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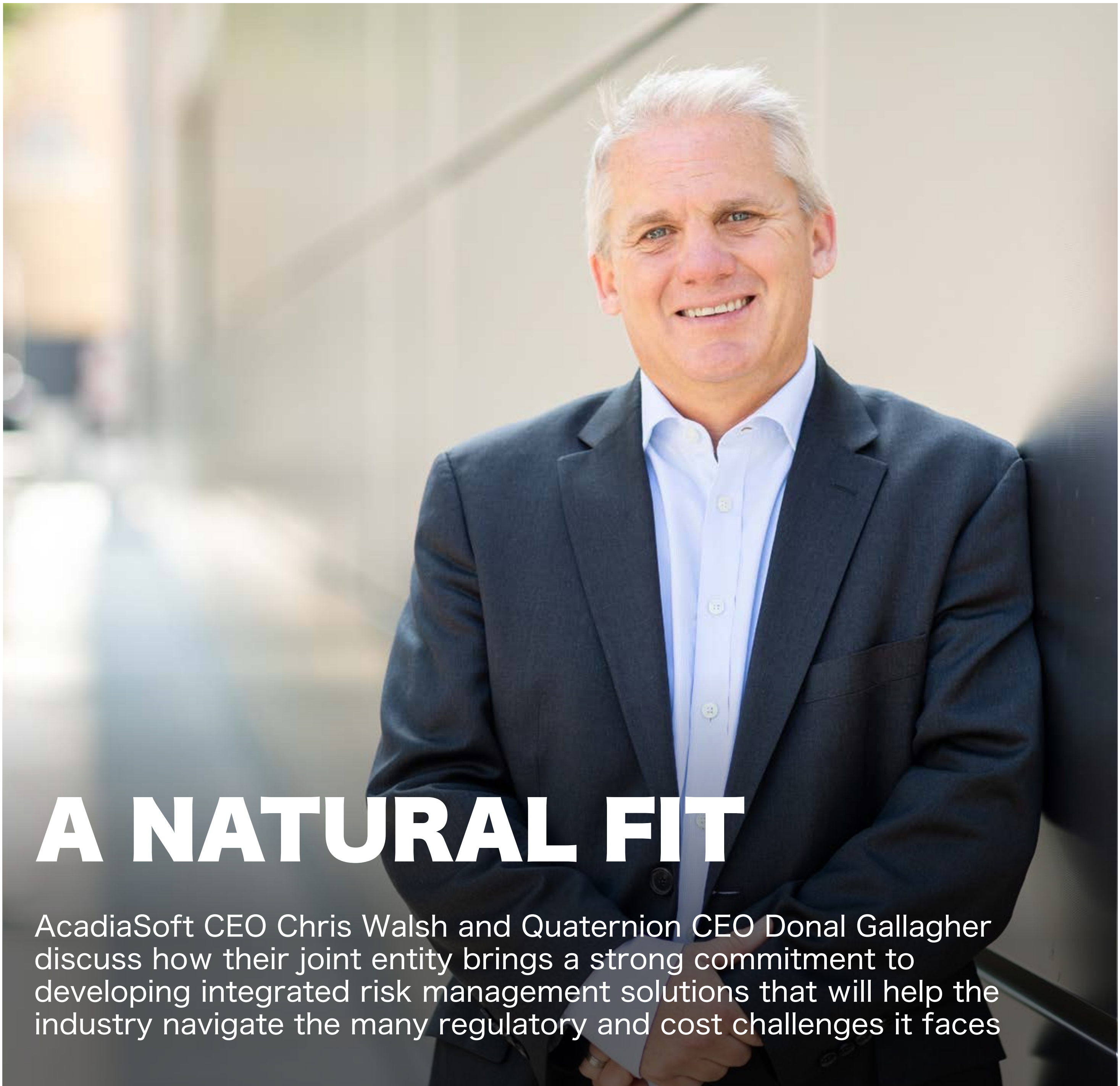

A NATURAL FIT

AcadiaSoft CEO Chris Walsh and Quaternion CEO Donal Gallagher discuss how their joint entity brings a strong commitment to developing integrated risk management solutions that will help the industry navigate the many regulatory and cost challenges it faces

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Eurex Lending CCP to close

Eurex Clearing has confirmed plans to wind down its European securities lending clearing business by March due to insufficient volumes and unstable projected market interest amid resource draining regulations and a challenging market environment.

The closure means there will be no venue to clear securities lending transactions in Europe from Q2.

The Lending CCP was formed in 2013 by the Deutsche Boerse subsidiary and covers global fixed-income securities, equities and exchange-traded funds in Europe.

Among other benefits, it promised yield enhancement while reducing credit, counterparty and other risks.

Clearinghouses also offer the benefit of providing a single counterparty for all trades which alleviates the need to maintain numerous bilateral agreements, a task too burdensome for many buy-side members.

At its launch, the Lending CCP was welcomed by market participants and forged connections with several service providers including EquiLend and Pirum Systems. It also gained interest from the borrower community but struggled to win over lenders, with some notable exceptions including BNY Mellon and Morgan Stanley.

Despite many successes and developments to the offering, by 2020 lingering concerns with the value proposition, including high costs and a complex onboarding process, caused Eurex board members to reallocate resources to other repo products within its funding and financing segment.

SFT understands that Eurex spent most of last year communicating with clients that the securities lending CCP could close if prospects didn't improve as business costs out-weighted projected returns.

Alongside the challenges of convincing buy-side firms to clear securities lending trades in the same way many already do for their repo activities, Eurex has cited external hurdles including new regulations, Brexit and the COVID-19 pandemic as driving down CCP adoption on the priority lists of potential clients.

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Inside this issue

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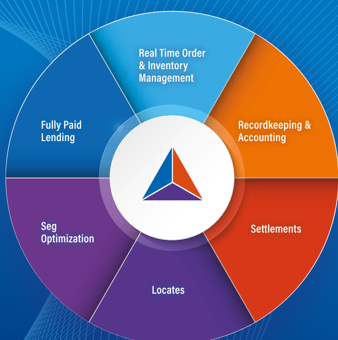

Eurex Lending CCP to close

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The significant demands of re-platforming the CCP to the Eurex Clearing's C7 engine added internal pressures.

Matthias Graulich, a member of the executive board at Eurex and chief strategy officer, tells SFT that although there was broad support for the service the timing was not right and trading volume had not hit "levels necessary to keep the business afloat".

Graulich says there may be greater demand to clear securities lending trades in the future but was unlikely to be in the near term.

Accordingly, stakeholders were informed in December of the board's decision to discontinue the securing lending CCP.

Eurex's counterparts that manage the pipes funnelling trades to the CCP are working to unwind positions in an orderly fashion.

