rma daily Day 2

33rd Annual Conference On Securities Lending October 2016

Mark on the market

OCC chairman and CEO Craig Donohue reveals how the central clearinghouse aims to evolve

***Inside:** The latest conference news and photos • OCC is making its mark • Morgan Stanley adapts to the new environment • Money market reform to squeeze cash • Collateral options are increasing*

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G-SIBs are struggling under single counterparty credit rules

The Federal Reserve's proposed single counterparty credit limits pose significant problems for large custody banks in the securities lending industry as the pool of potential counterparties is too limited, according to conference panellists.

Delegates at the 33rd Annual Conference On Securities Lending were warned by a legal advisor on a panel that globally systemically important banks (G-SIBs) are "going to really struggle" to manage their credit exposure to other G-SIBs operating in the securities lending market.

Under the rule, G-SIBs must cap their credit limit to other G-SIBs at 15 percent, but smaller banks are allowed a more lenient 25 percent limit to unaffiliated counterparties eligible capital base.

The US government and qualifying central counterparties are excluded from this rule.

For banks acting as agent lenders, the reason they are hitting these limits is directly related to the high cost of indemnification, explained another panellist.

Agents lenders must explain to their clients that the new regulatory environment has dramatically changed the feasibility of blanket counterparty indemnification.

"This [single counterparty credit limits] is one of the pieces of regulation I would most like to see changed," said the legal panellist.

"I hope the Federal Reserve will take account of the Basel Committee on Banking Supervision's recommended changes."

The next iteration of the rule is unoffically expected in late 2017.

Is there a doctor in the house?

Industry documentation will need to be amended and modernised as regulations are tweaked after implementation, attendees heard yesterday.

Tuesday's opening panel discussions dove deep into current and upcoming regulatory initiatives that are affecting securities lending, including Basel III capital rules and termination rights across jurisdictions.

Basel III capital rules such as the liquidity coverage ratio have forced banks to build up huge reserves of high-quality liquid assets (HQLAs).

In five years, seven US banks have increased their combined HQLA holdings by 48 percent.

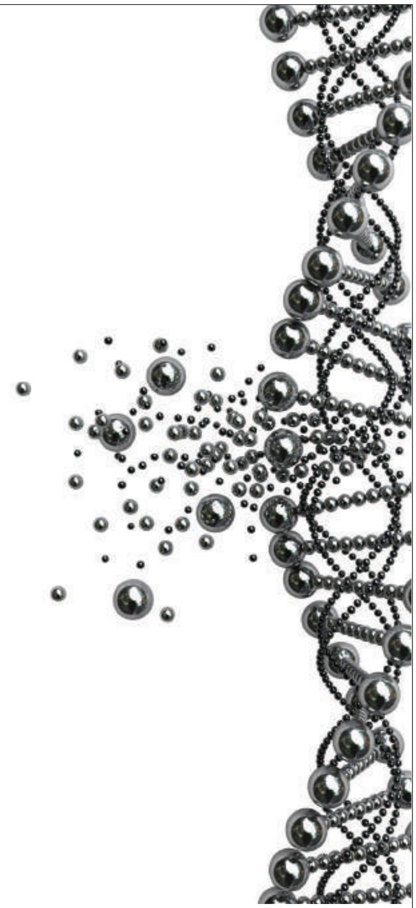
These huge reserves have left securities borrowing and lending documentation behind. "Unfortunately, our standard agreements are quite aged," said one panellist, who explained that contracts have to be modernised to cover all of the options and protections that are required to deal in such volume.

The 2015 Universal Resolution Stay Protocol was the subject of a comprehensive panel discussion on the worries about cross-border disputes that might arise from conflicting rules on termination rights.

The panel said that the pace of implementation of special resolution regimes is picking up, with multiple EU member states, the US and Japan already over the line.

Stay resolutions have attracted the most controversy due to gaps forming as different rules are implemented across jurisdictions.

According to the International Capital Market Association (ICMA), special resolution regimes provide resolution authorities with broad tools and powers to effect a resolution, including the imposition of a temporary stay on counterparties' early termination rights in the event a bank enters into resolution. But it is uncertain whether these stays would extend to contracts governed by foreign law.



