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Growing back stronger

This year's Asia Handbook is full of stories of optimism, hopeful that the 2020 disruption to securities finance markets is firmly in the rear-view mirror.

First and foremost are the new possibilities for foreign investors to engage in securities financing and short selling directly in Mainland China through its expanded QFII scheme. Whether there will be a big bang of activity this year or if we will still be predicting China's imminent coming of age in 2022/3 is yet to be seen, but the path to further development of the onshore securities financing market is now clear.

Northern Trust's Mark Snowdon writes that the QFII amendments are undoubtedly positive but by no means the end of the story (pg 24). He notes that there is currently no place in the value chain for agent lenders and the current rules are "restrictive and contain many unique requirements" which are a "barrier to any meaningful or scalable activity". Fear not, though, as Snowdon predicts much of this "fine-tuning" will be done in 2021 and we will see "some modest volumes on a day-to-day basis" by year-end.

Elsewhere, IHS Markit's Sam Pierson offers a mixed-bag of data points as part of an overall health check on the region (pg 36). APAC equity finance revenues declined 8 per cent YoY in February 2021, IHS Markit data shows, the 13th consecutive month of YoY declines. However, average daily revenues increased 7 per cent compared with January, the fourth consecutive month where daily returns increased MoM.

Additionally, multiple contributors point to corporate actions and the return of dividends in 2021 as likely drivers of borrower demand. In addition, the belated repeal of the short selling ban in South Korea (set for May at the time of writing) is also widely expected to bring an uplift to the region's overall revenue.

Another recurring theme is the development of buy-side market participants, who are increasingly sophisticated in their programme requirements and more closely resemble their peers in Europe and the US, according to J.P. Morgan (pg 28).

Finally, APAC has not escaped the blossoming of ESG as a hot topic for global financing markets. PASLA and its global partners are taking an active role in developing a version of sustainable financing that applies to APAC's varied and specific needs and this handbook offers an in-depth update on everything that has happened in that arena to date.

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J.P. Morgan was named Collateral manager of the year at the AsiaRisk Awards 2020, in September last year.

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Three of Australia's largest super funds stop lending

The arrival of COVID-19 in Australia has inspired a wave of anti-short selling sentiment that has so far driven three of the top-five largest lenders to shutter their programmes, with senior politicians cheering them on.

Since March 2020, when COVID-19 first exploded out of Asia, at least three of the top-five largest superannuation funds — measured by assets under management (AuM) — have closed or significantly curtailed their securities lending programmes to cut off short sellers from access to those assets.

Most recently, AustralianSuper, the market's largest fund with more than AUS 200 billion (USD 154.8 billion) in AuM made a temporary freeze on lending its Australian equities portfolio permanent in December 2020.

The fund first halted lending on domestic assets in March 2020 in response to concerns around the pandemic's negative impact on local equity markets.

An AustralianSuper spokesperson tells SFT the fund acknowledges securities lending is "an important part of any well-functioning market, and while required for short selling is also used for many other purposes such as derivatives hedging, balance sheet optimisation, index fair value and dual-listing relative value transactions".

Just before AustralianSuper instigated a lending freeze, UniSuper, the fifth-largest fund with AUS 85.5 billion (USD 66.2 billion) in AuM according to Australian financial comparison provider Canstar, publicly announced it had instructed its custodian BNP Paribas to recall on-loan shares as a direct response to the COVID-19 market turmoil.

Speaking at the time, the fund's chief investment officer (CIO) John Pearce said: "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."

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 CIO explained that during normal trading conditions short selling "adds to liquidity and price discovery in an orderly market" but one year on the fund says it has no plans to restart lending.

Pearce's rallying cry was heard by QSuper, the third-largest fund according to Australian financial comparison provider Canstar, which also shuttered its securities lending programme it had run through State Street since 2013.

The programme, which principally contained Australian and international equities, was terminated in April 2020, leading to several million dollars of gross earning losses compared to the fund's 2019 financial report.

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Atlantic Partners Asia launches securities finance programme

Hong Kong: September 2020

Atlantic Partners Asia (APA), a Hong Kong regulated asset manager for private equity funds, has hired Julian Smith, founder and principal consultant of consultancy firm JVLD, to build its new securities finance operation as head of equity capital markets within its corporate finance division.

The corporate finance division of the firm manages assets on behalf of institutional and sophisticated investors and advises governments and corporates on their infrastructure development and financing needs.

The firm is also active in cross-border foreign exchange in the region, using fintech platforms to increase the efficiency of business-to-business transactions between emerging markets and regional financial hubs.

Smith, who is based in Sydney, says he is focusing his initial efforts on the Australian securities finance market with plans already in place to expand into Hong Kong and then the rest of Asia once COVID-19-related travel restrictions are eased.

As part of the mission, APA has established Atlantic Partners Asia Capital which is the legal entity in charge of its securities finance business.

Smith tells SFT that the programme is already up and running and APA is trading for itself in simple delta-one transactions.

APA has also approached Gleneagle Securities, an Australian broker, to reach other global markets, particularly those where APA has existing contacts and exposure, such as South East Asia and Hong Kong in particular.

As the world's second-largest securities market opens,

Australia continued from page 6

More recently, the multi-billion dollar drain on the lending pool is being celebrated by some in the political sphere.

An Australian senator recently used a parliamentary debate to call on all superannuation funds to stop facilitating short selling, arguing it goes against their fiduciary duty to clients.

Speaking in the upper house of the Australian Parliament during the second reading on proposed amendments to the Treasury Laws Amendment (Reuniting More Superannuation) Bill 2020, Queensland Liberal National Party Senator Gerard Rennick said that short selling was a "heinous practise that should be abolished".

"Short selling is another example of how superannuation funds aren't protecting the interests of their fund managers," he declared to the house.

Rennick praised the example set by AustralianSuper and QSuper and recommended that others follow suit.

Following the hearing, Rennick tells SFT that he is also lobbying the treasurer and the assistant treasurer to repeal the loophole that allows share owners to lend stocks without having to pay capital gains tax.

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HKEX's OTC Clear carries out first trades for Japanese banks

Hong Kong: December 2020

OTC Clearing Hong Kong (OTC Clear) has completed its first client clearing trades for Japanese financial institutions.

OTC Clear is the central counterparty subsidiary (CCP) of the Hong Kong Exchanges and Clearing (HKEX).

The first trades expand the reach of HKEX's fixed income and currency product offering in the region and internationally.

OTC Clear cleared a USD-offshore CNY cross-currency swap by Mizuho Bank and a USD-Hong Kong dollar trade by MUFG Bank.

The Hongkong & Shanghai Banking Corporation acted as the clearing broker for both trades.

The latest trades underscore the growing client demand for cross-currency swaps (CCS), which support the expansion of OTC Clear's liquidity pool for CCS, according to HKEX.

Calvin Tai, co-president and chief operating officer at HKEX, says the trades are "major milestone" on OTC Clear's journey to a become a top clearinghouse for CCSs

Tai comments: "This is an important development in the continued expansion of our product and service offering, strengthening Hong Kong's relevance as a leading international financial centre."

BNP Paribas launches new securities lending desk in Hong Kong

Hong Kong: November 2020

BNP Paribas Securities Services has expanded its financing services for clients in Asia Pacific (APAC) with the launch of a new agency securities lending desk.

Located in Hong Kong, the new desk will focus on Asian markets and provide local client coverage to meet growing appetite from clients looking to increase their asset allocations into the region.

This new trading desk will complement existing services offered via desks in Sydney, London and New York.

In support of this, BNP Paribas has selected Anthony McDonald to head up the new Hong Kong agency securities lending desk.

In his newly created role, McDonald will focus on trading activities and developing services for institutional lenders and borrowers in the region. He will report locally to Natalie Floate, APAC head of market and financing services at BNP Paribas Securities Services, and globally to Andrew Geggus, global head of agency lending trading at BNP Paribas Securities Services.

McDonald joins BNP Paribas from SEB. He has worked in the equity finance segment for 20 years, starting his career in London before moving to Hong Kong.He has previously gained experience at RBS Trust Bank, Credit Suisse, Citigroup and Dresdner Kleinwort.

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[1] *Global Investor*/ISF Survey 2020 – Securities Finance Agency Lending named Most Innovative Lender

China: February 2021

China may become one of the biggest securities lending markets, says PASLA

China could become one of the largest securities lending markets in the world following the Qualified Foreign Institutional Investor (QFII) rule changes, according to the Pan Asia Securities Lending Association (PASLA).

China amended its QFII scheme late 2020 to allow foreign investors to lend and borrow securities directly in the mainland market. Following a flurry of transactions, PASLA and international custodians now forecast that China's equity and fixed income markets could knock the US off the top spot.

PASLA's chair Stuart Jones states: "Given the scale of the market and the pace of progress, it would be reasonable to expect that China will become one of the biggest securities lending markets globally."

Jones notes that it is unclear how long this will take and whether last year's reforms will make possible a vibrant securities lending market for foreign participants within the next five years.

International custodians, including HSBC, Deutsche Bank, and Standard Chartered have also welcomed the liberalisation of the QFII scheme and were quick to facilitate the first domestic securities lending transactions on the day the rules changed.

Standard Chartered's executive director, sales, China Access, financing and securities services, Susan Yu, says the move is "a remarkable step forward opening up the domestic securities lending and borrowing market to global participants".

Meanwhile, Deutsche Bank expects China's markets to continue growing, corresponding to the country's economy.

Tony Chao, head of securities services Greater China and head of securities services sales in North Asia at Deutsche Bank, says China will soon become "too big to ignore" for global investors, not only in terms of portfolio allocation and risk diversification but also for absolute returns.

A common opinion voiced by international banks active in China is that domestic assets can add diversification to global investors. Standard Chartered, Yu explains that global investors can "enjoy the dividends brought by qualitative economic growth".

However, Yu adds, global investors, must adapt to differing rules in China, similar to the rest of Asia Pacific. PASLA's Jones explains that over time "China has become a very investible and accessible market and is engaged with the full spectrum of portfolio risk management products and the importance of different investor types to the ecosystem".

"Embracing and understanding these factors is important to all global investors as they look to increase their exposure to such a large market," she states. "Any evolution takes time and today's reformed QFII scheme is a result of an ongoing dialogue and engagement by a regulator that is both forward-looking and collaborative."

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Citibank facilitates SBL trades in China A-share market under new QFII

China: November 2020

Citibank became one of the first custodian banks in China to facilitate securities lending transactions in the China A-share market under the newly-refined Qualified Foreign Institutional Investors (QFII) scheme.

