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THE ULTIMATE LOOK-THROUGH

The CEO of Kayenta Chris Hagstrom lifts the lid on the technology and the team underpinning the hedge fund treasury solution and details what it can do that others can't

Two new cum-ex investigations confirmed by UK FCA

The UK's Financial Conduct Authority (FCA) says it is now investigating eight individuals for cum-ex tax fraud as of 24 February, up from six in October 2020, a freedom of information (FOI) request reveals.

The cases opened this year mark the regulator's first new investigations into individuals since 2019, according to FCA data gained by SFT.

The latest figures show the regulator's activity into what has been called the "crime of the century" peaked around 2016, with scant evidence of the many UK-based persons or entities believed to be involved being pursued.

An FOI made by business crime solicitors Rahman Ravelli to the regulator confirmed that in addition to the new, unnamed individuals, 14 firms already known to be under investigation were still under the spotlight as of February.

All the cases against entities and individuals have been open for several years, some as far back as 2015, with none resulting in enforcement action by the FCA so far.

Aziz Rahman, a senior partner at the law firm, says the low numbers are a "cause for concern" and highlight the challengers regulators face in untangling the web of dividend arbitrage trading strategies that stretch around the globe.

The formulation of UK tax law meant it was largely unscathed by the tax revenue losses caused by cum-ex trading is thought to have deprived European authorities of an estimated €55 billion lost revenue. However, a significant portion of the actual trading is believed to have taken place in London or have been conducted by individuals that are UK residents, making the FCA's cooperation vital for EU authorities seeking damages.

As a result, the UK has remained largely removed from the cum-ex scandal that engulfed Europe in recent years where several continental tax authorities, most notably in Germany and Belgium, are proactively and publicly campaigning to bring several high-profile cases to trial despite COVID-19-related hurdles.

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Two new cum-ex investigations confirmed by UK regulator

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In a rare public comment on the matter, the FCA's director of enforcement and market oversight Mark Steward confirmed in February that the regulator viewed cum-ex trading as "abusive" and said it was working closely with European authorities.

On the continent, the German prosecutor alone is understood to have a list of several hundred individuals that are suspected of contributing to a global network of cum-ex strategies in which London was one of several trading hubs.

Despite this, the number of investigations by the UK regulator remains in the teens.

A separate FOI request made by freelance researcher Jack Barnett on behalf of SFT shows that in 2016 the regulator began two investigations into the conduct of individuals, and opened a further six cases in 2017.

Since then, three additional cases began in 2019, along with the two earlier this year.

Other than the latest pair, it is unclear which of the 11 cases opened since 2015 are still active.

When looking at institutions, the FCA began four cases in 2015, six in 2016 and four in 2017. It has not opened a case into any entity since, the FIO shows.

Responding to the FIO, the FCA says it has not issued any fines to individuals or firms as a result of an investigation into them using cum-ex trading strategies that pertain to dividend arbitrage trading strategies.

The regulator further notes that none of its investigations have resulted in 'final notices' being issued, which denotes when an investigation becomes enforcement action.

Commenting on Rahman Ravelli's FIO, Rahman says that while the figures can be partly explained by the UK's limited involvement in cum-ex they also show the difficulties facing the FCA.

"There has always been the view that while some of the architects of cum-ex trades may have been based in the UK, the vast majority of those involved were in other countries; most notably Germany," he says. "This is why reports have come out about there being around a thousand suspects in Germany, while there are not believed to be so many in the UK.

"But even if this is taken into account, the FCA does seem to be struggling to sanction those it believes are responsible for wrongdoing related to cum-ex."

Rahman further notes that even when the FCA does act, it is becoming entangled in a legal quagmire created by the cross-border nature of the arbitrage strategy which requires cases in multiple jurisdictions to set straight.

In February the FCA was forced to halt an investigation into a trader until next year, Rahman explains, when a separate court will decide on a case brought by Danish tax authorities against the former hedge fund manager Sanjay Shah — who is believed to be a central figure in one of the largest cum-ex schemes.

"This case is a matter that has been effectively taken out of the FCA's hands for now," he states. "But with the past year or


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more having seen many, many people being investigated in various European countries regarding cum-ex, the FCA not opening any new investigations in that time is a cause for concern."

Securities finance revenues up 10% YoY Q1, says DataLend

Global securities finance revenues increased 10 per cent in the first quarter of 2021 compared to the same period last year, according to the latest figures from DataLend.

The industry generated $2.07 billion in revenue for lenders across the globe in the first three months of this year, according to DataLend, the market data division of EquiLend. The same period in 2020 generated $1.88 billion.

The raft of Initial Public Offerings, Special Purpose Acquisition Companies and January's short squeeze were to thank for the boost in revenue from equities — an 8 per cent YoY increase to $1.65 billion. Revenue generated from fixed income securities increased by 20 per cent over the same time frame, representing $420 million.

The top-five hottest securities combined generated more than $50.8 million in revenue in March, according to DataLend. These were Futu Holdings, iShares iBoxx $ High Yield Corporate Bond ETF, United States of America Treasury Notes 1.125 per cent 15/02/31, Rocket Companies, and ChargePoint Holdings.

Again in March, the global securities finance industry generated $632 million in revenue for lenders, a minor increase from the $631 million generated in February and a 2 per cent increase from the $622 million generated in March 2020.

Broker-dealers lending and borrowing securities from one another generated $248 million in revenue in March, an 11 per cent increase from 2020.

Government debt was the main driver behind the 2 per cent increase of $9.6 million in lender-to-broker revenue YoY.

Q1 cleared contracts highest ever, OCC says

March marked the end of a quarter that had the highest volume of total cleared contracts in Options Clearing Corporation's (OCC) history. The world's largest equity derivatives clearing organisation's total cleared contract volume

for the month was 904 million contracts, the highest volume month on record and up 34.8 per cent compared to March 2020.

Regarding securities lending, the average daily loan value at OCC in March 2021 was $119.12 billion, a 75.4 per cent increase compared to March 2020. Central cleared securities lending activity also increased by 17.8 per cent in new loans from March 2020, with 143,987 transactions.

The organisation's year-to-date average daily cleared contract volume through March was 42 million contracts, up 48.7 percent compared to the same month last year.

Equity options cleared contract volume — including the exchange-traded fund options cleared contract volume of 269 million, an 11.2 per cent decrease — was 857 million contracts, up 45.1 per cent compared to March 2020.