The International Swaps and Derivatives Association (ISDA) developed the Resolution Stay Protocol in 2014, which it revised in 2015, to contractually address discrepancies in termination rules. “The beauty of that is it’s uniform,” said one panellist.

ICMA also published the Securities Financing Transaction Annex last year, to assist market participants that use certain securities financing master agreements in complying with relevant bank resolution laws and regulation requiring the recognition of bank resolution stays in certain cross-border contractual arrangements

Regulators have also sought to address cross-border issues, with multiple countries considering a requirement for amendments to contracts with regulated entities.

The panel did point out that that the risk of a cross-border dispute is low, although ignoring a stay would, hypothetically, contravene one or more laws in the jurisdictions in which a transaction was conducted, and clash with client requirements for agent lenders to obey local laws.

RMA and SIFMA update: collateral, OBFR and more

The RMA and SIFMA’s work on reform of US Securities and Exchange Commission (SEC) Rule 15c3-3 is continuing in earnest. The associations’ update on their work over the past year revealed that discussions with regulators are ongoing.

They have received comments from regulators on their plans to amend Rule 15c3-3, which prohibits certain funds from accepting equities as collateral, but cannot yet commit to a firm date for any changes to come into effect.

“It’s a delicate topic and we need patience,” one speaker urged.

No problems were reported when the the federal funds open rate (FFOR) was discontinued on 30 September.

ICAP confirmed plans to drop the benchmark for pricing and performance reporting earlier this year, a move that the RMA and SIFMA backed because the new overnight bank funding rate (OBFR) would better address the benchmark standards recommended by the International Organization of Securities Commissions.

But ICAP had to postpone plans to cease publishing the FFOR in July due to concerns from some market participants that they wouldn’t be ready. The RMA and SIFMA worked to secure the delay, buying their members until 30 September.

“We’ll consider this a small success,” noted a panellist at the conference.

In other news, the RMA is working on consultations and proposals relating to the US Office of Financial Research’s data collection pilot programme, single counterparty credit limits, the standardised approach to credit risk, special resolution regime documentation and tax reforms.

The RMA tax committee will meet with IRS and Treasury officials on 19 October to discuss proposed changes to Section 871(m) of the tax code. The changes, which have been the subject of two RMA tax committee comment letters this year, are scheduled to go into effect on 1 January 2017.

They would severely affect existing regulatory guidance for securities finance transactions that are supposed to lower the risk of excessive US withholding tax in a chain of transactions.

In its comment letters, the RMA tax committee has asked for a one-year delay to implementation of the proposed changes, as well several tweaks that would protect securities finance transactions.

These include special consideration for non-US subsidiaries of domestic institutions, due to the tax burdens they already face.

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Cash or non-cash? That is the question!

Although cash is still the predominant collateral, non-cash is catching up slowly, says State Street's Glenn Horner ahead of a panel debate on which is king

The trend towards non-cash collateral has slowed in the past few months. What do you think is driving that and do you think it will be a more long-term trend?

No, I don't think it will be a long-term trend. The move towards non-cash has been going on steadily since 2008—especially in the US. Although cash as collateral is still the predominant collateral, non-cash is catching up slowly.

In terms of what's driving the recent data trend, one reason might be the market's general opinion that a rate hike from the Federal Reserve seems to be on the horizon, as we're starting to see some shape to the yield curve. Some market participants might be looking to secure a yield pick-up by investing out on the curve that hasn't been there for some time.

At the same time, with US money market reform coming on 14 October, we are seeing an almost barbell-type mentality that is caused by the fact that prime money market funds are, in my opinion, not a viable option for securities lending cash now.

Overall, the use of prime money market funds has dropped dramatically.

Regulators favour HQLA collateralised lending transactions. What is it that keeps the debate alive at events like the RMA conference?

