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Hammer time

Norse mythology has it that Thor, the God of Thunder, wielded the indestructible hammer Mjölnir, and modern depictions continue to associate him with strength and power. But Thor and his hammer were also associated with life and fertility, and in an attempt to modernise the Thor comic book franchise, Marvel writers have given Mjölnir to a female character.

The Nordic securities finance markets also have multiple facets to their character. Denmark, Norway, Sweden and Finland are strong, but Iceland is relatively weak when it comes to business. There are also characteristics that make each market different, and these must be taken into account by borrowers and lenders alike.

Included within these pages is all of the information and advice you could want on securities finance in the Nordics. Thanks goes out to all of our partners, whose sponsorship and help has been instrumental in putting this handbook together.

If you have any comments or suggestions for future issues, please do drop us a line.

Editor
Mark Dugdale

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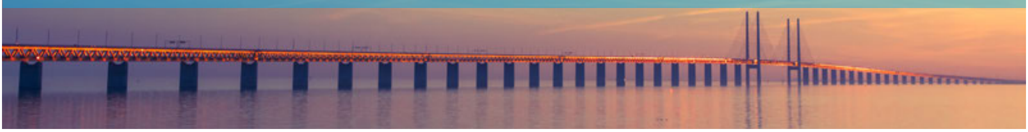

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Nordic delights

New mandates, expansion, collateral management, and hires and promotions show that the Nordics is thriving as a region. Mark Dugdale reports

The biggest story to come out of the Nordics in the past year was the news that Citi had secured a mandate from Norges Bank Investment Management (NBIM), the organisation responsible for managing the Government Pension Fund Global and foreign exchange reserves.

Citi is providing global custody and securities lending services to support NBIM's $850 billion investment portfolio globally. Its mandate's is believed to be one of the largest of its kind in the industry.

The Government Pension Fund Global, which returned 1.7 percent in Q1 2014, is made up of capital from petroleum investments in foreign countries, chosen in order to protect Norway's economy from the effects of fluctuating oil prices. The fund also invests in international equities, fixed income and property.

NBIM said in statement that it chose Citi because of the bank's "commitment to the custody business", demonstrated by a proprietary sub-custodian network and investment in technology, which enable the bank "to deliver custody services in an integrated, efficient and transparent manner".

Going forward, NBIM plans to expand its securities lending activities "in size and scope", and develop the infrastructure needed to lend securities in new markets and segments.

"It's a great privilege to have been selected by Norges Bank Investment Management to provide these services," commented Okan Pekin, global head of investor services at Citi.

"By having a global presence combined with in-depth, local expertise, our offering is well positioned to support Norges Bank Investment Management's mission and growth objectives."

In other Nordic mandate news, BNY Mellon and State Street secured global custodian and pension fund services contracts earlier in 2014.

BNY Mellon was reappointed by Swedish state pension fund Sjunde AP-fonden (AP7) to provide global custody and collateral services to assets valued at $28.8 billion. BNY Mellon was first appointed as AP7's service provider in 2006.

The new mandate includes securities lending services in addition to a comprehensive range of collateral-related solutions. AP7 will also continue to utilise DM Edge, BNY Mellon's derivatives margin management platform.

Svante Linder, COO at AP7, said: "We are happy to have reappointed BNY Mellon as our global custodian. All of the objectives we had set out in advance of this process have been met; BNY Mellon now provides our savers with a safer, better custody product. We look forward to further strengthening and enhancing our relationship with BNY Mellon going forward."

Hani Kablawi, head of asset servicing for Europe, the Middle East and Africa at BNY Mellon, added: "The thorough evaluation that AP7 conducted during this selection process is to be commended and the fact that it culminated in an extension of our valued relationship demonstrates BNY Mellon's expertise and commitment in support of our clients' fast-evolving investment services needs."

"In addition to our long track-record as a global custodian, our global collateral services business brings together an expansive and growing range of collateral solutions that ensure AP7 and our other clients have the best tools available to help them successfully navigate the ongoing changes that are reshaping the commercial and regulatory landscape here in Europe."

In Finland, Etera Mutual Pension Insurance Company selected State Street to provide it with a range of pension fund solutions, including securities lending

Etera is a mutual employment pension insurance company. It provides pension cover for employees and self-employed persons and promotes well being at work.

State Street is providing custody, fund accounting, transaction management, securities lending, futures clearing, agent fund trading, daily risk services, OTC derivatives servicing and collateral management for more than €5.6 billion in assets under management.

Jari Puhakka, chief investment officer of Etera, said: "Given the Finnish and European regulatory challenges facing the industry, and our enhanced investment strategy we needed to look to future proof our current business model. The ability of State Street to address our needs and provide a holistic solution to our liabilities was extremely important to us."

Paola Bergamaschi, head of asset owner solutions for State Street in Europe, the Middle East and Africa, said: "Asset owners need access to real-time data to optimise their investment decisions. This helps explain why almost nine out of 10 asset owners plan to invest in order management and execution management systems over the next three years."

"We're pleased to be able to bring our expertise of servicing some of the largest pension funds globally to meet Etera's specific requirements, and help them build a strong business going forward."

Oslo Clearing deal

SIX Securities Services completed its acquisition of Oslo Clearing from Norway's Oslo Børs VPS Holding in early May 2014, securing a firm that carries out central counterparty clearing of financial derivatives, equities and securities lending products, as part of it's services.

Oslo hit the ground running, contributing $1.2 million in revenue and $440,000 in profit to the SIX group in May and June 2014.

"The Nordics is a region we have been committed to for a while but it has been a wide spot on our map," explained Tomas Kindler, head of clearing at SIX x-clear. "We clear for Burgundy, the regional multilateral trading facility, but not for any Nordic clients."

Oslo Clearing deals with the clearing of equities, financial derivatives and security lending products in Norway. According to Kindler, Oslo is "roughly a quarter" of the Nordic market and its acquisition gives SIX access to Norway's trading venue, Oslo Børs.

"We wanted to make an acquisition in the clearing space and we looked at a niche player that [would] gives us complimentary assets. With Oslo Clearing, in addition to the Nordic customers, they give us access into derivatives clearing capabilities that we currently [do not] have so we can further diversify on the products side."

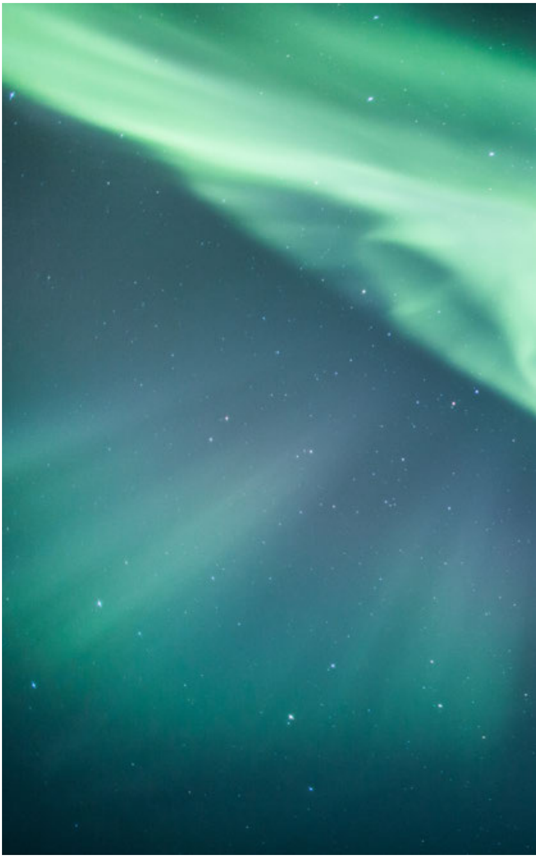
The move into Norway and into Oslo Clearing sets up SIX for future expansion of its derivatives clearing products, with a view to internationalising them in the Nordics and across Europe, added Kindler.