Women in SF launch website

The Women in Securities Finance industry group has launched its first website.

The new website states the group's mission is to "create a community to foster connections and promote the advancement of women in the securities finance industry".

The independent industry women's group was formed in early 2018 in the US by Elaine Benfield who serves as senior counsel at Vanguard, Arianne Collette global head of strategic client engagement at Morgan Stanley, and Jill Rathgeber, director at BNY Mellon, who act as joint chairs.

It aims to foster connections in the securities finance industry regardless of roles. It began with chapters in New York, Boston, Chicago, Toronto and has since expanded outside of North America to London.

The group's guiding principles are to encourage and empower women in securities finance to connect professionally, collaborate and share insights. Its members represent all facets of the industry, including trading, sales, relationship management, legal, technology, product development,operations, portfolio management.

Announcing the website launch on LinkedIn, co-founder Collette says: "After over three years the group continues to grow, create an impact and reinforce a community all through efforts visible on our new website. I am proud to be a co-founder, global chair and most importantly a member."

BrokerTec's euro repo volumes smash records

BrokerTec says its Q1 European repo volumes hit an average daily trading volume (ADV) of €286.7 billion, a new high for the trading platform.

In particular, the months of February and March saw new highs of €290.8 billion ADV and €299 billion ADV, respectively. Both figures trumped volumes of €284.7 billion in March 2020 at the start of the pandemic.

Additionally, BrokerTec saw a new all-time nominal record volume day on 1 March — €338.8 billion (single count).

This compares to the previous high of €320 billion on 11 March 2020. The previous quarterly high was in Q2 2019 at €282.1 billion.

BrokerTec's global head John Edwards says: "Last quarter's record volumes highlight that the short-term repo markets in Europe and the UK continue to function well and demonstrate the robustness of the platform as we continue to see a significant increase in volume traded and order flow.

"As market participants continue to seek the efficient deployment of cash and capital through secured borrowing and lending in the sovereign bond markets, as well as the broader benefits of trading electronically and anonymously, we anticipate this increased activity and customer participation to continue in the weeks and months ahead."

Global PSSL and prominent short sellers unveil new ESG standard on short activism

The Global Principles for Sustainable Securities Lending brought together a panel of renowned short sellers as part of unveiling a first-of-its-kind voluntary ESG standard on short activism.

The ESG standard was launched by Radek Stech, founder and CEO of Global PSSL and a senior academic at University of Exeter Law School.

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Yellen revives hedge fund oversight committee

The new head of the US Treasury has revived a dedicated committee to scrutinise the role hedge funds play in amplifying market stresses.

Last week, Janet Yellen, the first woman in the role, highlighted three new areas of vulnerability that she says the Treasury Department must focus on in the post-COVID-19 era.

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EACH responds to the EC Inception Impact Assessment on CSDR Review

The European Association of Clearing Houses is urging the European Commission to agree with ESMA to further delay the implementation of CSDR's SDR beyond February 2022.

The call for a further delay was outlined in its response to the European Commission's recent review of the regulation, which included the controversial buy-in rule.

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SRD II still in early stages of 'full and seamless adoption', says Broadridge

The European Commission's updated Shareholder Rights Directive is still in the early stages of a full and seamless adoption across European regulated markets, according to a new Broadridge report.

SRD II went live in September 2020, impacting any financial intermediary that holds or services European equities, irrespective of where the intermediary firm is located.

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FCA to launch SPAC consultation

The financing industry has welcomed the emergence of SPACs, but the UK regulator is now considering plans to tighten restrictions on this lucrative market segment.

Securities lending market participants stand to bank significant earnings from SPACs by facilitating arbitrage strategies, with market observers predicting this to account for an increasing portion of overall revenue.

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Saudi Arabia finalises new SBL and short selling rules

Saudi Arabia has finalised amendments to its securities lending and short selling rules to better align standards with international best practices and encourage further activity in the budding financing market.

The Saudi Stock Exchange (Tadawul) and the Securities Depository Centre Company (Edaa) have approved changes that were formulated as part of a public consultation in February 2020.

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The ultimate look-through

Chris Hagstrom, CEO of Kayenta, the market newcomer seeking to set a new standard of treasury efficiency and transparency for hedge funds, lifts the lid on the technology and the team underpinning the solution and details what it can do for buy-side-clients

Kayenta formed in 2018 and you joined as CEO from UBS in May 2020. The treasury management solution was formally unveiled in January. What attracted you to Kayenta's offering and what has the journey been like so far?

My first attraction came from understanding the hedge fund and bank landscape very well from my experience to date and knowing the huge opportunity that exists in solving inefficiencies in the financing space. I've seen the in-house technologies and I've seen what other service providers offer, and there is significant room for improvement given how important actionable data and transparency are to hedge funds today.

Fees from financing operations are a huge drain on most hedge funds and some of that can be attributed to allocation inefficiencies, booking errors and other very avoidable issues. But the data needed to get a clear picture of what's driving those costs is hard for a fund to aggregate and decipher. That's where we come in.

Kayenta has a simple vision of solving the financing and treasury challenges hedge funds are facing. We gather the data from their various financing counterparts, normalise it, and then compare it against our own calculations drawn from the fund's golden source of position data and processed through our proprietary accrual engine. Moreover, we are providing this at a time when funds are under pressure from both sides with their prime brokers wanting more revenues and their investors wanting lower fees.

Beyond the product, it was the team here at Kayenta that caught my attention. When you look at our management and technology teams and the experience they bring from their respective fields, I had to be involved.

Hedge funds come in all shapes and sizes. How many would benefit from your treasury solution?

From our experience, we believe the current market penetration by more established service providers is very low compared to the number of funds out there that need technology like ours. Besides the belief that our solution is superior, we feel that our backgrounds and having actually experienced these pain points ourselves in previous roles, at both banks and hedge funds, bring a trust factor that clients will respond to.

Our clients know that we truly understand what they need and are sensitive to, which is vital when it comes to committing to an external technology solution. Combined with technology that is extremely modern and scalable it allows us to offer valuable solutions at a price point that is going to be compatible with hedge funds of all sizes and strategies.

The issue you've identified is not a secret to the hedge fund or prime brokerage communities. Why has no one resolved it yet?