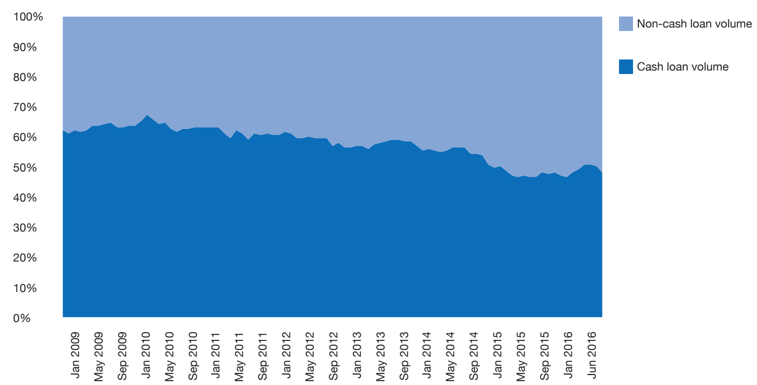
It's still a fairly complex issue because, at the end of the day, it comes back to the beneficial owners' risk tolerance and investment strategies.

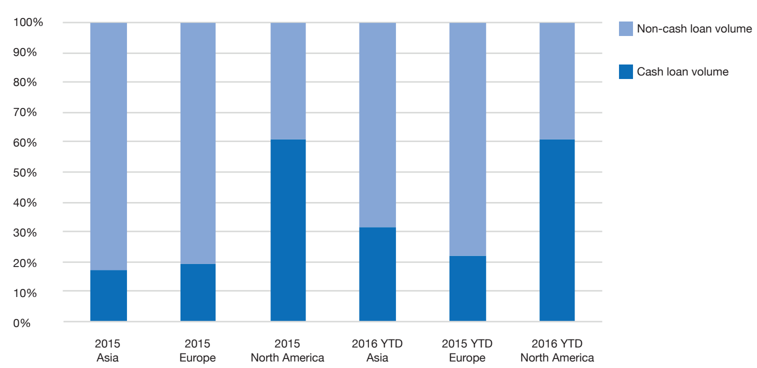
There are also the considerations around reinvestment strategies, which can vary hugely from lender to lender. You will always have a subset of beneficial owners that are able to accept they're in long positions with the securities and therefore can accept some more risk and fluctuation in their asset's value in order to get lending fees.

However, the majority will always shy away from taking on more risk as much as they can through what is ultimately a secondary revenue stream. **SLT**

> The majority will always shy away from taking on more risk

Glenn Horner
Chief regulatory officer
State Street





Source: FIS Astec Analytics

Mark on the market

OCC chairman and CEO Craig Donohue reveals how the central clearer aims to evolve from an important market utility to a market influencer

OCC has made several senior appointments this year, including your decision to stay on. Should we expect more hires this year and how does this fit into OCC's wider strategy going forward?

As chairman and CEO I must make sure we have the right people in the right roles to drive improved execution across our company so that we continue to serve market participants and the greater public interest. The enhancements to our leadership structure that were announced in September reflect that effort, and demonstrate our organisational agility and deep bench strength of talent. What I told our colleagues when we made this announcement was that this is a continuation of a process.

As stewards for the listed options industry, we will continue to evaluate our leadership team to make sure we have the right people in the right roles as OCC continues to implement its wider strategy and evolve from a market utility to a market influencer.

OCC's monthly data highlights that its securities lending volumes have grown significantly at a time when other clearinghouses have missed their targets. How do you explain this success?

OCC is focused on creating capital efficiencies for market participants. We saw early on the impact of the US Dodd-Frank Act and Basel III and the prospect of enhanced stock loan efficiency, and that the demand for capital and balance sheet efficiencies would fuel migration to a cleared stock loan solution. We have been actively engaged with agent lenders and their beneficial owners, and we have gained a comprehensive understanding of the operational and risk management requirements of all securities lending participants. We are making progress on our business model as well as the regulatory, technology and operational framework needed to support increased uptake of our clearing solution.

As a result, we are seeing strong engagement with borrowers and lenders, and the arrival of more restrictive capital and regulatory requirements has led us to expand the scope and scale of our clearing services to keep up with rising demand. Our strong foundation in operational and risk management capabilities is reflected in the 5,000-plus loans processed daily and approximately $130 billion in risk-managed open loans.

