market regulation arm of the Philippine Stock Exchange (PSE).

The implementing guidelines of CMIC address concerns over the effect of securities lending and short selling transactions on trading participants' books and records, error transactions, and the possible impact on trading participants' risk-based capital adequacy (RBCA) ratio.

The guide also reiterates that short sale transactions shall be limited to "eligible securities" which shall refer to securities of companies comprising the PSE index and to exchange-traded funds. It was noted that trading participants have the responsibility to ascertain that the parties have entered into the necessary borrowing arrangements prior to entering a short sale transaction.

The commission approved implementing guidelines on 17 December 2019 subject to particular amendments outlined by the SEC Markets and Securities Regulation Department.

However, the commission also outlined that it would not hesitate to use its right to suspend or prohibit short selling in an exchange when necessary for the protection of investors.

The SEC earlier approved the Philippine Stock Exchange's (PSE) guidelines on short selling transactions in an En Banc meeting on 5 June 2018.

The guidelines follow the expansion of the Philippines' securities lending market to include insurance companies in September 2019.

The Philippines' Insurance Commission stated in a circular that, as of September, insurance/reinsurance companies may conduct securities lending trades through direct lending, lending agent, lending pool systems or other schemes subject to the evaluation and approval of the commission.

LSEG chosen by Philippine Stock Exchange for securities lending services

London Stock Exchange Group (LSEG) Technology was selected by Securities Clearing Corporation of the Philippines (SCCP), a wholly-owned subsidiary of the Philippine Stock Exchange, to provide post trade services, including securities lending and collateral management.

Under the mandate, LSEG Technology will implement its Millennium Clearing and Millennium Risk products, with the aim of improving SCCP's clearing, settlement, risk and collateral management capabilities.

In a statement on the deal, LSEG said that its service will include securities lending functions for Philippine clearing participants in the equities capital market.

The deal marked LSEG Technology's first engagement with the Philippine equity capital market.

The post trade infrastructure uses industry-standard messaging, such as FIXML and ISO, and provides features such as real-time marking-to-market and initial margining through the Historical Value-at-Risk model.

It also offers collateral management and margin call workflows, as well as execution of real-time and batch settlements.

According to LSEG, the technology will help SCCP meet global best practices and standards such as Committee on Payments and Market Infrastructures, International Organization of Securities Commissions and Principles for Financial Market Infrastructures.

LSEG Technology chief information officer, Ann Neidenbach, said: "Built upon the Millennium Advanced Platform, LSEG Technology's Millennium Post Trade solutions provide significant benefits for our customers by improving operational efficiency, enabling adherence to international standards, and reducing the total cost of ownership."

South Korea bans short selling for six months

South Korea's financial regulator banned short selling in the KOPSI, KOSDAQ and KONEX for six months from March in a bid to curb the freefall in equities markets caused by the coronavirus, which was spreading itself across the globe.

At the time, South Korea was suffering from the region's biggest COVID-19 outbreak outside of China, with more than 8,300 confirmed cases and 81 deaths, according to Johns Hopkins University' virus tracker.

The country's market regulator, the Financial Services Commission (FSC), enacted the ban from 16 March to 15 September, after the previous day saw record-breaking losses recorded in the country's markets.

Seoul's benchmark index (KOSPI) plunged 13.2 percent last week, its biggest drop since the financial crisis in 2008, when the FSC also imposed a lengthy short selling ban. As a result, the country took unprecedented measures to help protect Asia's fourth-largest economy against the coronavirus.

During the six-month period, the limits on stock buybacks is lifted for select companies. The Korea Exchange may also ease the rules upon approval from the FSC.

The decision to ban short-selling is seen as the "strongest step" the FSC has taken since the financial crisis in order to address equity market volatilities.

Several other market regulators in France, Italy, Turkey, and elsewhere, imposed similar bans on for certain stocks, but these were limited to single trading sessions following significant sell-offs.

At the time, the next longest ban after South Korea's was imposed by Spain, which signed off on a one-month halt on all short selling. Spain was also among the list of countries most affected by the virus.

Superannuation fund UniSuper suspends lending to thwart short sellers

One of Australia's largest superannuation funds suspended its securities lending programme indefinitely, as of March, in order to stifle supply to short sellers amid the on-going coronavirus-fuelled market sell off.

UniSuper, which invests $85 billion on behalf of its 450,000 members in the higher education and research sector, instructed its custodian, BNP Paribas Securities Services, to recall all shares out on loan and suspend lending, without exception.

The fund's chief investment officer, John Pearce, explained in a statement that UniSuper's usual stance on securities lending is that it adds to market efficiency, while short selling "adds to liquidity and price discovery in an orderly market".

"However, we are now in a market gripped by panic and we believe that restricting the ability to short sell is in the best interest of promoting a more orderly market," he added.

The fact that shares are not exclusively borrowed in order to facilitate a short position was not referenced.

Pearce also called on other funds to follow UniSuper's example, noting: "We are only one fund and the efficacy of our actions will depend on how many other funds follow a similar path."

The securities lending programme's plug was pulled following global markets' slump to new lows as the coronavirus epidemic continued to worsen.

The ASX 200 was not immune from the global trend and on Monday chalked up its biggest daily percentage fall on record.

UniSuper is understood to be only lender to take the matter into its own hands by publically suspending its own programme in a bid to slow the sell off.

Commenting on move at the time, Roy Zimmerhansl founder and practice lead of Pierpoint Financial Consulting, said: "To me, there is a distinction between UniSuper's individual decision which they believe is in their best interests, that is different to a market-wide ban initiated by a regulator or exchange which has a wider obligation to the whole of the investment community rather than a perceived segment."

He added: "My concern with temporary bans, aside from impacting the liquidity and price discovery mentioned by UniSuper, is that when the ban is removed, if the company, country or global financial conditions have deteriorated, it is likely to create a catastrophic drop in price."

"Or maybe short selling should be banned forever and people should accept that what they really want is not a market with all available information, rather one that is structurally upward biased?"

J.P. Morgan renews lending mandate with Australian superannuation fund

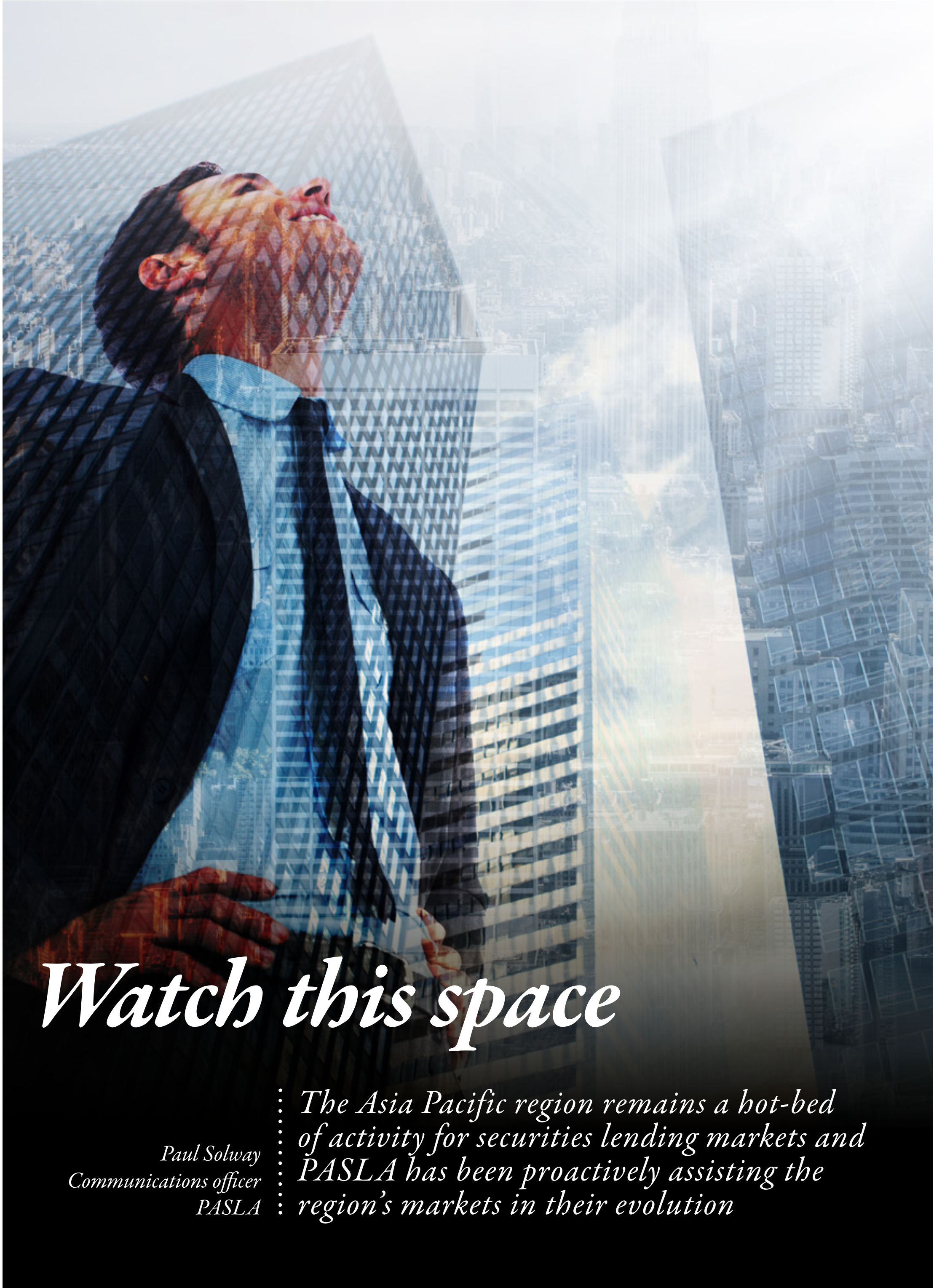
J.P. Morgan renewed its mandate to provide securities lending and other asset servicing services to the Australian superannuation fund, Local Government Super (LGS), for a further five years.