Most larger hedge funds are very aware of this problem but the first hurdle is that the methodologies and calculations a bank applies are very specific and will therefore vary significantly with each relationship. A fund may have several prime brokers but each will calculate financing costs and margin valuations in a unique way that's based on the bank's internal processes and balance sheet needs. This makes it very difficult for a fund to reconcile and standardise those data points across the board.

Moreover, even if you do have an Excel spreadsheet and can get all that information in one place then it's likely to be a manual and time-consuming process, and there's no guarantee that the numbers are accurate. Just effectively monitoring the financing bills the fund pays its service providers each month is very difficult to independently verify and is hugely resource-intensive. It can take days every month for a fund to achieve an approximate accuracy and until now there hasn't been a third party offering them a reliable alternative. Inaccuracies in this process can also accrue and resurface months later, which all requires further effort to quantify and correct. In a worst-case scenario, a sizable reconciliation inaccuracy can lead to a fund having to restate its performance or the bank having to write-off losses from the prior year's revenues, alongside some inevitably difficult conversations.

Simply, Kayenta is offering a solution that will do all that automatically and daily so that an investment manager can quickly understand and trust their costs whenever they need the information.

What we've seen from early adopters is that clients have saved a lot more on their financing overheads than we charge them for this service. I'm happy to be on record and guarantee that if you implement our technology for a year you will be able to save money above and beyond our fees.

To be clear, when we say this is a product that will benefit both hedge funds and prime brokers it means that although a fund's financing payments will decrease, overall wallet for the banks can increase. This happens because a truly efficient treasury function takes into consideration, and optimises for, the impact on both parties. It requires data transparency to flow both ways but will allow both parties to focus on the issue of the day rather than looking in the rear-view mirror to fix historic problems.

To underscore this point, we are in active conversation with some hedge funds because a prime broker sees our value and has introduced us to them.

Tell us more about the team behind the technology.

To develop our technology we were motivated to hire beyond established capital market technologists. We wanted to put together a team of specialists from fields outside finance that bring fresh perspectives to old problems. The result is we've created this great meeting of minds between a team that understands the problems intimately and a team of technical experts that bring novel solutions.

The modular platform is cloud-native and hosts full API (Application Programming Interface) connectivity, which allows for connectivity with other software while not burdening in-house systems under the full weight of the technology stack.

As part of the onboarding process, Kayenta will get authorisation from the investment manager to approach their financing counterparts to source all the relevant information, and the client themselves don't have to do anything beyond an introduction.

Once Kayenta has collected the fund's financing data and normalised it, we then offer an optimisation function to make the portfolio more efficient. This is from a cost perspective but also from an asset allocation perspective so that the banks get more of the assets they want and less that they don't.

The next implementation phase for Kayenta will be entirely client-driven. The feedback we have had focuses on portfolio efficiency, which is a broad term, but for us means real-time and reliable information that provides simple actionable ideas to optimally allocate balances. Prime brokers are already providing funds with a wealth of information through their existing reporting stack, it just needs to be digested and understood. For example, we have a very detailed waterfall model that categorises collateral in the way each prime broker categorises it, meaning we can suggest a fair distribution in terms of the value each counterparty is likely to realise.

We are also currently enhancing our securities lending benchmarking, margin management, currency optimisation and financing wallet functionality.

This new window into treasury management also appears to offer greater transparency to a fund right when its investors are demanding greater insight into its activities. Beyond the primary cost-saving potential is this secondary transparency opportunity also attractive to clients?

Good point. On the surface, the data we can provide is great for a treasurer or COO, but it also brings a lot of useful information to a portfolio manager, CEO or anyone on the investment or marketing side. This information can provide confidence to limited partners that they are paying the right amount and that the fund is being efficient with its capital.

Take the recent example of Archegos Capital, a default situation that caused several billions of dollars in losses to its prime brokers. When events like this happen, other fund's investors want to know if they are exposed and what it means for them. For most funds, answering this basic question means scrambling to look at multiple systems and amalgamating those numbers to come out with a simple figure. Our solution would give that to you straight away and would allow a fund to share its exact exposure and the risk profile as of that morning.

There will be other challenging situations like this in the future and funds need to be ready to communicate with their investors to demonstrate that they are on the ball.

There are several established treasury solution providers already in the market, but you mentioned that overall penetration into the hedge fund universe is limited. Why is that and why do you think you can do better?

We believe that our first-hand experience will ultimately allow us to articulate the problem hedge funds are having in a way that our competitors from other backgrounds have failed to do. The dialogue and direct feedback that we've been able to get regarding what people really care about and what they are willing to pay for is extremely valuable.

Our team is our secret sauce. Until 2020, I spent just over 15 years with UBS where I was head of global financing services for the Americas. Our founder and COO Matt Peakman brings 13 years of experience with Nomura, where he was most recently head of fund and corporate derivatives trading. Our CMO Mark Toone spent a decade with Morgan Stanley on the delta one structured product desk and also spent time with a multi-strategy hedge fund as a portfolio finance trader. Kelly Russo, who is focused on business development for Kayenta, was equities chief of staff at UBS and also a securities lending trader there and, before that, at Goldman Sachs. I could go on.

Between us, we've approached this problem from every angle for every client. We are multi-asset and service all strategies, from equity long shorts to quants and fixed income strategies, and we have solutions for all sizes. We recognise that if you're managing a single entity with $100 million assets under management (AUM) you will have very different needs to managing a platform of strategies with multiple billions of dollars in AUM, but the benefits of an efficient portfolio extend to both. And the value isn't just to the fund, it spans the whole length of the chain from the investors to the prime brokers.

We ultimately don't think the existing solutions out there are backed up with the very personal, first-hand knowledge of the market that we bring. With this in mind, although we have a clear development roadmap, we will never try and be all things to all people. We are portfolio finance specialists and we want to set the market standard for hedge fund treasury solutions. We are determined to be best-in-class so that when people talk about treasury, they talk about Kayenta.

> *"We ultimately don't think the existing solutions out there are backed up with the very personal, first-hand knowledge of the market that we bring"*
>
> *Chris Hagstrom*
> *CEO*
> *Kayenta*

SFTR reporting hampering some trades, Consolo says

Justin Lawson reports

Consolo's Sarah Nicholson runs through what worked and didn't work during lockdown and how the firm is helping clients navigate SFTR

How would Consolo describe 2020? And how did the restrictions and all the legislation impact you and your organisation?