Collateral considerations

Various Nordic players have made moves to manage collateral more efficiently, with Verdipapirsentralen ASA (VPS), the Norwegian central securities depository, and Clearstream signing a letter of intent aimed at developing new collateral management services in Norway.

The new service enables VPS to offer Norwegian market participants the allocation, optimisation and substitution of collateral.

VPS would offer these services on a white-labelled basis through Clearstream's fully automated

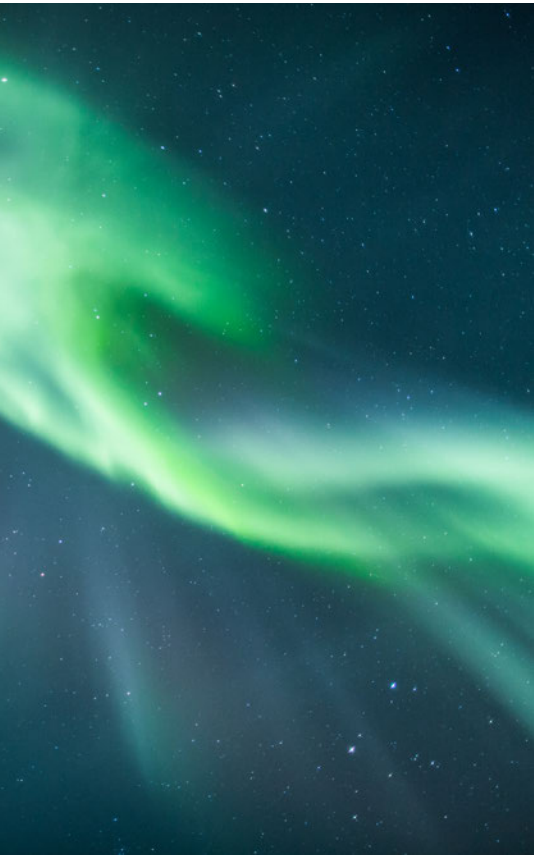


real-time collateral management engine, the Global Liquidity Hub.

Going forward, the partnership between VPS and Clearstream will also help Norwegian financial institutions and VPS customers to overcome internal collateral fragmentation across systems.

John-Arne Haugerud, CEO at VPS, said: "Our partnership with Clearstream will provide Norwegian financial institutions with the means to keep up with the increasing collateral requirements of Norwegian and international regulations."

"From a risk perspective, it was particularly important that the underlying assets do not leave the Norwegian jurisdiction and this is guaranteed



under the Liquidity Hub Go service. The Global Liquidity Hub offers more than a domestic solution and we will explore this potential along our journey with Clearstream."

Stefan Lepp, member of the executive board and head of global securities financing at Clearstream, added: "The regulatory agenda requires banks and financial institutions to better manage their capital and liquidity buffers."

"An efficient local and global collateral management service will become a must going forward—hence the growing popularity of our Liquidity Hub Go model through which our partners can offer sophisticated collateral management to their underlying clients without losing control over the assets. We are pleased about VPS joining our outsourcing service, thus including the first Scandinavian market in our global collateral management model."

Asset management firm Nordea has also signed up to use Rockall Technologies's collateral management solution.

The technology company's software, STOC, will enable Nordea to manage its collateral across Nordic countries Denmark, Finland, Norway and Sweden.

System extensions will be applied in other countries in future, according to Rockall, which has offices in Dublin, Ireland, and the US.

Movers and shakers

Finnish securities borrowing and lending broker Lago Kapital recruited Olga Nyström in February 2014 to lead equity finance sales for Eastern Europe.

Nyström joined Lago Kapital from Elite Pankkiiriliike Oy, where she was a private banker. She took up her new position on 3 March.

She has also worked as an account executive for institutional sales in East Europe and Russia at FIM, a Finnish investment services provider.

Jarkko Järvitalo, CEO at Lago Kapital, commented: "[Nyström] comes with a wealth of experience in financial sales in Eastern Europe and is a great addition given our future plans in Russia and other Eastern European countries."

SEB and Dankse Bank also made promotions and hires to strengthen their businesses in the Nordics.

SEB made Steffan Jordan its new global head of equity finance in Stockholm. He relocated from Frankfurt, where he was previously responsible for equity finance at the firm.

Jordan replaced Jakob Burell, who left in May 2014 to join Dankse Bank in an unconfirmed capacity.

Burell had worked for SEB for more than 14 years, during which he held a number of positions. He took up his new job on 1 September 2014. **SLT**

View from the top

The Nordics have weathered the financial crisis, says Stephen Kiely of BNY Mellon. Stephen Durham finds out what to expect of them in the future

How would you describe securities lending in the Nordic markets?

The Nordics is one of the more developed regions in the securities lending market and a region where, by nature, greater emphasis is placed on the risk/reward ratio. They don't specialise in trendsetting, but prefer a steady return from established paths. There was a swifter response to the financial crisis in the Nordics than there was in some other regions—lenders typically either pulled out or restricted their programmes in some way.

Consequently, they have given greater consideration to re-entering the securities lending market and have been doing so in a more directed and informed way, so that lenders are picking and choosing, insisting on a higher level of transparency and being more diligent in their approach.

We are seeing a lot of interest and pick-up in that area, together with a requirement to have greater knowledge of each programme, choosing trades and strategies in a more targeted fashion.

At the moment, most of the specials are in the wider areas such as the US, South America and Asia. We are still seeing interest in the yield enhancement specials during dividend season, and there has been a slight increase in specials through M&A and corporate actions, though most of it remains in the west and east.

Does BNY Mellon have much of a presence in the Nordics?

We have a growing presence in the Nordics and are looking at it holistically from the perspective of asset servicing, through custody, administration and securities lending. We have had successes in the region in the last year and it is a region that we feel still has potential for further growth.

We are looking to partner with investors and help them as best we can. For example, we are able to perform an advisory role in terms of the regulation that has arrived or is looming, be that Europe's Alternative Investment Fund Managers Directive, the Dodd-Frank Act, or another.

It is something that we are looking to help people navigate, as being the world's largest custodian and agent lender, we feel we have a competitive advantage in the guidance we can provide to clients.

Is the main competition for mandates coming from US rather than Nordic -owned banks?

In truth, it is a bit of both. On the buy side I don't think being a non-Nordic bank is any kind of disadvantage. Often, when we are competing in a request for proposal scenario we, are coming up against the usual global institutions and not just firms from the region.

Has it taken longer for the beneficial owners to start lending again?

Yes it has. In the Nordic region they have taken a long, hard look at the causes of any loss during the financial crisis and how they can enter into a programme and decrease the risk as much as possible, in a responsible fashion. They are very mature in terms of looking at the regulations and how far that will affect what they do and whether they should re-enter the lending market to help with some of the legislation that is coming down the line in terms of collateral transformation. They also take a good, hard look at the collateral. They understand how it all hangs together with a view to optimisation.

Of those coming back to the market, are any being driven by the search for indemnification?

Indemnification is still something that a lot of clients are looking for, but in no way would they rely on it. It is not a region where people will be satisfied by just being indemnified against borrower insolvency—they still want to understand the nuts and bolts, even though the indemnification is there. They understand that provision of indemnification actually costs the agent lender more in the post-Basel III environment and want to know what sits behind the indemnity.

In this region, they will ask questions about the indemnification itself, rather than just whether they

can have it. While some indemnities fall back on an insurance policy, ours is backed by the balance sheet of the world's largest custodian—I know which one I'd prefer.

Last year, there was a lot of talk about relaxing collateral requirements. Has anything happened with regards to this?