Under the contract, signed in December 2019, J.P. Morgan will be the sole custodian of LGS' more than AUD 12 billion (USD 8.22 billion) assets under management and will also offer physical safekeeping of assets, and account and administration services, including unit pricing and compliance.

The bank was unable to confirm how much of the LGS' asset pool will be available for lending or offer further details on the terms of the programme.

Nadia Schiavon, head of securities services for Australia and New Zealand at J.P. Morgan, explained that, in addition to custodial services, the bank will also provide performance reporting to support LGS' responsible investment strategy.

J.P. Morgan has been providing custody services for LGS since 2003 and was able to re-capture the pension funds' custom after LGS' management opened itself up to new offers from other agents and service providers.



Watch this space

Paul Solway
Communications officer
PASLA

The Asia Pacific region remains a hot-bed of activity for securities lending markets and PASLA has been proactively assisting the region's markets in their evolution

Image: /Shutterstock.com

The global securities lending community was deprived of the PASLA/RMA conference in Tokyo this year. What were the hot topics you were planning on discussing?

The executive and conference committees at the Risk Management Association (RMA) and the Pan Asia Securities Lending Association (PASLA) were very disappointed to have to postpone the conference. The decision was made given the potential threat to participants from COVID-19 and, in hindsight, was the right thing to do. We look forward to seeing everyone in Tokyo in March 2021.

The planned agenda was exciting and included, in addition to the popular topics from previous years, some new subjects.

- ESG: We had planned to launch the results of our environmental, social and governance (ESG) survey, undertaken in conjunction with EY, as well as considering the next steps for the securities lending industry to meet expectations around ESG. Radek Stech, the chair of the newly-launched ESG-focused council of the International Securities Lending Association, known as ICSF, was going to join discussions on possible formulations of guidelines for the industry.
- Diversity and inclusion: There was an exciting panel with representatives from the LGBT+ community who would have provided insight into challenges they have faced as well as discussing how to create a welcoming environment. We were also planning to launch the PASLA Inclusion Network (PIN) for PASLA members (see more later).
- Technology: The impact of fintech on securities lending would have been discussed/introduced, including methods for managers to introduce the changes in a positive way.
- Market updates: Exchange representatives and market experts would have provided insights into how both large and small markets have evolved since the previous conference as well as looking at their immediate and long-term futures.
- Previously popular sessions would have returned including regulatory updates, beneficial owners' views and industry leaders' opinions on the prospects for the industry.

Can you share some of the key takeaways of your ESG survey?

ESG came into focus at the end of 2019 with the highly publicised withdrawal of Japan's Government Pension Investment Fund from securities lending. PASLA has worked with EY to undertake an anonymous survey of our membership, in addition to more extensive interviews with key market participants, to create a document that aims to provide a snapshot of the region's current views and concerns over ESG in securities lending.

It will be released beyond the PASLA membership in May and will be part of PASLA's ongoing engagement around ESG within SBL.

We aim to work closely with the ISLA's ICSF to help create guidelines for the wider industry to help address any concerns that market participants may have over governance within the securities lending industry.

PASLA turned 25 this year, how has the association grown during that period? What were some of the key challenges you faced in establishing a pan Asian industry body, and what are some of your biggest achievements?

Whilst PASLA has obviously changed since its inception in 1995, some things do remain consistent, mainly the commitment from industry participants to help drive PASLA's objectives. We are continually thankful for the level of engagement by our members especially those who work tirelessly on our various committees.

Over the past 25 years, the securities lending industry has grown significantly in Asia, with fees from lending

in the region now outstripping that of the region of Europe, the Middle East and Africa. Taiwan, South Korea and Malaysia opened lending platforms and several other markets, most notably China and India, established domestic platforms. Additional markets, such as Indonesia and the Philippines are working to assess their own rules around securities lending and PASLA continues to work with the relevant regulators on potential further reforms.

PASLA continues to work with the more established markets and was, for example, closely involved in discussions with HKEx concerning the challenges posed by delisting rules that left suspended securities in limbo. After strong lobbying a clear guideline on delisting was issued, helping to resolve a sensitive issue.

The diverse range of market rules and lack of regional harmonisation provide an ongoing challenge to PASLA members and, in 2017, we participated in the development of a roadmap for Asia Pacific Economic Cooperation Finance Ministers via the Asia Pacific Financial Forum with the aim of improving regional market infrastructure.

Our annual conferences have continued to grow both in number of participants and breadth of topics covered. We hope that they now provide a recognised forum for regional market participants and any non-participants to learn about recent developments and to consider their future plans.

PASLA is active in several pan Asian markets working with regulators, governments and industry participants. What has PASLA been most focused on recently?

There is understandable interest and focus on the potential for a more active mainland China market as regulators there continue to review existing and potential models for offshore access (see later discussions).

PASLA arranged a roundtable for both the PSE and the SEC to review offshore collateral management and options to provide support to their ongoing plans to open up short selling and build upon their existing onshore lending programme.

We are in the process of creating a library of legal documents for PASLA members to access. The aim is to have readily available boiler plates for all regional markets that require additional documentation as standard. We started with the more challenging Korean market documents and, once these are finalised, plans are to roll the project out to all APAC markets.

Given the lack of regional harmonisation mentioned earlier, we have recently launched, in conjunction with the RMA and EquiLend, a regional market update which will provide a good level of understanding of the current status of Asia Pacific markets.

The opening up of the Chinese market has been something the global market has eagerly anticipated for a while now. PASLA's conference was meant to be there next year, does that mean progress is being made?

PASLA's China group has been working extensively with the Asia Securities Industry and Financial Markets Association to build consensus across industry to establish best practices in a T+0 environment.

There have been multiple meetings with the relevant regulators in both Hong Kong and China with the view to ensuring that the next suggested offerings create a long-lasting and productive securities lending frameworks.

Currently securities lending is allowed through Stock Connect but there remain several barriers to entry.

The recently launched STAR board short selling rules provide more of a central counterparty/bilateral hybrid and may offer an alternative source of development outside of the cross-border model.

We are still keen to host a future conference in Beijing and look forward to building on existing relationships with regulators.

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In total, APAC boasts 11 full-fledged markets and two emerging ones that are yet to install offshore securities lending frameworks. What's happening in those areas?

With regard to the nascent frameworks within Indonesia and the Philippines, PASLA has had meetings with the relevant authorities in Indonesia who are keen to expand the product offering available to investors, including an understanding that a securities lending product is required to facilitate and support the successful introduction of exchange-traded funds and futures. They are considering options for future market participants in securities markets.

The Philippines has a functioning onshore securities lending system that presents challenges to offshore participants. The Philippine Stock Exchange is reviewing its short selling proposals to ensure that they will meet with market requirements as well as considering the structure of its existing securities lending system to reduce barriers to overseas investors.

If all things go well we will all be in Tokyo in March next year. What can we expect from PASLA between now and then?

We are excited about the prospect of reconvening in Tokyo in March 2021. Likely an overlay will develop on each topic as to how this year's situation has been a catalyst to change our strategies and mindsets. PASLA, as mentioned earlier, is launching PIN in the next few months, led by Valerie Rossi, with the aim of creating an environment where PASLA members and its community can come together with their own views and feel respected.

Members will be able to guide the direction of the group to ensure that it responds to their requirements and interests. We will be using the momentum around our recent ESG work to actively contribute to best practices on governance within the securities lending industry.

A 108-page regional market update, with information across all active and developing securities lending markets in Asia, has been released and will provide a valuable resource to new market participants as well as a timely reminder to more seasoned professionals.

We will continue to work with legal counsels across the region to create a library of documents and addenda helpful to current and new entrants to the securities lending industry.

We will be using the momentum around our recent ESG work to actively contribute to best practices on governance within securities lending

Paul Solway, communications officer, PASLA

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Asia: on the rise

Industry leaders from the Asian securities lending sector discuss the region's outperforming revenue, the effects of the coronavirus on behaviour and which markets will lead the pack in 2020

Panel participants

Brian Leung
Vice president, trading, agency securities lending, Deutsche Bank

Simone Broadfield
Asia Pacific head of agency securities lending trading, J.P. Morgan

David Lai
Asia Pacific agency securities lending product manager, J.P. Morgan

Mark Snowdon
Head of capital markets, Asia Pacific, Northern Trust

Jansen Chua
Head of securities finance, Asia Pacific, State Street

Paul Solway
Head of securities finance, Asia Pacific, BNY Mellon Markets

Asia's securities lending revenue outperformed on the global stage in 2019. What drove this trend and can we expect it to continue this year?

Mark Snowdon: 2019 was a mixed year for securities lending, with a feeling of continued buoyancy despite the headwinds that slowed growth in comparison to 2018. Political and economic uncertainty, driven by Brexit and international trade tensions, contributed to a general lack of conviction globally, resulting in reduced demand particularly in the equities space. This was evidenced by a 14 percent drop in year-on-year revenues for Asia Pacific (APAC) equities, according to DataLend.

The securities lending industry in APAC continues to be optimistic, despite the impact of slower demand and lower fees. Key developments are expected to take place regarding new markets and different approaches which will affect the lending industry throughout 2020 and onwards.

Jansen Chua: We welcome the development of the Asian markets from a lending perspective and note that there have been positive signals from the Philippines who recently approved implementing guidelines on securities lending. China continues to take promising steps towards market liberalisation; recent index inclusion has further increased investor interest. However, the ability for offshore securities finance to fully participate remains contingent on significant regulatory and market infrastructure change.