2020 was obviously a challenging year for everybody. And because we're so used to face-to-face interactions, it's been quite a challenge to adapt to the 'new normal'. From our perspective, we've always worked on a remote basis, unless we're actually on a client site. So, I think that the transition to remote working has been probably easier for us than for most, and really, it's been business as usual. Certainly from the consultancy side.

All we really needed is that connectivity into the client sites. And, of course, most of the clients have been developing and establishing that in the early part of 2020. So, from a consultancy side, there's been very little impact and businesses have continued as normal. But from the training side, face-to-face courses, which were building momentum throughout 2019, they've had to be postponed. We reassessed the situation and where we were doing one and two-day courses, face-to-face with groups of 10 or 15, we decided to break them up into shorter sessions online. This was done on the basis that people can spend two or three hours on training courses but it can be quite difficult to concentrate online, if it's a whole day.

We took some of our securities finance courses, and we broke them up into three hour sessions for people to attend. And then we timed it so the sessions are early in the morning, and late in the afternoon, UK time, in order to try and help people fit them around what they were doing. These online courses have been well received; we've done a number of them through 2020. And I think the timing of them has meant that we've introduced a whole new raft of clients from both Asia and the US. So, they've been working really well.

What have you got planned for 2021?

For 2021, we were very much looking forward to — hopefully at the end of the year — arranging face to-face-meetings and getting back to some level of normality. And we're going to continue to provide the online courses, using three-hour sessions. And we will continue to develop our in-house bespoke courses. So, the training side will continue in much the same vein. And hopefully, by the end of the year, we'll be able to organise some in-person meetings. From the consultancy perspective, we're continuing to support our clients through the Securities Financing Transactions Regulation (SFTR), continuing to help them improve efficiencies and the accuracy of their data. And we've also been discussing with a number of clients, the European Market Infrastructure Regulation (EMIR) Refit and Markets in Financial Instruments Regulation data requirements and reporting and trying to aid the provision of that reporting for clients with the kind of extensive knowledge of systems and data management that we have, and have built up through the SFTR projects. It's a natural next step to expand that working knowledge into other reporting regimes, and so very much kind of looking forward to working with clients to develop that.

As SFTR implementation experts, how do you think that's been going? And where are we now?

Firstly, the good news is that it seems that everyone is reporting. And obviously, that's been challenging in itself, given that all of the implementation deadlines have essentially occurred during the lockdown while people are working remotely — so that's the good news.

A couple of trends that we are seeing, when we've been talking to smaller players or smaller clients, is them having to restrict the counterparties that they trade with, on the basis of SFTR reporting. So, a number of the smaller players are not in a position to report directly themselves yet and so we're relying on delegated reporting. We're seeing them having to restrict who they trade with to those counterparties, but can and are able to provide that delegated reporting. That's not great when the reporting regime starts to impact who you trade with. Obviously, that will have an impact on the cost effectiveness of the trading.

In terms of data, we're seeing some issues around data quality; more so in the modifications than in the new transaction reporting. And it seems that the pairing of the transactions with the handful of core data fields that need to pair prior to the matching process. There seems to be issues within that. We're not clear what's driving that, given that it's on the modifications rather than on the new transactions. It's a definite trend that we're seeing around those kinds of subsequent reporting requirements, rather than the new transactions.

More broadly, with reporting, we're seeing very clearly specific data fields that are impacting transactions' ability to match which causes breaks in the reporting. So, data fields like the trading venue, and interestingly, the execution timestamp, are causing some trades to mismatch and therefore, without the matching the unique transaction identifier cannot be shared by the issuer with the reciever. Within the regulation, you're given an hour's allowance around the time, which is much greater than any other regulatory reporting. As long as the two trades are booked within an hour of each other, it should match but we're seeing that consistently causing problems. About 5 per cent of the transactions are failing because of these core data fields and mismatches within them. Some of that looks like it's booking issues. Some of it is static data issues where defaults that have been agreed in the market and not been applied properly. But at this stage, these are our best guesses; we're just looking at the data and identifying the trends at the moment.

I can say that we've been helping clients to focus on that data quality, and also focus on the efficiencies of the process. We are ensuring that the data is managed in the most efficient and time effective way as possible, and that the accuracy is there. And we have a number of clients that we're working with on that basis. I think that's the focus in the market. Now we see everybody is reporting, it's really all about focusing on the quality of data, the accuracy of the data, and then the timing of the delivery of that data.

Tell me more about the training you provide, and what plans you have post-COVID.

Depending on where you fit within the market, there's something for you. For instance, we have our securities lending fundamentals course, which is essentially a three-hour session that talks about why people are involved, the roles and responsibilities and the processes within the securities lending industry. That course is really designed for new entrants to the market, or for people providing satellite services, who just need that overview or that understanding of how everything fits together. And that's been a very popular course. We've seen significant uptake, particularly from Asia and the US markets.

Alongside that, we've produced a number of sessions, which are focused on a specific element of the market. For instance, we have a session that looks at non-cash collateral and how you measure and manage collateral in the non-cash space and how you manage that in a default situation. We have another session that focuses on cash collateral. These sessions are really much more of a deep-dive into the specific aspects, and probably better designed for the sort of individuals that have an element of that already within their job.

Again, as an example, our corporate events session, looks at how corporate events are managed in the industry, what the best practices are, and some of the ways that they can go wrong and how that might be managed and mitigated.

As well as the online courses, we have the bespoke in-house ones at the moment. And these are the courses where we work with a specific client and develop a course that suits them, particularly, if going forward, we'd like to get back to the face-to-face. I think there's nothing quite like the interaction of a group of people coming together. And the debates that you can have around specific aspects of the training makes it a much richer learning experience. And also allowing that time and the focus for a full day on a specific topic is really helpful. So, going forward in 2021, we want to open up those public courses. We want to continue with the online courses. I think they're useful. We've certainly seen people taking quite significant value from those. And then to continue to develop the bespoke in-house courses, as and when we can get back to spending time with clients directly.

How does the in-house training work? In terms of clients coming to you with a particular area they want you to help them learn more about or because they've got new members of staff like me; is there a general case?