I'm not sure I'd say they have relaxed. Beneficial owners have given a lot more thought to the collateral requirements and are open to scenarios that they may not have considered previously. We are seeing greater use of equities as collateral, especially when lending equities. Clients understand that, while lending equities and taking government bonds worked in 2008, it does not necessarily mean that it's a correlation that is going to work again in 2014. We are seeing enquiries for information around types of acceptable equities, for example, main index, and also greater understanding of the margin requirements themselves.

Could this breed a move to more US-style 'cash as collateral'?

I still see cash collateral as something that makes a lot of people nervous due to its association with losses incurred during the height of the financial crisis. Unfairly, I think its reputation has suffered, because when used properly, it can be a low risk tool, but in Europe I still see people being inherently nervous about cash collateral.

If they are going to expand collateral guidelines, they are often looking more to the wider Organisation for Economic Co-operation and Development group of government bonds, some of the better corporate bonds and equities. Cash collateral really only works if there is a term involved, and I think this acts as a barrier to some clients as they prefer the flexibility of an open structure.

Have you seen any other important trends in the Nordic market recently?

Collateral is widening out with the interest in equities increasing. In the Nordic markets, where people are coming back into lending programmes, they are looking at high-value trades through intrinsic lending. There is decreasing interest in high utilisation levels of general collateral, with clients branching out into specials-only and targeted lending programmes.

and sourcing this asset class has become increasingly expensive.

From the borrower perspective, the demand for general collateral stock has also dropped, at the same time as the lender demand to lend as much of their book as possible has dropped.

People used to talk about utilisation as being one of the measures they scrutinised, but it has come full circle now as they would rather have low utilisation and high return—fewer trades, but with greater margins. Clients believe this gives them the best risk/reward ratio, and the Nordics market are keener on it than most.

> *"We are seeing greater use of equities as collateral, especially when lending equities. Clients understand that, while lending equities and taking government bonds worked in 2008, it does not necessarily mean that it's a correlation that is going to work again in 2014"*

Stephen Kiely
Head of securities finance, new business development
BNY Mellon

We are having some success in promoting short-form lending agreements whereby we lend a particular stock. We approach clients with the proposal, "this has gone special, we can lend it against this, at this rate", and they say yes or no. If clients are earning 80 percent of their revenue from 20 percent of the loans then they will only want to use that 20 percent.

In terms of risk/reward, you are getting the 'biggest bang for your buck', so to speak. This is especially the case with the long-equity managers, which are looking to lend a smaller amount of stock, for a shorter period, but retain the majority of their securities lending revenue.

The demand from borrowers to borrow general collateral has decreased because often they have to give government bonds in return,

Finally, do you believe new EU regulations will have a big effect on the Nordics?

I have seen a wide cross-section of how people deal with regulation. Some have got their best people in project teams stacked against it while some are just hoping that it all goes away, so it is a very broad spectrum. Overall, the Nordics got to grips with the regulations quicker than some other regions—they understand regulation because they have made an effort to understand it. I recently spoke at a Nordics back-office conference in Copenhagen and I'd say that 75 to 80 percent of the presentations had some regulatory content, with the focus on what the regulations practically mean and how clients are going to have to change the way they do business. **SLT**

Flexi-does it

Nordic beneficial owners must be as flexible in their approach to collateral as any other, as Simon Lee of eSecLending explains

In today's market, collateral flexibility is an important consideration for lenders looking to optimise programme returns. In what is a competitive environment, revenue optimisation is achieved by best addressing the requirements of both the supply (lender) and demand (borrower) side of the lending transaction, relative to overall programme objectives.

At first glance, opportunities for lenders to increase earnings without unduly increasing risk may appear limited in today's market environment, buts by recognising the joint dynamics of programme structure and collateral requirements, lenders can benefit from the increased emphasis regulation has placed on collateral, and its associated cost to collateral providers, ie, borrowers.

As the cost of collateral diverges across different collateral types it becomes increasingly important for lenders to recognise the impact that their collateral choice has on overall programme performance, particularly as it relates to the type of programme they participate in.

It is widely believed that lenders that employ a flexible collateral schedule enjoy advantages over lenders with restrictive collateral schedules. By accepting additional types of collateral, lenders can attract a larger and more diverse set of borrowers, increasing on-loan balances, and revenues. As the regulatory cost of collateral is clarified, it is becoming more apparent that when lenders restrict their collateral profiles they constrain their distribution channels, which can reduce their balances and therefore their revenues.

This dynamic can be illustrated by the example of a lender that solely accepts highly rated government bonds as collateral:

- Government bonds are expensive relative to other collateral types. The more expensive the collateral, the lower the overall spread available in any given trade. A borrower will pay a lower fee to borrow a security to offset its higher collateral costs, limiting programme earnings.
- By only accepting government bonds, lenders constrain their distribution to borrowers that are long in government bond collateral, limiting the number of borrowers willing to borrow from the lender's programme.
- By only accepting government bonds as collateral, lenders competitively disadvantage themselves relative to other lenders in the same

programme. This is most apparent when the lender participates in a pooled programme, and is becoming more relevant in what is a lending market of constrained demand.

The acceptance of equity collateral has been increasingly recognised as a tool to improve programme performance. From the borrower's perspective, equity collateral has always been a preferred form of collateral due to its plentiful supply, low costs, and liquidity. However, historically there was little demand from lenders and their agents: equity collateral was harder to administer, indemnity costs were higher and programme performance was not unduly hindered without it.

As indemnity costs are becoming better known and managed, administration of equity collateral by triparty providers is more sophisticated, and a flexible collateral schedule is now recognised as an important aspect of improving programme performance. As a result, more non-cash lenders are accepting equity collateral than before.

Lenders are always interested to know how much they will be able to enhance programme earnings when they diversify their collateral schedule. It is important to understand how the type of programme the lender participates in also impacts performance. This is particularly true for lenders participating in a pooled programme, where their assets are commingled with those of other lenders and loans are allocated through a 'queuing' system.

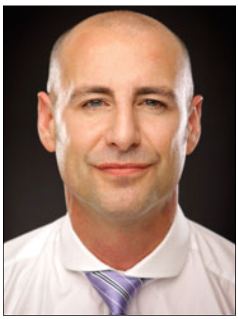
For example, a borrower wants to borrow a position that is held by three lenders in the pooled programme. Lender A and Lender B accept equity and government bond collateral, whereas Lender C only accepts government bond collateral. Rather than allocate this loan across three lenders, with two different forms of collateral and two different costs, the borrower will source the supply from A and B that accept the cheapest form of collateral (equity). This means Lender C, which only accepts the expensive form of collateral (bonds), will miss out on the loan entirely.

This is why lenders that participate in pooled programmes must always consider how changes to programme parameters, especially as they relate to collateral or programme enhancement, are viewed relative to other lenders in the same programme, as this can significantly influence the impact that any changes may have.