Simone Broadfield: Last year brought with it geopolitical unpredictability, global economic policies that led to trade-war tensions and sustained localised political protests. The combined volatility of these macro events impacted lending activity across Asia Pacific. Spread compression and a reduction in balances across equities were a notable trend towards the latter part of Q4.

Nevertheless, there were still significant opportunities available to generate alpha across equities assets within agency lending programmes, most particularly across longer term directional shorts in Australia, Hong Kong and South Korea. IPO assets entering the discretionary lending pool in Hong Kong, equities undergoing corporate activity in Japan and continued demand for flexible trading structures commanded a premium, particularly the last as balance sheet optimisation continued to be an ongoing focus for the market. The fee compression and balance reduction seen across equities were offset by increased opportunities within the fixed income space.

Demand for upgrade structures showed no sign of abating as 2020 began, with the main beneficiaries being those clients holding desirable risk-weighted asset ratings and a flexibility in terms of trade tenor and collateral parameters, such as the ability to accept Korean treasury bonds.

The combined volatility of macro events impacted lending activity across Asia Pacific in 2019. Spread compression and a reduction in balances across equities were a notable trend towards the latter part of Q4

Simone Broadfield
Asia Pacific head of agency securities lending trading
J.P. Morgan

As 2020 Q1 began, the theme of fee compression across equities showed indications of continuing; however, the slower start is now moving into a period of increased market volatility as the impacts from coronavirus begin to emerge, leading to directional short opportunities and an anticipated recovery across APAC equity lending markets.

To face the challenges that the unpredictable market conditions may bring, agent lenders need to respond rapidly to the evolving needs of the securities lending market. The focus will be less on traditional lending, although that remains a fundamental part of revenue generation, and will shift towards customised trading solutions and continued diversification of product offerings.

Paul Solway: Certainly, the first part of 2020 is going to be dominated by the ongoing Covid-19 situation, which we must anticipate will continue for at least a while longer. Consequently, we can expect APAC lending activity to focus on tourism and retail securities, and particularly in any names linked to China.

Once that situation is resolved – or at least stabilised – we could see a jump in lending activity as investors try to make up for lost time. We suspect that stocks in technology, biotech and biochemical industries could be popular in 2020 in addition to names in the healthcare space.

Looking at individual APAC nations, in Australia we can't see any specials on the horizon, so we expect 2020 lending to centre around the banking and retail sectors. Retail is also where we are looking for activity in Hong Kong, along with property, tourism and any names linked to the Chinese tech sector.

In Japan we're looking at export firms and the technology sector, with tech also being the centre of lending activity in Taiwan, as it almost always is. Finally, returning to Korea, we are watching out for borrower interest in bio names, export and the tourism sector.

Brian Leung: Asia's outperformance compared to its peers was largely driven by an increase in specials activity, particularly in Hong Kong where demand surged on the wave of the escalating US/China trade war and continued macro geopolitical uncertainty which drove end-users to increase China exposure. This was boosted by the fact that the Hong Kong market saw multiple high-profile capital raisings.

Similarly in Japan, strong corporate deal activity and increased focus by activist investors on Japanese-listed companies' corporate governance kept the Japanese market thriving. 2020 should see similar trends, as macro challenges are set to continue. Discerning lenders should be on the lookout for more corporate deals and be able to maximise their securities lending returns on the back of those transactions.

One of the big stories that came from Asia in 2019 was Japan's GPIF decision to partially pull out of lending. How big a shock was this and what is the impact on the market in Asia and afield?

Chua: While the decision was not communicated widely before the announcement, it was well-known that Japan's Government Pension Investment Fund (GPIF) holds a view on environmental, social and governance (ESG). There was also an internal opinion that the lack of transparency around securities lending trading activity did not support good governance. Despite the size of their holdings, the impact on the market appears to have been muted as most borrowers have been able to cover their exposure to this lender adequately.

Leung: GPIF's decision to pull out of its securities lending programme was disappointing, however a keen securities lender would see it as an opportunity. It was only noted as a suspension and not a withdrawal from the industry as a whole, which implies they would be open to re-entering the market at a future stage. It is widely proven with supporting empirical evidence that securities lending and short selling play a vital role to properly-functioning and efficient markets. The impact of their suspension is more psychological than economical. While overall lendable supply has dipped as a result from their absence, the rates (particularly

on specials and a broader level) have not shifted significantly since the announcement.

Solway: Japan's Government Pension Investment Fund's (GPIF) decision to suspend equities lending was based on its belief that the transfer of stock ownership rights during the course of a securities loan is "inconsistent with the fulfillment of the stewardship responsibilities of a long-term investor".

Studies undertaken by regulators have reached a different conclusion. Most recently, the European Securities and Markets Authority (ESMA) published a detailed report on securities finance in December 2019 which found that "securities lending, if done in a controlled way, is an opportunity to add value for fund investors and [is] compatible with long-term investment strategies".

We've not seen any measurable wider market impact from the GPIF suspension so far, which may suggest that beneficial owners agree with ESMA's conclusions that lending and long-term investment are entirely compatible.

That said, it is more important than ever to have a strong corporate governance policy underpinning lending activities. This has been a major area of focus for regulatory bodies in recent years, including ESMA and the United Nations, both of which have written at length about what a strong corporate governance framework should entail.

Just this past December, the International Securities Lending Association announced the formation of a new Council on Sustainable Finance which will also introduce a new series of Principles for Sustainable Securities Lending, so there are resources for beneficial owners to turn to when looking for guidance around developing robust lending policies.

Do you foresee other Asian funds following suit to GPIF?

Leung: From our discussions with existing clients, they acknowledge GPIF's high profile departure has not gone unnoticed, but they have fallen short of questioning their own participation in lending as a whole as they are soundly aware of the benefits that a transparent, well-function securities lending programme can deliver. Dialogue and communication with clients are key at this stage, and we expect the industry as a whole to be able to deliver the right type of solution for each participant.

Chua: Investors are increasingly reviewing the relevance of ESG principles to securities lending programmes, particularly how certain aspects (proxy voting, short selling) align to their stewardship responsibilities. The divergence of views today amongst participants, however, speaks to the lack of a uniform standard. Many investors understand that it is not a binary decision and it is possible to have effective ESG goals and still

The emergence of the coronavirus appears to be having a widespread impact on social and investor sentiments. Geopolitical instability will also continue to be a factor

Jansen Chua
Head of securities finance, Asia Pacific
State Street

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We have seen encouraging steps on short selling, from revised guidelines to new approvals. These are welcome as they allow for the increased understanding of the role that lending plays in the region

David Lai
Asia Pacific agency securities lending product manager
J.P. Morgan

participate in securities lending. We believe that this topic is likely to remain at the forefront of agent lender and beneficial owner discussions for 2020.

2020 will see big moves in Europe to harmonise markets and improve data quality and transparency under SFTR. Could a similar framework exist in Asia? Would you want it to?

Leung: Given Asia's level of market sophistication in the region and that almost every major market has a requirement for reporting over-the-counter derivatives, it stands to reason that each market is watching this space very closely. They will be learning from Europe's experience in implementing the Securities Financing Transactions Regulation (SFTR), how it impacts markets and market participants before making their own SFT reporting decisions based on best practices tailored for their own market idiosyncrasies. From previous experience, the more developed markets such in Japan as well as Australia are likely to take the initial lead, followed by Hong Kong and Singapore.

David Lai: Securities financing is employed in various degrees of volumes in each of the region's markets, and four of the 10 biggest stock exchanges reside in Asia Pacific (based on market capitalisation in USD, May 2019).

Therefore, it would stand to reason that there will eventually be calls for a similar framework in Asia to facilitate greater harmonisation and transparency.

Since securities lending in some Asian countries has been more recently established than in other countries, we believe that having a similar framework would help to further educate the region on the role securities financing plays in today's global marketplace and highlight the region's growing importance to global securities financing.

Chua: SFTR is specific to one regulatory regime (Europe). So, it is unlikely to be replicated across Asia, which has multiple regulatory regimes to consider. While many would welcome the transparency that SFTR is bringing to the market, a much simpler version with fewer requirements would be the model adopted by Asian regulators.

Solway: With so much focus on the Securities Financing Transactions Regulation (SFTR) in Europe, many participants forget that there are many markets in APAC that already offer full transparency around securities finance trades to both investors and regulators.

In countries such as South Korea, Taiwan and Malaysia, lending trades are facilitated by domestic intermediaries that include brokers, custodians and depositories. Those intermediaries track and record in some detail the movement of all domestically listed securities. Admittedly, those records don't

encompass the more than 150 fields required to be reported under STFR, but they certainly provide enough information to ascertain volumes and fees by security and tenure.

What other challenges do you see on the horizon for the securities finance industry in Asia in 2020?

Solway: There are a number of issues across the region with different challenges in different regions. The perennial challenge in domestic-only lending markets such as India and China is the question about when will they open up. There's little clarity on that issue on the horizon, beyond the much anticipated results of China's QFII/RQFII consultation that could see more market friendly developments potentially being rolled out.

Then there are issues around the differing routes to market we've seen emerging globally in recent years and the ongoing questions about when we are going to see them being embraced in APAC. Just to mention a few, we've seen the rise of central counterparties (CCPs) really accelerating in the past year or two, with repo clearing at the Fixed Income Clearing Corporation in the US and the first cleared securities lending trades in Europe taking place in 2019. We're yet to see comparable developments in APAC, although we are seeing clearing in Japan through the Japan Securities Clearing Corporation, but at this stage it's only used onshore by domestic counterparts.

Then there is the development of pledge structures being deployed in other parts of the world, which has delivered some meaningful operational efficiencies over the title transfer model. There has certainly been an uptake of pledge models in APAC, but there is definitely room to do more in this space and to expand the utilisation of these types of structures.