The bank's Direct Custody & Clearing (DCC) business completed a series of stock loan trades on 1 November, the first day that the regime governing foreign investor activity in China was reformed to allow securities lending and bond repos to be conducted, among other major changes.

Citi was unable to name the other counterparts in the trade but said it was acting on behalf of a "prominent global client".

QFII was first launched in 2002 and has seen several key amendments in the past year to make it quicker and easier for foreign investors to apply for and gain QFII status.

For example, the China securities regulator's review period has been shortened from 20 to 10 business days.

The latest reforms are by far the most comprehensive and radically expand the breadth of trading activities foreign investors can conduct in the market which has remained largely closed off for decades.

Among the key changes include the merging of the QFII scheme with the RMB Qualified Foreign Institutional Investor, which launched in 2011, to streamline and simplify the system.

As well as securities financing financial futures listed and traded on the China Financial Futures Exchange are now no longer limited to stock index futures but also include bond futures.

Other changes include the removal of the asset under management threshold for qualification.

David Russell, Citi's Asia Pacific head of securities services and Hong Kong Head of markets, says: "We are pleased to have implemented the securities lending transactions as a custodian on the first trading day when the new QFII regulation became effective."

"The relaxed QFII regulation provides exciting new ways for global investors to participate in China's capital markets," he adds.

Citi is assisting a "wave" of new foreign investors to apply for their QFII qualifications, including more successful applications for qualified hedge funds and private equity funds, according to Ji Yang, Citi's China head of markets and securities services.

This includes a quantitative hedge fund, which Yang notes is the first-of-its-kind under the QFII scheme and represents "another testimony of further China opening-up".

"With this new QFII regulation, we expect that global brokers and hedge funds can finally play an active role in China's A-share margin trading and securities financing, while private equity funds can enjoy a low-cost channel to invest in onshore companies with flexible repatriation, and asset owners and asset managers can lend out their securities for higher portfolio yield," he adds.

Citi was among the first banks to receive approval from China regulators in 2003 to act as a QFII custodian.

In subsequent years, Citi obtained the Bond Settlement Agent (BSA) license and the Futures Margin Depositary Bank licence.

Recently, Citi obtained the domestic fund custody licence, enabling it to service onshore mutual funds and private funds, including the private fund managers funds, which is now under the permitted investment scope of QFII.

The opening up of China's A-share market comes shortly after J.P. Morgan became the first known agent lender to accept China A-shares as collateral for a securities finance transaction conducted through the Hong Kong/China Stock Connect.

The wider use of China A-shares as collateral marked a significant step forward in the internationalisation of the Hong Kong/China Stock Connect which launched in 2014 but has so far been slow to stimulate major activity from global investors.

Philippines: February 2021

Philippines inches closer to allowing short selling

The Philippines Stock Exchange (PSE) will finally launch a short selling facility once three key final hurdles are overcome, CEO Ramon Monzon has confirmed.

While there are no more pending issues with regards to the short selling capabilities currently in the pipeline, there is a lot riding on the securities borrowing and lending programme, SFT understands.

A PSE spokesperson says the exchange is working to address concerns raised by foreign participants regarding the market's trading rules framework to make it viable for them to actively participate in the programme.

The rules and guidelines were initially approved by the Securities and Exchange Commission (SEC) in December 2019 but were subsequently sent back for revision upon feedback from market participants.

The PSE is waiting for the green light from the SEC on two key items before short selling can begin.

This includes approval of the Philippines Depository and Trust Corporation as an agent lender, and approval of identified offshore assets (securities and currencies) as collateral for foreign participants.

Elsewhere, the Bureau of Internal Revenue must approve the use of Global Master Securities Lending Agreement for foreign participants to replace the Philippines own MSLA.

The introduction of short selling into the Philippines market has faced repeated delays in recent years, with the framework and scope of the market being redefined and amended by different market forces.

The Pan Asia Securities Lending Association is among the regional stakeholders actively working to get the lending and short selling facility up and running.

Singapore: June 2020

The Singapore Exchange to launch new single stock futures

The Singapore Exchange (SGX) launched 10 Singapore Single Stock Futures (SSFs) on 15 June, in response to growing client demand for a broader suite of Singapore-linked equities products.

The list of underlying securities for the SSFs are Comfortdelgro, DBS, Genting, Keppel, OCBC, Singtel, Thai Beverage, UOB, Wilmar and Yangzijiang Shipbuilding.

Most of these securities are also SGX MSCI Singapore Free Index (SiMSCI) stocks.

In recent months, index trading activities between SGX cash equities market and SiMSCI futures reached a record high of almost S$650 million in a single day.

SGX observed greater synchronisation and correlation between the price of futures and the underlying stocks across various intraday timeframes, indicating growing institutional participation across both markets.

The exchange now says that SSFs represent a "next natural step in the growth of the ecosystem" and offer market participants a new shelf of risk management instruments.

Elsewhere, SGX has signed a licence agreement for four products on MSCI Singapore indices, including SiMSCI futures and options and net total return contracts, which will continue to be listed on SGX after February 2021.

Michael Syn, head of equities at SGX, says: "We integrated our cash equities and equity derivatives businesses a year ago, to form a single expanded platform capable of scaling product and service innovation for our clients.

"Our Singapore franchise is at the heart of SGX's pan-Asian access offering and with these latest developments, we are well on track to broaden the continuum of our equities shelf."

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South Korea to introduce securities lending to retail market

South Korea: February 2021

The South Korean Financial Services Commission (FSC) has committed to allowing retail market participation to directly engage in securities lending once short selling restrictions ease in May.

Following a consultation with the Korea Financial Investment Association, the FSC aims to expand the securities lending system to accommodate retail investors with a model that places the payment burden on institutional securities finance entities.

To promote active participation from securities firms, the FSC says it will work to improve rules on credit exposure limits, which are set at 100 per cent of their equity capital.

The regulator also commits to improving the risk management framework so that credit exposure limits do not constrain a firm's securities lending services to retail investors.

Many aspects of exactly how this will work in practice remain unclear and the FSC could not be drawn to elaborate on the specific terms of how a broker-dealer might manage the risks associated with setting up a securities borrowing programme with a retail client.

It is also unknown if retail clients can act as direct lenders.

The market watchdog says the move aims to address the discrepancy in access to short selling facilities that has so far seen retail investors largely shut out the retail market due to the "high risk involved" in lending to an individual investor.

The ambitious plan comes as part of a sweeping set of regulatory reforms aimed at tackling illegal short selling which has come under intense scrutiny in South Korea.

As of 3 May, when the current ban on short selling is partially lifted, the commission expects between KRW 2 trillion (USD 1.78 billion) and KRW 3 trillion (USD 2.67 billion) to become available to lend to retail investors.

The FSC predicts more stocks will be available to borrow in the future "through close cooperation with diverse institutions".

South Korea extends short selling ban

South Korea: February 2021

South Korea's Financial Services Commission (FSC) has extended its short selling ban again amid pressure from politicians and retail market participants to curb bearish trading.

A short selling ban was imposed on KOPSI, KOSDAQ and KONEX indexes in March 2020 as equities prices tumbled in reaction to the first spread of COVID-19 infections across the country, and, after two extensions, was due to sunset in March.

FSC chair Eun Sung-soo has now confirmed the ban will remain until 2 May, at which point short selling may resume on KOSPI 200 and KOSDAQ 150 stocks. The date was chosen to give the Korea Exchange time for system development and testing, the commission says.

KOSPI 200 makes up 22 per cent of a total of 917 stock items, while KOSDAQ 150 makes up 10 per cent of a total of 1470 stock items.

At a press conference this week, Sung-soo explained the partial resumption will minimise the impact on markets, as these stocks have large market caps and liquidity so that the resumption of short selling would have limited impact on stock prices.

Meanwhile, the short selling ban will hold on the remaining 2,037 smaller stock items until favourable market conditions allow for its reintroductions without disruption, the FSC says.

The decision to extend the ban again comes alongside a political campaign to revise the Financial Investment Services and Capital Markets Act to introduce harsher penalties for illegal short selling activities, including the threat of prison time and fines.

The FSC notes the revised act will come into effect on 6 April, meaning the extension will mean "there will be no issue of a legislative gap".

The revisions include requiring short sellers to keep their securities lending data for five years, while securities firms must actively tighten their monitoring of illegal short selling activities.

Taiwan: October 2020

Citi enhances equity trading and settlement automation

Citi Securities Services has enhanced its trade and settlement automation for Taiwan equity clients with the launch of a host-to-host connection with the Taiwan Depository and Clearing Corporation (TDCC).

The new solution will allow Citi to offer its clients near-real-time trade status and settlement confirmations for certain equity settlements, including securities lending and exchange-traded fund (ETF) activities.

Citi highlighted that it's the first custodian bank in Taiwan to use host-to-host connectivity for intraday feeds and to integrate it with an automated process for securities lending.

Bryan Murphy, global head of sales, DCC and intermediaries client coverage at Citi, reveals there has been "significant growth" with securities lending and ETF trading activity with the bank's clients in Taiwan.

Aashish Mishra, Asia Pacific head of direct custody and clearing (DCC) at Citi, says: "We are very pleased to roll out this solution in Taiwan, a strategically important market for Citi Securities Services and our clients. This, along with the innovative solutions that we recently launched to support automation in the Hong Kong market, demonstrates Citi's ongoing commitment to working with market infrastructures to deliver local solutions to our global clients."

Eurex clears first interest rate swap transaction from Japan

Japan: June 2020

Eurex Clearing, the Deutsche Boerse owned central counterparty (CCP) has cleared the first over-the-counter (OTC) interest rate swap transaction for a Japanese securities house since being approved to offer the service in Japan in March.

The transaction was executed by SMBC Nikko Securities with Citibank Global Markets acting as its clearing member.

In March, Eurex Clearing received 'foreign financial instruments clearing organisation's status from Japan's Financial Services Agency (FSA), thereby allowing Japanese financial institutions to directly access Eurex Clearing for swaps clearing.

Eurex says this is an important step as client demand from one of the world's largest fixed income markets will support the strong momentum of Eurex Clearing's EU-based liquidity pool for euro swaps. Total notional outstanding of greater than €19 trillion (as of end of May) keeps Eurex's overall market share at about 18 percent.

