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Moving on up

BNY Mellon's Brian Ruane reflects on collateral management's shift up the value chain

EquiLend launches regulatory technology solutions division

EquiLend has welcomed the launch of EquiLend RegTech Solutions, a new division developed to aid clients in meeting global regulatory requirements.

Kevin McNulty, former CEO of the International Securities Lending Association (ISLA), will lead the division as the newly appointed head of RegTech Solutions. McNulty joined EquiLend in a consultancy role in October 2021.

Alongside this division, the firm has launched the EquiLend RegTech Solutions group as part of a company-wide strategic initiative to serve the evolving needs of securities finance industry participants.

EquiLend RegTech Solutions includes an integrated suite of services supporting clients with multiple global regulations including Securities Financing Transactions Regulation, Central Securities Depositories Regulation, Agency Lending Disclosure, the proposed SEC 10c-1 rule, in addition to supporting clients with their ESG requirements.

Commenting on the launch, McNulty says: "The challenge of meeting regulatory requirements for industry participants is still great, with new requirements on the horizon around the world and the prospect of existing rules being reviewed and changed.

"Given EquiLend's focus on creating value-added solutions for clients, it makes perfect sense to create a division purely focused on this area. I am excited to lead this initiative and am looking forward to working with Brian, the EquiLend team and of course our clients in further developing our suite of regulatory solutions."

Inside this issue


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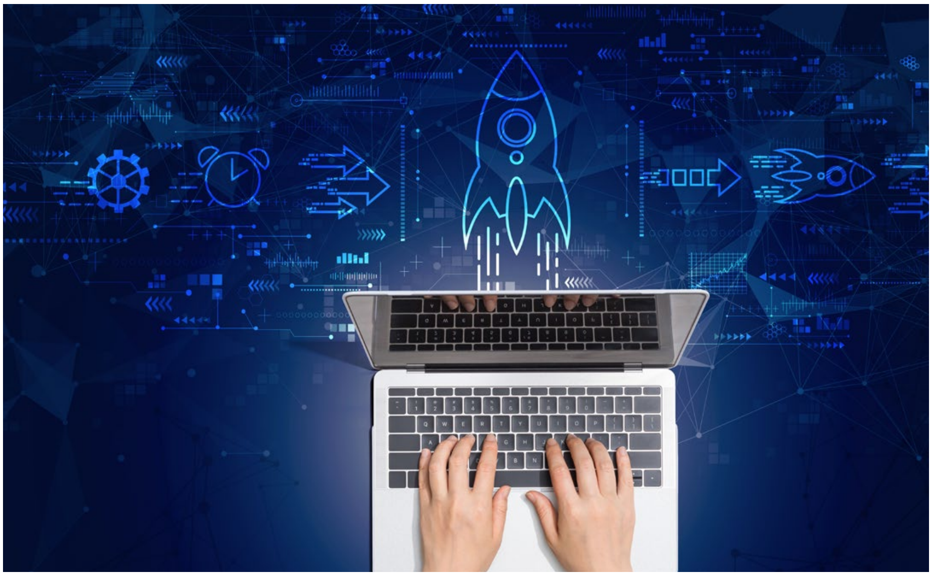
[1] *Global Investor* ISF Survey 2020 – Securities Finance Agency Lending named Most Innovative Lender



Delta One announces launch of equity finance trading platform

Delta One has announced the launch of its equity finance trading platform, which will be available through the Bloomberg app portal.

Delta One is a peer-to-peer stock lending and balance sheet management platform that uses options to pair participants and gives users pre- and post-trade analytics to help them make informed, real-time decisions at the portfolio level, according to the firm.

The Delta One platform will be available to Bloomberg customers through the in-terminal app portal, which allows users to access a diverse library of financial tools.

Speaking on the announcement, Harris Bock, CEO at Dynamex Trading and co-founder of Delta One says: “We built the platform to empower users to make informed decisions and then help them monitor risk on a portfolio level for the entire life cycle of the trade.”

Brandon Neer, founder of Delta One, adds: “The app provides a wide variety of real time metrics including early exercise modelling, net effective finance rate modelling in early exercise scenarios, optimal strike and expiration selection algorithms, and expected P&L forecasting.

“Trading stock borrow in the multi-trillion dollar options market can be a great source of alpha, but there are some narrow, deep holes that investors can fall into. Our technology helps model those risks and put them in the context of expected P&L. Investing risks can never be fully avoided, but we give our users the proper tools to face them head on.”

FCA fines TJM for facilitating Solo Capital cum-ex trades

The Financial Conduct Authority has fined The TJM Partnership slightly more than £2 million for control failures linked to cum-ex trading.

This is the third fine that the UK regulator has applied in connection with cum-ex and the largest penalty that it has imposed so far. These relate to trading activities that TJM conducted on behalf of Solo Group between January 2014 and November 2015, cases that have been extensively reported in Securities Finance Times.

The FCA rules that trades executed by TJM on behalf of clients of Solo Group were characterised by "a circular pattern of purported trades", characteristics which the regulator suggests "were highly suggestive of financial crime."

This trading, it concludes, appears to have been conducted to enable withholding tax reclaims to be made in Denmark and Belgium. These trades were for an aggregate value of £59 billion in Danish equities and £20 billion in Belgium equities. The FCA indicates that TJM received a total commission of £1.4 million for executing these trades, which represented a "significant proportion" of the firm's revenue for the period.