One of the challenges here is that these changes require a substantial investment in time, documentation, manpower, financial resource and operational support, so we made need to provide a bit more of a helping hand to see more clients in APAC through those issues.

Additionally, from a technology standpoint, the industry continues to automate right across the spectrum of active regional markets, vertically through the asset classes as well as the varying degrees of specialness (general collateral, warm and specials). Clearly the quant/algo space requires as much straight-through processing (STP) as possible in order to reduce latency and increase volumes but it's fair to say that the classic trader role even in securities lending is changing. Answering the question 'why' is becoming a differentiator across the street, as the buy-side continues to seek greater transparency over the qualitative and quantitative aspects of this business. This 'datatech' arms-race is set to continue whether it be lenders facing beneficial owners or primes feeding their hedge funds – all the while the cost-benefit conundrum keeps banging on in the background.

Chua: The emergence of the coronavirus in its latest form appears to be having a widespread impact on both social and investor sentiments. Geopolitical instability will continue to be a factor. With the US-China trade war still ongoing, tensions on the Korean Peninsula and the US election year are likely to materially impact the performance of stocks regionally. From a market perspective, the continued low interest rate environment will present a challenge to those investors reliant on returns from cash collateral. Continued regulatory implementation will add to the cost of running securities financing programmes.

Lai: One challenge for 2020 is to further expand the universe of acceptable collateral types. As demand for diversification continues to increase, along with the desire to utilise/monetise unencumbered assets, we are working closely with our clients and their counterparties to identify additional opportunities.

This follows the 2018 launch of international pledge in Asia Pacific, which our agency securities lending team completed independent of the industry initiative, and the 2019 introduction of expanded Korea collateral schedules to include Korean treasury bonds within our South Korean equity collateral programme.

> *I would expect that South Korea will emerge as the Asia Pacific (APAC) market to watch in 2020*
>
> *Paul Solway*
> *Head of securities finance, Asia Pacific*
> *BNY Mellon Markets*

Snowdon: While not necessarily a challenge, regulation is a fundamental part of every market players' agenda. It is likely that both global and converging local regulation will continue to transform the industry, despite the fragmentation it has across APAC.

April 2020 sees the first phase of SFTR go live. SFTR is a global regulation that mandates enhanced reporting of securities lending transactions for in-scope entities. This should help the industry better prepare for imminent challenges and better position market participants for a more flexible and efficient future.

Regulators introduced Resolution Stay Protocol requirements following the global financial crisis, in order to ensure benefits for the securities lending industry. Further requirements will be put in place to ensure the benefits of lending continue to accrue, whilst delivering a higher chance of positive resolution should a borrower default occur in the future.

Alongside growing cost pressures and lower yields, another challenge is the continued rise of responsible investing, which is the integration of ESG factors into investment processes and decisions.

Sustainability is a core element of ESG investing. It is also a benefit that a securities lending programme brings to capital markets generally, and to investors' returns specifically. Incorporating their securities lending programmes with ESG principles is important to investors as they become more involved in expressing their values through voting. On the surface, securities lending can appear to run counter to ESG principles, as when a security is on loan the investor loses the right to vote. However, securities lenders have been successfully balancing the returns from securities lending with the requirement to exercise good governance for many years.

In partnership with a supportive, client-focused securities lending agent, the right balance is achievable, and will come from an agreed approach between the agent and the asset owner or manager using technology, market insight and strong relationships with borrowing counterparties.

Leung: The COVID-19 outbreak has provided a stark reminder to ensure that participants have strong business continuity procedures and technology in place, such that securities lending programmes and client experience will not be affected adversely due to the pandemic. We have seen a reduced trade flow in some of the major markets since then, and while we foresee it is a temporary lull, we have yet to see how it will impact the wider securities lending industry as a whole.

Several Asian markets took steps to further develop their securities lending and short selling markets in 2019. How important have these developments been in improving the overall region?

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Snowdon: In Australia and Japan in particular, borrowers are looking to reduce the number of intercompany transactions by using a domestic entity to borrow local securities, rather than their European or US entity. This trend is expected to continue in the region, and will allow increased opportunities to expand distribution and generate additional revenue for lenders.

The trend of lending to non-traditional borrowers is growing in APAC, as we are increasingly seeing hedge funds borrow directly from lenders which offer opportunities for clients who want to utilise a different risk-reward profile, thus causing disruption to the usual value chain.

The Pan-Asia Securities Lending Association (PASLA) has been liaising with regulators and authorities to develop a working offshore model and increase usage of the operational, yet seldom used, onshore model. The upcoming model is expected to be a simplified bilateral one that is more transparent and inclusive.

Leung: With Philippines adding new short selling rules and Indonesia looking and potential CCP models, it is important the PASLA community continues to bring more countries into the fold. Each come with their own unique regulatory challenges which the PASLA committee has been working in partnership with regulators and industry bodies to overcome.

The elephant in the room continues to be China and its gradual easing and opening of its financial markets, particularly in providing a viable SBL framework that international investors can take part in. Industry players must be nimble and reactive to any possible (and sometimes sudden) changes the CSRC will announce as the onshore market has been under the microscope for the past few years given its potential and presents a significant opportunity.

Lai: We have seen encouraging steps on short selling, from revised guidelines to new approvals. Individual regimes also issued clarifications on various functions including collateral valuation and tenors.

These updates are encouraging as they allow for the increased understanding of the role that securities lending plays in the region's markets. We continue to see new entrants which is encouraging and can be partly attributed to the increased information about, and understanding of, the role securities lending plays in regional markets.

Every year, the developing markets of Asia are catching up with the more established markets. Which Asian markets do you expect to shine in 2020?

Solway: I would expect that South Korea will emerge as the Asia Pacific (APAC) market to watch in 2020. It's only been 15 years since South Korea established offshore securities lending but the growth we've seen has been absolutely tremendous. In that time

In Australia and Japan, in particular, borrowers are looking to reduce the number of intercompany transactions by using a domestic entity to borrow local securities, rather than their European or US entity

Mark Snowdon
Head of capital markets Asia Pacific
Northern Trust

we've seen insurance companies sovereign wealth funds and others begin lending and participation has increased year on year. Today, South Korea is the fourth largest lending market in APAC with $120 billion in Korean equities available to lend at the end of Q3 2019, and with around $13.2 billion of that out on loan. We expect that number to grow as more institutions recognise the potential for yield enhancement through securities finance.

Lending in local fixed income has also been growing rapidly as demand for Korean treasury bonds (KTBs) has swelled. Roughly 10 percent of the overall financing flows in KTBs are for securities lending purposes, with the remainder of the demand stemming from onshore banks and alternatives raising short-term cash by pledging KTBs as collateral. IHS Markit found that just 3.3 percent of available Korean government bonds were being loaned out as of Q3 2019, so there a huge amount of runway to grow lending activity in KTBs. Given all that, South Korea is definitely a market to watch.

Broadfield: Although Japan is an established market, we see significant enough growth opportunities to warrant a continued focus and expansion of our lending product in the market across all lendable asset classes. The Hong Kong lending market has been heavily impacted by the macro factors mentioned earlier; however, we remain positive that we will see a recovery and a return to increased activity. South Korea consistently offers high returns, in spite of increased onshore supply, and we expect this to continue throughout 2020.

For 2020, we would say that it is less about which market will shine and more about how the traditional agency lending product will evolve to meet client needs.

Snowdon**:** Since China A-Shares were added into MSCI benchmark indexes in 2018 and the number of these shares subsequently increased in 2019, China has stood out as one of the key opportunity markets for the securities lending industry. Both borrowers and lenders look to leverage opportunities in China, such as the development of links between onshore and offshore exchanges via Stock Connect. Hong Kong, however, faces various restrictions on who is authorised to engage in securities lending and therefore, the activity is only minimally utilised in the market. Although it is currently allowed under Stock Connect, only exchange members are permitted to participate, eliminating some of the largest asset holders such as custodians and asset owners.

The Australia market looks set to continue to grow in 2020, with Australian superannuation funds currently managing around AU$2.7tn of assets. As these assets grow and the industry consolidates, many superfunds have started to consider securities lending as an integrated investment solution. Securities lending is seen as a means to achieve increased returns with low risk, during a period of increased regulations and rising cost pressures.

Leung: In 2020, we expect the major players in Japan, Hong Kong and South Korea to continue punching above their weight, however, it will be nascent markets like Philippines and Indonesia, where if a viable market structure is achieved for international investors, can present significant first mover advantages for participants who are best equipped to capitalise on lowly tapped markets such as these. Beneficial owners will be well aware of which service provider is able to differentiate themselves with innovative ways to access new markets.

Chua: In absolute terms, returns are likely to be highest in Japan and Hong Kong. The Korean market continues to show higher returns than the previous years.

Several Asian markets have seen the introduction of emerging technology, such as blockchain, for securities lending. How big a part can technology play in developing interest in SBL and help interconnections across Asia?

Chua: The potential for technology to increase efficiency and enhance returns is enormous. However, some fundamental issues (such as market liquidity, infrastructure and regulatory environment particularly for cross-border investments) remain the same with

South Korea and Malaysia are experimenting with blockchain solutions. The potential for this technological breakthrough is huge

Brian Leung
Vice president, trading, agency securities lending
Deutsche Bank

several regional markets. These issues will continue to detrimentally impact the growth of securities financing activities in such markets.

Lai: Technology is critical to efficient markets, and securities lending is no exception. Whether it's at a client level, with better performance and analytic tools, or an industry/infrastructure level, with emerging technologies that can improve the flow of data, information and governance, we continuously seek better execution and access to data that supports transparency and liquidity.

Snowdon: Advanced technology is transforming financial markets globally, and the Asian securities lending industry is no different. Technology provides the opportunity to enhance entire lifecycles, from trading strategies through to operational efficiencies.