What should the industry expect from OCC going forward for the rest of 2016 and into 2017?

Our value proposition is evolving to focus on risk management and the delivery of capital and collateral efficiency. We will continue to develop risk management tools and processes to optimise the use of capital and collateral. We also will continue to serve as an industry advocate, as market participants are facing a changing regulatory and tax landscape that will increase the amount of capital they need to hold, increase compliance costs, and add to their tax burden. At the same time, OCC is maturing in its role as a systemically important financial market utility (SIFMU), which affects the amount of capital it is required to hold and the demand for investment in compliance and risk and control functions.

Specifically for stock loan, expanding our centrally cleared model for securities lending remains a high priority for us. We continue to work with an industry coalition to refine our collateral model to allow for expanded participation in our clearing solution and we continue to build the processing and operational framework that the market needs so we can have the technological, risk management and regulatory framework to support it.

OCC has committed itself to engaging with regulators for the benefit of the wider industry. What successes have you had in this regard and which areas still require more negotiations?

We have embraced our role as an advocate for the US listed options industry. Our efforts to ensure that OCC is recognised as a qualifying central counterparty (CCP) under the European Market Infrastructure Regulation are ongoing. Like other US CCPs, this recognition will have significant positive impacts on the capital treatment of exposures to OCC held by European bank-affiliated clearing members and other market participants subject to Basel III capital regulation in Europe. Our unique regulatory oversight regime requires OCC to actively work with the US Securities and Exchange Commission, the US Commodity Futures Trading Commission, the European Commission, and the European Securities Market Association, to achieve this goal.

Our efforts on the international regulatory and policy front extend beyond seeking CCP status. We have participated in international discussions and consultations emanating from the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (IOSCO) related to the Principles for Financial Market Infrastructures (PFMIs) that OCC must follow as a SIFMU. The issues presented by the PFMIs range from cyber security to governance to recovery and resolution.

We also are advancing our leadership role in Washington DC. In partnership with the US Securities Markets Coalition, OCC educated members of Congress and the US Department of Labor about the potential adverse consequences that a proposed fiduciary rule would have on individual investors who use exchange-listed options to manage financial risk in their retirement accounts. We were successful in having listed options excluded from the proposal. OCC is also continuing its advocacy efforts with the coalition and others in the industry on various tax initiatives and bank capital rules that, if implemented, would adversely affect the US equities options markets.

Would you share with us your thoughts on the impact of regulation on the listed options industry?

Centrally cleared, exchange-traded derivatives markets have flourished over the last several decades. Under substantial regulation at all critical points in the ecosystem, these markets have proved time and again to be resilient in times of market stress, most recently during the 2008 financial crisis. Following that crisis, global policy makers borrowed from the key tenets of centrally cleared, exchange-traded markets in mandating regulatory reform of the OTC derivatives markets.

Today, ironically, international policymakers are commencing efforts to revise the regulatory framework for CCPs such as OCC, in the form of 'further guidance' issued by IOSCO. The unintended adverse consequences of such actions of overly prescriptive regulations on CCPs and exorbitant capital requirements for banks and bank affiliates relative to the risk posed by listed US equity will be seen in terms of increased systemic risk and disruption to the continued use of critically important financial markets. My thought is that regulators should pause in rewriting the rules governing CCPs, engage in a holistic assessment of the regulatory landscape for cleared, exchange-traded markets, and perform a comprehensive cost/benefit analysis.

I am not advocating for de-regulation of these markets, rather, I am advocating for smarter regulation. Supporting the continued use of transparent and resilient derivatives markets like those cleared by OCC through a smart and proven regulatory framework is exactly what global policy makers sought to do after the 2008 financial crisis. As an industry we should be vigilant to ensure that global policymakers do not compound the error and snatch defeat from the jaws of victory.

Since the start of the year the market environment has evolved as more regulatory requirements are confirmed and the Federal Reserve continues to flirt with a rate hike. What sort of market environment is OCC expecting in the coming months and how is OCC preparing for it?