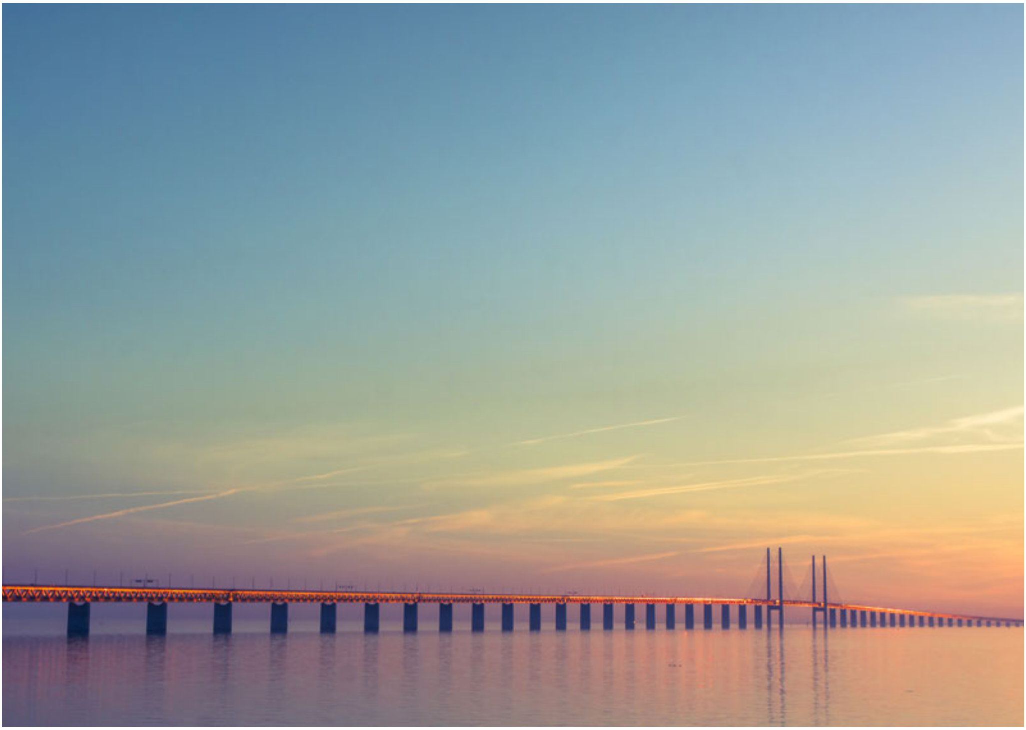
For lenders that participate in segregated programmes, where assets are not comingled across lender accounts, the question of performance relative to other lenders is irrelevant and does not apply. In these programmes, changes in collateral schedules can directly enhance the performance of the individual lender, given that their performance is not influenced by the parameters of any other competing lender.

For lenders that wish to take a more active role in enhancing securities lending performance, and where the opportunity to do so exists, lending via a segregated programme structure may be advantageous, particularly when considering expanding collateral schedules. **SLT**

"Lenders are always interested to know how much they will be able to enhance programme earnings when they diversify their collateral schedule"



Simon Lee
Managing director, business development, EMEA
eSecLending



The Nordic landscape

The Nordics make up a small slice of the global pie. But the region's large asset pools and seasoned lenders and brokers have resulted in a healthy securities finance business, says Christopher Gohlke of DataLend

By and large, most securities finance activity in the Nordics takes place across Norway, Denmark, Sweden and Finland. Iceland inventory is sparse. The total on-loan value of securities across all five markets exceeded $36 billion on a recent trading day. Of that $36 billion, equities outweigh fixed income securities by about 2.5 to 1 in terms of on-loan value (see Figures 1 and 2). That contrasts with the rest of Europe, where the value of fixed income securities on loan overshadows that of equities, but is broadly consistent with global trends.

On the aggregate, Nordic securities trade less general collateral and exhibit more volatility in fees to borrow than the global average (see Figures 4 and 5). On a typical trading day, about 50 percent of Nordic securities trade in a warm or hot range, compared to around 30 percent in the rest of the world. That is driven almost entirely by equities: government debt in AAA-rated Denmark, Norway, Sweden and Finland typically trades below 10 basis points (bps), while Icelandic debt tends to trade warmer but is sporadically traded with very little inventory. Corporate debt follows a similar trend across the region.

When the market really heats up is during Europe's busy spring season, particularly during April and early May, when upwards of 90 percent of Nordic securities will trade at 20 bps or more. As exhibited in Figure 6, Nordic securities trade hotter than the European—and global, for that matter—average during this time of year. This trend was more pronounced in 2013, when as many as 25 percent of securities

Figure 1: Equities on-loan value (USD billions), 4 August 2014

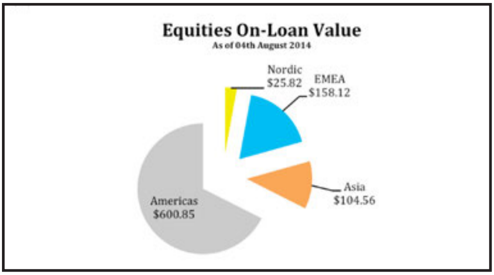


Figure 2: Fixed income on-loan value (USD billions), 4 August 2014

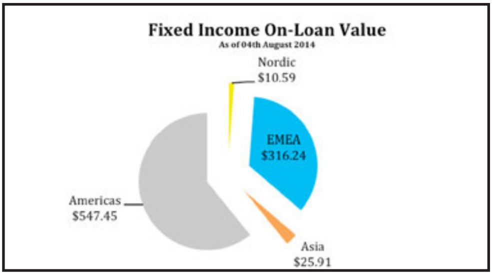


Figure 3: Europe total on-loan value

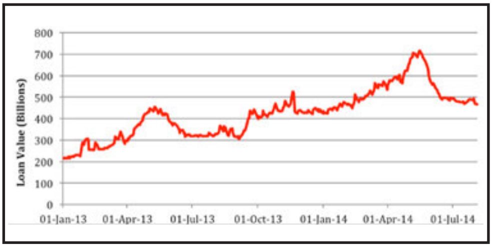


Figure 4: Fee bands, Nordics

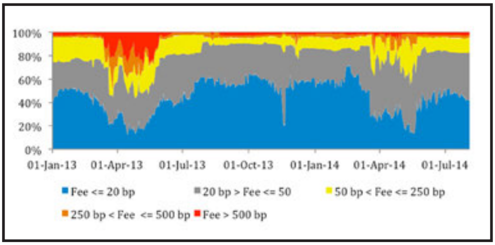


Figure 5: Fee bands, global excluding Nordics

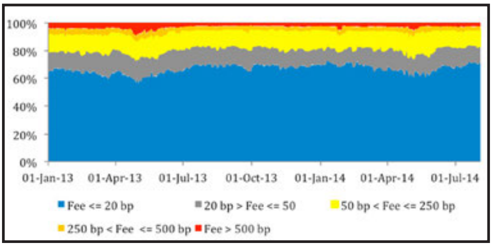
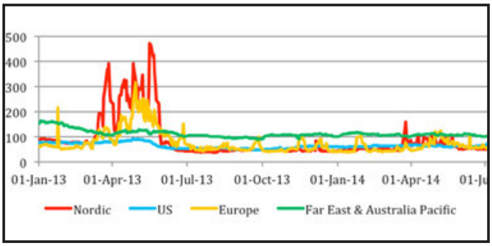


Figure 6: Volume-weighted average fees to borrow by region



Source: DataLend

were trading at greater than 500 bps, than in 2014 (see Figure 6). This year, a much broader swathe was trading in the cooler 50 to 250 bps range. This suggests demand for Nordic securities was greater in 2013 than it was in 2014.

Nordic top earners

The oil and gas and metals and mining sectors have driven much of the hot activity in the Nordics in recent years. A handful of such stocks have dominated top earners lists in the Nordics' securities finance industry in 2013 and 2014.

The top revenue-earner across the region in 2013 was Finland's Outotec, which provides technology and services to the metals and minerals industries. Outotec remains a top earner across all Europe to date. The stock price has been consistently fluctuating along with other service providers to the beleaguered mining industry. Utilisation has hovered between 65 percent and 85 percent for months, while fees are consistently hot. Shorts appear not to be exiting their positions in this name.

On the other hand, Finland's Outokumpu, a steel manufacturer and another top earner last year, appears to have shaken the shorts more recently. Fees to borrow the stock escalated to white-hot levels by March 2014 as the stock price fell off amid a rights issue. By the time of a reverse stock split in June, fees had dropped to the general collateral-to-warm range, where they remain today.