There is a potential for blockchain technology to drive both small-scale benefits for lenders and borrowers, and major industry-wide improvements. We expect the practical application of technology to strengthen competitive advantage for performance, efficiency and better client experiences.

With our experience and expertise in pioneering blockchain technology, we believe it has the potential to drive major industry-wide improvements and could significantly change the securities lending market. Blockchain and distributed ledger technology will allow automation so people can focus on the tasks that will bring the real value to the client. This will provide potential opportunities to achieve industry cost-efficiencies across the value chain. As confidence continues to grow in the technology sector, future opportunities are likely to develop in a wide range of areas.

Leung: Blockchain has already had a tremendous impact on the financial industry and the securities lending industry is no exception. Having a ledger that tracks the lending of securities that has been transferred multiple times between counterparties is ideally the most elegant solution which could in theory reduce costs, increase efficiency and execute transactions instantaneously between two parties.

The announcement of Deutsche Boerse's partnership with HQLAx to develop a blockchain-operated solution for the securities lending market also signifies the growing shift towards this technology. Asia is definitely watching this space closely, where similar to regulatory changes, it is expected the more developed markets to follow first, given their market structure and sophistication.

We have also observed individual firms in markets like Korea and Malaysia experiment with their own blockchain solutions. The potential for this technological breakthrough is huge, though one should temper timeline expectations given historical lead-times for rolling out market developments in the region and it the regulators' historical trend as followers instead of innovators.

Stock Connect - Changing the game for financing China A-Shares

J.P. Morgan, the Hong Kong Stock Exchange, and Linklaters have come together to offer an in-depth overview of the Hong Kong-Shanghai Stock Connect, along with key legal considerations and how securities can be utilised within a triparty collateral management structure

As offshore banks and broker-dealers continue to grow their China A-share positions, driven by increasing access to the A-Shares market via Stock Connect, demand to utilise these securities as collateral is on the rise. There is a significant opportunity for triparty lenders to accept Stock Connect securities as collateral as the triparty structure is one of the only practical options for securities financing.

J.P. Morgan recently hosted more than 50 participants from Hong Kong, London and Tokyo at a roundtable to take a deeper look at the structure and opportunity. J.P. Morgan, the Hong Kong Stock Exchange (HKEX) and Linklaters provided an in depth overview of Stock Connect, key legal considerations and how securities can be utilised within a triparty collateral management structure.

The basics… and beyond

Historically access to China's mainland capital markets by offshore investors has been restricted through investment quota limits and local currency controls. Over the past five years, with the introduction of the Stock Connect programme, offshore investors no longer have access or repatriation restrictions. Stock Connect was developed as a mutual market access service between Hong Kong and mainland China. Through this programme the Chinese regulators allow money to flow in and out of China in a controlled manner, via a single channel which is connected to the Hong Kong, Shanghai and Shenzhen Stock Exchanges.

Using Stock Connect, institutional and retail investors in Hong Kong and mainland China can directly buy shares in each other's markets. The structure allows for significant investment flows in both directions:

- Northbound trading: Hong Kong and international investors can trade in selected equities on the Shanghai (SSE) and Shenzhen (SZSE) Stock Exchanges, routed through Hong Kong brokers.
- Southbound trading: Investors in mainland China can trade selected equities on the HKEX through brokers in mainland China.

The programme is mutually beneficial: Hong Kong and international investors gain access to China, one of the world's largest equity markets which is largely untapped from an international investment perspective. At the same time, certain mainland Chinese investors can access equities listed on the HKEX, giving them additional diversification and investment opportunities via Hong Kong's more established stock market.

Expanding access to China

Stock Connect has created additional flexibility for international investors (institutional and retail) than existing programs available to international investors. Although the Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor (RQFII) program have allowed investment in Chinese securities for some time, they only allow participation from approved, well established institutional investors that meet certain requirements as set by the China Securities Regulatory Commission (CSRC).

While some of these requirements have been alleviated over the years, Stock Connect provides an option with no lock-ups or repatriation restrictions.

Our immediate focus is on northbound trading — specifically, how clients can access China A-shares for investment purposes and the associated opportunities for using these securities as collateral in global securities finance transactions.

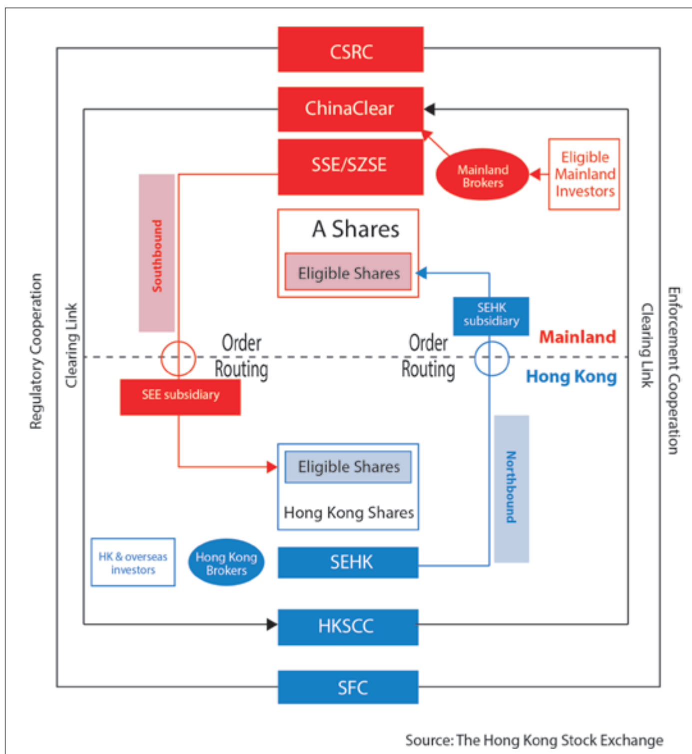
How does the trading link actually work for northbound trading?

Hong Kong and international investors trade A-shares through Hong Kong or international brokers. Clearing, settlement, depository and nominee services of A-shares executed through Stock Connect are provided by Hong Kong Securities Clearing Company

(HKSCC), a wholly-owned subsidiary of the HKEX, through the CSD and clearing links it established with the China Securities Depository and Clearing Corporation Limited (ChinaClear).

HKSCC, as ChinaClear's sole clearing participant, has opened and maintained two omnibus stock accounts with ChinaClear to hold A-shares for each China Connect Market (Shanghai and Shenzhen) separately on behalf of its clearing participants. HKSCC holds such China Connect Securities as a nominee.

A-shares purchased through Stock Connect will be recorded in the stock accounts held by their brokers or custodians in the Hong Kong Central Clearing and Settlement System (CCASS) operated by HKSCC as ChinaClear's clearing participant. The total shareholding of HKSCC in each China Connect security is equal to the aggregate shareholdings of all CCASS Participants of China Connect Securities recorded in CCASS.



Source: The Hong Kong Stock Exchange

How do international investors purchase China A-shares?

- Offshore investors instruct brokers in Hong Kong to buy A-shares
- Brokers instruct Hong Kong Exchange participants to conduct trades on SSE or SZSE Stock Exchange
- Hong Kong Exchange's subsidiary (as a SSE/ SZSE participant) effects instructions to trade on the SSE or SZSE Stock Exchanges
- The trade is cleared in ChinaClear. HKSCC is a participant in ChinaClear as nominee for all CCASS clearing participants. The shares for international investors are then held in an onshore omnibus securities account registered in the name of HKSCC
- HKSCC settles the buy trade with its CCASS participants in Hong Kong and offshore investors acquire an interest in A-shares

Importantly, international brokers trading through Stock Connect will only ever face the HKSCC as the clearing house, and will never face ChinaClear or the Chinese broker. The HKSCC essentially guarantees the performance of the trade to the offshore broker.

How is Stock Connect changing the game for market participants?

Stock Connect has presented a variety of immediate and long-term opportunities for investors, banks, broker-dealers and the buy side.

With Stock Connect providing the conduit for all northbound trades, broker dealers are now in a position to service investor demand for A-shares from multiple segments, including hedge funds, wealth managers and long only buy-side institutions.

Initial trading in Stock Connect was dominated by hedge funds, which did not have access to the licensed QFII and RQFII systems, and were thus locked out of the A-share market. Since the inception of Stock Connect, banks and broker dealers with prime brokerage (PB) operations have captured the vast majority of hedge fund trading activity and, as a result, have been providing the associated ancillary PB services such as financing, custody and clearing.

The opportunity for banks and broker-dealers to service traditional institutional investors and asset managers was initially somewhat muted as they were reluctant to participate due to a perceived lack of ownership rights and complex operational requirements.

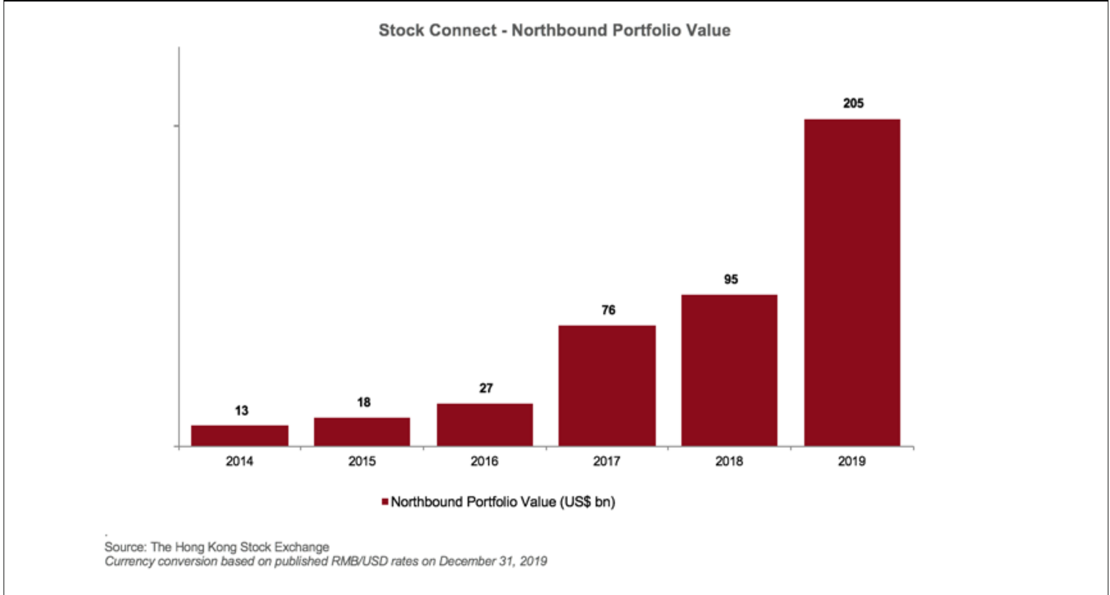
Over the past few years, however, beneficial owner rights have been clarified (as detailed by Linklaters in Ask an Expert) and HKEX has implemented operational improvements in Stock Connect, making it far more accessible to the international investment community.