"Eurex's connectivity will provide Japanese clients with a holistic clearing solution, encouraging competition," says Rohit Verma, Citi's Asia Pacific head of OTC clearing and FXPB.

Markus Georgi, Eurex's head of fixed income sales Asia, explains: "Adding Japan as an eligible jurisdiction for our OTC Clearing offering, followed by the first transaction cleared for SMBC Nikko Securities, marks a very important milestone for Eurex Clearing on our way to become the home of the euro yield curve."

Shun Yanagisawa, Citi's Japan head futures, OTC clearing and FXPB adds: "Our comprehensive clearinghouse connectivity allows our clients to access the deepest pools of liquidity while navigating the challenges of CCP basis."

J.P. Morgan to open Tokyo agency lending desk

Japan: November 2020

J.P. Morgan has confirmed plans to open a new agency lending trading desk in Tokyo next month to serve its onshore clients and the Japanese securities lending market.

The desk will be led by former Natixis executive director Kasumi Shibano, who is set to join J.P. Morgan in December.

As Japan's new head of agency securities lending trading, Shibano will report to Simone Broadfield, head of agency securities lending trading for Asia Pacific (APAC), who is based in J.P. Morgan's Hong Kong office.

SFT understands that the US' largest bank tapped Shibano for her wealth of experience and onshore connectivity, having led equity finance trading teams throughout her extensive career, including her most recent role with the French investment bank, where she has served from 2013 until January 2018.

In her nearly three decades of experience in financial markets, Shibano has also held senior roles with Barclays, Macquarie Group, and UBS, after a decade with Morgan Stanley as vice president.

J.P Morgan says the move will position it as the only international lender to have an onshore presence in Japan, reflecting the strategic importance of APAC's largest securities lending market to the bank's regional agency securities lending and securities service businesses.

The Tokyo desk will become our J.P Morgan's third APAC trading location, complementing the desks located in Hong Kong and Sydney.

The J.P. Morgan APAC trading teams manage equities, fixed income and cash reinvestment on behalf of a global client base.

Through the storm?

Drew Nicol reports

Paul Solway, head of securities finance for APAC at BNY Mellon Markets, takes stock of how the region fared in 2020 and what's on the horizon

How did APAC markets fare in 2020 compared to those in other regions?

While Asian equities performance have had a phenomenal run since the lows of March 2020 — with the MSCI Asia up more than 65 per cent since then — as a region, the Asian securities lending market suffered the worst globally in terms of equity lending revenues, which fell by 24 per cent last year, according to IHS Markit. Looking at individual countries, South Korea experienced the biggest impact stemming from reduced revenues, with on-loan volumes falling 37 per cent, and average fees falling almost 70 per cent, all of which is attributable to the short sell ban that was implemented in March 2020.

Malaysia was also affected, given that similar restrictions were implemented across the board, notwithstanding refinancing from different pockets of supply throughout the year; there was also an element of pre-positioning at year-end ahead of any anticipated lifting of the ban in 2021. It is worth noting that Malaysia remains a fairly nascent market, with on-loan volumes never going much above $1 billion, according to IHS Markit data. Elsewhere, Indonesia's short sell ban did not impact the offshore securities lending market, given the lack of a viable offshore lending model in that country currently.

Was this underperformance a one-off caused by the unusual circumstances of a year dominated by the global pandemic?

Some of the restrictions introduced in the region certainly had an impact. Market diversity is usually a key advantage for Asian revenues but the sheer wave of broad equities investment that flowed into the region meant that lending 'specials' were few and far between. Asia's role as the broad supply-chain to the world, as well the presence of key focus sectors such as technology and pharmaceuticals in the region, were a few of the reasons why equity markets soared in the sell-off aftermath, albeit under uncertain COVID-19 conditions. Hong Kong and Japan remained the key markets for investors, given their depth of liquidity as well as their pure size, scale and ongoing level of corporate activity.

You mentioned Japan and Hong Kong. Can you expand on their experience last year?

Japan has historically been the dominant market in Asia Pacific (APAC) for obvious reasons and continues to be so. The challenges that Asia faced as a whole hit Japan just as much as elsewhere, but with additional factors at play including a new prime minister taking office, lower merger and acquisition activity in the market and uncertainty around dividends. For BNY Mellon, Japan continues to be a significant and mainstay contributor to our APAC revenues and we found that our performance in the country did not suffer as greatly as the market at large. That performance came down to the diversity of clients holding Japanese assets, our collateral flexibility and being able to compete with domestic and offshore pools of liquidity. The bottom line is that Hong Kong produced more special situation names than Japan in 2021: only one out of the top-ten earners for the year was a Japanese name compared to seven in Hong Kong.

Changes to China's QFII scheme also made waves. Do you think it's likely to be a significant tailwind for those looking for exposure to Chinese markets?

QFII represents another big step forward in how China is opening up its capital markets, and the nation has engaged strongly with offshore participants as well as onshore participants over the last few years. The Qualified Foreign Institutional Investor (QFII) reforms all came off the back of an industry consultation and an understanding of the responses. While these reforms allow for more direct investment by offshore investors, many commercial details relating to securities lending still need to be clarified to allow for the larger pools of liquidity that are held by offshore custodial agents. China has the potential to become one of the biggest securities lending markets globally and these reforms show China's intentions to allow for the transparency and

liquidity needed to create a baseline framework for securities lending.

At BNY Mellon, we are very much focused on leveraging our triparty platform to support Hong Kong Stock Connect that enables China A-shares to be utilised as collateral; and later in the year Bond Connect eligible fixed income securities should be a realistic collateral target for our clients to consider within their lending programme. I would say that knowledge, credit appetite and operational understanding of the current, evolving frameworks (onshore and offshore via Connect) are needed in order to mastermind the complexities that are inherent in Asia's newest financing market.

How will the emergence of ESG impact various APAC markets and what is PASLA doing to advance its initiatives in this arena?

Environmental, social and governance (ESG) in APAC continues to gain attention and momentum, although the focus understandably remains firmly on the core investment strategies that are – or will be deemed to be — consistent with ESG requirements. For securities lending, there have already been many webinars, surveys and consultations on this issue and the message is clear: we need a basic framework, a starting point for establishing the key ESG factors that market participants often deliberate over. Those factors include participation of borrowers in short strategies, collateral and cash reinvestment, rehypothecation, tax elements and the exercise of proxy voting rights. Firms like BNY Mellon are working on the Pan Asia Securities Lending Association's initial ESG framework.

After a rocky 2020, what should we watch out for in the next 12 months?

The main trend to keep an eye on is China's growth story, which needs no further explanation. We are also looking forward to the progress being made in the Philippines given the exchange's recent announcements regarding a new short selling regime. This, in conjunction with Malaysia's recent industry consultation, which also concentrated on improving and simplifying it's short selling framework, should mean that we begin to see an evolving step-by-step harmonisation of markets across the region. The partial lifting of the Korean short selling ban on 3 May will also be a significant calendar event this year, which should see flows gradually return to normal.

> *"Automation via low-touch trading continues to be a recurring theme, ensuring that those who invest in front-end systems will have an edge"*

Automation via low-touch trading continues to be a recurring theme, ensuring that those who invest in front-end systems will have an edge — both in terms of scale, efficiency and ease of execution.

Given the continued volatility and uncertainty both socially and economically, risk management will continue to be paramount at the top of the house, which may cause institutional decision drags to continue — especially as thought-provoking ESG perceptions take hold.

Finally, collateral customisation and flexibility is another factor that must be recognised as vital to any lending programme. Whether it be investment-grade corporates, extending into peripheral equity indices or a cutting-edge special purpose acquisition company, an expansive collateral profile will garner premium returns for any security or portfolio that gets lent in 2021.

APAC securities lending trends 2020/2021

In the wake of 2020's market disruption and regional bans on short selling, Northern Trust's Mark Snowdon explains why APAC now boasts several promising growth opportunities

In 2020, far-reaching macroeconomic and market repercussions in the wake of COVID-19 had an inevitable dampening effect on securities lending globally. A combination of unprecedented market turbulence and short selling bans resulted in muted borrower appetite and, ultimately, led to a slowing of revenues around the world, including across Asia Pacific (APAC). The sweeping economic, financial and social unrest over the past 12 months has exacerbated several challenges that investors were already grappling with, even before 2020 began.

Among the developments impacting the market last year were:

- A combination of lower market valuations and temporary short selling restrictions introduced by a number of countries put lending plans for certain institutions on hold and led to a small number of other firms suspending existing programmes in the short term
- The rising number of dividend cancellations by corporations, encouraged by governing bodies and regulators around the globe, had a slightly negative impact on securities lending demand, especially where the borrowing demand may have been tied to a company's dividend distribution

This was a blow to expectations at the start of 2020 that it would be a strong growth year for lending, both in revenue and volume. Entering 2020, the securities lending industry had high hopes for APAC to be the region most likely to drive global lending growth. The focus was two-fold: attract institutions with a lending track record to resume or expand activity, as well as encourage others to enter the market.

The reality has been a realignment of expectations. According to IHS Markit, global securities finance returns totalled $4.57 billion over the second half (H2) of 2020, a 10 per cent year-over-year (YoY) decline. The utilisation of lendable assets declined substantially from the March 2020 peak as market valuations recovered.

For H2 2020, APAC's equity finance revenues of $707 million reflect a 27 per cent YoY decline. Average special balances decreased 26 per cent in H2 as compared with H1. The shortfall over the latter half of 2020 was driven both by the short sale ban in South Korea and a lack of high-fee lending opportunities in Japan. Lendable balance growth outpaced the marginal growth in loan balances, leading to a 10 per cent YoY decline in H2 utilisation.

In addition to the short sell restrictions, of which South Korea played a major part in overall revenue reduction, there was also a lot of short side risk activity taken off the table. Whilst it would not be true to say that short-side risk completely disappeared, it was enough to see a huge reduction in the number of 'specials' across the region due to a lack of crowded shorts. Quantitative funds still remained active, although this did not make up for the lack of fundamental trading on the short side. The March 2020 crash allowed expensive short positions to be unwound and we did not see a recovery in the volume of specials for the remainder of the year. This also translated into subdued activity around corporate events, where, despite record breaking amounts of capital issuance, we did not see many of these lead to heavy volume or high fee borrow activity.