As the foundation for secure markets, we recognise that markets move for many different reasons and respond to different catalysts. At OCC, our job is to ensure that we process transactions flawlessly and provide efficient and efficient risk management for market participants. We work hard to ensure that our systems are reliable and scalable to manage processing levels under extreme market conditions. Beyond that, we maintain a comprehensive financial safeguard package that allows market participants to act with confidence.

Finally, you have been outspoken recently on the issue of gender and pay equality. Why?

I have a wife, who was a trader and money manager, and two daughters, so when I reflect on the equality challenges they face today, I see the glass as half full. In the US, we have experienced significant progress on civil rights, gender equality, and more recently, the beginning of broader acceptance of the notion of equality for the LGBT community, including gay marriage. However, when I talk with my daughters about what is possible for them, I see how much more needs to be done and my responsibility and opportunity to further advance gender and pay equality in the workplace.

I don't know if I have the roadmap for how we accelerate and achieve true gender and pay equality in the workplace but there are several key ingredients for me. First, we must make an affirmative commitment to ensure more boards and management teams have highly qualified women as executives. For too many companies this is not yet an imperative and that has to change.

Second, companies must be willing to provide woman executives with a greater ability to balance and meet competing demands. This may mean creative solutions that allow for part-time leadership roles, job-sharing or simply work anywhere policies that help keep talented women in the workplace. And third, we must find ways to facilitate re-entry of women who have opted to spend more time with their children and subsequently wish to return to their careers. We must work harder at providing these opportunities, both so we can take advantage of their talent and experience that many women accumulate over the course of their careers but also so we can send the message that you can leave and come back. **SLT**

A vital resource

Morgan Stanley's Thomas Wipf explains how the bank has adapted to the new market environment without compromising its identity

You have been with Morgan Stanley's financing business ever since you joined in 1986. What would you say are some of the biggest changes you have seen in the industry?

Securities financing businesses have proven over time to be extremely flexible and adaptable to an ever-evolving environment. The ability for these activities to keep pace with and often lead change in the broader markets is a reflection of the significant role that these activities play in providing key resources and capacity across the capital markets.

It has been events such as the RMA Conference on Securities Lending that have provided market participants opportunities over many years to adapt business models to best advance and evolve these critical funding and financing activities.

As the lifeblood of the securities markets, it is imperative that market participants consider the changes that could affect these key channels.

How would you describe the current mood of the market?

We have observed a wide disparity of reactions to the current ecosystem of regulation. As the industry moves from theory to implementation on many of the enhancements to liquidity and capital regulations, the only productive outcome is to understand the challenges, address the action plans, and work to replace and create capacity for our clients within the framework.

Without a centralised structure across financing and collateral activities, firms will struggle to address the issues effectively. Organisational silos present the biggest impediment to optimisation under the new regulatory framework. So we think that those firms that have been able to centralise will have a more productive view of the road ahead, while those dealing with structural inefficiencies will have a dimmer perspective on the future.

With regulators imposing new rules and capital requirements, how has Morgan Stanley changed its approach to the market?

Having organised our financing and collateral businesses in a central framework, we find ourselves in a position to work collaboratively with our clients to navigate the new environment in securities financing. Post-crisis regulatory change is a fact of life. We have a responsibility to our clients to diligently optimise across all the new regulations. That will position us to provide exceptional approaches to assist our clients in not only understanding the implications to intermediaries, but to put forth a broader view of the future landscape. Our goal is to replace lost capacity and to create new capacity for our clients within the goals and spirit of the new regulations.

The Securities Financing Transactions Regulation is due soon. What are the main challenges firms are facing?

Further transparency is a critical step in the road ahead. Achieving a level of transparency that can create positive enhancements to market structure should be the goal. Clients, investors and intermediaries can only benefit from a clear market schematic.

You brought together fixed income and equities financing. How has this benefitted the bank and your clients?

Combining our equity and fixed income asset classes in securities lending and repo was only the first step in a much broader consolidation. Since 2007, our efforts to centralise our securities lending and secured financing activities under one structure have created the blueprint for even further consolidation.

Over the last seven years, we have centralised all collateral management, securities lending, client repo, secured funding, derivatives hedging and several other federal activities under the umbrella of our bank resource management group.