Interest from global investors accelerated in 2017, when the MSCI announced they would be including A-shares in their equity indices over a phased period through to 2020. Not long after, other major global benchmarks such as FTSE Russell and S&P Dow Jones followed suit and now include A-shares in their respective indices.

The actions of the major index providers signal a market-wide acceptance of A-shares into international portfolios, and is perhaps one of the most important outcomes for Stock Connect to date, particularly for clients that are considering receiving A-shares as collateral. The MSCI Emerging Markets index alone tracks US$1.8 trillion in assets. As a result, we have witnessed billions of dollars flow into A-shares, as both passive and active funds rebalance their portfolios, within a relatively short period of time.

As of 31st December 2019, total north-bound trading turnover on Stock Connect was approximately $2.88 trillion, bringing net capital inflows of $205 billion.

Stock Connect - Northbound Portfolio Value



What financing options are available?

With northbound trading volumes continuing to rise, banks and broker-dealers are building their A-share positions in order to support their market access activity. As a result they will be naturally looking for ways to utilise these securities within securities finance transactions as part of their trading strategies. To that end, there is an opportunity for lenders looking to further enhance their collateral profiles and potentially extract additional value from their securities finance transactions.

As stipulated in the CSRC Stock Connect rules, off-exchange trading is not permitted. Therefore, collateral is required to move under a pledge, rather than a transfer of title structure.

J.P. Morgan has developed two bespoke collateral management solutions that enable banks and broker dealers to utilise their A-shares as collateral through its tri-party collateral management platform. The two models were developed to give clients flexibility in utilizing J.P. Morgan's sub-custodian or their own custodian or clearing participant, based on their existing operating arrangements.

- **Model I** utilises a special segregated account (SPSA) that is opened at J.P. Morgan. The SPSA ensures that Stock Connect shares are captured in the daily presale "snapshot" completed by the HKEX.
- **Model II** was developed to address scenarios where clients would like to hold Stock Connect shares in a tri-party arrangement at their existing custodian. A separate segregated security account is established with the collateral provider's custodian and J.P. Morgan is given exclusive control over the movement of Stock Connect shares in to and out of the account.

For both models, the collateral allocation of Stock Connect shares will be done via pledge (rather than transfer of title) on J.P. Morgan's books and records. Collateral receivers will have a valid and perfected security interest over Stock Connect shares allocated to their collateral account.

What's next?

Foreign investors now have easier access to the world's second largest economy through the Stock Connect model, creating new opportunities to include A-shares in their portfolios – and even more benefits when those securities can be utilised as collateral to meet financing and liquidity requirements. The two models developed by J.P. Morgan were based on in-depth knowledge of pledge structures, market conditions and investor needs and provide a practical way to utilise A-shares as collateral in securities finance transactions.

We expect to see this market continue to evolve, particularly as the HKEX makes further market enhancements, potentially leading to further index inclusions. And, as investor demand continues to provide an incentive for broader access to China, close coordination amongst collateral agents such as J.P. Morgan, global investors, market infrastructure providers and other experts in the region will remain critical to developing new and effective structures and solutions.

Will Jeffries
Vice president, platform sales
J.P. Morgan

Top five legal considerations

1. Who is the beneficial owner of Stock Connect securities?

It is well established that HKSCC holds the shares on trust for investors under Hong Kong law. As such, investors have beneficial ownership of the securities held by HKSCC on their behalf. Under Hong Kong law, it is recognised that a nominee holder has legal interest in securities for which it is a nominee and that the beneficial interest is held by the entity for whom HKSCC acts.

Under the triparty collateral management structure, the collateral provider would be the beneficial owner and the collateral receiver will have a valid and perfected security interest over allocated securities.

2. What law governs the security interest?

The lex situs or "the law of the place where the property is situated" of A-shares held under the Stock Connect program would be where the collateral provider's custody account is located. As a result, the security interest over pledged A-shares would have to comply with the requirements for the creation, perfection and enforcement of security in the lex situs.

3. Would the security interest be recognised by mainland China courts?

The conflicts of laws rules of the Peoples' Republic of China (PRC) would apply the "place of creation" of the security interest as the applicable law for security created offshore.

4. Does the security interest have to be registered to be valid?

The charge should be perfected in accordance with the requirements of the lex situs and any applicable requirements in the jurisdiction of incorporation of the collateral provider. Registration under PRC law should not be required, as Mainland Chinese courts should not apply PRC law to determine the validity and enforceability of the charge.

5. In the event of a collateral provider's default, is there any requirement for regulatory approval? How long does it take to liquidate Stock Connect Collateral?

Liquidation would be done via the preauthorised sale of the Stock Connect shares in the relevant collateral provider's brokerage account. No regulatory approval is required for such sale. In general, investors can send sales orders to the Exchange Participant for trade execution the next business day.

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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Structured Finance & Derivatives Partner, Linklaters

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Linklaters

Trends in securities lending – Northern Trust's perspective on 2020

Mark Snowdon
Head of capital markets, Asia Pacific
Northern Trust

With pandemics, Brexit and trade wars, the macroeconomic landscape is fast changing beyond all recognition. But, despite this, the case for engaging in securities lending remains the same

For securities lending, 2019 was a mixed year with a feeling of continued buoyancy despite the headwinds that slowed growth in comparison to 2018. Political and economic uncertainty, driven by Brexit and international trade tensions, contributed to a general lack of conviction globally, resulting in reduced demand particularly in the equities space. This was evidenced by 14 percent drop in year-on-year revenues for Asia Pacific equities, according to DataLend.

Throughout this period, securities lending remained a low-risk way to generate additional returns on the

investments of asset owners and asset managers alike, through a well-managed, risk-mitigated and transparent program.

Cost pressures and low yield – is securities lending the solution?

In an environment where cost pressures on asset owners and investment managers are growing and returns are more difficult to achieve, securities lending can make a difference by enhancing portfolio performance and offsetting costs.

As investors expand their securities lending programmes in a strategic response to the persistent low yield environment, the securities lending industry is channelling time and resources into developing new markets and revenue streams for asset owners and investment managers. In addition to bringing return benefits to investors, securities lending plays an important role in the smooth functioning of developed financial markets by supporting market liquidity and efficiency.

Case study – Australian superannuation funds

Evidence of the above trend can be seen in Australia. Superannuation funds in Australia currently manage AU$2.9 trillion (US$1.75 trillion) of assets and this is set to continue to grow, with a mandated employer contribution level of 9.5 percent per annum. As their assets grow, we have witnessed a trend of super funds re-visiting securities lending as an integrated investment solution. Amidst increased regulation, rising cost pressures and low returns, lending is viewed as a way to achieve increased returns with low and managed risk.

Optimising returns through a lending programme is often in the best interests of super fund members. We see increasing examples of clients entering lending for the first time, as well as long standing lenders who are already in a lending programme, seek opportunities to further optimise their asset returns through an expanded and increasingly sophisticated lending programme. As funds consolidate and increasingly internalise their investment decision-making, many are incorporating securities lending into their strategies.

Marrying securities lending and ESG

Alongside growing cost pressures and lower yields, another trend is the continued rise of responsible investing. Responsible investing is generally understood as the integration of environmental, social and governance (ESG) factors into investment processes and decisions. ESG as a concept had its first growth wave in the early 2000s, and is now a mainstream approach with many institutions now operating an active ESG agenda, although there are material differences in the specific execution strategies of different investors.

Sustainability is a core element of ESG investing. It is also a benefit that securities lending brings to capital markets generally, and to investors' returns specifically. Marrying their securities lending programmes with their ESG principles is important to investors as they increasingly look to express their values through voting. On the surface, securities lending can appear to run counter to ESG principles, as when a security is on loan the investor loses the right to vote. However, securities lenders have been successfully balancing the returns from securities lending with the requirement to exercise good governance.

In partnership with a supportive, client-focused securities lending agent, the right balance is achievable, and will come from an agreed approach between the agent and the asset owner or manager. This agreement will cover points such as:

- Which securities need to be voted on
- Which type of votes are important – all or contentious-only
- Whether voting on a percentage of shares is acceptable, or do all shares need to be voted on
- Are all markets of equal importance when it comes to voting
- What revenue might investors be prepared to forego by recalling loans to ensure voting?

A securities lending agent such as Northern Trust will structure a bespoke solution to take these requirements into account, including the automated recall of securities that an investor wants to vote on, thereby combining lending returns with adherence

to the ESG principles. Of course, voting is less of a concern for a fixed income lending programme, and some investors may choose to restrict their lending to non-equities only.