The bespoke courses are really about providing whole teams, whole departments or whole companies with the same training that's focused around their particular business or business needs. For instance, the process would be to identify the need to work with the human resource teams and the businesses to formulate an agenda that's very specific to the core of the company. For example, we have run courses on a number of different topics outside of securities lending and we have a number of different trainers with different experiences within our group and they can provide the expertise around a broad range of topics.

We've recently run training for a company, in fact online because of the lockdown, but bespoke, where we have implemented internal processes across the business. That meant spending some time with the business unit, in this case it was the risk team, understanding how they want the new process and the new risk management approach to be applied across the business. And then we've rolled that out to all of the businesses and by doing that we have ensured that everyone has consistent training and a consistent message. And we have then been able to link it back to people's specific roles and specific jobs.

The nice thing about the bespoke sessions is we have a broad range of trainers and we cover a much broader topic range than just securities lending. We have run courses on fund administration, teaching a new fund administrator all about the kind of subscription and redemption processes and the roles and responsibilities of the fund administrator. We have looked at derivative operations and quite recently we've done a significant amount of work in the capital space. So, with all of the collateral requirements in securities lending and in the derivatives space through EMIR and the Uncleared Margin Rules requirements really hitting home now we have been focusing on enterprise-wide collateral management.

Taking the benefits of those processes we have spent a lot of time looking at specific systems so that we are able to come in and talk to you about collateral management but also relate that back to the specific systems and processes that you have internally. Really the bespoke sessions are about working with the business to ensure that the content within the training is very specific and bespoke to the business itself.

Sarah Nicholson
Senior partner
Consolo

Options Industry CONFERENCE

April 28 & 29, 2021 | Virtual

Join OCC and the options exchanges for the 39th annual Options Industry Conference, April 28-29, 2021. This year's virtual conference will be unlike any other event in our long history. Over the course of the two-day conference, attendees will have opportunities to interact with leaders and innovators in the options space during thought provoking presentations and panel discussions.

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Keynote Speakers

The Honorable Allison Herren Lee

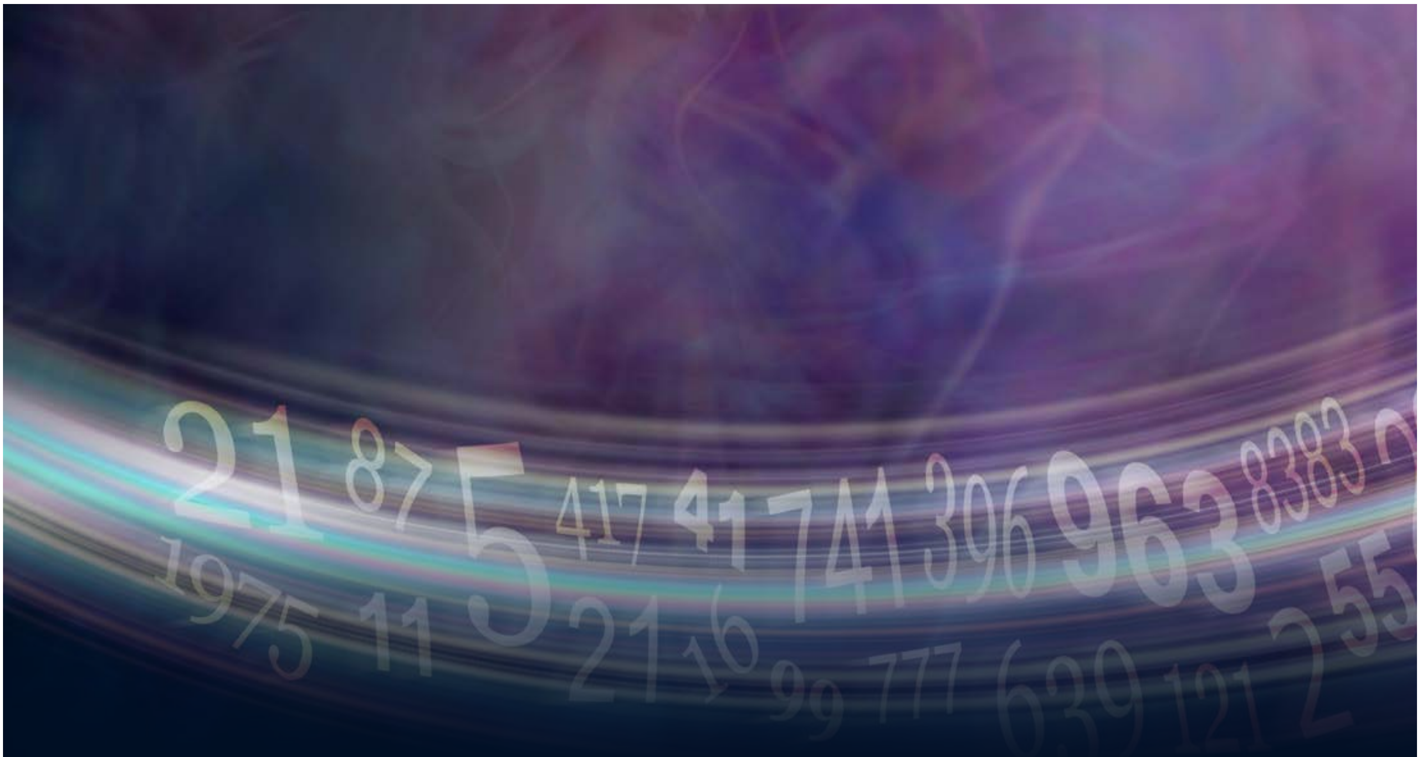
Acting Chair, U.S. Securities and Exchange Commission

We are pleased to welcome Acting Chair Allison Lee as keynote speaker for day one of the Options Industry Conference virtual event on April 28, 2021. Acting Chair Lee will discuss her views on current market issues and priorities for the SEC in 2021.

The Honorable Randal Quarles

Vice Chair for Supervision, Board of Governors of the Federal Reserve System

We are pleased to welcome Vice Chair Randal Quarles as keynote speaker for day two of the Options Industry Conference virtual event on April 29, 2021. Vice Chair Quarles will be discussing current initiatives and priorities at the Federal Reserve.



LEIs, damn LEIs and statistics

Alex Pugh reports

With poor adoption and a grace period ending today, is the adoption of LEIs outside of the EEA ever going to gain momentum?