Morgan Stanley is a clearing member of Eurex Clearing's Lending CCP. How has this progressed?

We are extremely pleased with this important collaboration with Eurex on securities finance transaction clearing. Eurex Clearing has clearly demonstrated proof of concept for buy-side clearing of securities finance transactions.

We have grown cleared balances meaningfully since the inaugural launch and look forward to broader volume increases as new members come online.

Having seen the benefits of clearing across many other products, we believe that clearing for securities finance transactions represents a fundamental change in navigating new regulations, while creating new capacity for our clients. A clearing model that allows us to preserve our current execution model with clients while enjoying the many benefits of central counterparties (CCPs) is a major development for all market participants.

Morgan Stanley has, and will continue to, pursue all avenues that can serve to benefit our financing clients. We have established a leadership position across a number of CCP solutions in Europe, the Middle East and Africa, the US, Japan, and the Asia Pacific. Although we see many opportunities to replenish capacity through more tactical optimisation, the bulk of opportunity relies on the development of CCPs for securities finance transactions across all asset classes and regions. We are committed to this effort and there are several other models that are nearing the point of roll out.

What can you share about future plans?

As we move through the final implantation phases of new regulation, we look forward to working with our clients in implementing financing strategies that will create optimal outcomes within the current regulatory ecosystem. We will work collaboratively with our clients and industry stakeholders to develop and implement solutions that can optimise across the regulatory framework, while operating within the boundaries and the spirit of new liquidity rules.

This environment presents challenges and tremendous opportunities to differentiate for our clients and continue to evolve our financing and collateral activities. **SLT**

Thomas Wipf
Global head of bank resource management
Morgan Stanley

Cash worries

Owen Nichols, managing director at State Street Global Advisors, is moderating the Money Market Reform and the Impact on Cash panel discussion. He reveals what beneficial owners need to know ahead of the 14 October compliance deadline

Money market reform has long been mooted, and much maligned. What's coming into force on 14 October, and how will securities finance be most directly affected?

The reform has a number of requirements. While the additional disclosures and stress and diversification testing represent significant change for the industry, I believe it is the floating NAV, liquidity fees and redemption gates that have severely limited the attractiveness of prime institutional money market funds as a fit for collateral reinvestment.

The floating NAV introduces additional operational challenges and disclosures for lenders and the ability of a money market fund's trustees to implement a gate is severely limited given that borrowers can return loans at will. There has certainly been plenty of time to prepare for these changes and I believe lenders have successfully adjusted their lending programmes well ahead of the reform's effective date.

What will this reform do to operating conditions? Do you expect to see a flight to quality, such as government securities?

What we've observed is more asset managers moving to US government money market funds. As these clients most often just loan specials, the impact on returns was relatively limited. However, there are still a good number of asset managers that see value in general collateral loans and are seeking an investment product with yield adequate to consistently fund these trades. Obviously, as so much cash has migrated from prime to government money market funds and credit spreads have widened this year, these general collateral trades are far more lucrative than they've been in many years past and lenders have taken notice. Among asset owners, generally they've been invested in unregistered investment products or separately managed accounts rather than money market funds and other than benefiting from increased reinvestment spreads, have been little affected by these reforms.

When and where do agent lenders fit into this? How will they have to manage their beneficial owners' portfolios, bearing in mind already implemented liquidity requirements?

Agent lenders have been working closely with lenders since the reforms were finalised to explain programme structure options and estimate the approximate returns associated with each. Additionally, agents have been focused on expanding non-cash collateral sets for lenders and slightly revising reinvestment guidelines where appropriate. Agents assist lenders in setting liquidity requirements for separately managed accounts that reflect both current market dynamics and the specific lendable asset mix for their client's portfolio.

We believe that agents with in-house investment managers are best positioned to set and continuously refine these requirements given the integration between their firm's traders, cash managers, and risk professionals.

What do you want RMA attendees to take away from your panel? How should they go about their business once this reform is in effect?