The securities lending industry is committed to helping investors align their lending programmes with their ESG philosophies. The International Securities Lending Association recently formed a Council for Sustainable Finance in a bid to introduce and promote ESG and Sustainable Development Goals principles for sustainable securities lending.

New markets for securities lending in 2020

With the addition of China A-shares into MSCI benchmark indexes in 2018 and the subsequent increase in weights in 2019, China continues to be one of the key opportunities for the securities lending industry globally, as borrowers and lenders progressively look for the ability to finance these securities.

Positive steps have been taken towards market liberalisation, there has been an increased offshore participation through the increased MSCI inclusion and links have been developed between onshore and offshore exchanges via Stock Connect; Chinese authorities are continuing to develop securities lending.

However, there is minimal usage of securities lending under the Stock Connect model as it restricts participation to only exchange members, thereby excluding asset managers and custodians who are some of the largest asset holders. The Pan-Asian Securities Lending Association continues to work closely with regulators and authorities to explore the development of a working offshore model and the expansion of the currently-functioning, yet lightly-used, onshore model.

Productive Pan Asia Securities Lending Association (PASLA) industry meetings took place about Indonesia, indicating a smoother road ahead by addressing the topic of improving the lending and borrowing model for that market. The future state will be a simplified bilateral model that is more transparent and inclusive from a participation perspective, with first phase progress expected in 2020.

The road ahead

Despite the backdrop of slower demand and diminished fees in 2019, the lending industry in Asia Pacific remains upbeat and growth-focused. With new markets, new approaches, and positive growth trends, the road ahead looks positive.

COVID-19

In the opening months of 2020, global markets experienced unprecedented volatility. For securities lending on the fixed income front, demand for high-quality liquid assets (HQLA) such as sovereign bonds increased in a flight to quality. Conversely there was also increased demand for emerging and frontier market sovereign debt that has been blighted by rating agency downgrades. For equities, discretionary spend-linked sectors which have been most exposed to the effects of the pandemic, have seen heightened demand from borrowers. Securities such as exchange traded funds are also well sought after as they are an efficient way for hedge funds to gain short exposure or as a hedging tool for their long exposures.

Securities lending activities have also been impacted by several developments in the market. For example, short selling bans introduced by a number of countries as a temporary measure intended to stabilise stock markets, have impacted hedge fund demand, although on a limited basis. The rising number of dividend cancellations by corporates, as encouraged by governing bodies and regulators around the globe, is also likely to have a slightly negative impact on securities lending demand over coming months, especially where the borrowing demand may have been tied to a company's dividend distribution.

As we brace ourselves to deal with the reverberations of the COVID-19 pandemic, markets continue to be cautiously optimistic that the securities lending business will remain relevant in the "new normal" environment.

ASIA PACIFIC

DATA SNAPSHOT

Data represents the average figure for from Jan-Dec 2019 and are provided in USD where relevant

Australia

Average Total Market Available to Lend (USD)
$351,086,445,327

Average Total Market Loan Volume (USD)
$21,885,348,451

Average Total Market Util. Rate
6.2%

Total Market Intrinsic Loan Revenue (USD)
$115,864,852

Figures provided by DataLend

Indonesia

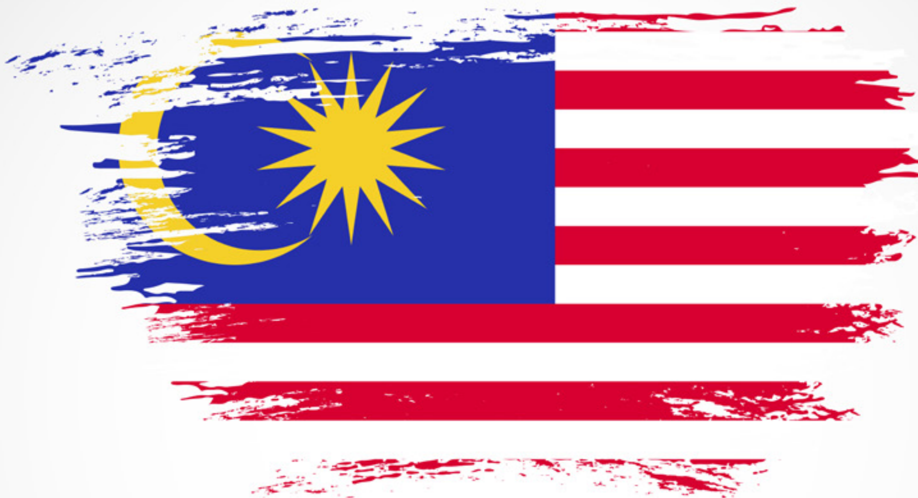
Average Total Market Available to Lend (USD)
$1,310,455,176

Average Total Market Loan Volume (USD)
$21,382,838

Average Total Market Util. Rate
1.6%

Total Market Intrinsic Loan Revenue (USD)
$329,398

Figures provided by IHS Markit



Malaysia

Average Total Market Available to Lend (USD)
$13,945,152,167

Average Total Market Loan Volume (USD)
$534,945,071

Average Total Market Util. Rate
2.9%

Total Market Intrinsic Loan Revenue (USD)
$14,873,006

Figures provided by IHS Markit

New Zealand

Average Total Market Available to Lend (USD)
$12,530,625,211

Average Total Market Loan Volume (USD)
$1,319,767,215

Average Total Market Util. Rate
11.3%

Total Market Intrinsic Loan Revenue (USD)
$6,272,769

Figures provided by FIS Astec Analytics

Philippines

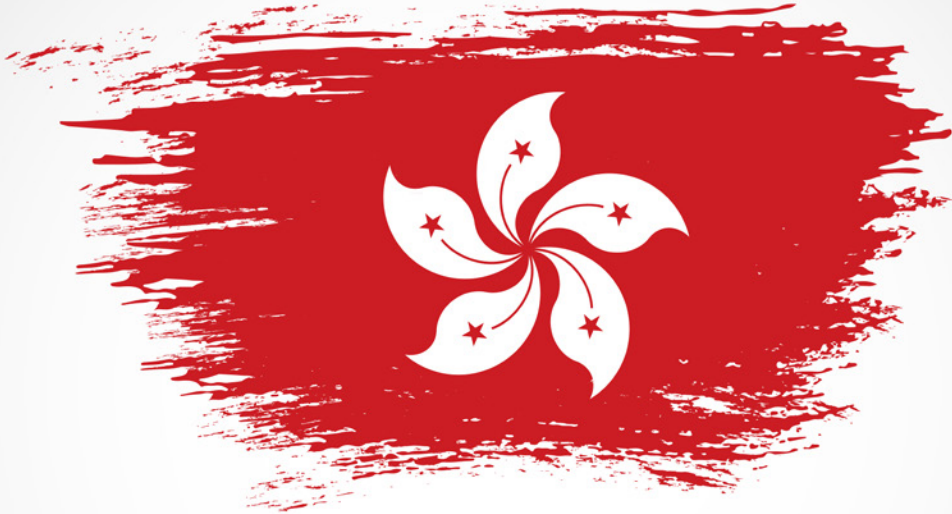
Average Total Market Available to Lend (USD)
£944,345,695

Average Total Market Loan Volume (USD)
$27,387,900

Average Total Market Util. Rate
1.4%

Total Market Intrinsic Loan Revenue (USD)
$240,009

Figures provided by IHS Markit



Singapore

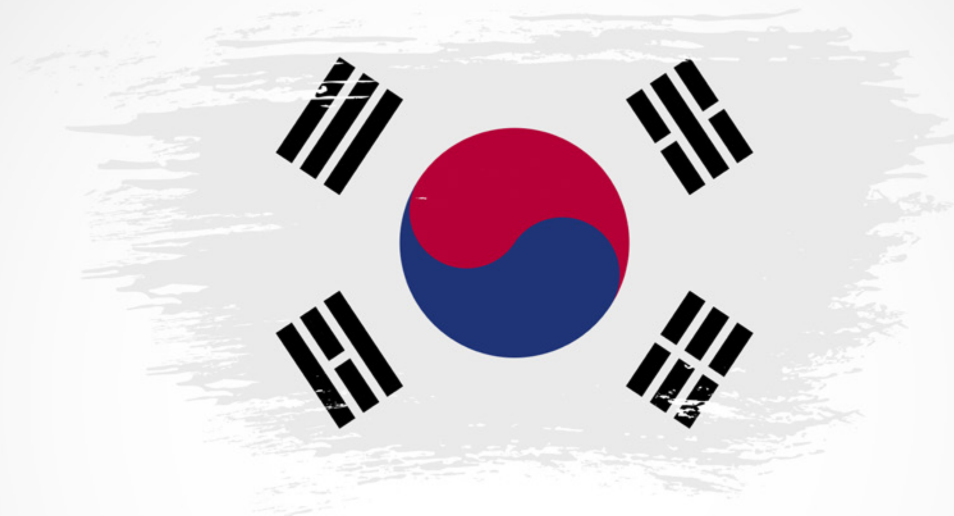
Average Total Market Available to Lend (USD)
$48,439,884,644