The deadline for third-country counterparties to gain a legal entity identifier (LEI) for reporting under the Securities Financing Transactions Regulation is 13 April — today. But, despite a 12-month delay to the requirement's implementation, coverage remains patchy, putting the integrity of reported data at risk. A grace period was granted by the European Commission in January 2020, beginning in April when SFTR first went live, following a market survey that found a significant disparity between the level of LEI coverage in the EU (roughly 88 per cent), compared to non-European Economic Area (EEA) jurisdictions, where around a third of assets were not attached to an LEI.

At the time, the European Securities and Markets Authority (ESMA) stressed that it expected agent lenders and triparty agents that interact with third-country entities to ensure those counterparties are "aware of the temporary nature of the rule change and that they are ready for the new 13 April 2021 deadline".

However, recent evidence suggests there is yet to be significant improvement in LEI coverage in non-EEA jurisdictions.

The EU's hardline stance before it authorised the grace period, 'no LEI, no trade', raised fears that the introduction of SFTR would inadvertently cut off unprepared third-country entities from the securities finance liquidity pool. The latest market survey of EU and non-EEA ISINs, conducted in February 2021, included members of the International Securities Lending Association (ISLA), the International Capital Market Association

(ICMA), the Association française des marchés financiers and the Association for Financial Markets in Europe, in collaboration with IHS Markit.

The results were cross-referenced with several LEI-focused entities and found that of the 4,7570 unique ISINs identified, 37,207 (78.22 per cent) were missing LEIs.

Of those missing LEIs, 98 per cent (36,505) were for ISINs issued in non-EEA countries, most notably, the US (17,563), Japan (3,466), China (3,382), Canada (2,210), and South Korea (2,133).

Last week, the UK's Financial Conduct Authority extended the deadline again for the reporting under UK SFTR until at least 13 April 2022.

Despite calls from industry trade bodies including ISLA and ICMA for the commission to follow suit, at the time of publication, no decision has been made. In a joint letter addressed to UK and European national regulators and the EU's market overseer sent 8 March, called for the grace period to be extended to "avoid unnecessary disruption" by allowing non-EEA issuers "significantly more time" to get their houses in order.

SFT spoke to industry experts Iain Mackay, global product owner, post-trade services at EquiLend, Jean White, managing director at SEI Investment Manager Services, which provides infrastructure and services for investment managers, and Jonathan Lee, senior regulatory reporting specialist at Kaizen Reporting, on why so many firms have been dragging their feet, whether the grace period will be extended and what will happen if it is not granted.

On what progress, if any, has been made to increase adoption of LEIs, Mackay says there has been a "collaborative exercise" between market participants, vendors and industry bodies to scope the size of the problem and its reporting impacts. He says that the letter and survey coordinated by several different industry bodies serves to "demonstrate another example of the collective work that has been achieved throughout this SFTR experience" and highlights the importance with which the market treats this issue.

White echoes the sentiment of collaboration as it relates to the letter and survey but says that as significant gaps in LEI coverage remain across major non-EEA markets, "it is clear that more will need to be done to guarantee full compliance by the grace period's expiry date".

Lee says that progress has been "slow but steady" and there remains a lot to be done as the EU SFTR deadline for the adoption of issuer LEIs is looming.

Asked what is being done to encourage important but lagging counterparties in countries such as the US, China and Japan to catch up with the EEA, White singles out the Financial Stability Board (FSB), which has been "very vocal" in its efforts to encourage and promote LEI adoption at national and international levels.

"However, the question on everyone's lips is what more can be done, beyond repeating such rhetoric more regularly, to encourage those outside of the EU's jurisdiction to adopt LEIs. Unfortunately, the answer may be nothing," White says.

Trade associations have been working "tirelessly" and across borders, Lee says, with the weight of organisations like the FSB behind them highlighting the issue and encouraging universal adoption of issuer LEIs.

"The Japanese Exchange group — including the Tokyo Stock Exchange — have been most vocal and proactive in closing the gap," Lee adds. But he also sees light at the end of the tunnel, hoping that as COVID-19 restrictions ease, "there will be greater opportunities for global regulators to get together and promote their concerns and agenda".

Mackay refers again to the joint letter, which invites ESMA to encourage relevant regulators to promote a broader adoption of the LEI code in their jurisdictions and "also to raise the matter in appropriate international regulatory forums".

Moving on to what is actually going to happen in the EU once the grace period lapses, if LEIs have not been adopted, Mackay says that reports on trades conducted on an impacted ISIN will be rejected by the relevant trade repository. "However, the likely biggest impact will be on the reporting of collateral for loan portfolios which are collateralised on a net exposure basis."

He says that because the collateral report for net exposure is submitted as "one large message with repeating blocks of data" for each ISIN, if any one of the securities in a pool of collateral assets does not have an LEI of the issuer, the whole collateral file will be rejected.

White says that national competent authorities (NCA) are "under an obligation to pay significant attention to the accuracy" of reporting and matching rates and the potential exists for penalties to be applied for non-compliance.

"If there are no workarounds or changes in the number of LEIs by the time the grace period lapses, this could expose all entities undertaking securities finance transactions in Europe to the risk of regulatory penalties," she adds.

Beyond regulatory fines, there is also the potential for liquidity issues within the market, White says, as a single missing LEI in a collateral pool is likely to result in a rejection of the submission. "The industry will be watching closely for signs of this detrimental knock-on effect to liquidity."

What actually happens once the grace period lapses will depend on how firms react, Lee says. "Until we hear otherwise from ESMA or NCAs, we have been advising firms to essentially maintain the status quo and report LEIs where they have been published, otherwise continue to report but leave the field blank."

As the trade repositories have not adopted any changes to the validation rules to demand issuer LEIs are always populated, Lee says, only populating LEIs where available will not result in any breaks at present.

If the LEI field is left blank — one of the mooted options if the grace period is not extended — what impact will a validation error have on transactions and the quality of SFTR reporting data?

In this case, White says that if an extension of the grace period is not under consideration, it is important that NCAs are advised of the scale of this challenge and of the potential increase in SFTR submission rejections, in trade and collateral reports, when data is validated by trade repositories. "An alternative solution discussed among our client base is using a dummy LEI where no LEI exists, although this will undoubtedly have unintended consequences on the quality of data," she adds.

Mackay is less equivocal: "If firms leave the LEI field blank, the report will be rejected," which means that they will have to choose between not reporting the entire file, or trying to remove the offending item from the list, "arguably leading to misreporting of that collateral position". Either approach, Mackay says, will mean that the regulator does not receive the transparency with regard to market risk for which SFTR was arguably conceived.