TJM, which is now in administration, also failed to maintain adequate systems and controls to mitigate risk that it was being used to assist fraudulent trading and moneylaundering.

The FCA also referred to two other cases related to Solo Group where TJM failed to identify or escalate concerns about financial crime or moneylaundering. In another instance, it found that TJM had accepted money from a third party without conducting necessary due diligence.

In March, Denmark established an extradition treaty with the United Arab Emirates to lay the foundations for the extradition of Sanjay Shah, founder of Solo Capital, who was resident in Dubai. Shah and another British national are accused by the Danish government of having defrauded the Danish exchequer out of more than DKK 9 billion (approx £1.5 billion) through illegal cum-ex trading and associated activities.

The FCA indicated that TJM had agreed to resolve all the issues of fact and liability that emerged from this case and, as a result, the fine was reduced by 30 per cent. Without this reduction under the FCA's Settlement Discount scheme, the regulator indicated that the fine would have been £2,399,000.

In its Final Notice on the settlement, the regulator states that Solo Group purported to provide clearing and settlement services as custodian to its clients within a closed network. These clients were principally offshore companies, including entities incorporated in the British Virgin Islands and the Cayman Islands, along with US 401(k) pension plans.

According to the FCA, the Solo Group clients were often entities controlled by a small number of individuals, some of whom had previously worked for Solo Group, and which did not appear to have access to sufficient funds to settle the trades.

TJM was found to have executed OTC equity cum-ex trades for a value of approximately £58.33 billion in Danish equities and £19.71 billion in Belgian equities on behalf of Solo Capital clients during the period under investigation.

This reportedly featured a circular pattern of high-value OTC equity trades, back-to-back stock loan transactions and forward trades involving EU equities on or around the last day of the cum-dividend period. These trades were then subsequently unwound through trades conducted after record date.

The FCA says that OTC trades conducted by TJM were executed on platforms that did not have access to liquidity from public exchanges. These shares were reportedly filled “within a matter of minutes”, despite representing up to 24 per cent of the shares outstanding in the Danish-listed companies and up to 10 per cent of the equivalent Belgian stocks.

These OTC trades equated to an average of 47 times the total number of shares traded in the Danish stocks on the Danish stock exchange and 22 times the total number of the shares traded in the Belgian stocks on European exchanges on the last day that the shares were cum-dividend.

The purpose of this trading, The FCA concluded, was so that Solo Group could arrange for dividend credit advice slips (DCAS) to be created which purported to show that Solo clients were owners of the shares on the record date. In some cases, these DCAS were then used to reclaim withholding tax from the Danish and Belgium tax authorities under the relevant Double Taxation Treaties.

TJM staff were reportedly eager to maintain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their relationship with Solo Group, which was referred to as the "chicken that laid the golden egg", according to the FCA's Final Notice. Before taking on this Solo Group business, TJM was losing approximately £20,000 to £30,000 each month, according to this statement.

EquiLend to release Swaptimization TRS platform in EU

EquiLend will release its Swaptimization platform for clients in the European Union in the autumn.

The company is currently close to finalising regulatory approval from the Central Bank of Ireland to operate Swaptimization as an organised trading facility (OTF) that will allow EU financial institutions to trade on the platform.

The platform employs a proprietary matching algorithm to pair positions to support trading in bilateral security-based total return swaps (TRS). This facility has been operating since 2019 for the US swaps market.

Prior to its EU launch, EquiLend has supplemented the features offered on the Swaptimization platform to include credit approvals and hedging notifications to counterparties, along with smart allocations for GC funding baskets. This also now offers an improved audit trail across the trade lifecycle.

To boost its capability in this area, the securities finance trading, post-trade, data analytics and regtech company has appointed Matthew Zienau as swaps product specialist.

Based in London, Zienau will report to EquiLend's head of Swaptimization and clearing services Matt Collins and head of trading for EMEA and APAC Rowena Brown.

Commenting on his appointment, Zienau says: "I am thrilled to be joining EquiLend at a pivotal moment for the swaps industry as the firm continues its strategy of bringing automation to the global swaps markets.

Tradeteq to launch TRADA Tokens on XDC Network

Tradeteq, a data, technology and software provider, has selected the XDC Network to launch fully regulated, trade-finance-backed fungible security tokens, TRADA Tokens.

The firm aims to deliver significant liquidity to the trade finance sector by securitising a traditionally illiquid asset class on the XDC Network — a public decentralised blockchain.

By using fungible security tokens with concrete collateral, Tradeteq says it will begin the process of “ramping up on-chain transaction volume of regulated, real-world assets” and extends access to the trade finance market to retail and institutional investors.

According to Tradeteq, the TRADA launch signals blockchain’s adoption in a regulated arena. It positions the XDC Network as a way to connect real-world finance origination with decentralised finance (defi) markets, confirming a number of reports that foresee a wave of tokenised assets on the blockchain.

Speaking on the announcement, Nils Behling, chief financial officer and co-founder at Tradeteq, says: “This launch is an important move in the democratisation of trade finance through XDC’s enterprise-grade blockchain technology.

“By investing in trade finance, which historically has been restricted to banks and larger institutional investors, private investors can now invest in the real economy. The XDC Network is our chosen blockchain to develop this system and XDC is the only crypto asset that can be used to purchase TRADA.”