Pirum Systems, which operates the CCP Gateway, states it is working with all parties to ensure a "seamless close-out" of open positions by 31 March.

Eurex is now understood to be focused on its numerous products centred on the more mature repo market, which is more aligned to a CCP model.

Eurex Repo's markets are by contrast thriving, recording a double-digit percentage growth in 2020 trading volumes compared to the year before.

The cleared repo market is expected to grow in both Europe and the US where stakeholders are pointing to the success of the Fixed Income Clearing Corporation's sponsored repo programme which has bloomed in recent years and saw a significant spike in usage during the 2020 Q2 volatility.

Cum-ex suspect joins Interpol's 'most wanted' list

Cum-ex suspect Paul Mora has become one of Europe's most wanted fugitives after refusing to travel to Germany from New Zealand to face tax fraud charges linked to €113 million in suspected illegal withholding tax claims.

Mora has been sought by German authorities since 2017 concerning an alleged cum-ex trading framework devised and executed during his time at HypoVereinsbank (now part of UniCredit) in London between 2006 and 2008.

He has consistently denied any wrongdoing and argues any dividend arbitrage activities were not explicitly outlawed in Germany and were supported by legal opinions.

Mora, a Kiwi native, was meant to face charges around the same time as two former colleagues that appeared in a Bonn court last year but said he was unable to travel to Europe due to the COVID-19 pandemic, a defence he has maintained since.

The Wiesbaden Regional Court has since admitted Mora to the prosecutor's office in Frankfurt am Main, where an arrest warrant was filed against him for "particularly serious tax evasion" and a public manhunt initiated.

After the latest attempt to bring Mora to Europe failed, German authorities escalated the matter to Europol, the EU's law enforcement agency, which has now issued a red notice and added him to its list of 'Europe's most wanted fugitives'.

The International Criminal Police Organization

(Interpol) has simultaneously issued a red notice for Mora related to tax fraud charges.

A red notice is an international wanted person notice, not an arrest warrant and Interpol cannot force New Zealand's law enforcement authorities to arrest Mora.

The EU and New Zealand also do not have an extradition agreement in place.

Europol stated in its listing that there is "probable cause" Mora, in his capacity as the bank's division head, "planned and executed cum-ex transactions" resulting in a refund of the withholding tax on capital investments worth more than €113 million, "even though no corresponding tax had actually been withheld".

Europol adds that Mora allegedly concealed the true background of the transactions with the help of a deception system

South Korea to introduce securities lending to retail market

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 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 unknown if retail traders can lend directly.

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 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".

The regulator acknowledges concerns exist about the risks of granting more short selling opportunities to retail investors and emphasises "a balanced approach is needed between retail investors' demand for more opportunities and ensuring investor protection".

To this end, the FSC will gradually allow retail investors to engage in short-selling according to their individual experience and capabilities.

Retail investors must complete a pre-investment education programme, which emphasises the risks and characteristics of short selling, as well as a mock investment trial that showcases the real short selling stages and process.

There will be investment caps on retail investors to prevent "excessive losses" until they become more experienced, the KSC says.

For beginners, a maximum cap for short orders will be set at KRW 30 million (USD 26,722).

For those with more than five times the short selling investment experience over the recent two years with the accumulated amount of securities borrowing of KRW 50 million (USD 44,539) or more, the cap will be KRW 70 million (USD 62,355).

For professional investors, or those with more than two years of short-selling experience, there will be no investment limit.

These limits are adjustable depending on future circumstances and risk factors, the exchange adds.

Between now and May, the FSC says it will closely track the preparedness of different market participants.

The FSC is currently operating a task force on improving the short selling system, which is due to present its findings to the National Policy Committee of the National Assembly in February and April.

DNB to leverage Trading Apps securities finance solution

Trading Apps has secured Norway's largest financial services group DNB as its newest client.

DNB will be using Trading Apps' full front-end software to "further enhance" its securities finance capabilities, the UK-based fintech says.

"Our platform will enable them [DNB] to increase efficiencies through automation and provide them with actionable insights to their customers' behaviours. We are proud to be helping DNB to achieve their business goals," Trading Apps says in a statement.

Trading Apps has begun a new phase under the leadership of Laura Allen and last year welcomed several senior hires including Carol Kemm who joined as a consultant director in May 2020.

Allen recently spoke to SFT to outline her vision for the fintech firm including a new product 'TA Link' — a specialised global secure messaging network providing an alternative method of communication for the securities finance market. The software-as-a-service venue aims to allow peer-to-peer encrypted communication through the Amazon Web Services cloud platform.

After GameStop, don't shut-out day traders, says ISLA's CEO

The apparent rise of retail investors flexing their financial muscles is an opportunity to promote democratisation, education and trust between individuals, institutional market participants and politicians, says International Securities Lending Association (ISLA) CEO Andrew Dyson.

In his latest blog post, Dyson explains that, despite the thorny due diligence question of where a broker or regulator should draw the line in maintaining market stability and protecting amateur investors from themselves or abuse, regulators should not try to put the genie back in the bottle.

Dyson says suggestions that retail investors should be barred from leveraging more complex products "may appear expedient from a political perspective" but are "fundamentally flawed".

This is because it risks creating "further divisions between the traditional financial markets 'elite' and their counterparts, and the new populist day traders".

"Part of opening-up of markets to retail investors must include a commitment from regulators and politicians to empower its citizens through the development of greater financial fluency, in the form of better education that will build the trust that is needed for these markets to reach their full potential," he states.

Moreover, anecdotal evidence of investors losing their life savings as the share price plunged back to 2020 levels further "highlights the importance of advocating for such broader education".

Greater and more direct action from retail investors is here to stay, Dyson concludes, advising that it is therefore "crucial that these [market] changes are embraced".


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Korea extends short ban

South Korea's Financial Services Commission has extended its short selling ban that was due to expire in March until May again amid pressure from politicians and retail market participants to curb bearish trading.

From 2 May, short selling may resume on KOSPI 200 and KOSDAQ 150 stocks.

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ICMA calls for CSDR reforms

The International Capital Market Association is using the Central Securities Depositories Regulation consultation to reiterate its calls for the mandatory buy-in element of the settlement discipline regime to be scrapped.

The association argues that buy-ins, whether regulatory or contractual, should be discretionary and not mandatory.

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Clearstream and Eurex target enhanced repo netting capabilities

Clearstream and Eurex say they have made several enhancements in their trading, clearing and settlement infrastructure and processes to enable repo traders to achieve balance sheet netting and benefit from the highly-liquid and flexible GC Pooling triparty repo market.