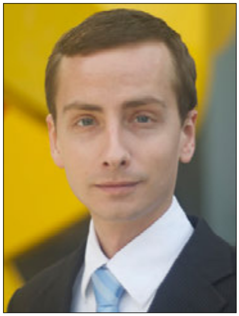
Frontline, the Norwegian oil tanker shipping company, has been another hot stock in the region. The stock price has been on a steady decline for most of 2014 as rates for crude carriers have tumbled, according to media reports. Some news reported, citing analysts, reported that the stock could plunge up to 43 percent in 2014. It is already well on its way. Fees reached very high levels at one point earlier this year, and while they have steadily declined since then, they remain hot. Finland's Neste Oil also was a regular on our securities finance top earners lists at one time, but has fallen off more recently. Its stock price is down from a peak in September 2013, but fees to borrow have declined as operating profits are reportedly up.

In the transportation sector, low-cost airline Norwegian Air Shuttle was Norway's top earner in 2013 and remains among the top 10 securities finance revenue earners across all Europe today. The stock has remained hot since last year as questions remained over the airline's ability to appease regulators and legislators on its recent launch of long-haul service between Europe and the US. Fees declined somewhat in July 2014 when the service launched, but they began heating up again by August when it became clear it would be an uphill battle to pass regulatory hurdles to operate using a so-called 'flag of convenience' Irish subsidiary.

The technology sector also houses a pair of top securities finance earners, including Sweden's Axis and Finland's Nokia. Axis, a network camera manufacturer, has seen considerable swings in its stock price in recent quarters amid a decline in sales in Q4 2013 and Q1 2014 and a subsequent rise in Q2 2014. Fees to borrow the stock have fluctuated from warm to hot levels all year, and were back in the high end of the range more recently. As for Nokia, the stock was a top earner in 2013 but has hovered around low-warm levels in 2014. However, news that the mobile company's maps chief was leaving the company sent fees much higher at the end of August.

Capital goods sector firms were trending hotter in 2013, but have departed our top earners lists more recently. Firms including Finland's Kone, Sweden's Atlas Copco and Denmark's FLSmidth were familiar names on these lists last year, but have fallen off more recently. **SLT**

“When the market really heats up is during Europe's busy spring season, particularly during April and early May, when upwards of 90 percent of Nordic securities will trade at 20 bps or more”



Christopher Gohlke
PR and social media manager
DataLend

Nordics by numbers

DataLend highlights the key securities finance metrics of Denmark, Finland, Iceland, Norway and Sweden

Denmark

On-Loan Value: $2,965,062,743

Inventory Value: $47,554,606,572

Average Utilisation: 21.45 percent

Average Fee (Equities): 40.88 bps

Average Fee (Fixed Income): 4.27 bps

Finland

On-Loan Value: $13,365,954,410

Inventory Value: $44,078,649,915

Average Utilisation: 38.95 percent

Average Fee (Equities): 44.46 bps

Average Fee (Fixed Income): 7.91 bps

Iceland

On-Loan Value: **$28,142,526**

Inventory Value: **$165,837,477**

Average Utilisation: **15.3 percent**

Average Fee (Equities): **5.90 bps**

Average Fee (Fixed Income): **37.28 bps**

Norway

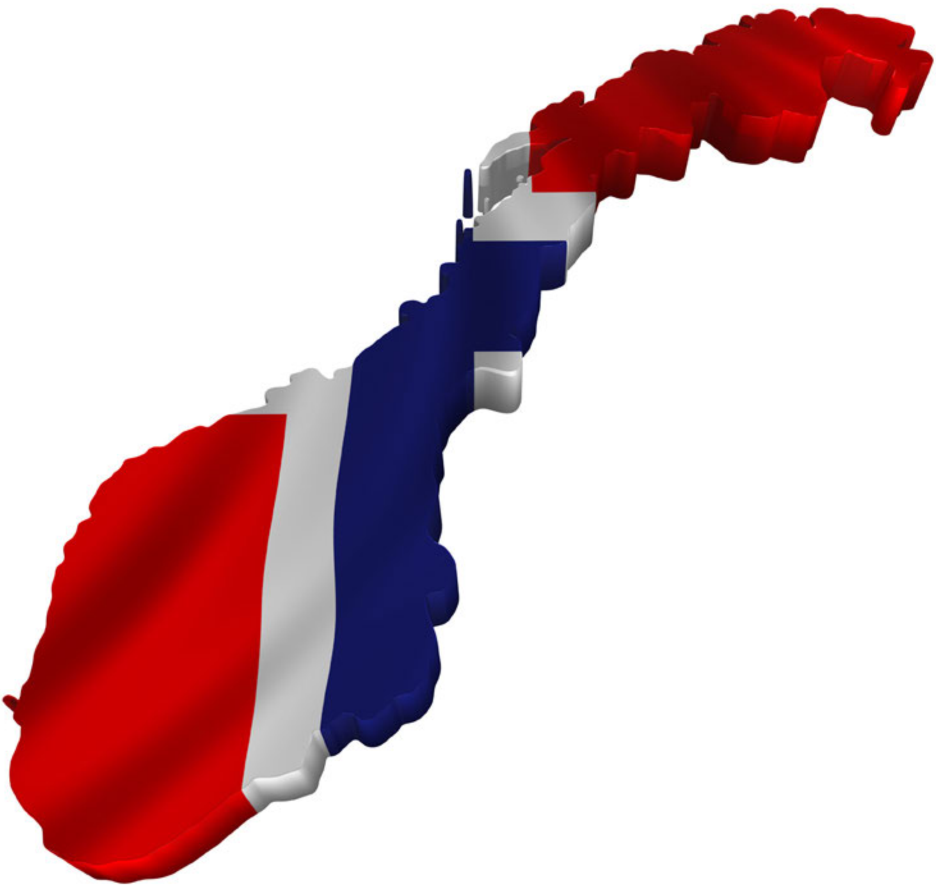
On-Loan Value: **$6,010,566,112**

Inventory Value: **$34,851,271,372**

Average Utilisation: **19.27 percent**

Average Fee (Equities): **72.42 bps**

Average Fee (Fixed Income): **8.55 bps**



Sweden

On-Loan Value: $14,042,065,228

Inventory Value: $123,077,828,683

Average Utilisation: 17.58 percent

Average Fee (Equities): 60.52 bps

Average Fee (Fixed Income): 11.36 bps

Taxation of securities lending in Denmark

There are myriad decisions and rulings to be aware of when borrowing and lending securities in Denmark. Michael Nørremark of Kromann Reumert explains

The Danish tax treatment of securities lending transactions is not explicitly regulated in Danish tax legislation.

However, the tax authorities have published a number of rulings and decisions regarding various Danish tax aspects of securities lending transactions, which provides a framework for the tax treatment of securities lending.

Each of these rulings and decisions are based on the specific facts and circumstances set out in each specific matter. Furthermore, the published practice has changed over time (and may change in the future). Finally, the arguments and statements set out in the rulings do not appear to the 100 percent consistent. While the published practice gives some level of guidance as to the Danish tax treatment of securities lending transactions, there are still considerable uncertainties.

Securities lending—sale or loan?

The majority of the published rulings on securities lending transactions deal with the fundamental question of whether a loan of securities by a lender to a borrower for Danish tax purposes is to be qualified as a sale or a loan.

Broadly speaking, if a securities lending transaction for Danish tax purposes is qualified as a sale, then a Danish lender will for Danish tax purposes be deemed to have realised the securities lent, and this will result in the lender realising any gains or any losses on the securities lent.

On the other hand, if a securities lending transaction for Danish tax purposes is qualified as a loan, then a Danish lender will not for Danish tax purposes be deemed to have realised the securities lent.

Pursuant to the rulings issued by the Danish tax authorities, a loan of securities by a lender to a borrower should not for Danish tax purposes be treated as a taxable sale or exchange (but instead as a loan), provided that the following three cumulative conditions are fulfilled:

First, the securities lent are listed on a stock exchange or traded on another regulated market.