Atul Khekade, co-founder of the XDC Network, adds: “XDC Network is completely decentralised and has been optimised for enterprise applications over a period of years. As the preferred network for its token issuance, Tradeteq offers further validation of the XDC Network's real-world utility."

SEC beefs up crypto enforcement unit, charges insider traders

The US Securities and Exchange Commission (SEC) has announced that it will reinforce its powers of supervision and investigation through its Crypto Assets and Cyber Unit with the appointment of 20 new specialists to the division.

Through this expansion, the agency intends to strengthen its investor protection capacity linked to crypto markets and cyber-related threats, with particular focus on securities law violations linked to crypto asset offering, trading exchanges, broker-dealers and lending of crypto assets.

These measures will also reinforce its supervisory and enforcement powers related to decentralised finance, non-fungible tokens and stablecoin.

The SEC indicates that the division has filed more than 80 enforcement actions associated with fraudulent and unregistered crypto asset platforms and crypto asset offers, which have resulted in total penalties or monetary relief totalling more than US$2 billion.

This enhanced oversight programme, announced by the US securities market regulator on Friday 21 July, will particularly target "gatekeeping accountability" and the failings of financial gatekeepers to fulfil their obligation to ensure financial probity.

Gatekeepers such as accountants and attorneys are often the first line of defence against misconduct, the SEC states, and when they fail to live up to their responsibilities, investors often suffer and the integrity of financial markets is called into question.

The agency has brought a number of recent cases against gatekeepers that have themselves been engaged in malpractice, have attempted to cover up wrongdoing or they have failed to implement compliance obligations and procedures.

The SEC has also announced charges against three persons for alleged insider trading violations linked to digital assets, including a former Coinbase product manager.

Its complaint states that the Coinbase manager, Ishan Wahi, repeatedly tipped off his brother Nikhil Wahi and another person, Sameer Ramani, about the content of forthcoming listings announcements.

This alleged offence, which took place while Ishan Wahi helped to coordinate Coinbase's public listings announcements, involved sharing details of crypto assets or tokens that would soon be made available for trading.

The SEC's complaint maintains that, in doing so, Ishan Wahi acted contrary to Coinbase corporate policy, which specifies that Coinbase treats this information as confidential and its employees must not trade on the basis of this information, or "tip" this information to others.

The SEC statement indicates that this "long-running insider trading scheme generated illicit profits amounting to more than US$1.1 million.

Speaking about this enforcement action, the SEC's director of its enforcement division Gurbir S Grewal says: "We are not concerned with labels, but rather the economic realities of an offering. In this case, those realities affirm that a number of those crypto assets were securities and, as alleged, the defendants engaged in typical insider trading ahead of their listing on Coinbase."

"Rest assured we will continue to ensure a level playing field for investors, regardless of the label placed on the securities involved," he says.

Carolyn Welshhans, acting chief of the SEC enforcement division for crypto assets and enforcement division, adds: "In nearly a year, the defendants collectively earned over US$1.1 million in illegal profits by engaging in an alleged insider trading scheme that repeatedly used material, non-public information to trade ahead of Coinbase listing announcements."

BMO joins GPFA and raises total assets to $10tn

The Global Peer Financing Association (GPFA), the peer-to-peer lending company, has announced BMO Wealth Management Canada as the newest member of its global asset owner community.

BMO Wealth Management joins as the 26th asset owner member of GPFA, raising the total assets across the global GPFA member community to more than US$10 trillion.

Commenting on the news, GPFA says: "We are excited to deepen our community with additional asset and wealth management perspectives. Welcome BMO Wealth Management – Canada!"

GPFA brings together beneficial owner members with the goal of encouraging the development of a more effective and transparent marketplace for securities financing activities, liquidity management and collateral management.

Members of the GPFA community share a goal to increase and support peer-to-peer securities financing trading activity.

Brian Ruane
CEO
BNY Mellon Government Securities Services Corporation and Clearance & Collateral Management

Collateral management: promoting flexibility, connectivity and data utilisation

Brian Ruane, CEO of BNY Mellon Government Securities Services Corporation and Clearance & Collateral Management, recently met with Justin Lawson to discuss the firm's growing collateral business and the first phase of the new user interface for their flagship application, AccessEdge

This new redesigned user interface will include enhanced inventory and trade management capabilities, and a unified portal that simplifies the client experience. BNY Mellon has invested in, and is focused on, enhanced resiliency, improved operational workflow and increased collateral efficiency.

Brian, please tell us about BNY Mellon's collateral management services?

BNY Mellon provides clearance and collateral management solutions to a wide spectrum of client types, including banks, broker-dealers, investment managers and other buy-side market participants. Total global collateral balances on our platform are US$5.5 trillion, representing repo, derivatives and other secured financing transactions.

We are encouraged by the market's move to managing more collateral balances via a tri-party structure and continuing to connect to new markets and pools of collateral, including central counterparties. In 2022, we launched a new version of our AccessEdge User Interface, which provides clients with visibility into total collateral sources and uses across regions and legal entities on our platform. We have also introduced Your Collateral Universe, where users can access those solutions in a single state-of-the-art ecosystem, bringing to life all our market-leading capabilities.

What is new in the collateral management space at BNY Mellon?