They laid out their progress in tackling the challenge of netting in a recent white paper

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SFDR: Draft RTS published

The joint committee of three European Supervisory Authorities (ESAs) has submitted its final report to the European Commission, including draft regulatory technical standards (RTS) for the Sustainable Finance Disclosure Regulation, ahead of the 10 March implementation date.

The regulation aim to strengthen protection for end-investors by improving environmental, social and governance disclosures to end-investors.

Read full article online

Ample IPOs should drive revenue in 2021, says Northern Trust

The slew of initial public offerings (IPOs) could mean a vintage year for lending revenue, says Northern Trust's Mark Coker.

Looking back, Coker said that although there were very few IPOs in the first half of 2020, as equity markets improved in the second half of the year some IPOs of firms in sectors that thrive in the remote working environment flourished, a trend he expects to continue in 2021.

Read full article online

GameStop was January's biggest earner

The high-profile "short-squeeze fireworks" centred on so-called 'meme stocks' favoured by retail investors last month made January the most-revenue-generating month for US equity finance on record, says IHS Markit.

US equity revenues came in at $453 million for January, a 75 per cent year-on-year (YoY) increase, and an 11 per cent increase relative to December, explains IHS Markit securities finance analyst Sam Pierson.

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A natural fit

Natalie Turner reports

AcadiaSoft CEO Chris Walsh and Quaternion CEO Donal Gallagher discuss how their new joint entity brings a strong commitment to developing integrated risk management solutions that will help the industry navigate the many regulatory and cost challenges it faces

What does the acquisition of Quaternion mean for Acadiasoft's clients?

Walsh: For AcadiaSoft clients, the Quaternion acquisition is mostly driven by the Uncleared Margin Rules (UMR), which entered the market in 2016. With phase five going live in September of this year, we are now seeing the impact on the buy-side. It requires our clients to transform in another way and calculate risk under new regulations. To do this, they need competencies that they haven't had to invest in previously.

Our partnership with Quaternion reduces the burden on clients by delivering a risk solution that calculates their risk sensitivities and ultimately enables them to submit initial margin to their counterparties. We also realised our clients need a greater level of expertise and additional services. The more we saw this, the more we realised that including quantitative capabilities would be critical for our clients in the long-term. Once they have calculated risk, they need to start optimising it, so they are going to need these new competencies. The only way we could see ourselves providing that service was by moving beyond the partnership with Quaternion and joining together.

AcadiaSoft stated that the deal will bring "significant depth" to its risk product offerings, could you please elaborate on this?

Gallagher: The founders of Quaternion have been in risk management for over 20 years. We established Quaternion in 2010, working across the full range of risk, market risk, and counterparty credit risk. We initially started with the European banks and we quickly found ourselves working with the tier-one banks globally in their core market risk and counterparty credit risk. We rode that wave through all the regulatory changes that have come through in the past decade. From UMR and the changes in CSAs, CBAs, credit evaluation adjustment, to the interbank offered rate (IBOR) transition going on now, you name it, we have been working on it with our clients and developing software solutions.

Our strategy is unique in that we released the core risk engine, which does most of these things as an open-source project, as well as an open-source library on which you can run a small-to-medium-sized bank. You could run an entire industry by providing core risk calculations for capital and risk management. That's really why we joined the AcadiaSoft family – we can combine the strengths and depth of Quaternion's experience and our intellectual property, together with the technology capabilities, distribution, information security and client reach of AcadiaSoft. There's very little we can't do in terms of addressing the global market.

What have you achieved so far through your partnership?

Gallagher: What we have done so far in our partnership with AcadiaSoft is focus on UMR and UMR compliance; so we do the difficult task of back-testing which is a big challenge for many firms. Now that we have accumulated that resource, which is the golden data, and market data source, the open risk engine and proprietary risk engine, we are moving onto the core elements of risk capital. This includes things like the capital calculation, the SA-CCR or the standard approach to credit risk; all of the market risk measures and risk valuation. So we have an ability and can offer risk as a central service to the industry. That takes something very bespoke and specific to each institution and therefore costly, and centralises it so we can offer it as a service to the industry, which saves a huge amount of time and cost and is a real benefit to the industry overall.

Walsh: We're offering risk as a central service to the entire industry. There are immediate services that will be coming out following the acquisition. A service will be coming out that will provide a mark-to-market variation margin calculation. Another service coming later this year will focus on CSA valuations, which will help gauge the economic impact when firms need to negotiate CSAs by helping clients estimate and calculate the financial impact of CSA changes when they go through the negotiation process.

The biggest achievement is the significant adoption of AcadiaSoft's initial margin (IM) solutions for phase five clients that will go live

> ***There are several things that we are doing here, the number one being to make our capabilities available to all market participants going forward***

Chris Walsh
CEO
AcadiaSoft

in September of this year, more than half of which are using AcadiaSoft/Quaternion calculation services. We have around 120 clients using AcadiaSoft's IM services. At least half of them are leveraging the calculation services that we put together with Quaternion. First and foremost, we have been able to help the market prepare for phase five together, and that's what led to the position we are in right now. We have also been able to support clients with back-testing and validation for their calculations and offer that as a service. This has been really popular with clients and they loved the fact that we were able to offer capabilities that they didn't have before thanks to the partnership. It then became a natural transition for us to take the next step forward in the relationship, which led to the acquisition.

What's the timeline for internalisation?

Walsh: We have been working together for the past three years and we have developed an integrated platform jointly from the start, so the technical integration is complete. Right now, we are focused on our client needs and how we can help clients in an organised and integrated way. Those steps, such as integrating sales, and ensuring that we continue to provide a common service to our clients will be completed by the first quarter of this year.

The next step will be integrating the business. We are going to take the time to do this the right way, which will involve bringing people together in person once we return to business as usual.