Lee disagrees. He says if the issuer LEI has not been published, leaving the field blank "would appear the best course of action". Reporting without LEIs in these circumstances ensures the reporting firm is "maximising its transparency" under SFTR and if the firm were to report a "dummy" LEI code in place of a missing one, that could be deemed to be misreporting. Similarly, if a firm excludes securities from reports that do not have issuer LEIs then this would constitute under-reporting, Lee adds.

On how long the grace period should be extended for — and whether it's even likely — Mackay says that, "ESMA recognises that the issue has not gone away and, as such, the likelihood of an extension or additional grace period is rising". Because there is a "practical element" of getting LEI adoption and there is also now another "sizeable" regulatory initiative on the horizon in the form of CSDR, "firms cannot be the only source of encouragement".

The difficulty with regulatory exemption periods, White says, "is that they're usually granted late in the day and with little indication ahead of time that they'll be extended other than unreliable market mutterings".

With such limited progress made on non-EEA issuer LEIs, "it's arguable there isn't much value in requiring the population of an additional field, which would so rarely be possible anyway," White adds.

If the European Commission did provide an additional grace period, it would need to be prepared for market participants "paying less heed" to other timeframes. "This may not be a message worth sending from their perspective," White says.

Lee says that focusing on the length of the grace period is not the most important question as the "fundamental challenge" for reporting counterparties and regulators is that the relationship between reporting counterparties and security issuers is far too tenuous to force them to request LEIs from their numbering agencies.

"For example, if the reason behind needing to report the issuer LEI of a particular security is that you have received it overnight as a piece of collateral on a loan and only hold it for one day, this is far too tenuous a relationship with the third-country issuer to compel them to request an LEI," he says.

Lee says that pressure needs to come from global regulatory bodies and local NCAs to mandate security issuers to request LEIs.

"I would argue that this is for ESMA, the FCA and other NCAs in Europe to take away, raise through the FSB, rather than impose on SFTR reporting counterparties. On this basis, it would make most sense to make this field conditional on the LEI existing for the foreseeable future, until these lobbying efforts take full effect," he concludes.

The key question of course is whether an extension of the grace period will have any positive effect on recalcitrant markets at all.

Lee is pessimistic. "The relationship with issuers of securities is very different from the relationship with market counterparties, where you can impose some conditions."

Mackay says that due to the practical effects that not adopting LEIs will have on reporting, it makes sense to extend the period to allow institutions to become compliant.

"However, there does need to be a concerted effort not just from the market participants and industry bodies, but also pressure from regulatory bodies like ESMA and potentially also the NCAs to encourage these firms to get the LEI."

White is less optimistic. "It's difficult to argue that granting further extensions ever has the effect of encouraging those who, up until that point, have failed to take it seriously, to give it due attention from there onwards," she concludes.

Securities finance: Q1 2021

Over the first three months of the year global lending revenues increased by 15 per cent YoY as US equity special balances went to the moon and back. IHS Markit's Sam Pierson walks through the Q1 data

Global securities finance revenues totalled $2.6 billion for Q1 2021, a 15 per cent year-on-year (YoY) increase. Returns increased 11 per cent sequentially, as compared with Q4 2020. The new year came out of the gate at a sprint pace, with the short squeeze in US equities and soaring borrow demand for US treasuries. Growth in fixed income borrow demand extended to corporates and exchange-traded products as well. Global lendable assets reached a record high in Q1, $30 trillion, while on-loan balances reached a post-global financial crisis (GFC) high of $2.7 trillion.

APAC equity

Asia Pacific (APAC) equity finance revenues of $404 million reflect a decline of 6 per cent YoY; however, the trend is upward, with March posting a YoY increase of 4 per cent. Daily average loan balances increased by 13 per cent YoY while narrower fee spreads dragged on returns. Asia equity special balances averaged $8.7 billion for Q1, an 11 per cent YoY decline. The YoY comparison is materially impacted by the South Korea short sale ban, which is due to substantially conclude in May 2021. Compared with Q4 2020, APAC special balances increased 37 per cent in Q1, reflecting a steady increase from the low point in November 2020. Special balances are defined in this note as balances with a fee greater than 500bps.

Depository receipts

Revenues from lending American depository receipts (ADRs) increased 279 per cent YoY for Q1. Most of the increase was driven by Hong Kong SAR domiciled Futu Holdings, which generated $191 million in Q1, 66 per cent of the total ADR return. Excluding the impact of Futu, Q1 ADR revenues increased 30 per cent YoY. Depository receipts listed outside the US generated $16 million in Q1, a 74 per cent YoY increase.

Americas equity

Revenues for Americas equities came in at $996 million for Q1, a 13 per cent YoY increase. Americas revenues declined 2 per cent sequentially compared with Q4 2020. The YoY revenue increase in aggregate was the result of higher loan balances, though the quarterly aggregation belies substantial variation by month. In January, average fees were up 32 per cent compared with 2020, while loan balances were up 13 per cent, both reflecting the broad short squeeze for shares with elevated short interest. For March, the decline in special balances weighed on average fees by more than enough to offset the YoY increase in loan balances. Americas specials balances averaged $15.5 billion for Q1, a 56 per cent YoY increase, and 17 per cent sequential increase compared with Q4 2020.

European equity

European equity revenues came in at $294 million for Q1, a 5 per cent YoY increase. Revenues declined 17 per cent sequentially compared with Q4 2020. The decline compared with Q4 2020 was impacted by the drop-off in balances following the January short squeeze, most notably including Varta Ag. Specials balances for Europe, the Middle East and Africa averaged $3 billion for Q1, a 22 per cent YoY decline and 45 per cent sequential decline compared with Q4 2020.

Exchange-traded products

Global exchange-traded products (ETP) revenues totalled $137m for Q1, the highest quarterly revenue ever recorded, representing a 42% YoY increase. Loan balances increased by 41% YoY, the largest contributor to revenue growth. However, average fees also increased 6 per cent YoY. Loan balances reached a new all-time high on 23 March, $102 billion, with the final uptick to the record driven by Penn National Gaming & Caeser's Entertainment being added to the S&P 500. That narrowly edged out the prior record set in December when Tesla was added to the S&P 500. Fixed-income products generated 27 per cent of Q1 ETP revenues, up from 18 per cent for full year 2020.