We are enhancing our platform to enable clients to utilise assets as collateral against trading liabilities in a variety of venues. As such, we are focused on three key areas, namely resiliency, digital enablement and market connectivity.

We have made significant investment in resiliency. Our modernised platform is secure, scalable, recoverable and we run our production environment in multiple data centres simultaneously.

"We are encouraged by the market's move to managing more collateral balances via a tri-party structure and continuing to connect to new markets and pools of collateral, including central counterparties"

Our new digital tools leverage data and create insights to help to grow our clients' business and improve their margins. Collateral optimisation continues to be a key focus and we are helping clients to optimise for the market's most complex regulatory objectives. We have built a suite of customisable solutions, allowing clients to simulate collateral eligibility and optimise very large portfolios within minutes, including the ability to run what-if scenarios on assets held on and outside our platform.

Building on the strength of our collateral optimisation solutions, we are delivering advanced analytics that will help clients to forecast bilateral treasury repo rates and bilateral settlement fails. Clients will be able to mitigate these fails in an automated manner that will deliver material benefit to the market, improving liquidity and reducing their costs.

We have implemented RULE, a flexible and intelligent self-service application for the creation and management of collateral schedules, allowing clients to book new trades more efficiently as well as to manage the modification of existing trades, all without manual intervention.

Digital assets and distributed ledger technology continue to mature and we are in the early stages of working with clients to tokenise US treasury securities to enhance collateral mobility and liquidity. Additionally, BNYM Securities Lending recently led the market with a trade booked on the HQLA^{X} platform.

> *"Collateral management has moved up the value chain from primarily driving back-office efficiencies to being an integral part of our clients' funding and trading models"*

Our platform was developed to support open architecture, promoting connectivity to other market infrastructure providers. Recent examples include our first-to-market solutions supporting the use of offshore Chinese assets for both Stock and Bond Connect on our platform. It is critical that we continue to develop new markets for our clients and enhance their ability to finance assets globally. In addition, we are enhancing our central counterparty (CCP) connectivity, making it easier for clients to move collateral to meet margin requirements and support collateral substitutions.

What trends are you seeing in the industry?

Collateral management has moved up the value chain from primarily driving back-office efficiencies to being an integral part of our clients' funding and trading models. Three trends that clients continue to look for in the marketplace are increased flexibility, improved connectivity and better utilisation of data.

Clients want the flexibility to optimise their portfolio across a broad range of metrics in a central funding model and to minimise costs by using the right asset to support the right obligation in the right legal entity at the right time. This includes greater integration and interoperability between settlement locations, leading to increased velocity of collateral.

Clients are looking for increased connectivity to other market infrastructure, technology partners and clients via modern methods such as application programming interfaces (APIs), while continuing to support standards such as SWIFT. In addition, our open platform allows for CCP connectivity, making it easier for clients to move margin collateral and make substitutions.

Given our position in the marketplace, clients look to BNY Mellon to leverage our data view to provide efficiencies to clients. A key example of this is our recent investment in our front-office analytics portal. Imagine a front-office trader who logs into their own view of BNY Mellon's platform to identify Fed-eligible securities settlement fails multiple hours before they occur in near real-time throughout the day. The trader can then source a security to mitigate the fail via a push-button solution in real-time, ensuring settlement finality right up against the Fedwire cutoff. We feel the market could save multi-millions in Treasury Market Practices Group (TMPG) fails charges, while improving counterparty relationships and market liquidity.

It is evident that, as the market moves, we adapt to provide services for our clients' demand. BNY Mellon is a leader in global collateral management and active in the entire lifecycle of collateral management. The investment in our core technology and user interface is improving the client experience and simplifying doing business on our platform. We continue to invest in the business and explore new technologies to ensure that our platform supports our clients' collateral management needs and the increased demand for decision-making tools. We are excited about the future.

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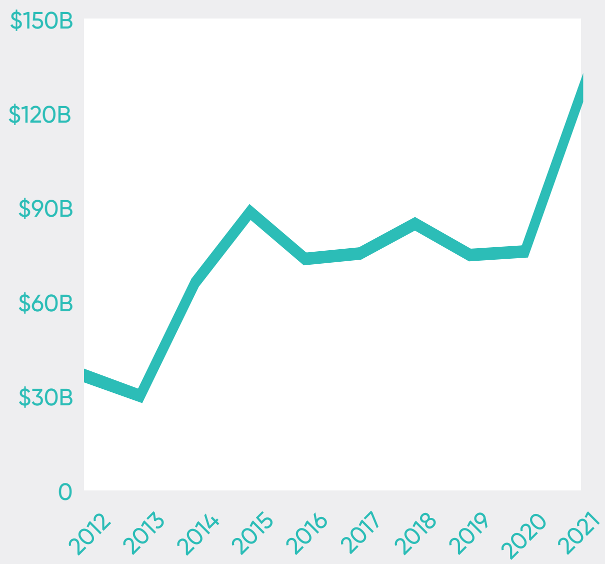
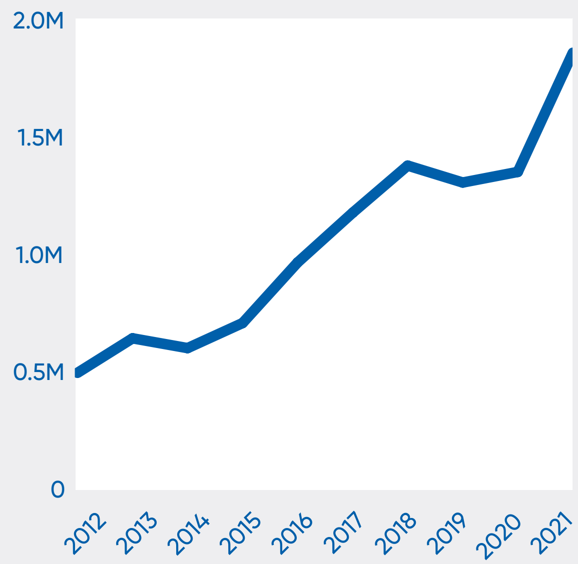