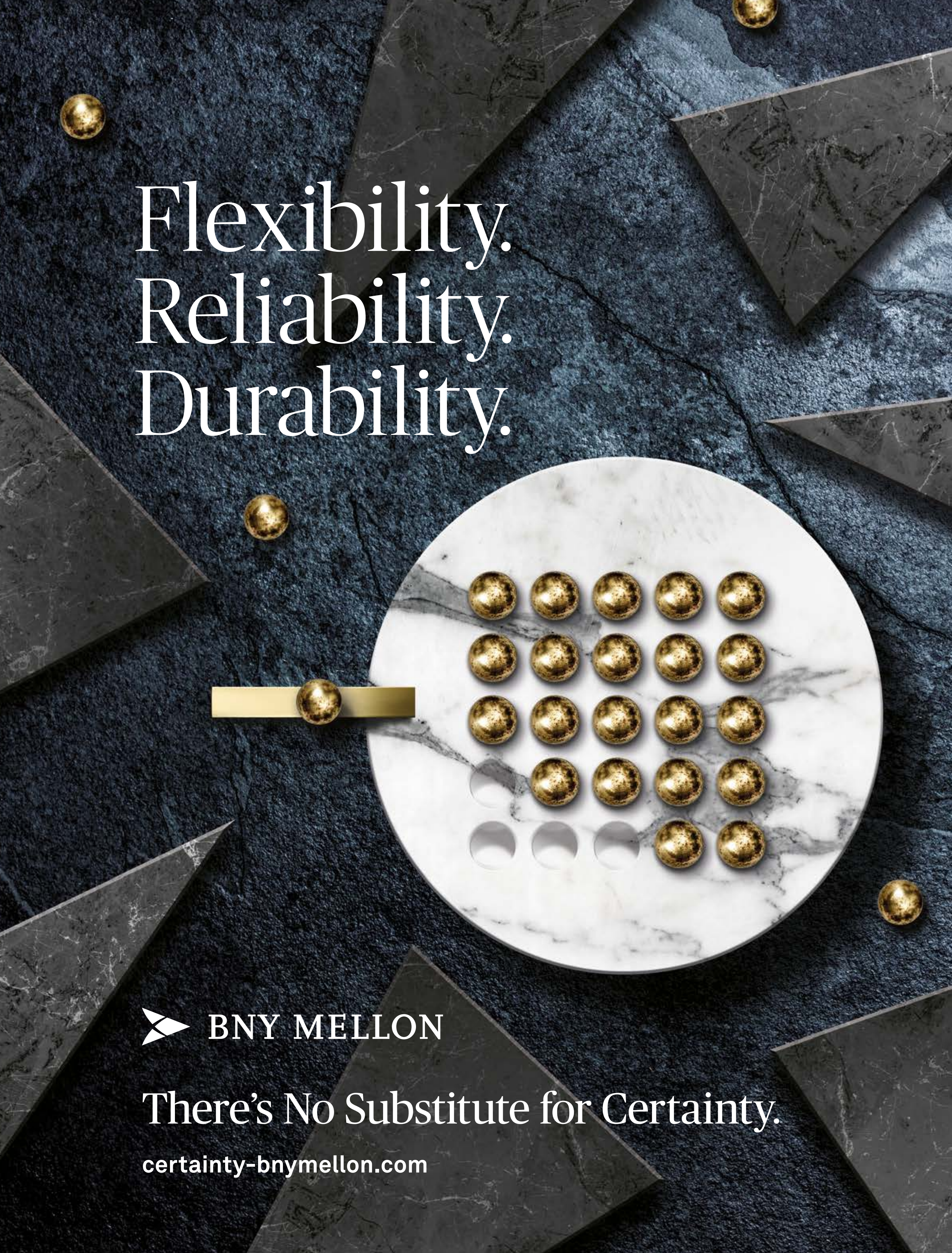
Walsh: There was a lot of rescuing of firms following the crisis, but what's shifted now is that we aren't talking about rescuing anymore, it's now about preventing it from ever happening again. I think embedding it in the infrastructure of the industry is the best way to ensure it doesn't happen again and that's what we are doing.

Can you share any more details your plans?

Walsh: We are embedding risk management into the infrastructure of the industry. We're making ORE capabilities available as a service to all market participants. As we start bringing central calculations out to the markets – offering services to allow counterparties to prevent disputes from occurring across the market – we can leverage the calculation that underlines it to eliminate the disputes that surround the derivatives markets today.

> ***What we have done so far in our partnership with AcadiaSoft is focus on UMR and UMR compliance; so we do the difficult task of back-testing which is a big challenge for many firms***

Donal Gallagher
CEO
Quaternion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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

Panellists

Brian Leung
Regional trading head for APAC, agency securities lending, Deutsche Bank

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

David Lai
Product manager, agency securities lending, APAC, J.P. Morgan

Mark Snowdon
Head of capital markets, APAC, Northern Trust

Jansen Chua
Senior managing director and head of securities finance APAC, State Street Global Markets

Sunil Daswani
Global head of agency securities lending, Standard Chartered

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 have 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 were 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

Jansen Chua, senior managing director and
head of securities finance APAC,
State Street Global Markets

"Specials activity across the region was also unusually sparse in traditionally strong markets like Japan, Australia, Taiwan and Hong Kong"

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.

Simone Broadfield, APAC Head of Agency Securities Lending Trading, J.P. Morgan

"2020 offered lending participants a chance to demonstrate their abilities to adapt and evolve to unexpected market conditions"

Snowdon: Hong Kong has benefitted to some extent by 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.

Mark Snowdon,
head of capital markets,
APAC
Northern Trust

"Taiwan fared 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"

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 for 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,

Sunil Daswani,
global head of agency
securities lending,
Standard Chartered

"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 CSRC and in December the number was 26"

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,pthe 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

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

"Without a doubt, the Chinese securities lending market has an exciting trajectory ahead"

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 programs. 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 program.

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 the lookback of 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

Brian Leung, regional trading head for APAC, agency securities lending, Deutsche Bank

"ESG will drive appetite and sentiment for sustainability investors so one should expect more opportunities to lend and borrow in highly-rated ESG names"

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 Korea 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.

Supply and demand

Justin Lawson reports

Darren Crowther, general manager at Broadridge Securities Finance and Collateral Management, discusses his firm becoming an approved securities finance transaction submitter for the National Securities Clearing Corporation Equities Clearing Service

The market is aware of the new NSCC SFT Equity Clearing Service. What will be Broadridge's role as an approved SFT submitter?

The role is to provide a technology utility which brings together, compares, and matches trades from both the lender and borrower before submitting them to NSCC on behalf of both parties. We call this a 'Y' shape as the service model resembles the 'Y' with two inflows at the top feeding into one outflow. The reverse will be when the NSCC accepts the trade event and pushes it back up the flow to the lender and borrower which will be viewed on the Broadridge user interface (UI). The process involves not just the trades, but the required trade lifecycle changes that come in from the lenders and borrowers. These are again matched and pushed down to NSCC for communication and then repeat the same life cycle.

Why did Broadridge get involved and what do you bring to the market?

Broadridge has a history of providing market utilities like this. For example, it's part of the work we do today for the Consolidated Audit Trail for the US market. We have these matching data communication services already and we have a background in middle and back-office functions within the US market through the Impact and Brokerage Processing Services (BPS) products. These felt like a natural fit for our knowledge and services. We already have a large number of clients using a comparable service for the Fixed Income Clearing Corporation in repo and sponsored repo, and services on other cleared products where we do all the messaging protocols and data delivery.

Do you have interested participants already?

