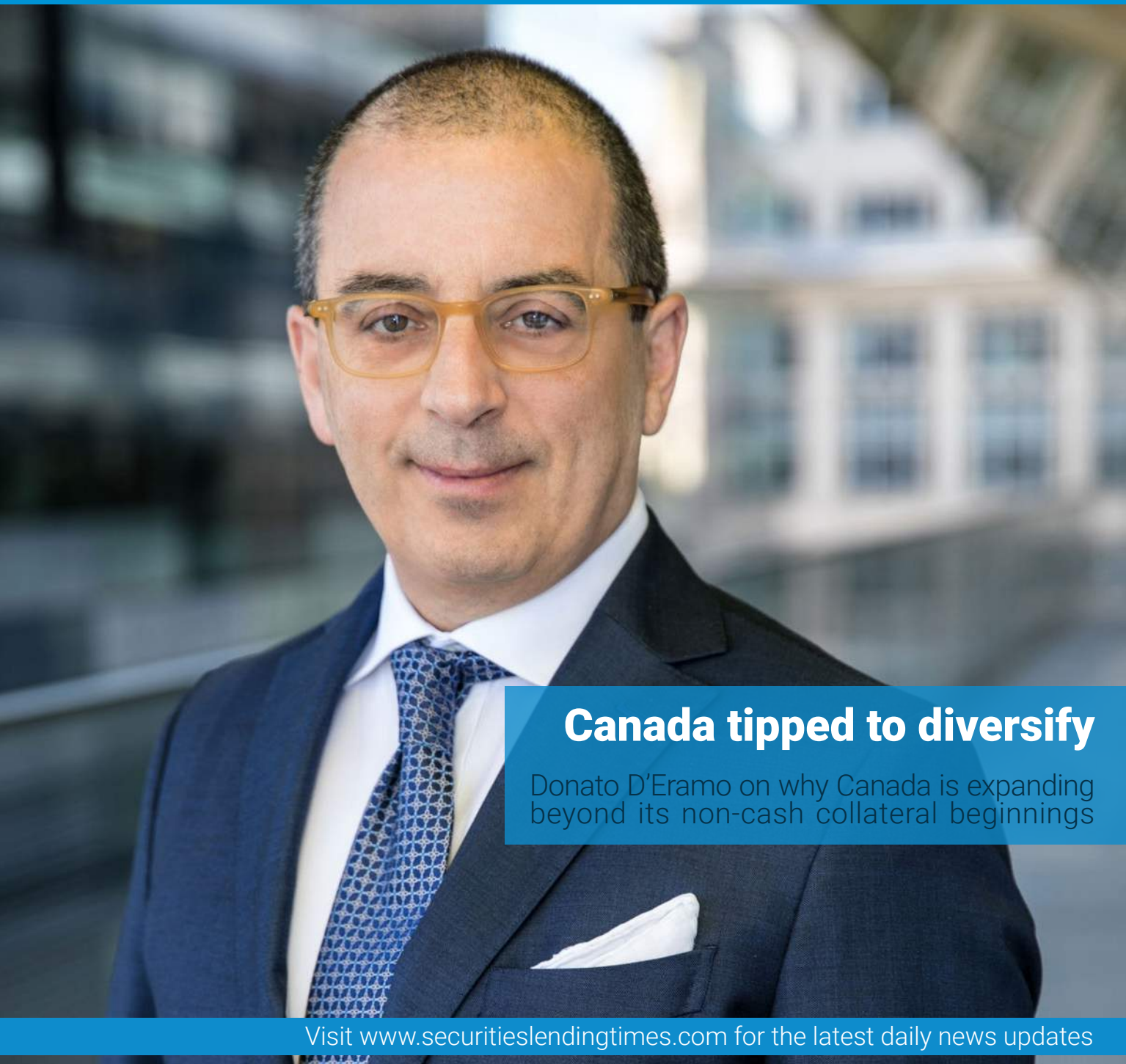


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ISSUE178 Conference Special



## Canada tipped to diversify

Donato D'Eramo on why Canada is expanding beyond its non-cash collateral beginnings

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## Canadian pension funds' winning streak continues

Canada's pension funds achieved a fourth consecutive quarter of growth in Q1, posting returns of 2.9 percent, according to RBC Investor & Treasury Services.