Annual New Loan Transactions



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Rethinking the economics of indemnification

Securities lending indemnification is mispriced, subsidised by the agent providers and not all it's cracked up to be as a risk mitigant, according to Credit Benchmark's co-founder Mark Faulkner. He talks to Bob Currie about how to reset the economics of the agency lending market

"Something's happening and it's happening right now, you're too blind to see it", said UK punk band The Stranglers back in 1977. Perhaps this was a veiled reference to the extension of borrower default indemnification in the securities lending world and to the heavy regulated capital cost this would come to represent for the agent lender community.

Mark Faulkner liked the song enough to name a research paper after it — or so SFT would ask you believe — and his study, Something Better Change: Securities Lending Indemnification is Unsustainable in its Current Form ('the report'), combines an ear for a good tune with a thought-provoking assessment of pricing, risk and competitive dynamics in the SBL marketplace.

An overarching thesis running through the report is that beneficial owners have become "overly dependent" upon securities lending indemnification, with many requiring it as a matter of course rather than after carefully evaluating its value as a genuine source of risk mitigation. This indemnification offers protection to the lender against two potential concurrent statistically low risk events — the default of the borrower counterparty and a shortfall in the collateral following liquidation.

This situation persists, in part, because securities lending indemnification remains poorly understood by those receiving the benefit. In many cases, Faulkner suggests, indemnification is mispriced — and artificially subsidised — by the service providers offering this protection. With the associated capital cost, this has become increasingly expensive for the agent bank to deliver (p 8).

Cost of protection

Running a more detailed cost-benefit analysis — and building on the groundwork done by State Street's Glenn Horner in a 2013 paper named The Value and Cost of Borrower Default Indemnification — the report estimates that the economic benefit realised by the beneficial owner, the protected party, is low at approximately 0.2bps. This is well below the real-world cost of providing the indemnification, which it estimates to be closer to 0.9bps — a sizeable difference that, Faulkner suggests, is invariably absorbed by the custodial lending agent and almost never passed on to the lender or the borrower (p 22).

When the regulatory capital cost attached to providing indemnification is also factored in, the gap between the economic benefit to the lender and the aggregate cost of providing indemnification widens dramatically — roughly 13bps regulatory capital cost under the Basel III bank capital adequacy regime.

This regulatory cost, he notes, has grown significantly since 2015 and is likely to remain well above 2015 levels with enactment of forthcoming Basel IV regulation. "Although agent advocacy with regulators has gone some way to reducing this cost, the spreads between the benefit, economic cost and regulatory cost of indemnification remain material," says Faulkner.

Recognising the economic drag, or disutility, presented by this cost overhead, the report argues that the regulatory capital costs have become decoupled from the economic reality. In practical terms, this has been punishing for agent lenders, with this heavy regulatory capital cost simply not an efficient use of capital for those organisations.

As one un-named agent lender told the report author: "We think about capital being fluid and moving around our organisation seeking returns. With the cost of capital across the street [being] circa 10 per cent and targeted post-tax returns of 15 per cent, using capital to support securities lending indemnification is not the best use of capital for any organisation — especially when significantly higher returns on capital are available elsewhere." (p 9)

Responding to this dialogue, Mark Faulkner indicates that it is hard to understand why a large institutional lender (for example, a sovereign wealth fund, a large pension fund or endowment) would continue to demand this indemnification requirement from their agent when this provides such limited economic benefit for the recipient.

Faulkner understands that State Street has been in the securities lending business since 1974 and has never been required to pay out on an indemnification programme. Yet, the regulatory capital cost that agents bear in providing this indemnification remains punishingly high.

The train has long since left the station, however, and agents have missed earlier opportunities to explain the regulatory challenges that they were facing to their clients and to potentially reset the economics of the securities lending market.

This divergence between the cost, the benefit and the regulatory capital cost of indemnification is unsustainable in current market conditions, he notes, and this "will hopefully provide a catalyst for change". The report urges interested parties to work with regulators to ensure that the securities lending industry can continue to deliver its important role in providing short-side liquidity for global capital markets. Failure to change could have significant ramifications for global capital markets, it concludes.

(Don't you like the way) I seem to enjoy it

So how will the industry adapt from the current indemnified orthodoxy? For a lender that receives indemnified lending at heavily subsidised cost from the agent lender, there may be little motivation to change. And borrowers, who are unlikely to pick up this indemnification cost, will not be shouting loudly for reform. Somewhat caustically, the paper indicates that the largest borrowers have been "free riding" the provision of effectively free indemnification, which in practice has lowered the price of the GC lending market.