Ideally, the panel discussion will increase attendees' understanding of the challenges associated with utilising an institutional prime money market fund for collateral reinvestment and highlight how lenders have responded to the reform. Our hope is that the panel also illustrates that reinvestment options continue to evolve and that lenders with broader guidelines and more expansive non-cash collateral sets will benefit from additional loan activity. **SLT**









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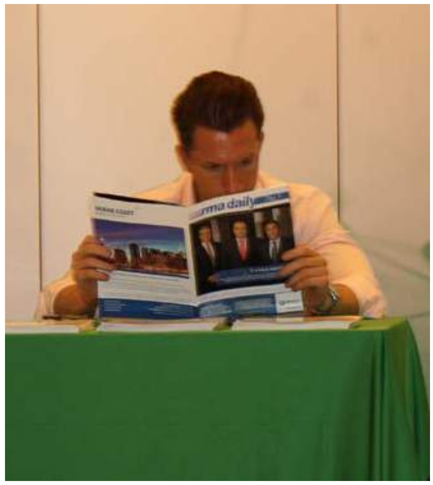
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Agenda **Day 2**

7:30 to 8:45

Buffet Breakfast — Sponsored by: Scotiabank

8:45 to 9:00

Welcome Remarks
Michael Kelleher, Co-Chair, J.P. Morgan
Patrick Morrissey, Co-Chair, Vanguard

9:00 to 9:45

Money Market Reform and the Impact on Cash

This October, money market reform—including floating rate NAV, gates, and fees—will be implemented. How will this impact the yield curve and liquidity, and will the industry trend towards separately managed accounts? What will agent lender's resulting product mix be for their clients? How will this affect the amount of liquidity in cash reinvestment pools, and what will be the capital at risk for borrowers?

Moderator: Owen Nichols, Managing Director, State Street Global Advisors

Panellists:
Robert Fort Jr, Managing Director, BNY Mellon
Thomas Poppey, Senior Vice President, Brown Brothers Harriman & Co
Robert Reardon Jr, Executive Director, Morgan Stanley
John Tobin, Managing Director and Global Head of Liquidity Portfolio Management, J.P. Morgan Asset Management

9:45 to 10:30

Cash vs Non-Cash Collateral Discussion

Regulation is giving way to new methods of collateralizing trades. So where is this market headed? Learn about the rise of other noncash collateral, such as ETFs, and what a portfolio of collateral will look like in the future. How will it work operationally and what are areas of inefficiency and current industry needs that should be addressed? What are some of the impacts on capital and risk as the market settles, what about capital gains moving from fixed income to floating, and how does this move affect other asset classes?

Moderator: Frederick Nadd-Aubert, Managing Director, Credit Suisse

Panellists:
Brendan Cusick, Managing Director, UBS
Duncan Foster, Executive Director, Morgan Stanley
Glenn Horner, Managing Director & Chief Regulatory Officer, State Street
Patricia Hostin, Director, BlackRock

10:30 to 11:00

Coffee Break with the Exhibitors

Co-sponsored by:
BNP Paribas
Brown Brothers Harriman & Co
Deutsche Bank Securities
Natixis
OCC
Pleeco
Transcend Street Solutions

11:00 to 12:00

Keynote Speaker

Anthony Scaramucci, Founder and Co-Managing Partner, SkyBridge Capital

12:00 to 1:00

Fixed Income Markets and Global Liquidity

Fed interest rate policy, regulations, money market reform, and geopolitical risks have affected the structure of repo, treasuries, and the overall fixed income market? What impact have these factors had on the supply and demand for liquidity? What does this mean for central banks and their ability to transmit monetary policy? How will this affect global liquidity?

Moderator: Alexander Blanchard, Head of US Repo, Goldman Sachs & Co

Panellists:
Gene Meshechek, Global Head of Fixed Income, BlackRock
Patrick O'Callaghan, Vice President, Goldman Sachs Asset Management
Jarrod Polseno, Managing Director, State Street
John Schwartz, Executive Director, J.P. Morgan
Mark Wendland, Head of Global Fixed Income Finance, Citadel

1:30 to 4:30

Tennis Tournament
Sponsored by: IHS Markit

5:30 to 7:30

RBC Reception
Sponsored by: RBC