Impact of short selling ban

There were four markets affected by short selling restrictions:

- **South Korea:** absolute six-month short selling ban from 16 March 2020. This was subsequently extended to March 2021 and likely to be extended again until June 2021
- **Taiwan:** reduction in the daily short sell quota from 30 per cent of 30-day average daily volume (ADV) to 10 per cent of average-daily value from 19 March 2020 plus a tick rule for stocks falling more than 3.5 per cent from the previous days' close. This was initially set for a three-month period but was lifted one week early
- **Malaysia:** ban on all types of short selling from 24 March 2020 (except permitted short selling for exchange-traded funds market makers) until 30 April originally, then until 30 June then finally extended until 1 January 2021 when it was lifted with newly-introduced enhanced control measures
- **Thailand:** Introduced a new tick rule on 13 March until 30 June 2020. This was subsequently extended to 30 September and lifted on 1 October 2020

The ban had the most impact on South Korea, with overall revenue down 45 per cent year-on-year according to IHS Markit. Short positions were allowed to remain and unwind naturally but this unwinding led to greater unutilised lending supply which led to an aggressive downward re-rating by borrowers. The various restrictions certainly had a negative impact, but it is difficult to estimate the precise impact when a number of other market dynamics were at play leading to substantial revenue attrition across the region.

Across the client base, the market did witness some beneficial owners suspending or pulling out of their lending programmes as they had concerns around market volatility and 'perceived' correlation between securities lending and short selling. In Australia, the Australian Securities and Investments Commission (ASIC) did reach out to the Australian Securities Lending Association (ASLA) to discuss the potential impact of key super funds pulling out of lending programmes and how that impacted market liquidity. However, there was no consideration of any short selling bans. This demonstrates that after the global financial crisis in 2008, developed markets have learnt that short selling bans have a negative impact on the financial markets.

Opportunities for market expansion

There is scope across APAC for securities lending to develop in new markets that either haven't had a lending culture to date, or which have grown to a size to make lending economically viable.

China's economy expanded by 2.3 per cent in 2020, making it the only major economy to report economic growth for 2020 — providing confidence for investors. In a long-anticipated move, the China Securities Regulatory Commission introduced updated measures for securities and futures investment by foreign investors. For the first time, this referenced allowing participation in short selling and securities lending from the start of November 2020. This positive development saw the execution of the first lending transactions and short sales by offshore Qualified Foreign Institutional Investor (QFII) participants.

The new securities lending and short selling rules are a huge boost to the international securities lending community which has been working toward this step for many years. However, it is very much a work in progress with currently no place in the value chain for agent lender participation. The current rules are also restrictive and contain many unique requirements which will be a barrier to any meaningful or scalable activity until these nuances are addressed. We hope to see work being done in 2021 to fine tune the current offering and perhaps by the end of the year we will see some modest volumes on a day-to-day basis. Nevertheless, we expect the Chinese regulators will need to be comfortable with each step before introducing any changes, and it may be optimistic to see agent lender participation before the second half of 2022.

In other emerging markets, such as Indonesia, Taiwan and the Philippines, productive Pan Asia Securities Lending Association (PASLA) industry meetings have taken place, indicating a smoother road ahead by addressing the topic of improving the lending and borrowing model for that market. The future state for Indonesia will be a simplified bilateral model that is more transparent and inclusive from a participation perspective.

Incorporation of ESG

The pandemic has accelerated the developments of environmental, social, and governance (ESG) policies, influencing all aspects of investment decisions. This includes how they intersect with securities lending, with a growing number of asset owners and managers now integrating them into the business.

The outcome of a survey conducted by EY on behalf of PASLA revealed that ESG has become a key consideration in APAC securities lending practices, albeit with an appreciation that various implementation hurdles are making this easier said than done, and that incorporation of ESG into some programmes is still catching up with the importance that participants place upon it.

There is now work underway by PASLA to create a practical set of guidelines to enable buy-side

institutions to integrate their lending programmes with their approach to ESG. The aim is to enable investors to execute a lending programme efficiently whilst maintaining the focus on ESG policies.

Positive outlook

If normality returns in 2021, there will be more deal activity such as initial public offerings, mergers and acquisitions and potentially a return to pre-COVID dividend payments, making certain dividend reinvestment plans and scrip trades more attractive. Additionally, sectors or assets that appear to be overpriced, such as technology, could lead to more broad-based shorting that may support the specials environment in 2021.

Although the International Monetary Fund still expects somewhat subdued domestic demand in Asia amid continued social distancing and containment measures, the region is likely to rebound more quickly economically than the US or Europe. The pragmatic approach taken generally to the pandemic should underpin the speed of activity re-emerging in APAC — including confidence for investors, some of which had suspended lending programmes.

In addition to a resumption of this activity, it will also likely encourage a variety of asset owners and managers to want to explore new and more efficient ways to meet the types of portfolio and collateral management objectives that a broad securities finance offering can deliver.

Ultimately, faced with growing cost pressures and the challenge of generating returns in a lower-for-longer rates environment, asset owners and investment managers cannot ignore the difference that securities lending can make in terms of enhancing portfolio performance and offsetting costs, while also supporting liquidity. Going forward, markets are expected to stay cautiously optimistic that the securities lending business will stay resilient and adapt to remain relevant in the 'new normal' landscape for investments today.

"Faced with growing cost pressures and the challenge of generating returns in a low rate environment, asset owners cannot ignore the difference securities lending can make"

Mark Snowdon
Head of capital markets, Asia Pacific
Northern Trust

Collateral mobilisation: A buy-side view

J.P. Morgan outlines how established trends in collateral optimisation and liquidity management are being adopted by large buy-side institutions in APAC

Over the past few years, the securities finance industry has experienced a structural convergence. As institutions evolve their business structure, we have continued to see disparate business lines become more aligned, the emergence of central funding units, and increased investment spending on collateral services.

These trends not only create new efficiencies within individual institutions, but also the potential for new synergies across securities financing. The ability for institutions to optimise collateral and liquidity pools is fundamental in delivering economic efficiencies and improving portfolio performance.

Initially led by some global investment banks, we are seeing the larger, more sophisticated buy-side institutions in Asia Pacific (APAC) following similar approaches.

Converging market trends at a glance

Increased participation in securities lending: this has been driven by firms looking to benefit from the intrinsic value of their long assets to deliver additional returns or offset costs. The recent low return environment and growth in low cost passive investing has amplified this.

In-house management of assets: increasing in-house management of assets and the use of overlay and treasury functions at asset owners has led to a greater use of derivatives and financing transactions by institutions. There has also been a corresponding increase in their focus on how their assets are used to generate the most optimal outcomes.

Direct financing transactions: Sophisticated institutions are taking an active approach to differentiate themselves from other lenders to gain a larger share of the financing wallet and increase their returns. As part of this strategy, these institutions are increasingly discussing and agreeing financing transactions directly with broker dealers.

Derivative regulations: variation margin and more recently initial margin requirements under the Uncleared Margin Rules (UMR) are bringing in a host of new challenges for firms, and triggering decision points on optimal operating models, requirements and funding approaches.

Triparty use: the use of a triparty agent to manage the allocation and segregation of initial margin was the default choice for firms captured in the earlier phases of the UMR requirements and we see this continuing for phase five, which starts to capture buy-side firms in Asia Pacific. This is accelerating the take-up of triparty by buy-side firms, which emerged to support some direct financing transactions.

The convergence of these trends is leading to a greater focus on an institution's balance sheet and the optimal use of their assets across multiple and often competing requirements.

As an example, there is a greater awareness of the cost of collateral, which can be impacted by:

- The performance drag of larger cash buffers held to meet increased collateral requirements
- The opportunity cost of using securities for Initial Margin, which have significant intrinsic value in the securities lending markets
- The need for firms to source eligible collateral if internal assets of the fund or portfolio do not meet the specified eligibility parameters

The asset owner's response

These changing dynamics and regulations are acting as a trigger point for many institutions to review their approach to collateral and financing so that they can maximise opportunities and minimise costs.

J.P. Morgan is seeing more asset owners setting up treasury and liquidity functions to optimise the use of their assets. Initially focused on cash management and increased participation in securities lending, this has evolved into direct financing transactions and the centralisation of collateral management.

The market volatility we witnessed in March 2020 and the requirement for many asset owners to raise funds to meet expected redemptions – under the COVID-19 early release of superannuation in Australia as an example, or to meet the higher level of margin calls triggered by the wide moves in mark-to-markets of derivatives – has led to funds looking for alternative ways to generate funding. For example, there has been an increasing use of repo transactions of a fund's long assets to generate cash. This removes the need to liquidate assets, and as such the potential need to crystallise losses.

In order to differentiate themselves from other security lenders and maximise returns, active beneficial owners are now looking to be more flexible in their approach. This includes reacting to changing demand dynamics by accepting different collateral assets such as South Korean securities and China A-shares, and looking at

new structures such as collateral pledge or synthetic structures such as total return swaps, which can help address the binding constraints borrowers are looking to solve.

There has been an increase in structured term transactions between asset owners and brokers as lenders look to maximise utilisation of their assets and borrowers aim to partner with sophisticated asset owners to agree trades that help them meet funding requirements often linked to regulatory ratios such as the liquidity coverage ratio and more recently the net stable funding ratio.

What are the current challenges?

The ability to maximise revenue opportunities in the financing space, meet regulatory requirements and minimise the opportunity cost of doing so generates a new set of considerations for buy-side firms.

In order to comply with the Uncleared Margin Rules, buy-side institutions need to decide how they will calculate their initial margin requirements and manage the margin call process with counterparties. Initially, whether they manage in-house or via an agent, and then how they will manage the funding of the required collateral.

> ***"Maximising financing revenue, meeting regulatory requirements and minimising the opportunity cost of doing so creates a new set of considerations for the buy side"***

The increased use of derivatives by asset owners has led to a growth in the number of principal ISDAs and credit support annexes these institutions have with broker dealers. Some asset owners have centralised all derivatives, whether managed in-house or by external fund managers, under their principal agreements.

This centralisation of collateral can bring netting benefits to a fund, reducing the overall required amount of collateral, with the benefit of minimising cash drag and missed opportunities in the securities lending markets.

Globally, around 75 per cent of all variation margin is settled with cash. As more firms are captured by the initial margin requirements there is a growing need to post and receive non-cash collateral. Cash that sits on a custodian's balance sheet does not meet the segregation requirements of the initial margin rules. To date, and a trend we expect to continue, initial margin requirements are being met by government bonds, generally G7, which are also assets that can generate significant revenue in the lending markets.