Understandably, many within the lender and borrower communities rather like the current arrangement. “For years, the agents have effectively been picking up the tab for facilitating business between principals while insuring one side of the trade against the default of the other,” says the report (p 28).

One reason for reform, Faulkner notes, is that this will potentially deliver a more cost efficient and innovative industry where lenders can explore more creative ways of lending either through intermediated or non-intermediated channels. In their cost-benefit analysis, lenders would do well to factor in the potentially significant benefits of being able to opt out of an indemnified programme and construct a bespoke lending solution for themselves.

A group of large global lenders — formed initially by the California Public Employees’ Retirement System (CALPERS), the Healthcare of Ontario Pension Plan (HOOPP), the State of Wisconsin Investment Board (SWIB) and the Ohio Public Employee Retirement System (OPERS) — have been collaborating for almost a decade (and considerably longer informally) to drive peer-to-peer securities lending and financing. For organisations that are not members of this Global Peer Financing Association (GPFA), attractive opportunities also exist to widen their lending opportunities through directed trading, by extending loan terms and employing wider collateral flexibility.

According to Faulkner, the benefits to asset owners of employing greater flexibility in their lending strategies is more than likely to outweigh the costs of foregoing this low value indemnification. He is encouraged that some forward-thinking asset owners are already moving in this direction and are active in the securities lending market without borrower default indemnification. He recounts a recent discussion with the head of risk at a global sovereign wealth fund, for example, who had already reached the same conclusion — that indemnification is unnecessary to operate their programme effectively and they may achieve better programme performance and more creative lending strategies without being indemnified.

Let me down easy

The genesis of this situation was that, at the time that indemnification was introduced, the economics involved in offering this service were not well understood. But with the way that margins have moved in the global securities services marketplace subsequently, Faulkner believes that the economics of indemnification are not sustainable for the agent lender as they are structured currently.

General collateral lending, in particular, consumes a high level of capital for the agent lender and provides relatively low returns for the lender — but, the report notes, this continues to be priced at unrealistic levels.

To sustain this GC lending activity, Faulkner believes that the market needs to embrace new business models, reduce the “historic and unnecessary dependency on indemnification” while potentially also managing down loan supply. The market, he feels, is saturated with GC supply and agents need to start managing some lenders — beneficial owners that generate limited supply of higher-value hard-to-borrow loan securities — out of the market. “It is well understood that managing an ‘unattractive’ lender out of a programme is fraught with difficulties,” notes Faulkner, “not least because there may be a material source of revenue for the agent in other business units such as custody and foreign exchange. However, it might make sense for agents to grasp this nettle.”

Several factors have worked in combination to reduce loan demand. Equity bull markets have suppressed short selling activity and reduced demand for hot and warm securities. Use of synthetics, particularly total return swaps, has lowered demand through “traditional” lending markets, with prime brokers and hedge funds meeting a greater share of their borrowing requirements through synthetic channels. Improved technology and process management at borrower organisations have enhanced their ability to manage internal inventory and to internalise more of their stock borrowing requirements. As noted, there is also a rising appetite from some large beneficial owners to transact directly between each other through a P2P network such as that extended by the GPFA.

With a decline in the volume of specials, which generate high lending fees, this has reduced the appetite for borrowers to maintain high GC balances with agent lenders to secure preferential access to these higher value specials.

This economic pressure has been exacerbated as lenders have negotiated more aggressive fee splits against their indemnified lending activities. The report notes that in the early 2000s, the custodial agent lender might receive 25-30 per cent of the lending fee, against 70-75 per cent paid to the beneficial owner. Subsequently, this split has narrowed over the past decade — often to just a 10-15 per cent fee share for the agent lender, or sometimes even lower.

Recounting a conversation with a large global custodial lender, Faulkner explains that with roughly 10bps revenue for GC lending and a 10-15 per cent fee split, the agent is receiving 1-1.5bps for GC lending prior to costs and tax. "Given the cost of indemnification of 10.3bps in a Basel III world, one needs to seriously ask whether it's worth doing," comments the agent lender (p 20).

Value and volume

Noting the aggressive fee splits that have developed within some agency lending relationships, SFT asked Faulkner whether this could work to the advantage of large custodian lenders, with huge lending books, high automation levels and powerful optimisation engines — thereby driving consolidation in an heavily populated agency lending market and enabling them to win further market share at the expense of smaller competitors.

Faulkner politely rejects this proposal, indicating that the economics do not add up even for the highest-volume players. "It is doubtful whether this will work to their advantage," he says. "If the agent is being compensated 1 to 1.5bps for GC lending and faces a capital charge of 10 to 13bps per loan transaction in providing indemnification, a higher loan volume simply results in a higher capital overhead. For a GC volume-based lender, automation is likely to compound this problem – higher balances mean higher regulatory capital expense."

By contrast, he believes that some of the smaller players that position themselves as value lenders may be better placed to take advantage. Brown Brothers Harriman (BBH), a self-professed value-based lender, looks likely to be purchased by State Street for example, potentially bringing wider value-lending opportunities to the Boston-based bank through the acquisition. But integrating this business may present its own organisational and operational challenges, recognising the complexity of running a value-based lending business and heavily automated GC flow alongside each other via a common architecture.