Absolutely. We are seeing a lot of demand coming from both lenders and borrowers. We have had a number of meetings and we have clients in different stages of discussion. We are ensuring we understand how it works for them, what their volumes look like, and what their connectivity activity will look like. There have been some really good discussions with clients across the lender and borrower community.

What type of organisations do you see using this utility and is there a different use-case based on size?

It's very supply and demand-oriented, so the supply needs to be there on the asset side. The agent lender and asset managers are definitely looking at this to get their supply out.

On the demand side, you have the broker-dealers and the banks who are looking to tap into the supply and get the ultimate capital reduction benefits. The firms are keen to make sure the supply is going to be there and they can access and transact it via clearing, ensuring they utilise that reduction.

The question about the different organisations' sizes is something we have had to think about and tailor our offering. Larger firms may look to have connectivity and messaging to transit the trade events. The small organisations who are doing a lower number of trades per day are okay with creating and moving spreadsheets directly in the UI. Our user experience and services need to cater for all.

In the end, everyone's trades will be compared, matched and submitted to NSCC as part of our role, but how those events get to us will vary depending on the different types of business models and how the market size will grow.

It's very supply and demand-oriented, so the supply needs to be there on the asset side. The agent lender and asset managers are definitely looking at this to get their supply out

We may also see organisations who are quite manual now but may move into more automation. That flexibility is part of the offering we are creating.

When can clients begin using this service?

The product is in the final approval stages with the regulator in the US. We are working with the Depository Trust and Clearing Corporation on the build and we will be starting this month with NSCC testing to make sure all the protocols are working. In April and May, we will then look to make it available to our clients at the top of the 'Y' service model so they can input their events either via UI or messaging.

When the full service is ready, we will offer end-to-end testing for clients.

This sounds like a great utility you will be offering, how are you feeling about it?

We are excited about this opportunity. We firmly believe we are the correct partner for firms in the marketplace for a utility of this type. We have a proven track record in delivering and running services of this type. The service will be key to our clients trading business and Broadridge's proven solution resiliency, modern technologies and understanding of the securities finance market makes us the perfect partner.

Global Funding & Financing Summit 2021

Drew Nicol reports

Deutsche Boerse's first virtual GFF Summit brought together securities finance professionals to discuss the state of the market in 2021

Panel one: To clear or not to clear?

Deutsche Boerse's discussion focused on the development of central counterparties (CCPs) and posed the question: to clear or not to clear? The panellists were unanimous in their answers: maybe.

Elaborating, speakers representing buy and sell-side market participants, explained that when asked whether to clear repo, factors including what type of transaction it is, what side of the street you're on, whether you're looking to give or receive cash and, crucially, the market environment and level of volatility at the time all played a part in how to answer the session's central question.

Taking the past 12 months, panellists noted that the decision to send repos through a CCP has fluctuated in lockstep with the market's volatility as overall liquidity and the economics of bilateral versus cleared trading shifted.

The growing volume of transactions put through CCPs such as Eurex has been a clear trend in recent years but the volatility seen in 2020 and particularly March and April offered an ideal case study for when the costs of a clearinghouse are worth it for netting efficiencies and security.

Eurex Repo saw term-adjusted volumes jump 10 per cent year-on-year in 2020, including a 39 per cent and 29 per cent YoY increase in GC Pooling and Repo markets in March, respectively.

The panel agreed that the benefits of clearing during market stresses are solid, but whether clearing repo will break out of the 'use in case of emergency' mould and build a use case for day-to-day activity was a key area of debate.

Setting the scene, the panel moderator acknowledged the modest but steady growth in cleared repo among the largest sell-side institutions in the US but went on to probe panellists on why the uptake for sponsored repo by buy-side members has not seen a significant uptake so far.

There is roughly $5 trillion in US treasury repo outstanding at any given time. In comparison, only $300 billion is cleared through sponsored repo, Inglis highlighted.

In response, sell-side panellists emphasised that sponsored repo was only one piece of the total repo market and has evolved in recent years.

In 2018, the panellist conceded, the Fixed Income Clearing Corporation's (FICC) US treasury repo clearing programme had limited activity. Since then the volume has grown between 10-15-fold due to key changes to the model, including expanding the membership.

The joining criteria for sponsored members and sponsoring members now includes all qualified institutional buyers instead of only registered investment companies. Expanded requirements for sponsoring members means the broker-dealer community have joined well-capitalised custody banks. Additionally, FICC adapted the programme from overnight to term and made it a two-way flow to allow repo and reverse repo.

According to a fellow sell-side panellist, this has led to more than 20 members providing sponsors today, up from only three in 2018.

The first speaker explained further how although the average notional volume might be $300 billion, during the COVID-19 volatility period in March and April 2020, the volume hit a high of $550 billion.

"Central clearing is in the toolkit to be utilised when needed," they explained. "When there was volatility in the market and a need for capacity you saw people accessing this programme."

The speaker added: "Buy-side clearing doesn't seem like it's at critical mass at this point but if you look at the evolution over the past couple of years you're seeing an increase which points to the fact this is becoming a tool both sell and buy-side are using to create efficiencies and for safety."

Reviewing the past year, another speaker reinforced the point that the market environment will impact the economics of cleared repo and will therefore drive demand.

"If you can buy treasury bills that offer higher yield than repo then you will. But we are now seeing repo start to overtake bills so we will see the market revert back," he explains.

However, a panellist representing a buy-side firm that does not clear repo offered a different perspective.

According to the speaker, their firm's abstention from clearing repo is due in part to the different economics depending on whether you're a cash giver or taker. The concept of clearing was created when cash was king, which is no longer the case.

"No one wants cash, it's persona non grata, you can't place it anywhere which is why money market and treasury funds are being pushed into clearing to gain access to counterparts," the speaker explained. "I'm sitting on the other side of that and paying for that leverage which is extremely cheap and available today, which you can see from the crunch that didn't happen at the end of 2020."

For as long as cash is so accessible it will be cheaper and easier to trade bilaterally, the speaker stated, but went on to acknowledge a future scenario where central bank cash is less available than today and her counterparts reduce their balance sheet availability, inverting the market dynamic.

"The economics must be considered on a case-by-case basis and I will only ever see clearing as part of my toolkit and not my defined route of trading," the panellist concluded.

Turning to the equity market, the moderator noted Eurex is building out its capabilities in this area, as is the Depository Trust and Clearing Corporation, and invited panellists to offer predictions of whether clearing of equities can match the growth in fixed income.

A speaker representing a major US bank said what he sees in the fixed income space makes him hopeful for equities, both in securities lending and repo products, as he believes in the merits. However, he also echoed the reservations, stating that the cost-benefit analysis for clearing equities is still not good enough for many of his clients.