Buy-side firms are required to sign up to triparty providers, or third-party custodians, to manage the allocation and segregation of assets, as well as receive pledged collateral from their counterparts. They need to negotiate eligibility schedules with the borrowers and ensure they will be able to source the assets they agree to deliver as Initial Margin.

The use of triparty brings operational efficiencies to the collateral eligibility and allocation processes, although this introduces additional considerations around the mobilisation of assets from a custodian to the triparty or triparty agent. In addition to the movement of assets, consideration needs to be given to how assets are monitored in the case of sales, how corporate actions will be processed and any impact on their securities lending programme due to assets with intrinsic value being locked up as collateral.

Designing solutions: how an agent can help

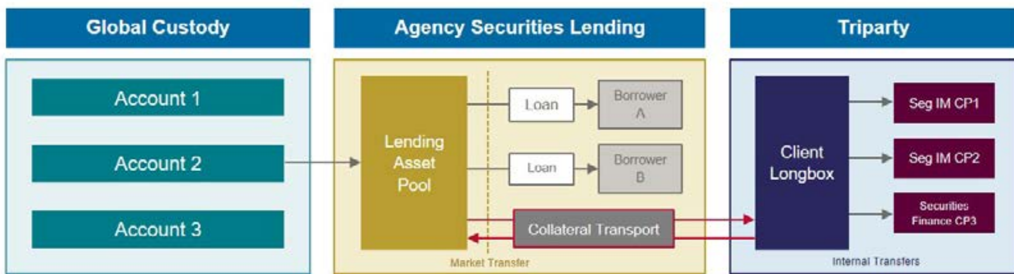
By bringing together our agency securities lending,

collateral management and triparty services under our trading services business, J.P. Morgan is able to offer a flexible, modular suite of services to buy-side clients that is unique in the industry.

An example of this is the new mobilisation service we developed in partnership with an Australian asset owner.

While market forces and compliance with regulatory requirements will continue to shape the structure and operation of the securities finance industry, a focus on asset mobilisation and overcoming challenges through developing innovative solutions will generate the most optimal outcomes for funds and their members.

Figure 1



This service utilises our agency securities lending infrastructure to manage the mobilisation of assets from their custody accounts into triparty, while managing the recall/substitution process for sales.

Importantly, it also identifies when assets used as collateral develop intrinsic value in the lending markets. This allows the substitution of these assets with other securities that are not in demand and have little or no intrinsic value – optimising the use of the available, eligible assets.

This capability also enables easier use of equities and triparty structures for other financing trades where there is a requirement for an asset owner to post collateral. The operational benefits of triparty is also prompting some firms to look at the possibility of utilising triparty for non-cash variation margin.

Stephen Michael
Platform sales, agency securities lending and collateral management, APAC
J.P. Morgan

The sleeping giant stirs

China has amended its QFII scheme to allow foreign investors to lend and borrow securities directly in the mainland market. As the world's second-largest securities market opens, SFT examines what it means for securities finance participants globally

China's equity and fixed income markets are the second largest in the world in terms of capitalisation, after the US. The question of when this vast sea of assets will become easily accessible to international investors has been the multi-billion dollar question for decades.

Since 2014, the Shanghai-Hong Kong Stock Connect has offered exchange participants a way to engage in China-A shares securities lending, but, even though engagement on the stock connect has increased, securities financing volumes remain muted, relative to the size of the market.

However, in December 2020, after a lengthy consultation between regional regulators and

Asia Pacific market players, the scope of products available to those who had a Qualified Foreign Institutional Investor (QFII) licence was expanded to include securities lending and short selling, among other amendments.

The potential for what this could mean for China's underdeveloped securities financing market, and the rest of the world, cannot be overstated.

The QFII relaxations including quota abolishment, a simplification of the application process and the removal of the eligibility criteria for applications, along with investment scope expansion, and multiple channels opening up including Stock Connect and Bond Connect have all contributed to an increase of inflow to the onshore market, explains Patrick Wong, head of China business development and client management, securities services at HSBC.

The index inclusions also act as a catalyst for demand, he notes. Major index providers including MSCI, FTSE, and S&P all include China A-shares in their benchmark indices, which create demand for global passive flows into China A-shares.

"Given the scale of the market and the pace of progress, it would be reasonable to expect that China will become one of the biggest securities lending markets globally," says the Pan Asia Securities Lending Association's (PASLA) chair, Stuart Jones. "The real question is how long this will take, and whether last year's reforms will make possible a vibrant securities lending market for foreign participants within the next five years."

International custodians, with hubs in Hong Kong or nearby, including HSBC, Deutsche Bank, and Standard Chartered have also welcomed the move and were quick to facilitate the first domestic securities lending transactions on the day the rules changed late last year.

Standard Chartered's executive director, sales, China Access, financing and securities services, Susan Yu, says the move is "a remarkable step forward opening up the domestic securities lending and borrowing market to global participants".

Meanwhile, Deutsche Bank expects China's markets to continue growing, corresponding to the country's economy. Tony Chao, head of securities services Greater China and head of securities services sales in North Asia at Deutsche Bank, says China will soon become "too big to ignore" for global investors, not only in terms of portfolio allocation and risk diversification but also for absolute returns.

With this barrier to international involvement in China now removed, market observers are unanimous that the Asian giant will become a major player in the global securities finance market; the only question is when. A feeling-out process is inevitable as domestic and international firms get comfortable with each other's needs and wants, but further integration is widely believed to be in the best interests of everyone.

China today

Since Mao Zedong declared the creation of the People's Republic of China in 1949, the Chinese Communist Party has ensured the country's financial markets remained insular. As a result, the domestic market is dominated by retail investors, who account for around 80 per cent of the average daily trading volume, according to Standard Chartered data, which Yu notes is "in general opposite to other international markets".

In contrast, foreign institutional investors make up a mere 3 per cent of the market. Margin loan and short selling participation in the domestic market is also low, around 2 per cent to 3 per cent, compared to overseas markets where it is closer to 10 per cent, according to HSBC, although, the bank predicts these volumes will now grow in the near term.

Wong notes this market dynamic is "not healthy on a longer-term as volatility is comparatively high". Yu further notes that retail investors are more focused on short-term gain and seem to worry less about company fundamentals. This partly explains why volatility in China A-shares is much higher than other developed markets, where institutional and sophisticated investors are the major players.

Both Wong and Yu hope that the predicted influx of foreign institutional investors will bring some much-need stability by improving price discovery and reducing volatility.

Deutsche Bank's Chao also highlights that a large body of research now exists to suggest an activity securities lending and short selling market positivity contributes to a healthy and transparent market and will likewise benefit China.

Wong says the demand is there from long term investors and exchange-traded funds who entered the Chinese market and the growing securities lending market "will definitely enhance their yield onshore".

PASLA's Jones also believes the QFII reforms should reduce the volatility risk around index rebalancing events, which he says will become increasingly valuable as China grows within various index-tracking products. "However, there are commercial, credit, legal and collateral factors that will need clarification for offshore participants at some point," he adds.

Elsewhere, Jones notes that changes to the QFII scheme are also an example of the healthy relationship between Chinese regulators and their regional counterparts, along with other stakeholders that are pushing for the country to open to the world.

The reforms are "an important part of this progressive approach, coming on the back of an industry-wide consultation in which they listened to views on how they could respond to market needs," Jones says, noting that domestic development has also been ongoing for a while before the rule change. "It's very encouraging to see that domestic investors, retail and institutional, are embracing the expansion in product choices available to them," he says, adding, "we see this as a growth story for the market as a whole, not one that is exclusive to offshore investors".

Hello, world!

Deutsche Bank's Chao believes there is "tremendous pent-up demand" for international assets from Chinese investors for the same reasons international investors want to invest in China. Moreover, he argues, the continued growth of the China wealth management and fund industries is also expected to "lead to demand for value-added products and services that currently can't be offered by domestic service providers".

A common opinion voiced by international banks active in China is that domestic assets can add diversification to global investors. Standard Chartered, Yu, explains that global investors can "enjoy the dividends brought by qualitative economic growth".

However, she adds, global investors must adapt to differing rules in China, similar to the rest of Asia Pacific. PASLA's Jones explains that over time "China has become a very investible and accessible market and is engaged with the full spectrum of portfolio risk management products and the importance of different investor types to the ecosystem".

"Embracing and understanding these factors is important to all global investors as they look to increase their exposure to such a large market," Yu states. "Any evolution takes time and today's reformed QFII scheme is a result of an ongoing dialogue and engagement by a regulator that is both forward-looking and collaborative."

Despite the market demand, gatekeeper not affected by possible profits remain and Chao predicts China will likely remain a standalone market for some time. Like Yu, Chao suggests China will maintain its regulations and market practices. International investors must adapt to these rules of engagement and manage their investments in China in a somewhat segregated manner, he says.

Although the QFII reforms present a new gateway for foreign investors to enter China, regulatory walls that have stood for half a century around the country's markets are not quite ready to come down altogether.

Power to the people

FIS' senior director David Lewis places Asia in a global context to explore how the latest macroeconomic trends and new investor behaviours, such as the rise of retail trading, will play out in the region

To say that 2020 affected the way much of the world lived and worked is an understatement on a truly global scale. Working from home and shopping online were growing trends that were both quickly accelerated by the pandemic, but how has COVID-19 impacted investment markets? Much has been written about stocks that have soared or crashed, but what about our interaction with the market?

Asian investors, like many of their global counterparts, are spending more time at home and online. It has been assumed for some time that there is a higher general propensity to save money across Asia compared with other countries. World Bank statistics from 2015 indicate a global average savings rate of 9.96 per cent, with the U.S. at 3.3 per cent and the EU at 4.9 per cent. Compare that with the averages for South Asia at 20.8 per cent, East Asia and Pacific at 24.7 per cent, and Singapore at 33.5 per cent.

Combine this economic behaviour with the rise in retail brokerage and investment apps. Now add in more time at home on the computer, and what we see is the rising power of the individual investor and their place in capital markets. Access to trading data and low or even no-cost brokerage has opened up markets that were once too difficult and expensive to access, including securities finance. Retail brokerages need to pay their bills somehow, and securities lending is one such source of revenue that is allowing them to bring more retail investors into the market than ever before.

Whether this is a positive impact on the market or not is largely immaterial as it is already happening. Consider the drama around GameStop in the US, which led to restrictions placed on trading and even questions in Congress. This is likely to lead to additional safeguards and rules being imposed on short selling with an onward impact to securities lending, but it is very unlikely to make any attempt to curtail the growth in retail investor activity.