All the rulings and decisions from the Danish tax authorities confirming that a loan of securities does not constitute a sale for Danish tax purposes have concerned securities listed on a stock exchange or another regulated market.

Furthermore, in a number of the rulings, the Danish tax authorities have explicitly stated that the fact that the securities in question have been listed on a stock exchange or traded on another regulated market has been decisive for the outcome of ruling.

Rulings confirming that a loan of securities does not constitute a sale for tax purposes have been issued both in relation to listed shares and listed bonds.

Secondly, the lending of securities is governed by certain approved standard agreements.

Rulings have been issued on securities lending on the basis of the following standard agreements:

- Morgan Stanley & Co International Limited—Overseas Securities Lenders Agreement (version: December 1995); and
- International Securities Lenders Association—Global Master Securities Lending Agreement (version May 2000).

Furthermore, it appears from the rulings that the lending of securities under other forms of standard agreements also may be deemed a loan from a Danish tax point of view, provided that it clearly follows from such agreements that the securities are lent and not sold.

One of the factors relevant when considering whether a securities lending transaction for Danish tax purposes is a loan or a sale is whether the borrower to the lender pays a consideration for the securities, and it is not 100 percent clear whether security in the form of cash collateral could be deemed a consideration for the securities in this respect.

In our view, this should not be the case, provided that it clearly follows from the wording of the documentation that the cash in question is security for the return of the securities lent, and not consideration for the securities lent.

Thirdly, the lending of securities may be terminated at any time with immediate effect or very short notice (no more than a few days).

Until 2011, in order to not consider the lending of securities as a sale for Danish tax purposes, a requirement that the lending period was maximised to a period of six months followed rulings and decisions published by the Danish tax authorities.

However, in a case decided by the Danish National Tax Board in 2011, a taxpayer requested a binding tax ruling on the Danish tax treatment of a securities lending transaction entered into for short selling purposes. No maximum lending period was fixed under the terms of the transaction. Instead, the terms provided that the lender was entitled to terminate the loan with three days' notice and that the borrower was entitled to terminate the loan with one day's notice.

The Danish National Tax Board found that an agreement to lend securities that can be terminated by one or both parties must be considered securities lending (and not a sale of shares) for Danish tax purposes, even if there is no maximum lending period.

Following the new ruling, the tax authorities have published a notice stating that the ruling constitutes a change of practice regarding the Danish tax treatment of securities lending transactions and that this change of practice applies to securities lending transactions entered into on or after 11 October 2011.

According to the notice, the change of practice only applies to securities lending transactions with termination provisions similar to those in the decided case.

It is not 100 percent clear whether a transaction with a maximum lending period of six months, but where the lending may not be terminated at any time with immediate effect or very short notice would be considered a loan (and not a sale) if the other two conditions mentioned are also fulfilled.

However, our view is that a transaction with a maximum lending period of six months, but where the lending may not be terminated at any time with immediate effect or very short notice, for Danish tax purposes should be considered a loan (and not a sale).

Collateral

In a securities lending transaction, the lender will often receive collateral from the borrower in the form of securities. Provided that the above conditions are fulfilled also in relation to the collateral, the transfer of securities as collateral should not be deemed a sale for Danish tax purposes.

Manufactured dividend

In most cases, dividends, etc, paid on securities lent to the borrower must, pursuant to the terms of the securities lending documentation, be 'passed back' to the lender in the form of what is referred to as a 'manufactured dividend'.

Provided that the conditions set out above are fulfilled, the lender should from a Danish tax perspective be considered the owner of the securities lent to the borrower (as the lending of the securities in such case are not considered a sale).

As a consequence, the lender should, from a Danish tax perspective, be taxed on payments of manufactured dividend from the borrower in the same way as if the lender had not lent the loaned securities to the borrower and had received payments of real dividends on the securities directly.

By way of example: if dividends are paid on the securities loaned to the borrower and the borrower therefore pays a manufactured dividend to the lender, it should, from a Danish tax point of view, be treated as a dividend for the lender, meaning it should be taxed as a real dividend.

Likewise, if under the terms of the lending documentation the lender is required to pass on to the borrower any income received on any securities provided as collateral, such payments should, from a Danish tax perspective for the borrower, be taxed as if the borrower had received the payments of real dividends on the securities directly.

If a Danish holder of foreign shares (ie, shares in a non-Danish company) receives a real dividend on the shares that are subject to withholding in the jurisdiction of the dividend-paying company, then—generally—the Danish holder is entitled to set-off such foreign withholding tax against any Danish taxes levied on the dividends (ie, a tax credit).

"The Danish National Tax Board found that an agreement to lend securities that can be terminated by one or both parties must be considered securities lending (and not a sale of shares) for Danish tax purposes, even if there is no maximum lending period"

Michael Nørremark
Partner
Kromann Reumert

Specifically in relation to dividends on foreign shares, there is no published practice dealing explicitly with the question of whether a Danish lender that receives a manufactured dividend from a borrower is entitled to a Danish tax credit for any foreign withholding tax on the real dividends paid on the foreign shares to the borrower.

However, our view is that this should be the case if the source state (ie, the jurisdiction where the company paying the dividend is a tax resident) also views the Danish lender as the owner of the shares, and therefore the recipient of the dividends from a tax point of view (ie, if the source state agrees with Denmark that the lender, from a tax point of view, is the owner of the shares and therefore the recipient of the dividend). **SLT**

In the right direction

Finland has one of the most stable economies in the eurozone. Jarkko Järvitalo of Lago Kapital looks at securities lending in the country

The securities market in Finland is relatively developed in general, though the securities lending market has a rather short history and is characterised by a few local idiosyncrasies rising from the legislation. Regardless, the short selling opportunities in Finland's own Nokia during the past few years has probably increased interest in the Finnish market globally—not to mention the major short squeeze seen during the autumn of 2013 when the Microsoft-Nokia deal was announced.

The securities lending business in Finland started as late as 1995, when the Finnish securities exchange HEX launched its own securities lending pool for settlement failures. As the legislation matured, it eventually enabled Nordic banks to start offering their own over-the-counter (OTC) securities lending products during the 2000s, but mostly for the big players, such as Nordic mutual funds. It meant that the availability was concentrated in a few of the biggest names and that there were constant and substantial recalls in the market with difficulties to find replacement loans.

The market has matured a lot in a short period of time with new players entering the market, leading to an increase in liquidity. Also, pricing has become more transparent and consistent with lenders becoming more aware of current market levels. Lago Kapital, as the only Finnish firm providing securities lending services, has provided the possibility for many new entrants, such as private investment companies, to enter the securities lending market.

Moreover, it used to be possible for private investors and smaller investment companies to sell short only the OMXH25 (the benchmark index for management of diversified Finnish stock portfolios) names and a few Swedish stocks. Lago Kapital provides short selling possibilities in virtually all of the markets in the world. Our lenders currently provide the market with stable positions in many interesting and uncommon names, which increases overall liquidity considerably.

Operationally, the market is robust, with efficient and trustworthy loan settling. Recalls also provide much smaller risk than previously, as increased liquidity usually provides the possibility to replace a loan without having to recall or buy-in the borrower. Although the number of lenders has increased, there is still a bit of conservatism among some local investors, especially government-linked entities. This, together with the fact that individuals cannot effectively lend stocks, means that liquidity in a few names, of which ownership is rather concentrated, can be limited at times, driving up premiums. Furthermore, the Finnish Financial Supervisory Authority (Finanssivalvonta) has a positive and cooperative attitude to developing the securities lending market.

There has been a considerable amount of specials in the recent past in Finland, with Nokia, Talvivaara, Outotec and Outokumpu all providing good opportunities for lenders and borrowers. Even though there are no extremely hot names currently, we are expecting to see new and interesting possibilities in the market going forward.