Other major global custodian banks have been developing enhanced custody solutions and stepping further onto the prime brokerage domain, offering an integrated custody, securities lending, financing, clearing and settlement solution, in some cases with directed lending and peer-to-peer repo services available as part of the package. With peer-to-peer loan value rising through the GPFA, large lending agents may be interested to explore opportunities to apply their sophisticated machines and workflow to support P2P transactions, along with associated collateral management and custody services, thereby facilitating principal-to-principal trades which will not typically require indemnification. The convergence of enhanced custody and agency prime seems to be gathering momentum in the marketplace.

For the agent bank, this offers a much more attractive business proposition which will potentially free up a large capital overhead that can be reinvested into product innovation and into delivering further service enhancements to the client.

More broadly, Faulkner predicts that at some point the scale of agency lending activity — with outstanding lending balances close to US$2 trillion according to recent estimates — will force change and a major lending agent will make the "prudent and brave" decision to change their lending business models and pricing.

No doubt, this will trigger resistance and will require awkward initial conversations with some clients. This may prompt a reaction from some large prime brokerage counterparties, for example, that may decide to withdraw their business and reposition GC balances with other providers. A problem, Faulkner notes, is that things that are given away for free will tend to be consumed infinitely — and perhaps indefinitely — and that is a hard cycle to break.

But, alluding to the Pareto Principle (think 80:20), Mark Faulkner indicates that it is not essential to change the whole market from day one. By convincing 20 per cent of the market that has the greatest impact and influence, this can have a major effect on the industry's direction of travel.

For asset owners, Faulkner proposes that larger beneficial owners should ask themselves whether they really need an indemnification, given the risks it protects them from. If they do, they might consider sourcing this from a third-party insurer which, as a specialist insurance provider, may be better positioned to craft an indemnification package that is tailored to beneficial owners' specific needs.

Significantly, the regulatory environment applied to insurance business may allow third-party insurers to indemnify this risk at a lower regulatory capital cost than is applicable to banks under the Basel regime. With this in mind, some banks are also exploring avenues to transfer significant risk associated with securities lending indemnification as a means of reducing the regulatory capital overhead. ■

Mark Faulkner, *Something Better Change: Securities Lending Indemnification is Unsustainable in its Current Form,* Credit Benchmark, June 2022, can be accessed here.

Latest industry appointments at J.P. Morgan, OCC and Sharegain

J.P. Morgan has announced the formation of a new global trading services sales team for securities finance and collateral services products, which is to be led by Eileen Herlihy.

Prior to this role, Eileen Herlihy was head of derivatives clearing sales for Europe, Middle East and Africa at J.P. Morgan.

The team, headed by Herlihy, will be responsible for selling J.P. Morgan's agency securities finance and collateral services products and will also provide securities services coverage to the firm's bank and infrastructure clients.

This sales team will sit within J.P. Morgan's platform sales team, which sits alongside the collateral management and agency lending division that is led by Ben Challice.

Standard Chartered has appointed Andy Ross as global head of prime and financing, financing and securities services (FSS).

In addition to his prime and financing role, Ross will serve as financial markets head in the UK, commencing 1 August.

Based in London, Ross will report to Margaret Harwood-Jones, global head of financing and securities services, financial markets, and to Molly Duffy, head of Europe and Americas, financial markets.

Ross has more than 20 years of experience in the financial services industry, and joins Standard Chartered from the London Stock Exchange (LSE) Group-backed derivatives market CurveGlobal, where he was CEO and member of the capital markets leadership team at LSE Group.

Prior to CurveGlobal, Ross held a number of senior management positions at Morgan Stanley during his 16-year term with the firm, including European head of over-the-counter clearing.

Commenting on Ross' new appointment, Harwood-Jones says: "Prime and financing

Sharegain appoints Tuliebitz to head of business development

Sharegain, a capital markets infrastructure finance technology company, has announced the hire of Samuel Tuliebitz as head of business development.

Based in London, Tuliebitz will build on Sharegain's existing partnerships with banks and wealth managers, and drive the company's strategic expansion plans into new markets and geographies.

Tuliebitz joins after 12 years at J.P. Morgan, where he led fintech strategy for the firm's international private bank.

Speaking on the new role, Tuliebitz says: "I have had the greatest privilege of meeting and assessing a significant number of top fintech companies for J.P. Morgan's investment bank and private bank. Sharegain — without a doubt — was the most innovative of them all, uniquely delivering monetizable value into institutional capital markets, as well as retail wealth, which I found to be remarkable."

Boaz Yaari, founder and CEO of Sharegain, adds: "We are delighted to have Sam on board. First and foremost, because he is a terrific person and a natural leader. And second, because Sam has a proven track record of working with, understanding, and commercialising new technologies."

is core to the FSS business, and I am thrilled that someone of such high calibre is joining our team to further enhance the growth momentum of our business and deliver our client commitments."

BNY Mellon has appointed Joshua Lavender to its securities services and digital team as global head of consultant relations.

Based in New York, Lavender will work to drive engagement with the global consultant community, in addition to developing and executing on a coordinated coverage model and collaborating with market influencers to implement solutions.

Lavender's experience in the financial sector extends across three decades, which includes a 13-year term with J.P. Morgan.

Prior to joining BNY Mellon, Lavender acted as client executive and head of US asset owner consultant relations within the securities services division of J.P. Morgan.