Corporate bonds

Corporate bond lending returns came in at $36.3 million for Q1, a 17 per cent decline YoY. The YoY comparisons continue to be driven by narrower fee spreads, with global loan balances with positive spreads reaching a post-GFC record, $225 billion, during the last week of the quarter. Lendable assets reached an all-time high in December, though declining valuations for investment-grade corporates drove lendable value lower in Q1.

Government bonds

Government bond borrow demand remains robust, with nearly $1.2 trillion in average positive fee global balances for Q1 reflecting a 20 per cent YoY increase. Revenues totalled $383 million in Q1, a 4 per cent YoY increase. US government bond lending revenue came in at $230 million for Q1, a 7 per cent YoY increase. The most revenue-generating bond was the 10-year due November 2030, which saw substantially greater loan balances than prior 10-year notes. The US treasury 10-year due Feb 2031 delivered a revenue uplift in March, trading special for longer than prior issues, albeit with lower loan balances than the November 2030 note.

Conclusion

If the year 2020 felt like a decade, Q1 2021 was a lifetime. The short squeeze in January drove the most monthly equity finance revenue on record for US equities. Equity special balances ended the quarter well below the January peak. However, a positive signal is found in the relative underperformance of crowded US equity short positions in February and March; specials balances declining because the trades are delivering alpha may boost future demand. Beyond directional short demand, corporate actions and capital raising, the latter including special purpose acquisition companies business combinations, are likely to boost demand going forward, along with the resumption of dividends halted or reduced in 2020 and the anticipated conclusion of the remaining short sale bans. Trading in fixed income products picked up with renewed vigour in Q1, as global growth expectations ratcheted up substantially.

Borrow demand for investment-grade credit also received a tailwind from rates volatility. Varying expectations about the course of action for the Federal Reserve, inflation and economic growth appear likely to persist into the remainder of 2021. Tying the themes together, as often they do, ETPs saw soaring demand for credit, rates and equities in a record-setting.

Comings and goings at Deutsche Bank, State Street, Pirum and more

MUFG has gained Thomas Ryan from Deutsche Bank as the newest member of its global securities lending solutions group (GSLS).

Ryan joins as a senior vice president, where he will be head of asset and liability management for the Americas' GSLS business.

He will report to Anthony Toscano, head of the Americas' GSLS business.

Ryan will continue to be based in Boston.

"We are incredibly excited to welcome Tom to MUFG and GSLS teams," says Tim Smollen, global head of GSLS.

"He brings with him a very unique set of skills both on the trading and the client sides of the business in addition to a long track record of delivering outstanding results for clients."

There has been a steady stream of Deutsche Bank's agency lending team re-appearing at MUFG since Smollen led the charge in 2020.

Most recently, Christopher Morley swapped Pantone blue for red and grey when he joined MUFG in January to lead the Luxembourg branch of the global securities lending enterprise.

He left Deutsche Bank in January 2020 after just under five years as a director in global transaction banking.

Elisa Poutanen joins HQLA^X

Clearstream's Elisa Poutanen has joined securities lending blockchain platform HQLAX in the newly-created role of sales lead.

Poutanen joined Luxembourg-based HQLA^X from post-trade services provider Clearstream, where over the course of five-and-a-half years she worked in global sales and business development banking, funding and financing positions.

Before Clearstream, Poutanen had a lengthy stint at BNP Paribas, where she worked her way up to dealing services, head of client services.

Guido Stroemer, chair and CEO of HQLA^X, says: "We are absolutely thrilled that Elisa has decided to join HQLA^X to lead our sales team. Elisa has a proven track record for delivering successful results, and she joins us with incredible endorsement from across the securities finance industry.

"We are very much looking forward to Elisa's leadership in accelerating the expansion of our client footprint," Stroemer told SFT.

Nick Barnes has joined Pirum's business development team from Eurex where he was responsible for various central counterparty (CCP) and repo-related initiatives.

Barnes says: "Pirum is a company I have admired for a long time. They have a great product and are a trusted provider to many of the largest financial institutions in the world.

"I'm incredibly excited to be joining the team and leveraging my experience in fixed income, clearing and technology to contribute towards its future growth and continued success."

Starting in 1997, the former repo trader and broker spent 15 years at Barclays Capital in a number of senior front office roles. In 2015, Barnes spent three-and-a-half years as a financial investigation consultant, before a year-and-a-half stint in repo sales and development at the electronic trading platform MarketAxess.

Barnes' time at the European derivatives exchange in Hesse, German, saw him become senior vice president for the firm's fixed income, derivatives, funding and financing sales division. He will now relocate to London for the role at Pirum.

Pirum's CEO Phil Morgan says: "We're thrilled that Nick chose to join the team here at Pirum. His front office and clearing experience will be invaluable as we roll out a range of new products throughout the remainder of this year and beyond."

State Street's Wilson takes on collateral role

State Street's collateral and funding business has gained Darren Wilson from State Street Advisors, the bank's investment management division.

Based in London, Wilson spent the past two years as part of the cash and liquidity sales for Europe, the Middle East and Africa.

He will now be responsible for distributing collateral, peer-to-peer (P2P) and cleared financing solutions.

This will centre on the bank's Collateral+ product suite and the Direct Access Lending platform which offers a managed P2P trading platform.

Wilson will report to Staffan Ahlner, global head of collateral, who says Wilson's "extensive knowledge of the cash market, buy side and corporate treasury segments is instrumental in driving our Collateral+ strategy forward".

Wilson also brings experience from a stint with Bupa where he held senior roles in asset management and treasury.

The collateral and funding team's growth comes shortly after the Collateral+ suite added a major string to its bow with the addition of triparty collateral service for buy-side-clients.

In the adjacent financing vertical, the bank also expanded its P2P services with a new repo marketplace.

Upcoming Securities Finance Training

Non-Cash Collateral Fundamentals

Date: 14th Apr 2021
Location: Online
Provider: Consolo
This live on-line training course is delivered by an experienced market practitioner and designed for anyone who needs to understand non-cash collateral purpose, process and requirements.

SFTR

Date: 16th Apr 2021
Location: Online
Provider: Consolo
This live online training course is designed for anyone who needs to know the background, structure, reporting obligations and timeline for delivery of the European SFT Regulation