Led by markets where savings and interest in market economics is higher than in many other developed economies, the power of the retail investor to move markets and influence behaviours is only likely to rise. Market actions, such as securities lending and short selling, will become more democratised as the barriers to those markets are broken down. The market will have to adapt and move towards viewing this as an opportunity, rather than a threat to the status quo. This adaptation will affect financial institutions competing for market share as well as technology providers like FIS that are moving to support investors across the globe. The increasingly blurred lines between individual investors and the giants of the capital markets will have a profound effect on those investors and institutions.

Information has always been the basis for power, and the information age has shifted some of that power into the hands of the consumer and retail investor. Markets, led by behaviour in Asia as early adopters, will adapt and thrive no doubt, but it is going to be a very interesting time for everyone involved, and not just for the large financial corporations who may no longer have everything their own way.

APAC by numbers

IHS Markit's Sam Pierson offers insight into the performance of APAC as a region and which asset classes or markets shone brighter than the rest

After seeing year-over-year (YoY) declines for each month of 2020, Asia Pacific (APAC) equities are at least narrowing the gap, with the 8 per cent YoY decline in February 2021 the best monthly YoY comparison since November 2019 when revenues increased 1.3 per cent YoY.

The revenue recovery in APAC has been the result of increasing specials balances since the low point in November, which is an encouraging trend considering that the South Korea short sale ban is still in place; the partial removal of the short sale ban may be a tailwind for the latter half of 2021.

Another potential APAC equity finance revenue driver is the forecasted increase in dividend payouts. APAC dividends are expected to grow by 6.7 per cent in 2021, with growth expected across all sectors excluding travel and leisure and oil and gas. China and Hong Kong are both forecast to grow in 2021, increasing by 9 per cent and 3 per cent respectively. After declining 5 per cent in 2020, dividends in Japan are forecast to increase by 5.6 per cent in 2021, sufficient to notch a narrow increase compared with 2019.

Exchange-traded products (ETPs) listed in APAC have seen steadily increasing borrow demand, with year-to-date (YTD) loan balances the highest on record. Revenues from lending APAC-listed ETPs have also been increasing, with full-year 2020 seeing $31 million in revenue, a 93 per cent YoY increase, while YTD 2021 $4.5 million reflects a 115 per cent YoY increase.

Another potential revenue driver for 2021 in APAC, as in the rest of the world, is borrow demand relating to capital raising. Convertible bond and Special Purpose Acquisition Company issuance, along with conventional IPOs, are likely to drive borrow demand as the global economy continues to recover.

> *"APAC dividends are expected to grow by 6.7 per cent in 2021, with growth expected across almost all sectors"*

APAC equity round-up (February 2021)

APAC equity finance revenues declined 8 per cent YoY in February, the 13th consecutive month of YoY declines. Average daily revenues increased 7 per cent compared with January, the fourth consecutive month where daily returns increased MoM. Asia equity special balances continue the recovery from the 2020 low point in early November, with February's $9.2 billion in daily average special balances being the most for any month since February 2020. Special balances are defined in this note as balances with a fee greater than 500bps.

The largest market, Japan equities, delivered $42 million in February revenues, a decline of 14 per cent YoY, however daily average revenues increased 5 per cent MoM.

Hong Kong equity finance revenues increased by 60 per cent YoY in February, the fifth consecutive month with increasing daily average revenue. Apart from Malaysian firm Top Glove Corporation, Hong Kong equities owned the top of the revenue generation leaderboard. The short sale ban in South Korea continues to limit lending revenue, with $6.4 million in February revenue reflecting an 83 per cent YoY decline.

Revenues from lending American Depository Receipts (ADRs) increased 549 per cent YoY. Most of the increase was driven by Hong Kong domiciled Futu Holdings, which generated $94 million in February, 75 per cent of the total ADR return. While Futu dominated February returns, and represented a third of January revenues, there is a broader demand narrative taking shape. Excluding the impact of Futu, February ADR revenues increased 65 per cent YoY.

Apart from Futu's impact on HK ADR revenues, ADRs for Mainland Chinese firms also contributed to revenue growth in February, with $20.4 million in revenue reflecting an 80 per cent YoY increase. European ADRs delivered $4.8 million in February revenue, an 8.9 per cent YoY decrease. Depository receipts listed outside the US generated $5.1 million in February, a 74 per cent YoY increase.

APAC: A new era begins

Drew Nicol reports

APAC securities lending market experts take on the region's hot topics including the opening of China, a post-COVID recovery, short selling bans and ESG

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Global head of agency securities lending
Standard Chartered

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2020 saw a wave of short selling bans across Asia of varying lengths and severities. How did this affect securities lending markets?

Mark Snowdon: There were four markets affected by short selling 'restrictions'. South Korea – an outright six-month short selling ban from 16 March, subsequently extended to May.

Taiwan — A reduction in the daily short sell quota from 30 per cent of the 30-day average daily value (ADV) to 10 per cent of ADV from 19 March 2020 plus a tick rule for stocks falling more than 3.5 per cent from previous day's close. Initially set for three months but was lifted a week early.

Malaysia — A ban on all types of short selling from 24 March 2020 (except permitted short selling for exchange-traded fund (ETF) market makers) until 30 April, then 30 June, then extended until 1 January 2021 when it was lifted with newly-introduced enhanced control measures.

Thailand — A new tick rule was introduced on 13 March 2020 until 30 June, subsequently extended to 30 September and lifted on 1 October.

The ban had the most impact on South Korea with overall revenue down 45 per cent YoY, according to IHS Markit. Short positions were allowed to remain and unwind naturally but this unwinding led to greater and greater unutilised lending supply which led to aggressive downward re-rating by borrowers. The various restrictions certainly had a negative impact (psychologically as well as materially) but it is difficult to estimate the precise impact when several other market dynamics were at play leading to substantial revenue attrition across the region.

Across the client base, the market did witness some beneficial owners suspending or pulling out of their lending programmes as they had concerns around market volatility and the perceived correlation between securities lending and short selling. In Australia, the Australian Securities and Investments Commission (ASIC) did reach out to the Australian Securities Lending Association (ASLA) to discuss the potential impacts of key super funds pulling out of lending programmes and how that would impact market liquidity but there was no consideration of any short selling bans. This demonstrates that developed markets have learnt that short selling bans harm the financial markets after the financial crisis in 2008.

Simone Broadfield: The measures to limit short selling across several Asia Pacific (APAC) markets, combined with the longer-term short selling ban in South Korea led to diminished lending opportunities and significant industry-wide spread compression.

We initially saw a risk-off sentiment, however as market limitations were lifted, recoveries were swift and activity grew increasingly stronger as 2020 drew to a close.

As it relates to South Korea, lending flows are muted and the market is taking a conservative approach due to the uncertainty concerning when market trading will return to normal.

Brian Leung: South Korea and Taiwan were previously home to some of the most lucrative specials in 2018 and 2019 accounting for a significant portion of the region's securities lending revenue. The short selling restrictions introduced in 2020 presented significant challenges to the dynamic as loan balances and fee levels saw reductions in these two markets. This however allowed some of that demand to be allocated elsewhere as we saw balances in Japan and Hong Kong increase to compensate for the decline in returns. While the industry is hopeful that the lifting of the ban will help re-energise these markets, we also are optimistic that regulators will recognise the market efficiencies that securities lending has on a well-functioning market, as evidenced by the added liquidity and effective price discovery which undoubtedly would have been beneficial to their investors.

Jansen Chua: For the most part, it appears that the market has taken the regional short sale bans

in their stride; similar actions have been taken by regulators previously with corresponding changes to the demand profile and revenue expectations.

One of the interesting situations we are currently observing in South Korea as a result of the short-sell ban is a decline in institutional (particularly quant funds) broad-based down-side hedging. In the meantime, the proportion of the Korean stock market owned by retail investors and the corresponding value of the market indices has grown significantly. Given how highly politicised short selling has become locally, it may make exiting the short sale ban a very challenging endeavour for the regulators. Focus has also shifted to affording retail investors the same access to short selling capabilities as institutional investors; a retail-focused platform for short-selling is now being considered, with the short-sell ban extended from March to May instead.

In the meantime, investor attention has turned to APAC markets unaffected by short sale bans, namely China A and to a lesser extent, Taiwan. The progressive liberalisation of China's stock market (through the Stock Connect and the Qualified Foreign Institutional Investor scheme) has seen increasing interest from offshore investors. Onshore Chinese hedge funds have also gathered significant amounts of investor assets over the past 12 months with strong performance results. Since lifting restrictions, Malaysia has bounced back with a strong demand for borrows.

Sunil Daswani: APAC securities lending markets suffered the largest year-over-year (YoY) revenue decrease for 2020 compared to other global lending regions across Europe, the Middle East and Africa (EMEA) and the Americas. While much of this decline was attributable to the various short selling bans put in place across specific Asian countries, the largest contributors to revenue in the region, Japan and Hong Kong, also saw significant declines in revenue YoY even without short selling bans in place. The change in relative performance between APAC securities lending markets and EMEA and the Americas in 2020 compared to past years highlights how impactful the short selling bans were to the region's revenue. We have seen revenue increase following the lifting of short sell bans in markets like Malaysia and we expect to see the same occur as some of the restrictions are lifted in South Korea in May.

APAC suffered the worst YoY revenue decrease for 2020 compared to other regions. Was this a one-off?

Chua: The protracted short sale ban in South Korea has certainly created significant revenue drag. Specials activity across the region was also unusually sparse in traditionally strong markets like Japan, Australia, Taiwan and Hong Kong. As an example, short selling activists' reports on Hong Kong securities in previous years would have led to strong borrow demand; however, in 2020, impacted companies appear to have learned from prior examples and managed to change the narrative at a pace and with sufficient confidence that has dampened the demand for shorting.

The reduction in yields in Japan was less impactful than in Europe, however the competition from Japanese domestic liquidity providers remains intense, meaning demand during intra-record date periods has become progressively softer over the past few years. Australia and Singapore corporate action activity has also declined given the environment in 2020 but one would hope to see a recovery in 2021.

China has remained a positive story for prime brokers with synthetic access to China A-shares at high premiums driving strong outperformance. We expect this to continue in the medium term as investor demand continues to outstrip stable liquidity.

One would expect 2021 to provide a catalyst to increased revenues in APAC, with a strong initial public offering (IPO) pipeline in Hong Kong, a more favourable environment for corporate mergers and acquisitions and an eventual 'return to the mean' for specials in the region.