"But, on the repo side I don't think we are there and there's a further evolution of the model that needs to happen for it to be one everyone can have access to."

A fourth speaker representing an asset manager that is currently onboarding with Eurex is more bullish. He explains, as a cash giver, that clearing short-dated repo is expected to be a structural part of how the firm runs its cash portfolio. More generally, the speaker said cleared volumes will benefit from increased standardisation in the market, such as with collateral baskets. Like the other panellists, the buy-side speaker implored CCPs to put every effort into minimising the paperwork needed to onboard and said streamlining this process will likely contribute to a volume uptick.

Apart from the CCPs themselves, panellists cited regulators and

> ***"During the March/April 2020 volatility regulators wanted to ensure there was safety, soundness, liquidity and resilience in the market and utilising the FICC repo programme resonates on all those points"***

"Those costs and the model are proving to be challenging right now. We are working through those but fundamentally that's a challenge," he said.

In addition, the panellist admitted to being worried that the journey to CCP adoption is still suboptimal in most cases.

"If I look at the hundreds of clients in my bank's agency lending programme and lay at their doorstep a stack of lending agreements, some will be comfortable with them but not all will be," he said. "To gain further adoption we need to ease the on-boarding process. We are working on it but it is still early days in this process."

Looking ahead, when questioned on where the clearing space may be in five years time, the buy-side panellist said she's confident derivatives, particularly those that contribute to gross notional for regulations such as the Uncleared Margin Rules, will increasingly be put through a CCP.

"It gives you the benefit of liquidity and access, as well as reducing the need to post initial margin bilaterally, which is pretty painful," they said.

incoming regulation as additional drivers of clearing adoption. When describing the rush to FICC's repo programme in 2020, a sell-side speaker said that "during that volatility regulators want to ensure there is safety, soundness, liquidity and resilience in the market and utilising the programme resonates on all those points". The speaker went on to predict that the combination of market pressures and approval of CCP use from regulators will eventually make clearing an everyday tool as opposed to just one used to mitigate heightened volatility.

Reinforcing this, the second sell-side speaker added that regulations including Basel IV, which has implications for the risk weighting of counterparts, will make trading through a CCP more attractive.

To clear or not to clear is, it seems, a perennial question both within firms and across the securities finance market that must be asked repeatedly and often. Whether it's driven by a need for liquidity, resilience, regulation, balance sheet efficiency, or all of the above, every time it is posed more of the industry appears to have made a clearinghouse a home.

Panel two: Repo and securities lending: what to expect

Any prediction about what to expect in the year ahead must be made in the context of the year just gone, panellists agreed. The pandemic brought severe volatility to equity markets and a decade of post-crisis regulation to the ultimate test.

As the dust settles and the world appears to be heading towards a post-COVID environment, securities finance market participants are now able to assess the lessons of 2020 and take stock of whether their technology and innovation strategies are still optimal.

Reviewing the fallout of the March-and-April volatility, the panel moderator questioned whether the securities finance market is mispricing risks.

"It's important to still apply fundamental risk metrics, examining counterparties, asset mixes and adjusting and reconfirming views frequently," they stated.

Another panellist added: "The industry's risk management skills were put to the test in 2020."

Liquidity risk emphasised by the spike in margin calls hammered home the importance of repo and secured financing markets which are intertwined with collateral and derivatives markets, he argued.

Secondly, settlement frictions also became apparent, noting "we have this global infrastructure which works fine during normal times but when we hit these periods of stress it really does start to creak".

> ***"We are not even 12 months past the volatility last year and haircuts are around the lowest they've ever been while spreads are also very low so we need to watch that stretch on risk and reward"***

A panellist suggested that 2020 changed the risk landscape by ratcheting up many new factors in addition to the normal financial risks, including several non-traditional exposures such as reputational risk and legal risk.

The major differences between the 2020 volatility and previous crises is that the financial risks going into March were low as banks generally had stronger balance sheets than years gone. Additionally, the market shock was caused by a healthcare issue, not a financial one, which has in part allowed for a rapid recovery only months after the initial shock.

Compared to the 2008 financial crisis, or even in September 2019 when the repo markets had a wobble, last year market overseers were quick to mitigate liquidity issues to such a degree that a panellist questioned whether repo markets are "too comfortable" due to implicit backstops.

An abundance of cash in the market naturally drives a hunt for yield, the speaker said and warned that too much of this trend could create a race to the bottom, which must be avoided.

"We need to look for solutions that enable us to move collateral and liquidity around the globe during all the currency timezones and jurisdictions," the speaker mused.

Thirdly, the panellist highlighted counterparty risk while acknowledging that the market appeared to be mobilising to prevent defaults by assisting in meeting margin calls, a very different reaction to previous crises when haircuts increased sharply and ensured troubled entities were drowned in capital demands.

"We are not even 12 months past the volatility last year and haircuts are around the lowest they've ever been while spreads are also very low so we need to watch that stretch on risk and reward," he concluded. The moderator followed this by asking if these concerns amounted to an argument for minimum haircuts. The speaker responded that the Financial Stability Board has done a lot of research into this question and minimum haircuts might help but went on to argue more emphasis should be placed on the models for making sure market participants are "thinking very carefully about the risks they are taking".

Turning to the future and comparing US and EU repo markets, an EU-based speaker predicted that changes to balance sheet reporting and leverage ratio calculations under Basel III will impact the market landscape.

From March, US banks will begin applying capital charges and will be required to report a daily snapshot of their balance sheet as opposed to a quarterly report, with European banks applying a similar system from January 2022.

"There's no doubt that because European banks have so far been managing their balance sheets on quarter-end this will reduce the amount of balance sheet available for clients," he said.

The speaker noted that US rule changes contributed to an increase in sponsored repo volume and suggests the same may occur in Europe.

"The new rules are a good development that will help market stability enormously," added a panellist. "Some of the temporary leverage ratio exemptions have added capacity for banks to provide liquidity and it's really important that they aren't constrained from providing liquidity against high-quality liquid assets from a risk-weighted asset perspective."

However, he noted, moving liquidity away from banks and into a direct clearing system only shifts the problem. Banks need to be allowed to lend responsibly as that's the only way the market can wean itself off the central banks, he affirmed.

The European panellist concurred and argued that the financial market community should not give up the fight in lobbying for government bonds to be permanently excluded from the leverage ratio "to keep the stability and good functioning of the markets".

The future is digital

According to a different panellist, the future is digital, but foundations for widespread adoption are not yet firmly established.

The standardisation of data, legal hurdles and the technology infrastructure that surrounds it are all areas that must be addressed before widespread adoption can be achieved, he said.