This year's Q1 returns far outstripped the 0.5 percent chalked up in Q4 2016 and set Canada's pension industry up strongly to surpass last year's annual return of 6.8 percent, as recorded in the All Plan Universe, which monitors \$650 billion worth of Canadian pension assets.

Positive global economic conditions in Q1 2017 helped lift global equities in delivering a return of 6.2 percent, up from 3 percent in Q4 2016.

The MSCI World Index reflected a similar trend, returning 5.8 percent for Q1 2017, up from 3.9 percent in Q4 2016.

Canadian equities bucked the trend in the last quarter, with a returns of 2.3 percent, down from 5.7 percent in Q4.

Canadian fixed income assets rebounded in Q1, posting a return of 1.4 percent, compared to a loss of -3.4 percent in Q4 2016.

"Canadian pension plan returns, led by strength in Canadian and global equities, are off to a good start in 2017, however, vigilance is still required," said James Rausch, head of client coverage for Canada at RBC Investor & Treasury Services.

"While ongoing business investment in Canada could spur growth, asset managers will undoubtedly be focusing on maintaining a diversified portfolio and actively managing their risk exposure in the period ahead given evolving macro-economic and political forces around the world."

## RMA sec lending committee offers amendments to Dodd-Frank rules

The Risk Management Association's (RMA) securities lending committee has written to the US Treasury as part of its President Donald Trump-mandated review of regulatory burdens on the financial system.

Trump's February executive order on the core principles for regulating the US financial system charged the Treasury with reviewing regulations with a view to relieving unnecessary burdens.

In its letter, the RMA's securities lending committee set out four recommendations for revisions to the Dodd-Frank Act, which

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"grossly overstates the risk of agency securities" and is "putting US agent banks at a severe competitive disadvantage".

Primarily, the RMA suggested that the Federal Reserve should drop plans to adopt single-counterparty credit limits.

Single-counterparty credit limits are based on "a flawed methodology from the federal banking agencies' capital adequacy rules that grossly overstates the risk of agency securities lending transactions and discourages sound risk management practices". If adopted, single-counterparty credit limits would likely "have an immediate and drastic impact on market liquidity".

Federal banking agencies should also review the collateral haircut approach in order to ensure that agent lenders are able to continue operating effectively in the lending space.

The risk-weight for exposures to securities firms that come under capital rules could also be brought in line with similar rules in other jurisdictions. "Failure to do so places US agent banks at a severe competitive disadvantage relative to non-US banks and severely limits their ability to service the US markets".

Finally, federal agencies could avoid placing "enormous administrative and operational burdens on agent banks without any tangible benefits to financial stability" by narrowing

## Canadian securities regulator fields final T+2 proposals ahead of 5 September intro

Toronto | Reporter: Drew Nicol



The Canadian Securities Administrators (CSA) is currently fielding comments from financial market participants on its final proposed amendments to its roadmap for Canada's transition to a T+2 settlement cycle, scheduled for 5 September.

The proposals relate to the National Instrument 24-101 Institutional Trade Matching and Settlement (NI 24-101) for equity and long-term debt market trades.

These amendments will apply to registered dealers and advisers, clearing agencies and matching service utilities.

CSA confirmed that, because of the interconnectedness of Canadian and US capital markets, final amendments to NI 24-101 will come into force in tandem. At the same time, the CSA published a notice and request for comment on the adoption

of a T+2 settlement cycle for conventional mutual funds, along with proposed amendments to National Instrument 81-102 Investment Funds (NI 81-102), which would see the settlement cycle for conventional mutual funds cut to T+2.

Comments on the proposed amendments to NI 81-102 should be submitted by 26 July.

Regulators expect to publish the final amendments late in the summer of 2017.

"Canadian securities regulators are committed to facilitating a smooth transition to the T+2 settlement cycle and to ensuring consistency across the markets by applying the shorter settlement cycle to all securities, including mutual funds," said Louis Morisset, CSA chair and president and CEO of the Autorité des marchés financiers, the stock market regulator in France.

the scope of their proposed rules regarding contractual stay requirements for qualified financial contracts.

The narrower scope would exclude categories of agreements under US law that do not create the types of cross-border resolvability issues that the rules are intended to address.

The RMA's securities lending committee stated: "The federal banking agencies have long acknowledged that financial regulation should not only be efficient, effective and appropriately tailored, but also should benefit American investors and ultimately help foster economic growth and vibrant financial markets."