Leung: The aforementioned ban was one key factor in APAC's underperformance compared to its global peers and where the difference was more pronounced could be attributed to the lack of Asia representation in the 'top performers' lists. There was a strong COVID-related theme to this year's highest-grossing names, particularly in the pharmaceuticals, retailing, transportation/travel and technology space. Most larger corporate players seeing event-driven demand were American or European. With the reinstatement of short selling in South Korea and as the world economy recovers as vaccines roll out, we should see a slow but steady recovery in exposure to the region as investors re-apply risk.

Snowdon: In addition to the short selling restrictions, of which South Korea played a major part in overall revenue reduction, there was also a lot of short-side risk activity taken off the table. This appeared to be more pronounced in APAC than other regions due to the typical retreating to home markets for international players that we see in times of stress. While it would not be true to say that short-side risk completely disappeared, it was enough to see a huge reduction in the number of specials across the region due to a lack of crowded shorts. Quantitative funds remained active, though they did not make up for the lack of fundamental trading on the short side. The March 2020 crash allowed expensive short positions to be unwound and we did not see a recovery in the volume of specials for the remainder of the year. This also translated into subdued activity around corporate events where, despite record-breaking amounts of capital issuance, we did not see many events leading to heavy volume/high-fee borrow activity. Exposure to China did increase but this was via synthetic structures so for traditional securities lending there was little opportunity except some overflow of this to Hong Kong.

Broadfield: A multitude of negative contributing factors converged across APAC in 2020 leading to the lowest industry performance for years.

The region was the first to feel the global effects of the pandemic and has been subject to long-term geopolitical tensions fuelling investor uncertainty.

While the resultant market volatility did provide multi-asset lending opportunities, it also prompted regulators to take measures to control liquidity through quantitative easing, the imposition of tighter short selling rules or, in the case of South Korea, the implementation of an ongoing short selling ban.

These measures by default created a more subdued lending environment across some markets which, combined with fund deleveraging and a reduction in volumes across corporate event activities, had a detrimental impact on spreads.

Notwithstanding the above, 2020 offered lending participants a chance to demonstrate their abilities to adapt and evolve to unexpected market conditions. The increasing need to differentiate on both sides of the trade led to a positive divergence in product offerings and trade structures.

The regional revenue figures belie significant market-to-market disparities in revenues, with Japan among the worst performers YoY compared to Hong Kong. What's behind this?

Leung: Similar to European and American counterparts, Japan was also impacted by the reduction of dividends paid in 2020 as companies saw the need to shore up cash reserves and boost capitalisation ratios to weather the COVID storm. This reduced balances in Japan's traditional peak months of March and September allowing Hong Kong to make up ground, as participants shifted their focus on directional names in the electric vehicle and technology sectors. These areas witnessed market optimism and government policy support which buoyed short interest in names such as BYD, China Evergrande EV and Tianneng Power. Coupled with Sino-US relations fraying in the past year, this led to attractive pockets of opportunity in Hong Kong.

Snowdon: Hong Kong has benefitted to some extent from the increased inflows to China as well as short exposure to China-themed ETFs. Hong Kong's stock market fared relatively badly for 2021 losing 3 per cent for the year compared to a stellar performance for other markets – Japan up 16 per cent, Taiwan up 22 per cent. Hong Kong was a much easier market to put short-side risk in compared to markets where the upward trajectory was seemingly incessant. Taiwan managed to fare comparatively well due to the intercompany competition dynamics of that market, particularly in the technology sector where it was probably easier to perform arbitrage activity with some degree of confidence even in a rising market. Japan, on the other hand, faced a rising market without that special dynamic, lack of specials and a reduction in yield enhancement revenues due to cancellation or reduction of dividends by corporates, which resulted in a heavier hit to the securities lending revenue in 2020. Of interest is that the Bank of Japan (BOJ) and the Government Pension Investment Fund are significant shareholders of the Japanese equity market and their market share continues to grow.

A recent article has outlined how much money the BOJ, in particular, has put in the Japanese equity markets (ETFs) as part of their monetary stimulus. This is not something seen in Hong Kong.

Broadfield: The Japanese market experienced a significant reduction in specials-driven activity throughout 2020. Reporting season brought with it a handful of cancelled or deferred dividend payments and, broadly speaking, we saw less directional trades in play across sectors which were subject to pandemic-related stress as compared to elsewhere in the region.

The Hong Kong market recovered relatively quickly from the H1 volatility, benefiting from increased corporate capital raising activities, strong sector-driven demand and longer-term hedging needs specific to Hong Kong-listed Chinese ETFs or A/H share spread trades.

Despite the 2020 industry performance, there were positive signs of a recovery in Q4 and Japan remains a market which consistently offers significant opportunities for growth across multi-asset products within lending.

Daswani: There has been a general lack of shorts in Japan and Hong Kong, which results in fewer securities trading specials and lower fees. Revenue for both large-cap and small-cap Japanese equities, for example, have been trending lower consistently over the past two years. Data shows that small-cap returns are currently at the lowest level they have seen in over two years in Japan.

Chua: Generally speaking both markets have struggled for specials YoY; lacklustre corporate activity in Japan and the waning impact of short sell activists in Hong Kong led to subdued returns. On a YoY measure, Japan looks as though it was impacted more severely. In part, this is reflective of a special stock, Takeda Pharmaceutical, which generated strong returns for Japan in Q4 2018 and Q1 2019. There have since been no similar opportunities to offset that performance. Conversely, Hong Kong has started to see benefits from work previously done by the Hong Kong Exchange which responded to market feedback and sought to restructure their IPO listing rules in 2019/20. Hong Kong saw a strong pipeline of new listings in 2020 and, though not huge long term specials, these presented short term opportunities for securities lending. One would expect that over time the increased capital flow and broadening of the types of companies listed in Hong Kong will foster more trading opportunities.

A big story of 2020 was the amendments to China's QFII scheme. How do you expect this trend to progress in 2021 and beyond?

Daswani: We have seen a significant increase in the number of QFII applicants in just the past two months. In November 2020, there were 19 QFII licences approved by the China Securities Regulatory Commission (CSRC) and in December the number was 26. This was explained by

major changes to the QFII scheme, including the expansion of investment scope, the flexibility of funding sources and allowing for securities lending and borrowing, all of which have attracted foreign investors to revisit their QFII projects. We expect this will continue into 2021 and beyond.

It's a significant development that under the QFII scheme securities lending and borrowing is permitted for foreign investors for the first time. Having said that, as foreign investors only account for less than 3 per cent of overall ownership of domestic equity assets, and the majority of these foreign investors are using Stock Connect to access the market at the moment and are not going via the QFII channel, securities lending and borrowing via the QFII channel will still only account for a small part of these activities.

Leung: The opening up of China's A-share market is also being highlighted in the newly-refined QFII scheme, in which China has begun to allow CNY-denominated securities lending and bond repos. While it is still a far cry from being a freely-traded securities lending market, we have seen some symbolic securities lending transactions facilitated between QFII HF/PE funds and domestic players. In addition, we have also witnessed a handful of lenders being permitted to accept China A-shares as collateral (via the HK/CN Stock Connect) which shows the CSRC's willingness to soften its stance on liberalising its currency and securities markets. The next steps would be for the regulator to look at further relaxing restrictions governing offshore securities lending participants, ratios and names which could be shorted via the Stock Connect and by which time we may see a more traditional market begin to develop. We are hopeful that despite the recent sanction issues, international investors should not be discouraged by the benefits that exposure to the Chinese market can provide.

Chua: The direction of travel is positive, and on the face of it, the recent stock lending-related reforms trialled in the STAR (Shanghai) and GEM (Shenzhen) boards provide much optimism for the future evolution of the market.

However, there are several challenges which will likely need to be addressed to promote further development and growth of the market. Firstly, the current model mandates fixed duration of loans and fixed loan pricing, although there are discussions that the regulators are considering moving to a model which will allow bilaterally negotiated terms. Secondly, investors who have traditionally relied on their agent lender in other markets would need to get comfortable with exposure to China Securities Finance (CSF) as the central counterparty. Thirdly, borrowers need to adhere to additional operational complexities such as heightened disclosure of activity, short sale proceeds needing to remain onshore and uptick rules on 'borrowed but not sold' shares which could affect other long positions in the same name. Finally, capital costs (for beneficial owner indemnification), enforcement of collateral interests, high intermediation fees charged by the CSF and the complexity of trading will likely limit scalable solutions in the near term.

The Stock Connect is the other access channel which has generated significant interest among offshore investors. Despite having established securities lending and short selling rules since its inception, Stock Connect lending activity remains difficult to achieve without significant regulatory or infrastructure change. As an example, the rules allow for an SFC-licenced asset manager, unit trust or collective investment scheme physically located and managed in Hong Kong to participate as a principal lender. However, most investors that fit this requirement have traditionally relied on their agent lenders, with the requisite infrastructure and experience, to help them conduct such activities in lieu of making that investment themselves. The Stock Connect programme today, unfortunately, does not recognise the role or concept of agent lenders.

While the industry continues to lobby for change, the regulators do not appear, at this point, inclined to make the required adjustments which would promote a model more akin to securities lending activity in other markets. These impediments will continue to likely drive synthetic access as the current alternative for hedge fund investors looking

for short exposure, with the prime brokers being primary beneficiaries.

Snowdon: China's economy expanded by 2.3 per cent in 2020, making it the only major economy to report economic growth for 2020 — providing confidence for investors. With steps towards market liberalisation via China A-shares added into MSCI benchmark indexes in 2018 and the subsequent increase in weights in 2019, as well as links developed between onshore and offshore exchanges via Stock Connect, the Chinese market continues to offer big potential for the securities lending industry globally.

The new securities lending and short selling rules are a huge boost to the international securities lending community which has been working toward this step for many years. However, it is very much a work in progress with currently no place in the value chain for agent lender participation. The current rules are also very restrictive and contain many unique requirements which will be a barrier to any meaningful or scalable activity until these nuances are addressed. We would expect in 2021 to see work being done to fine-tune the current offering and perhaps by the end of the year we will see some modest volumes on a day-to-day basis. However, we expect the Chinese regulators will need to be comfortable with each step before introducing any changes, and it may be optimistic to see agent lender participation before the second half of 2022.

Despite being somewhat overshadowed by QFII over the past year, the progress being made to the short selling platform via Stock Connect should not be forgotten. Although interest in Stock Connect has been muted over the past five years, the progress made on QFII could well encourage regulators to revisit this avenue and that could be a game-changer for agent lenders.