“Operationally, the market is robust, with efficient and trustworthy loan settling. Recalls also provide much smaller risk than previously, as increased liquidity usually provides the possibility to replace a loan without having to recall or buy-in the borrower”

Jarkko Järvitalo
CEO
Lago Kapital

In terms of the country’s legislation, the maximum period for a securities loan is 365 days, after which it needs to be rolled over to avoid triggering any capital gains taxes for the lender, in the case that it is a Finnish entity.

Finland is the only market we know with such a time constraint. It should be noted that lending is generally only possible for companies, as the act of lending will trigger capital gains taxes for private persons. Foundations also face the same challenge although, in the case that they are tax-exempt, the legislation might not be as much of an issue. The fact that these private persons and the majority of foundations do not generally lend out any securities has undeniably had an impact on overall market liquidity.

Moreover, even though Finland, as a part of the EU, should have implemented the directive on financial collateral in its domestic legislation, the implementation is still not fully compliant with the directive. This has had an impact on the collateral side, with securities as collateral also triggering capital gains taxes. Therefore, mostly cash collateral is used in the Finnish market.

Finally, there are some other local specialties, such as the requirement to report received and paid manufactured dividends to the tax authorities annually. This aspect might not be that familiar to the majority of foreign players, since the forms that need to be used for the reporting seem to exist only in Finnish and Swedish. **SLT**

Bardarbunga’s party

Iceland is still feeling the effects of the financial crisis. Mark Dugdale reports

Ominous rumblings from Iceland's Bardarbunga's volcano have prompted the country to warn the aviation industry of an imminent eruption, much like the one that grounded flights across Europe in 2010.

That was the largest closure of European airspace since the Second World War, with losses estimated at between €1.5 billion and €2.5 billion. Iceland, which suffered greatly during the financial crisis following 2007, will not want to have to deal with its share of such losses if its economy is going to bounce back.

The Central Bank of Iceland's monetary policy committee was optimistic about the country's economy in its Q3 2014 bulletin, in which it confirmed that Icelandic interest rates would remain unchanged at 6 percent.

It predicts GDP growth to reach 3.7 percent this year, while the inflation outlook has improved since its previous bulletin.

The central bank's foreign exchange transactions in the past year have contributed to greater exchange rate stability.

It has bought significantly more foreign currency than it has sold, in both regular and ad hoc purchases, and it intends to continue its regular purchases in the current amount as long as conditions remain relatively unchanged.

"The slack in the monetary policy stance has probably disappeared, and it appears, based on the bank's baseline forecast, that the current interest rate will suffice to keep inflation at target.

Robust growth in domestic demand in the near term and growing tension in the labour market could generate increased inflationary pressures, however, and necessitate an increase in the bank's nominal interest rates."

Icelandic equities do not reflect this optimism, according to Íslandsbanki.

Turnover in the Icelandic equity market totalled only ISK 6.6 billion ($56.3 million) in the first six months of 2014, down 2 percent on same period in 2013.

"Considering that three new companies (N1, Grandi, and Sjóvá) were admitted for trading on the OMXI Main List in the first half of the year, and two others (VÍS and TM) were listed around mid-2013, the difference between the two periods is even greater than the numbers imply," commented Íslandsbanki.

"These five new companies account for nearly a fourth of the total current value of the equity market. That being the case, it is safe to say that the market has been drifting in the doldrums in the first half of this year in terms of turnover."

The bond market has also been relatively inactive in 2014, added Íslandsbanki. The OMXI's main bond index, Nomxibb, which tracks price developments for government-guaranteed bonds, fell 0.4 percent in the first half of 2014.

Supply of various types of financial products has been relatively strong, according to Íslandsbanki, which added: "The slump in the securities markets therefore appears to be due to weak demand."

Icelandic pension funds achieved returns on assets of more than 11 percent in 2013, thanks to well-performing domestic securities, said Íslandsbanki.

The pension funds, which have more than ISK 2 trillion ($17.1 billion) in total assets, saw returns of 11.1 percent in 2013.

Their domestic securities returned 12.5 percent. Foreign holdings returned 7.9 percent.

Securities lending and borrowing, meanwhile, appears to be non-existent in Iceland.

A source said that the central bank does run a discount window, but the country is not a busy or interesting market, with only limited bond lending and no equities business. **SLT**

Ahead of the competition

Norwegian players must compete against foreign banks, but as DNB Bank's Dag Rudiløkken tells Stephen Durham, there is plenty of business to go around

How is the securities lending market composed in Norway?

Over the past two years in Norway, there has been a marked increase in the volume of securities lending, with the lion's share of activity centered on the big names on the OBX (Oslo stock exchange) index.

We are also seeing more interest now in the smaller cap stocks, as the volumes still appears to be increasing.

The Norwegian market is mostly interested in the oil, rig and offshore sectors, as well as the stocks related to the fishing industry. Oil and drilling companies have always been interesting to foreign clients.

When we look at the market we see that demand is driven mainly by these foreign customers, but we also see local clients being more active.

Mostly, general collateral levels in Norway are stable. Occasionally, we see levels go higher but that mostly arises from special events in specific names. Availability falls, demand rises and lending costs goes up, but this happens in every market.

Our securities lending desk supports stock loans to a broad number of clients, both domestic and international.

In Norway, we are the only local bank active in the lending market. The biggest competition in our market comes from the other Nordic banks based in Sweden, which also trade Norwegian stocks.

Lately, we have seen an increased demand for financing trades both from domestic and international clients. We are running this business alongside the normal lending business.

Is the pension fund market a big part of Norwegian business?

Many of the biggest pension funds in Norway are using foreign custodian banks so we do not see their lending activity locally. But I believe they lend out portions of their portfolio through the agent market.

The smaller or mid-sized pension funds have not been very active so far—some of them have done bits and pieces but not in a large scale.

I think that there might be a shift if the volumes, especially in the Norwegian market, pick up. Then it might be more interesting for the pension funds to lend as well.

How has the recent NBIM deal with Citi affected Norwegian markets?

It has not really had much effect. We saw the news that they have switched to Citi but they are primarily invested in foreign securities.

As a result it does not really affect our market. They have been active in the lending side for many years and I guess they will continue lending after the switch over to Citi as well.

How are the recent European regulations affecting people's mentality in Norway?

The regulations that are coming into force will definitely have an effect on how DNB Bank conducts its business. It is too early to say how it will affect us but it definitely means that the business will be more cost-conscious due to capital requirements.

I guess, if we look at the wider market, the regulations will mostly affect us when trading with foreign and investment bank clients. Domestic clients will not be hit by this regulation it the same way that we do as a bank. However, I still do not think this will change things in terms of who we do business with. In the future that might be a different story, but so far it's business as usual.

Previously, on the collateral side, most of the collateral was cash and cash only. With more international requirements, flexibility on collateral is more important. We have seen changes in the Norwegian market over the past two years.

I guess every participant in this market is now sitting there, trying to find out how best to do this business. The margin in this business is not that big and, and every participant needs to become more cost-conscious.

Locally on the regulation side, there is work going on to lift up some of the hurdles that mutual funds face. Hopefully, if changes are made this will have a positive effect on how they will look at the opportunities in the lending business. **SLT**

“With more international requirements, flexibility on collateral is more important. We have seen changes in the Norwegian market over the past two years”

Dag Rudiløkken
Head of trading, securities finance, securities services
DNB Bank

The path yet trodden

Flexibility of collateral will have a direct impact on income or future income levels in the country, says Steffen Jordan of SEB

Sweden, the biggest economy and biggest financial market within Scandinavia, has seen solid development following the Lehman Brothers and financial crises. The banking sector in particular is seen as one of the healthiest and best capitalised within the global financial system.

Swedish politicians as well as regulators have been on the forefront of setting high standards and requirements that in some cases significantly exceed EU standards. This is reflected in higher capital requirements that exceed the minimum level set by European regulators as well as the liquidity coverage ratio (LCR) calculation and reporting that became mandatory in 2013.