### Lacklustre Target2-Securities take up drives volume drop-off

Moves to the Target2-Securities (T2S) platform across the EU has not yet "translated in market participants changing their model to take full advantage of the T2S benefits," according to Clearstream CEO Marc Robert-Nicoud.

Currently, legal barriers still make it complex to hold securities cross-border, Clearstream explained in its monthly volume report for April.

This leads to higher costs for transactions and causes uncertainty among investors when exercising their rights abroad.

"Further measures, such as a reduction in the realignment fees charged by central securities depositories (CSDs) to each other as part of their cross-border links, are therefore essential in order to increase the attractiveness of doing business cross-border in T2S," the report continued.

Clearstream noted that its migration to T2S earlier this year meant volumes on the platform had doubled to 500,000 transactions per day. However, cross-border activity in central bank money through T2S remains a small fraction of these volumes.



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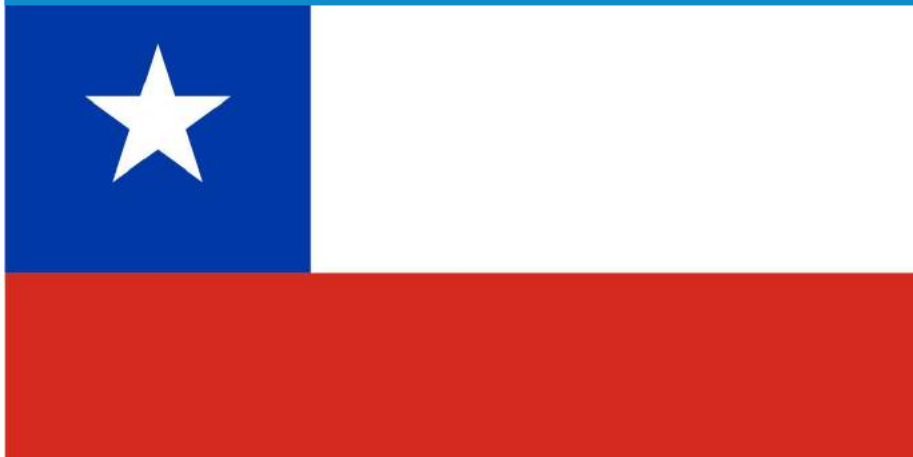
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## Chile to launch securities lending blockchain

Santiago | Reporter: Drew Nicol



Chile's Santiago Exchange will become the first Latin American exchange to offer a blockchain-based short selling solution for securities lending.

The Santiago Exchange is partnering with technology giant IBM for the solution, which will be based on the open source Linux Foundation's Hyperledger Fabric.

In a joint statement on the partnership, IBM and the exchange pledged that the solution will be widely available to support multiple parties across the country's financial industry ecosystem this year.

According to the statement, the solution is designed to help reduce errors, possible fraud, and processing time for each transaction, while also improving transaction management and lowering costs. In the case of the Santiago Exchange, the solution will result in significant time savings for the back-office processes.

Meanwhile, Nasdaq has been chosen by Chile's central securities depository (CSD) to create a securities lending accounting infrastructure as part of a major technology overhaul.

Chile's Depósito Central de Valores (DCV) aims to leverage Nasdaq's extensive technology products to revamp its trade and instruction management, as well as its settlement, custody, corporate event management and registry capabilities, among other features.

DCV said it has tasked Nasdaq with creating "support for smooth, fault-free settlement with optimisation algos, as well as potentially provide facilities to securities lending and borrowing accounting".

The system will also enable straight-through processing and be based on global standards. It will also reduce operational complexity, according to DCV.

Robert-Nicoud said: "The harmonisation objective requires both infrastructure development and a change in market behaviour. T2S migration has not yet translated in market participants changing their model to take full advantage of the T2S benefits."

"When contributing to market safety and efficiency, market harmonisation should be welcome by all market participants. We continue to develop T2S driven solutions in close cooperation with clients and other market infrastructure providers to ensure that T2S delivers on its pan-European ambitions."

"We see these efforts as critical to ensure that the market gets the benefits of the investments made over the last years."

Clearstream saw outstanding volume in its global securities financing drop 13 percent year-over-year for April.

The Deutsche Börse subsidiary recorded monthly volume of €460.2 billion in April, down from €530.1 billion during the same period in 2016.