Lai: The amendments announced towards the end of 2020 are a welcome development and should build on the short selling framework that was already in place.

Without a doubt, the Chinese securities lending market has an exciting trajectory ahead. We believe this goes hand in hand with the developments that the Chinese securities markets have witnessed over the recent years with the launch of Stock Connect, Bond Connect and the inclusion of China shares in various global indices, to name a few examples.

Additionally, if we look at published data, the Shanghai and Shenzhen stock exchanges are both ranked in the top seven globally in terms of market capitalisation which not only points to the diversity and success of their listed companies but also supports the natural evolution to offer and support hedging strategies.

For now the transactions are limited to a principal set up but with an established and well regarded global agency securities lending programme, J.P. Morgan remains committed and well-positioned to help our clients navigate this new and exciting market.

ESG is a global growth area for securities lending markets and APAC is no exception. What does ESG look like in APAC with initiatives such as PASLA's ESG roadmap to standardisation?

Snowdon: A relative bright spot in the wake of the pandemic has been the acceleration of environmental, social, and governance (ESG) policies influencing all aspects of investment decisions. This includes how they intersect with securities lending, with a growing number of asset owners and managers now integrating them into the business.

The outcome of a survey conducted by EY on behalf of the Pan Asia Securities Lending Association (PASLA) revealed that ESG has become a key consideration in APAC securities lending practices, albeit with an appreciation that various implementation hurdles are making this easier said than done, and that incorporation of ESG into some

programmes is still catching up with the importance that participants place upon it.

There is now work underway by PASLA to create a practical set of guidelines to enable buy-side institutions to integrate their lending programmes with their approach to ESG. The aim is to enable investors to execute a lending programme efficiently while maintaining the focus on ESG policies.

Chua: PASLA conducted two ESG surveys during 2020. From the result, we can see Asian investors looking to take a more proactive approach to manage ESG factors in their securities lending programmes. Standardisation of factors remains a point the industry is still working towards; current focus appears to be on issues such as proxy voting and the ability to exclude non-eligible investments in portfolios and collateral schedules. The facilitation of short-selling through participation in securities lending is also another area that we are seeing increasing client interest. We believe short-selling and securities lending provide significant value in terms of the efficient functioning of capital markets, and also in the promotion of a robust governance framework over investment activities.

Daswani: The survey participants overwhelmingly recognised the importance of ESG. The excellent work PASLA did summarised nicely not just where APAC is in relation to ESG, but more broadly, the global view that ESG should apply in the decision-making from end-to-end as it pertains to investments and securities lending programmes. The three key themes identified were: governance; non-ESG compliance as a risk to business; and, the need to have an ESG control system in place.

We at Standard Chartered are in complete agreement with the findings of the survey.

Lai: ESG has become more important in securities lending in APAC and will only continue to grow. An interesting, but perhaps unsurprising, observation is there is no uniformity in approaches. For example, across APAC, we've seen lenders in Australia and Japan take the lead, whereas lenders in other markets are mostly looking to first implement ESG on their direct investments rather than in their lending programme.

Within securities lending, some lenders focus on negative screening in their lending programme parameters whereas others place more importance on making informed decisions on when issues are material enough for them to recall loans to vote.

In the absence of regulation, industry initiatives such as those driven by PASLA are certainly helpful in bringing standardisation to an evolving market. Standardisation offers both lenders and borrowers more clarity and comparability and reduces the risk of fragmenting liquidity based on differing ESG benchmarks. How much standardisation the market can converge on remains to be seen, especially given how subjective a topic such as ESG is.

Leung: Historical examples of ESG from a securities lending perspective have been catered around the governance of the programme. Some examples (and not limited to) are: which securities are eligible to be lent and used as collateral (i.e. no stocks that have inadequate ESG ratings such as tobacco/fossil fuel names); recalling positions for proxy voting or certain corporate events; and ensuring collateral received fits in with beneficial owners' investment criteria.

Market participants (beneficial owners, agent lenders and participants such as triparty agents) should continue to meet together to ensure that the constantly evolving ESG needs can continue to be met. Agreed practices would be around enhancing transparency on the impact of securities lending in the environment, advocate wider law, policy and regulation at a national, regional and global level and finally ensuring there is a pathway for education on ESG and exchanging best practices.

2020 reminded us how difficult it is to make accurate predictions. But, assuming normality returns this year, what are the main trends to watch in APAC?

Leung: The aforementioned ESG topic will undoubtedly be watched very closely in the upcoming year as the securities lending community will ensure that market behaviour and practices are in line with expectations of the wider investment community. ESG will also be driving appetite and sentiment for sustainability investors so one should expect more opportunities to lend and borrow in highly-rated ESG names.

The also previously mentioned short selling bans are expected to be lifted and we should hopefully see a return of demand for South Korean exposure, particularly in the previously popular biotech space. One should not also forget 2020 when it came to how participants fared working from home/backup sites and business continuity in a particularly disruptive year. Hopefully, members were well-equipped to handle the pandemic and did not see a marked interruption in deal/lending flow YoY.

As we expect vaccine roll-outs and companies having employees slowly return to work amid the virus recovery, lenders and borrowers alike should be looking to find ways to increase efficiency, be it more automation, adopting more cloud-based solutions or blockchain technology to reduce the operational or in-office workload to ensure that highly-functioning securities lending programmes are maintained.

One can expect outbreaks to sporadically re-emerge thanks to new virus variants and the industry participants' response to it will be of vital importance to ensure all members of the value chain are minimally impacted.

Chua: We expect to see increasing pools of supply to enter the market driven by a search for yield and a shift from active to passive investing. This increasing supply, set against what has been a muted demand profile (as a result of generally poor hedge fund performance as well as increasing prime broker internalisation efforts) will likely have profound impacts on how beneficial owners view lending programme performance and the expectations of future returns, how agent lenders compete for and service these pools of inventory, and how borrowers choose to source their inventory needs going forward.

Capital efficiency, programme flexibility and routes to market are going to become increasingly important differentiation factors for beneficial owners and lending programmes alike. Issues such as the use of indemnification, collateral flexibility, central clearing, and peer-to-peer constructs will likely gain more attention as the impact of capital regulatory change (such as Basel IV) continues to influence prime broker and agent lender (the two intermediaries most impacted) behaviours. We believe the focus on and implementation of technology will continue to drive and enable these changes. Nevertheless, investors need to consider the risk-return implications, in addition to the potential internal infrastructure investment needed, of participating in such facilities.

We also expect to see the continued maturity of Asian investors. There is increasing internalisation efforts in the investment management function amongst Asian asset owners, some of whom have since also set up investment offices in major financial centres such as New York and London, and have stated ambitions to significantly increase allocations to alternatives (including hedge funds). We view these as positive developments for the industry.

Asia also remains a focus region for global investors. We continue to see promising moves by South-East Asian markets towards developing securities lending infrastructure and are most likely to provide sources of alpha in the next three-to-five years. However, one should caution that the path to a developed securities lending market in these countries is likely to remain bumpy due to complicated local regulations and lack of infrastructure. The potential for China to remain an important engine of growth in the short to medium term as the market continues its path towards liberalisation is a story that is also well traversed.

Daswani: We expect to see South Korean lending revenue return to good levels once the reopening of lending for the top 350 securities resumes on 3 May. Also, the Philippines has reiterated that securities borrowing and lending rules are expected to be finalised in 2021, which may offer new revenue opportunities for some lenders in the coming months, and of course, we all watch closely for further developments in China.

Lai: Having embarked on a new year, we should note that from a regulatory perspective the industry successfully implemented the latest phases of Securities Financing Transactions Regulation. However, we should remain cognisant of the fact that various other new regulations remain on the horizon.

Additionally, from an educational point of view, I believe it would be beneficial for the industry to look back at the events of 2020 for us to plan for the opportunities ahead.

For example, globally the industry saw various forms of amendments to short selling rules with varying degrees of duration. Most markets have rebounded strongly from their March 2020 lows. So what can be deduced from these various amendments? Is there a common set of principles in times of market uncertainty that can be implemented or is the collective agreement that markets will occasionally be subject to volatility?

Snowdon: We are likely to see increased volatility as the upward market impetus wakes up to the impact of the pandemic and starts to identify winners and losers. With the conclusion of the US election and the start of the vaccine rollouts there is slightly more economic certainty which should enable hedge funds to put their money to work. This can be seen in the number of placement stocks with strong borrowing demand and take-up, despite seemingly plentiful lending supply.

For example, the demand for Xiaomi Corp (1810 HK) at elevated levels despite there being plentiful availability has shown us that hedge funds have sufficient appetite to put on trades. Hedge funds in Asia had a strong 2020 and their confidence should support further robust sentiment in the coming year. As Asia gradually begins to recover economically, we are likely to see more deal activity such as IPOs, mergers, and acquisitions and potentially a return to pre-COVID dividend payments that will make certain DRP and SCRIP trades more attractive. Additionally, there will be sectors or assets that appear to be overpriced which could lead to more broad-based shorting that may support the specials environment in 2021. Such sectors may include technology and the electric vehicle industry.

We also anticipate a continued push from borrowers to release underutilised regional assets for collateral and a trend toward trading through local entities for increased cost-efficiency.

On the client front, ultimately faced with growing cost pressures and the challenge of generating returns in a lower-for-longer rates environment, asset owners and investment managers cannot ignore the difference that securities lending can make in terms of enhancing portfolio performance and offsetting costs, while also supporting liquidity.

In APAC there is greater recognition than ever before of the need to add the kind of value to a portfolio that a broader securities finance offering promises. A faster return to pre-pandemic levels of economic activity in the region may also spur tactical re-allocations accordingly.

As a result, interconnecting the lending of securities with repo capability and collateral management, for example, will be key to the success of investment firms in the future. Such an approach gives investors a good reason to be optimistic about being able to incrementally add alpha and manage costs more efficiently. Providing a holistic and integrated capability to support this enhanced type of activity will be an important factor to allow lending agents to differentiate themselves.

Vendor profiles

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(1) Based on CRR-CRD4 rules as reported on June 26, 2013, including the Danish compromise - without phase-in.

Figures as at 31 December 2020

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(1) Standard & Poor's (AA-) and Moody's (Aa2) legacy senior long-term debt ratings of Royal Bank of Canada as of February 23, 2021

(2) RBC quarterly results as at 31 January 2021

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