The implementation of the Securities Financing Transactions Regulation revealed "an industry-wide failure" as firms tried to communicate with each other with "wobbly standards" that prevented them from effectively sharing information both externally and internally.

A lack of standardisation with credit ratings, ISINs and legal entity identifiers (LEI) is undermining efforts to allow for the free-flow of data, he explained.

Preliminary data from a market survey by several trade bodies, including the International Securities Lending Association (ISLA), indicates that there are more than 49,000 securities within the securities finance ecosystem that were reported to have a variety of LEI issues.

The speaker emphasised the conclusion first made at the 2020 Securities Finance Times Technology Symposium that the CDM and blockchain are "a match made in heaven" but reiterated that the foundations of good data husbandry must be in place first.

"By the end of this year, once these blocks are in place, both ISLA and the International Capital Market Association will be in a position to have something that firms can start adopting," the panellist said. "This time next year we will have a much clearer view about what the impact of these initiatives will be."

A separate speaker reinforced this point, noting that when distributed ledger technology (DLT) was first introduced it was touted as a grand solution to very broad challenges but now the market is finding specific practical use cases.

"There are great opportunities for DLT to streamline and optimise the movement of collateral obligations so that settlement can be simplified and that will add a lot of benefits for securities finance markets," he explained.

Taking the concept even further, a third panellist suggested there is a "wider DLT question for capital markets as a whole, which is how do we go to multiple ledgers solving niche problems to full capital market solutions?" This will be the ultimate destination of digitisation, he stated.

The speaker theorised that everything from issuance, to custodian, settlement and financing on a DLT solution could be the answer to a lot of the problems of our market.

Short squeeze by the numbers

Sam Pierson, IHS Markit securities finance data analyst, breaks down the uses and limitations of exchange short interest data and explains how the SI Forecast solution aims to do better

A well-known use for US equity finance data is estimation of the short interest (SI) published by US exchanges in between the bi-monthly publications of that dataset. This can be done effectively and result in a timeliness and level of insight unavailable from the exchange SI data alone. There are important considerations when applying these methods, which we'll discuss here. These considerations are critical for market participants, highlighted by the January short squeeze when a demand for real-time insights faced the real-world challenge of providing them. Estimating exchange SI with a model has advantages and drawbacks which are revealed by reviewing the model output in the context of the inputs.

The bi-monthly exchange SI publications show the gross short positions across underlying accounts held with FINRA member broker-dealers. The disclosures are aggregated and made available after the close on the seventh trading following the settlement date they were collected for. The 29 January SI dataset was published by US exchanges after the close on 9 February. Since the dataset was collected for 29 January settlement, it reflects settled open short positions held from trade-date 27 January.

Equity finance data including the number of shares on loan, is also published for a settlement date and reflects the trade date two days prior. This brings in an essential consideration for estimating the SI: the number of shares on loan, as published by IHS Markit Securities Finance, can be considered the net borrow demand beyond broker-dealers' internal supply of shares.

When a short sale is made, the broker settling the trade can either borrow shares from an external counterparty (picked up in the equity finance dataset) or they can use shares already in their custody for delivery to the counterparty who made the purchase from the short seller. For prime brokers (PB), who handle most short sales, the key sources of internal supply are hedge fund longs (which may be in margin or fully paid accounts) and delta-one long positions. The gap between the SI and shares on loan can generally be interpreted as the internal supply the brokers held in custody and delivered to settle short sales.

The management of dynamic internal supply means that brokers will modify their borrowing both to reflect changes in client short positions and to reflect changes in their own internal availability. They may also modify their usage of internal supply in anticipation of supply or demand changes, which is why shares on loan may react to an event on trade date or T+1. This creates a challenge for estimating the SI in real-time based on shares on loan, because it's possible that a decrease in borrowing reflects an increase in internal availability as opposed to a decrease in short positioning.

To deal with share borrowing changes potentially being driven by variations in broker-dealer longs, a model which estimates the SI needs to qualify the changes in shares on loan by estimating the probability that they reflect a change in SI. The SI Forecast from IHS Markit does this partly by looking at the historical relationship between the SI and shares on loan. The goal is to correctly forecast changes with a minimum of error introduced by forecasting large changes that don't materialise. For that reason, the SI Forecast incorporates the most recently published exchange SI data and subsequently adjusts based on model inputs including shares on loan. The forecast is unlikely to fully reflect a change in shares on loan unless the two series are very similar historically, which suggests a minimal PB internal availability.

GameStop example:

The 15 January NYSE SI dataset showed 61 million shares short for GameStop, a 9.4 million share decline since the 31 December publish. The 15 January dataset was published after the close on 27 January. The timeline is important to note because during the trading sessions from 22-27 January, when the share price increased from \$65 to \$347, the most recently available NYSE SI data was the 31 December observation, which showed 71 million shares short.

GameStop shares on loan was published by IHS Markit as 51 million shares for 15 January, 9.4 million shares lower than the NYSE SI for 15 Jan settlement. The 15 January equity finance dataset was published on 18 January (S+1, with a weekend). By 27 January, when the 15 January SI was published, the most recently published equity finance dataset was 26 January, which showed 41.7 million shares on loan, a 9.3 million share reduction since 15 January.

From the perspective of post-close 27 January, market participants knew that the SI for 15 January was 61.8 million shares, which declined by 9.4 million shares since 31 December. The 26 January shares on loan showed a decline of 9.3 million shares as compared with 15 January; if that were fully reflected in a reduction in SI, that would mean 52.5 million shares short on 27 January.

The first SI forecast published by IHS Markit which reflected knowledge of 15 January SI was for the 27 January dataset. That was published on 28 January and estimated the SI at 56.4 million shares. The forecast was heading in the direction of assuming the change in shares on loan was the change in SI (52.5 million shares). However, the model gave a lower weighting to the equity finance data and was nearly 4 million shares higher for that reason.

Over the final days of January, the shares on loan continued to decline. From the perspective of 1 February, when the 29 January equity finance dataset had been published, there were only 17.4 million shares on loan, reflecting a 31.5 million share reduction in shares on loan between 15-29 January. The most recent SI was still 15 January at 61.7 million shares, so if the change in shares on loan were fully reflected, that would mean 30 million shares short. The SI Forecast published on 1 February estimated 50 million shares short.

On 9 February, the SI dataset for 29 January settlement was published, which showed that SI had declined by 40 million shares to 21.4 million shares. The gap between the shares on loan and SI declined from 10.7 million shares on 15 January to 1.9 million shares on 29 January. The declining gap indicated the possibility that hedge fund longs who had previously lent their shares (in so doing reducing the need for their brokers to borrow shares externally for client shorts) had recalled their shares over the last two weeks of January, forcing a larger portion of the total short position to be settled with shares borrowed from the equity finance channel. The 29 January settlement pertains to 27 January trade date, which means the vast majority of the short position had been covered by trade date 27 January.