Average Total Market Loan Volume (USD)
$2,032,827,070

Average Total Market Util. Rate
4.2%

Total Market Intrinsic Loan Revenue (USD)
$29,294,769

Figures provided by DataLend



South Korea

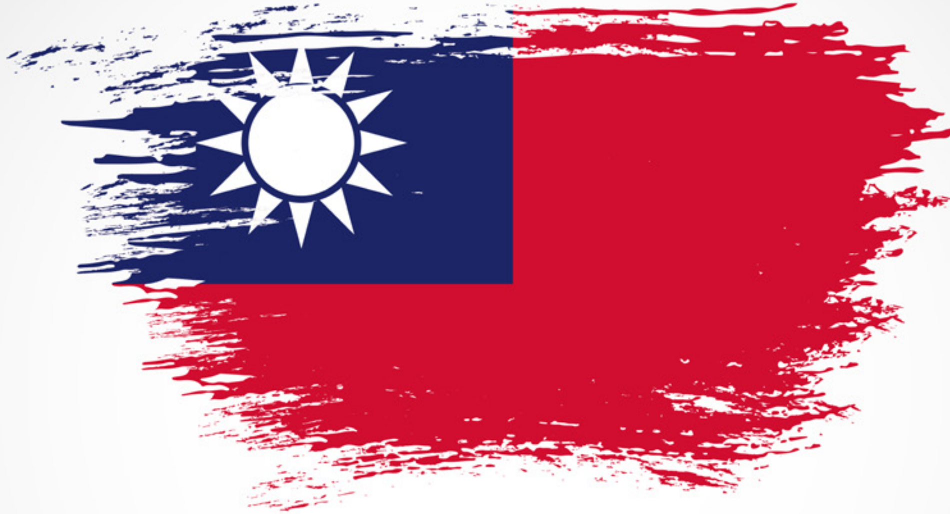
Average Total Market Available to Lend (USD)
$112,008,054,988

Average Total Market Loan Volume (USD)
$9,406,819,486

Average Total Market Util. Rate
5.0%

Total Market Intrinsic Loan Revenue (USD)
$281,057,872

Figures provided by FIS Astec Analytics



Taiwan

Average Total Market Available to Lend (USD)
$58,386,746,045

Average Total Market Loan Volume (USD)
$8,256,756,797

Average Total Market Util. Rate
5.4%

Total Market Intrinsic Loan Revenue (USD)
$207,564,606

Figures provided by IHS Markit

Thailand

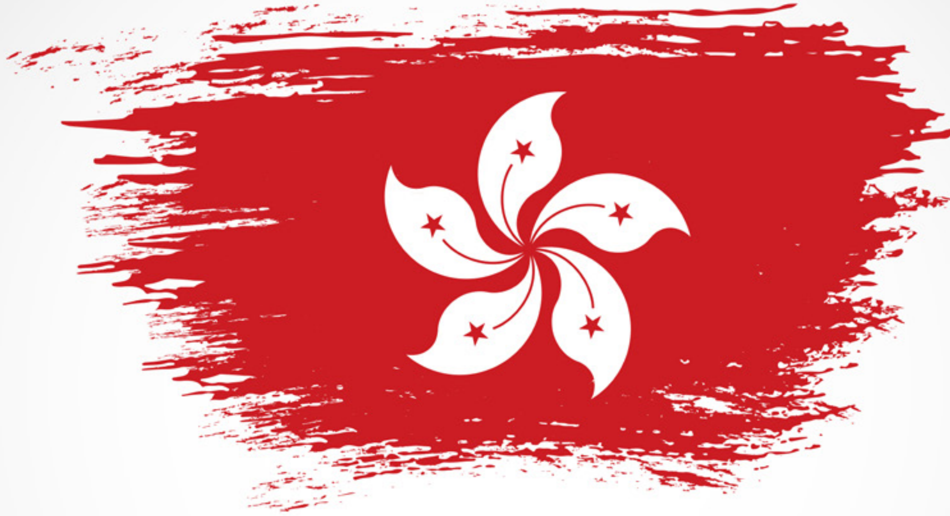
Average Total Market Available to Lend (USD)
$29,050,309,374

Average Total Market Loan Volume (USD)
$1,160,843,847

Average Total Market Util. Rate
3.9%

Total Market Intrinsic Loan Revenue (USD)
$24,853,800

Figures provided by FIS Astec Analytics



Hong Kong

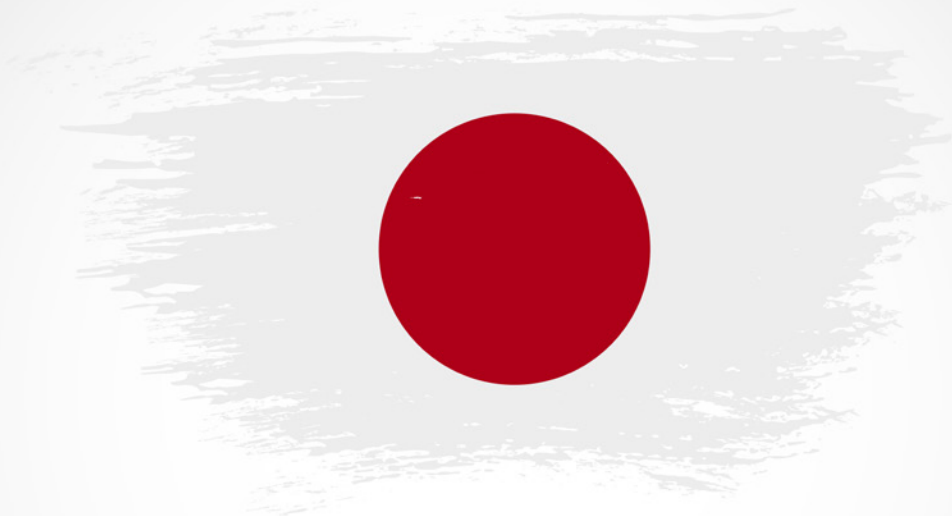
Average Total Market Available to Lend (USD)
$416,462,308,046

Average Total Market Loan Volume (USD)
$31,297,893,535

Average Total Market Util. Rate
5.5%

Total Market Intrinsic Loan Revenue (USD)
$349,010,397

Figures provided by IHS Markit



Japan

Average Total Market Available to Lend (USD)
$822,544,959,774

Average Total Market Loan Volume (USD)
$116,569,777,497

Average Total Market Util. Rate
6.7%

Total Market Intrinsic Loan Revenue (USD)
$813,747,878

Figures provided by IHS Markit

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BNP Paribas Securities Services is a multi-asset servicing specialist with local expertise in 35 markets and a global reach, covering over 90 markets. This extensive network enables us to provide our institutional investor clients with the connectivity and local knowledge they need to navigate change in a fast moving world.

As of 31 December 2019, BNP Paribas Securities Services had $ 11,825 billion in assets under custody, $ 2,817 billion in assets under administration, 10,484 funds administered and over 12,000 employees.

Six desks worldwide cover established securities lending and borrowing markets and provide in-depth knowledge of local market trends and across multiple asset classes. BNP Paribas Securities Services' proven track record in the securities lending and borrowing industry is the result of strong trading expertise, robust risk management policy and control and the continuous development of operational efficiencies.

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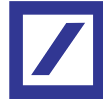
Deutsche Bank 

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Deutsche Bank's Agency Securities Lending programme provides institutional clients with turnkey access to the world's securities lending and repo markets. Our experienced team is located across multiple time zones, including our dedicated regional Asia team based in Hong Kong, helping clients to generate liquidity and incremental returns with access to a broad range of developed and emerging markets.

We specialise in non-custodial lending strategies and work consultatively to design the optimum solution for each client. Our global presence and distribution capabilities, operating model flexibility, choice of routes to market and greater access to loan opportunities are among the key features and benefits of our solution.

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For more than 40 years, J.P. Morgan has offered institutional investors the opportunity to enhance portfolio returns with customised agency securities lending solutions that draw on our risk and credit expertise and global equity and fixed income trading capabilities. Through a programme designed specifically for them, our clients may define individual parameters to meet their specific risk/return requirements. Our approach to client service means we deliver the full capabilities of the firm—including trading, risk and market intelligence, technology and experienced servicing teams—to help all clients enhance return, mitigate risk and increase efficiency.

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Natixis is a French multinational financial services firm specialized in asset & wealth management, corporate & investment banking, insurance and payments. A subsidiary of Groupe BPCE, the second-largest banking group in France through its two retail banking networks, Banque Populaire and Caisse d'Epargne, Natixis counts nearly 16,000 employees across 38 countries. Its clients include corporations, financial institutions, sovereign and supranational organizations, as well as the customers of Groupe BPCE's networks. Listed on the Paris stock exchange, Natixis has a solid financial base with a CET1 capital under Basel 3(1) of €11.4 billion, a Basel 3 CET1 Ratio(1) of 11.5% and quality long-term ratings (Standard & Poor's: A+ / Moody's: A1 / Fitch Ratings: A+).

(1) Based on CRR-CRD4 rules as reported on June 26, 2013, including the Danish compromise - without phase-in and including current financial year's earnings and accrued dividend (based on a 60% pay-out).

Figures as at 30 September 2019.

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www.northerntrust.com

The Northern Trust Corporation (Northern Trust) is a leading provider of wealth management, asset servicing, asset management and banking to corporations, institutions, affluent families and individuals. Founded in Chicago in 1889, Northern Trust has a global presence with offices in 22 U.S. states and Washington, D.C., and across 22 locations in Canada, Europe, the Middle East and the Asia-Pacific region.

As of March 31, 2020, Northern Trust had assets under custody/administration of US$10.9 trillion, and assets under management of US$1.1 trillion. For more than 130 years, Northern Trust has earned distinction as an industry leader for exceptional service, financial expertise, integrity and innovation.

With offices in 11 locations across Asia Pacific - Beijing, Bengaluru, Hong Kong, Kuala Lumpur, Manila, Melbourne, Pune, Seoul, Singapore, Sydney and Tokyo – and servicing clients in the region since 1986 - Northern Trust is a full-service provider offering a comprehensive range of customised asset servicing, asset management and capital markets solutions including foreign exchange, institutional brokerage, securities lending and transition management to institutional and investment manager clients.

For more information follow us on **LinkedIn** or **Twitter**

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(1) RBC quarterly results released on February 21, 2020
(2) Standard & Poor’s (AA-) and Moody’s (Aa2) legacy senior long-term debt ratings of Royal Bank of Canada as of February 21, 2020
(3) Global Investor/ISF 2020 Beneficial Owners Survey (unweighted category)

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