He began at the firm in 2008 as a practice leader within the treasury and securities services division, before transitioning into more senior roles such as head of US consultant relations, securities services.

During the course of his career, Lavender also held positions at General Motors Asset Management and Merrill Lynch.

Commenting on the announcement, Jane Mancini, head of business development and asset servicing at BNY Mellon, says: "BNY Mellon has a long history of working closely with the consultant community to address the needs of institutional investors.

The Options Clearing Corporation (OCC) has elected Mike Nowak as chief financial officer and a member of its management committee, effective 8 August.

At his new post, Nowak will oversee all of OCC's corporate finance functions including treasury, finance, accounting, strategic sourcing, as well as facilities and vendor management.

Prior to joining OCC, Nowak was the chief financial officer of ABN AMRO Clearing Chicago — a broker-dealer and futures commission merchant — where he oversaw the day-to-day management of liquidity, capital, balance sheet and regulatory reporting for the firm.

Additionally, he had previously served as the chief operations officer at ABN AMRO, overseeing all back-office functions.

Nowak has been involved in multiple committees and working groups over the years including the Depository Trust Committee, the Financial Industry Regulatory Authority, CME Group, and the Futures Industry Association. He was also a member of OCC's board of directors.

Commenting on Nowak's new appointment, Craig Donohue, OCC's executive chairman, says: "As both the former CFO at one of our member firms and a former OCC Board member, Mike has been a strong partner over the years who has a deep understanding of our industry and our business.

"He is an established leader with a track record of success, and we look forward to him joining our team."

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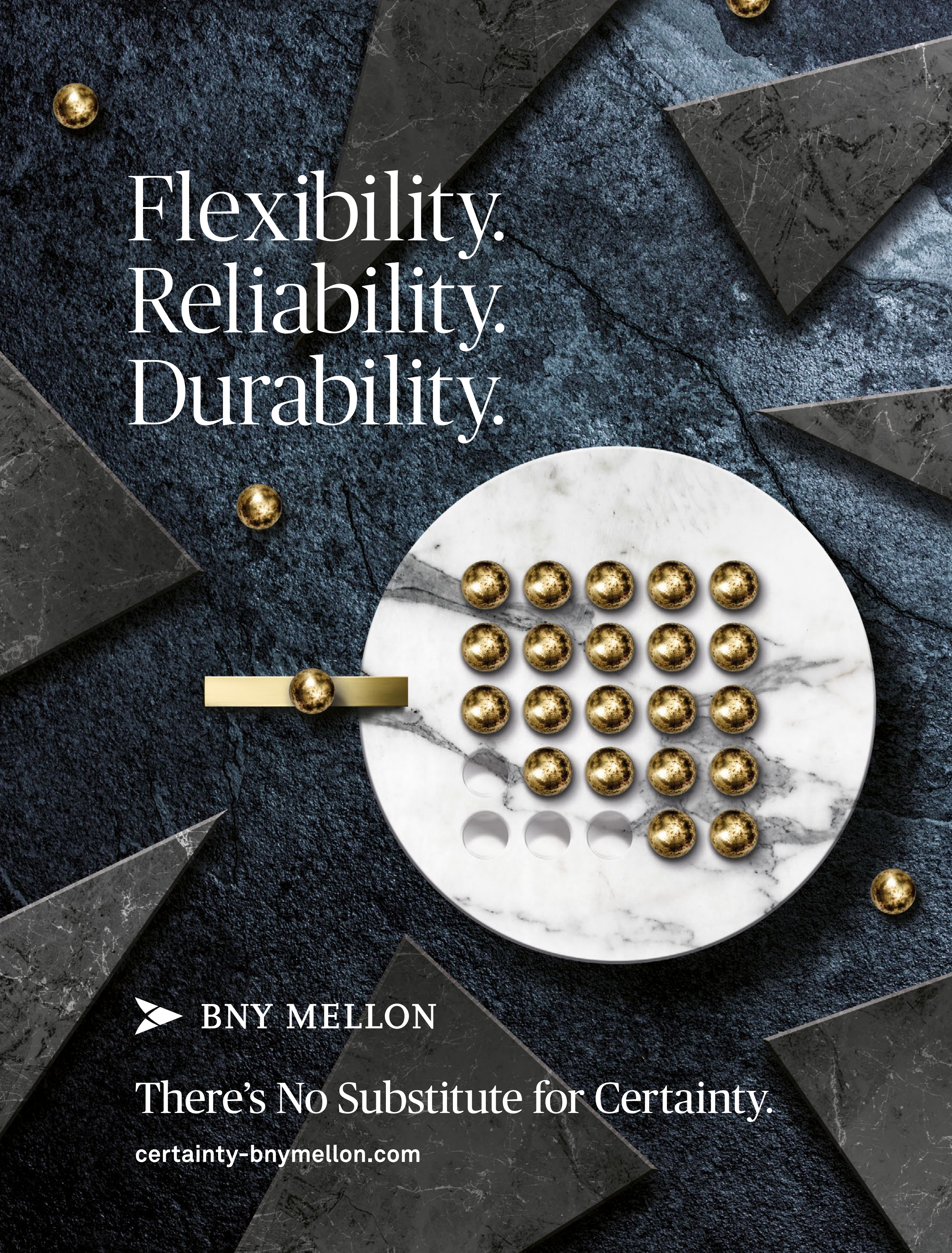
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