Those developments can also be seen in the Swedish securities lending landscape.

Similarly to the banking arena, most Swedish pension funds, investment companies and lenders in general have also not been affected significantly by the financial crisis.

Quite recently one of the biggest pension funds, AP1, celebrated a remarkable victory in a London courtroom over BNY Mellon on the back of losses out of cash collateral reinvestments done by BNY Mellon before the crisis. Off the back of this situation, there has been less interest from the bigger lenders to participate in cash reinvestment programmes, as they would rather focus on triparty. Interest in participating in securities lending is still growing, significantly driven by the low interest and return environment. The need to generate return in times with almost negative interest rates has presented a new regulatory landscape that raises the requirements for participating in this business.

Reporting to regulators as well as to investors is entering a new dimension with the aim of increas-

> *The forecasted squeeze of high level/high quality collateral has not materialised yet, though there has been a clear increase in demand from banks in borrowing top-rated government bonds*

Steffen Jordan
Head of securities finance
SEB

ing transparency and enabling fund investors to better understand risks and returns linked to securities finance transactions. This has prompted managers to act in the interest of investors in relation to the use of securities finance products. The new regulation also focuses on collateral management and outlines the thresholds for concentration limits and haircuts. For example, the Swedish UCITS rules put a cap on the overall lending volumes as a fund may not lend out financial instruments to an extent greater than the equivalent of 20 percent of the its net asset value.

The operational requirements and costs to participate in the business are also increasing. As a consequence, lenders are becoming more cost aware and more demanding in regards to compensation agreements. The ability to provide state-of-the-art services (collateral management, reporting, etc) is becoming equally important to creating the highest possible return when using EPM (efficent portfolio management) techniques.

Looking into the 2014 development of the Swedish securities lending market, we can identify a few trends that follow global developments in the industry. General collateral lending is becoming a commoditised and more automated product that sees little focus and little growth. Trading specials on the back of an increasing number of rights issues and corporate action activity is opening return opportunities, especially as lending fees on those have been increasing significantly in the past years.

The amount of lendable assets in Sweden has grown substantially and ranges between $110 and $120 billion for equities alone, depending on the data source used. With a utilisation rate of 7 to 8 percent, the Swedish market shows a significant lower number than Norway or Finland, which are constantly above 10 percent.

Lending of fixed income assets has seen increased interest, that is partially driven by the high quality status of Swedish debt.

In the past, fixed income underlyings have been traded predominantly using repo. Securities lending in bonds is also on a significant growth path. This falls in line with the general focus of the industry in collateral trading, upgrading, downgrading and optimisation.

The forecasted squeeze of high level/high quality collateral has not materialised yet, though there has been a clear increase in demand from banks in borrowing top-rated government bonds. The progress in implementing the LCR regime has also led to significant demand in borrowing longer term and in a more structured way (using evergreens, for example).

Flexibility of collateral is key in this situation and has a direct impact on income or future income levels. This has to be dealt with in an environment that has seen significant restrictions from internal credit departments and regulators.

Optimal and advanced handling of this antagonism is needed in order to replace shrinking income streams from general collateral business and yield enhancement and to achieve growth in the new world of financial markets. The Swedish market has just started to walk this path. **SLT**

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Global Collateral Services offers a comprehensive suite of capabilities to help our clients address their collateral, liquidity and securities financing needs. As they face evolving global regulations and rapidly changing market requirements, clients can leverage BNY Mellon's products and services to better manage counterparty and market risk in their collateral transactions, engage in more investment opportunities to help maximise their investment returns and access new financing alternatives.

BNY Mellon currently services approximately $2 trillion in tri-party repo collateral globally, approximately $100 billion in assets through its Liquidity DIRECT investment portal, and operates one of the industry's largest securities lending programmes, with $3 trillion in lendable assets.

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BondLend is a securities finance technology platform created specifically to support the fixed income borrowing, lending and repo community. BondLend's Trading and Financing Services provide straight-through processing automation for borrowing, lending and repo using a common standards-based protocol and infrastructure processing eliminating manual processes, freeing up valuable resources.

BondLend comparison services add efficiency and reduce the risk of potential collateral management errors. Comparison services are security type agnostic and support global usage for cash and non-cash records. BondLend's trading and post-trade services help drive down unit costs and increase efficiency. It allows firms to free up resources to expand their market presence, increase trading volumes, and reduce error rates all without additional cost.

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DataLend is the securities finance data services division of EquiLend, providing the market with global data across all asset classes.

This offering extends EquiLend's position as the standard of excellence in the securities finance industry.

DataLend builds on EquiLend's strengths in technology and benefits from its economies of scale. EquiLend, as a regulated trading platform, is a trustworthy repository for sensitive securities finance data.

Our innovative approach enables our clients to have a direct hand in shaping the evolution of the securities finance industry by producing market data that is best suited to serve the needs of industry participants.The DataLend mission is to be the leading provider of securities finance market data.

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DNB is the leading provider of securities finance services in Norway. It offers commitment, knowledge, experience and excellent service.

DNB is Norway's leading financial services group and one of the largest in the Nordic region in terms of market capitalisation. The group offers a full range of financial services, including loans, savings, advisory services, insurance and pension products for retail and corporate customers and the public sector.

DNB Securities Services offers a wide range of services in the market related to the administrative management of securities and securities finance. The securities services business actively participates in the development of local infrastructure and strongly cares for the Norwegian market, because it is so important to us.

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EquiLend is a leading provider of trading services for the securities finance industry.

EquiLend facilitates STP by using a common standards-based protocol and infrastructure, which automates formerly manual trading processes. Used by borrowers and lenders throughout the world, the EquiLend platform allows for greater efficiency and enables firms to scale their business globally.

Using EquiLend's complete end-to-end services, including pre- and post-trade, reduces the risk of potential errors. The platform eliminates the need to maintain costly point-to-point connections while allowing firms to drive down unit costs, allowing firms to expand business, move into different market, increase trading volumes, all without additional spend. This makes the EquiLend platform a cost-efficient choice for all institutions, regardless of size.

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eSecLending is an independent global financial services firm providing customized securities financing, collateral management and auction technology solutions for institutional investors and financial companies worldwide. eSecLending's innovative approach introduces investment management practices to the industry, offering an alternative to traditional pooled lending programs. Its differentiated approach facilitates best execution through a transparent, disciplined and repeatable process that determines its clients' optimal securities lending strategies. In addition to outperformance, eSecLending's approach provides clients with greater control, allowing them to more effectively mitigate risks.

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Lago Kapital Ltd is an independent securities finance broker based in Finland and regulated by the Finnish Financial Supervisory Authority. We are the leading equity finance broker in Finland. Our client portfolio consists of mainly institutional lenders holding a wide selection of stable positions total worth of approximately €4 billion. We are specialised in Scandinavian and Eastern European markets. We offer flexible ways of trading to meet our clients' needs, either by traditional securities lending, repo contracts or single stock futures.

We are constantly looking for new opportunities and partnerships.

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SEB is a Northern European banking group for companies, institutions and private individuals, with a 150-year history and strong franchise in investment banking and asset management.

With more than 30 years of experience with leading European and US hedge funds, SEB is one of the largest prime brokers in Europe on equity strategies and the leading provider of equity finance products for hedge funds in the Nordic market. SEB is the top equity broker in the Nordic region. Furthermore, it offers high performance direct market access to more than 40 global equities and futures markets.

With AUM of SEK 1.475 billion, SEB is one of the largest asset manages in Northern Europe and has a leading position within alternative investments with SEK 145 billion AUM, including private equity, real estate funds and funds of hedge funds.

At year end 2013, SEB had total assets of SEK 2.485 billion.