The question may then be asked: why bother with the forecast? The purpose of the forecast is to provide a daily estimate of the exchange SI which will be as close as possible to the as-yet unpublished SI figure. The previous publication of that figure will, in general, be reasonably close, so the assumption of no-change will yield a result that appears accurate in comparison to a specific date, but obviously does nothing to track changes between publishes. There is a persistent correlation between the shares on loan and SI for many US equities, so using the shares on loan in a model makes sense; however, there are known causes for the series to diverge (changes in broker-dealer internal availability). Any suggestion of change from the prior SI has the potential to introduce error, so a substantial recognition of changes in shares on loan should only be done when the two series are highly correlated, grading slowly toward a very limited reliance on equity finance data where there is a low expectation for forecasting success. In this view, the forecast performed as expected with the inputs available. It would have been possible for the 29 January SI to print at 50 million shares, which would have been interpreted as a substantial uptick in dealer inventory, likely the result of an increase in hedge fund longs (possibly also some index related delta-one longs). Given the events which unfolded over the last week of January, along with the decline in shares on loan, that may have been deemed unlikely, but is important not to discount as a possibility when considering the model output.

The exchange SI is a valuable source of data which is widely used. When the phrase ‘short interest’ is used pertaining to US equities it is understood to mean the bi-monthly figures. One important caveat is that exchange SI only includes short positions cleared by FINRA member broker-dealer entities, which means it is possible short positions will not to be included.

While the knowledge that the SI data is not comprehensive is important, the narrative impact from the common knowledge of SI may be more significant than ever. The reporting lag and the lag to trade date mean that the shortest time between a short sale being traded and included in the SI dataset is 10 trading days. On the eve of an SI release, the prior publish is more than three weeks old. Equity finance data can help identify short flows between publishings, and the comparison reveals other signals; however, it is no panacea. Using a model to estimate SI can be helpful but introduces a new source of error and should therefore, when precision is required, be considered in the context of model inputs.

Comings and goings at Clearstream, BNY Mellon and more

Federico Becerra has left TP ICAP to become head of treasury at Clearstream, Deutsche Boerse's post-trade services provider.

In his new role, Becerra is responsible for the treasury front office management in Luxembourg and Singapore.

Based in Luxembourg, Becerra will report to Mathias Michel, head of treasury at Deutsche Boerse.

Becerra has 20 years of experience working in treasury, collateral and liquidity risk management.

Most recently, he worked as interim head of group liquidity management, TP ICAP, a global firm of professional intermediaries that operates in the world's financial, energy and commodities markets.

At TP ICAP, he was responsible for implementing the group (Europe, the Middle East and Africa, Asia Pacific and the Americas) liquidity risk management framework and investment policy. This included ownership and administration of the group's cash flow reporting and forecasting system.

Prior to that, he worked at the Intercontinental Exchange (ICE) for just under seven years. At ICE, he served as director of treasury and banking services as well as director, liquidity risk management.

Becerra has also served in roles at Euroclear, Lhoist, and BNY Mellon.

FICC board CEO Martin Pluves to step down

Martin Pluves, CEO of the Fixed Income Currencies and Commodities (FICC) markets standards board (FMSB), will step down in Spring, once a successor is found.

Pluves joined FMSB in 2019 and played a "pivotal role in all FMSB activities, including the establishment of new working groups, the finalisation of several standards and the production of a series of Spotlight Reviews looking at various areas of market practice," according to the board.

Alongside his role as CEO, Pluves has significant charitable and other commitments, including to the Ellen MacArthur Cancer Trust where he is a trustee.

In a statement, Pluves confirmed he has "decided the time is right" for him to take a step back from his full-time leadership role in financial services to allow him to focus his efforts and time on these non-executive roles.

Pluves will stay in his post until the Spring, to allow the board time to find a successor.

Prior to joining FICC's board, Pluves was at clearinghouse LCH for a decade where he served in several senior roles starting as COO of ForexClear and ending as LCH's CEO.

Mark Yallop, chair of FMSB, says: "Martin has been an extremely effective leader and during his time FMSB has produced a range of important materials, all of which support its role of enhancing the fairness and effectiveness of wholesale markets."

BNY Mellon has opened a Spanish branch in with Mariano Giralt and Ana Arias taking on the role of branch manager and deputy branch manager, respectively.

Giralt joined BNY Mellon in 2011 and is global head of tax and regulatory and Europe, Middle East and Africa (EMEA) digital lead for BNY Mellon Asset Servicing.

He previously worked at JPMorgan Chase and prior to that was a senior lawyer at Spanish law firm Cuatrecasas.

Giralt is also chair of the blockchain and tax group at the European Fund Asset Management Association.

Arias joined BNY Mellon in Madrid in 2013 and is head of corporate trust in Iberia.

She previously worked at Santander CIB in a range of roles including bond syndication, structuring, trading, research and sales.

The branch supports clients seeking access to BNY Mellon's global capabilities and solutions and follows the opening of the Copenhagen branch in December 2020.

Former Blackrock global equity trading chief Matt Boyd has become head of prime brokerage financing at Coinbase

Boyd, based in San Francisco, joined the digital currency exchange as a consultant in June 2020 before accepting the full-time position.

Boyd previously worked for Numerai, a crowdsourced hedge fund based in San Francisco, where he served as chief operating officer for just shy of three years followed by a year as an advisor.

He was responsible for the design and development of its investment platforms including direct management of the portfolio management and data teams. Before then he worked for EquiLend as a consultant.

Prior to that, Boyd worked for Blackrock for just under 11 years as its global head of international equity finance trading and was also the Europe, Middle East and Africa and Asia Pacific head of securities finance trading.

Boyd was product head of international equity finance and responsible for a team of equity finance traders.

AccessFintech has appointed Paynter Higgins as executive vice president for global enterprise sales and Sarah Lloyd Parry as executive vice president for marketing.

Paynter recently served as vice president, enterprise sales at Collibra, a data analysis firm, while Parry was chief marketing officer for Avora.

The hires come as a response to the recent momentum across all products and services and will play a pivotal role in supporting the company's next stage of growth, says AccessFintech.

Paynter will develop and manage the growing AccessFintech sales team and will be responsible for the strategy and execution of enterprise sales globally.

Meanwhile, Parry will lead overall corporate marketing and brand strategy of AccessFintech.

Roy Saadon, CEO of AccessFintech, says: "In Paynter and Sarah, we have gained two industry veterans who provide a deep understanding of the software-as-a-service universe and a great track record in building, developing and managing sales and marketing teams."