Clearstream's January to April average volume was €479.8 billion, down from €530.2 billion in 2016.

### LGPS board releases transparency code for asset managers

Asset managers working on the new Local Government Pension Scheme (LGPS) for England and Wales are now able to sign up to a transparency code as a way of boosting their attractiveness for mandates.

The voluntary code focuses on shedding light on investment cost and fees applied by asset managers to the administering authority of the pension fund.

Managers that conform to the code must create an automated annual reporting





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system with their client for relevant fees and transaction costs within 12 months of signing up. Pension funds can request these reports on a quarterly basis.

The reports must be presented using templates created by the LGPS board.

There are separate templates for segregated portfolio management and for pooled funds.

If an investment manager operating a segregated mandate invests in a pooled fund as part of that mandate, the reporting will be done via the manager's own template.

KAS BANK UK product manager Stewart Bevan commented: "It's excellent to see the cost transparency debate take another major step forward at the Pensions and Lifetime Savings Association conference."

"The transparency code launched by the UK's LGPS looks like a significant contribution toward better cost disclosure for pension schemes."

"Adoption will develop into best practice in time, but real success will be achieved once all this information is presented in a meaningful way for schemes, and used by trustees to make better-informed investment decisions for their members."

The code was developed to assist LGPS authorities with gaining greater clarity on investment fees. It was created in partnership with the the Chartered Institute of Public Finance and Accountancy, along with other key stakeholders.

The LGPS pooling project is set to launch in April 2018.

### Northern Trust expands UAE ops

Northern Trust has opened a new branch office in Abu Dhabi, as part of a continuing focus on business in the United Arab Emirates (UAE).

Located in the city's international financial centre, the Abu Dhabi Global Market (ABGM), the new branch will offer a range of asset servicing and management solutions to institutional investors and high-net worth individuals throughout the UAE.

It is Northern Trust's second office in the city, adding to a representative office opened in 2008. The bank also has an office in Riyadh, Saudi Arabia, and has been providing services for client in the Middle East for 30 years.

Robert Frazer, head of Northern Trust in the Middle East, commented: "Northern

Trust has a long history of servicing clients across the region, and we look forward to our continued collaboration with ADGM at the Abu Dhabi's financial free zone. We see significant opportunity to bring our institutional level offering to asset managers, sovereign wealth funds and wealthy families across the region."

Richard Teng, CEO of the Financial Services Regulatory Authority of ADGM, said: "Internationally recognised as one of the key industry leaders in the global markets, Northern Trust's affirmation and presence add to the breadth of the asset management and asset servicing community in Abu Dhabi."

### Prime brokers are failing to retain hedge funds, says Preqin

Service providers to the hedge fund industry must "address concerns over cost and quality of service" in order to retain securities lending clients, according to Preqin's Amy Bensted.

A Preqin survey of 270 hedge funds found that a quarter of respondents had changed service providers during 2016 due to dissatisfaction.

Of that quarter, 75 percent only changed one service provider and 39 percent switched prime brokers.

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The survey was conducted in November 2016 and also used data on more than 2,000 hedge fund service providers from Preqin's Hedge Fund Online database.

Preqin's survey also revealed that 19 percent changed their fund custodian in 2016. When questioned on their reason for changing providers, 55 percent cited cost as a key reason, with 21 percent citing dissatisfaction over service, according to Preqin. A further 15 percent said that coping with regulations was also a factor.

Amy Bensted, head of hedge fund products, said: "Service providers are a vital part of the hedge fund landscape, assisting in the smooth running of operations. They perform a range of vital services in the industry, such as custody and valuation of assets, facilitating securities lending, providing advice on regulation and fund terms, and assisting with the fundraising and investor subscription processes."

"In order to retain hedge fund clients and win new business, service providers need to address concerns over cost and quality of service, particularly as investor scrutiny over fees and performance continues to grow. These firms will need to maintain a careful balance by improving their service offering while still reducing costs."

### SS&C expands Acadian mandate

SS&C Technologies has secured Boston-based Acadian Asset Management's long/short portfolios as a client of GlobeOp.

SS&C will provide collateral management, reporting, accounting, trade capture and lifecycle processing services to Acadian. The new mandate builds on their existing relationship for fund administration services for Acadian's long/short strategies.

This initial partnership has existed since Acadian launched its diversified alpha equity strategy in 2016.

Acadian cited SS&C GlobeOp's capabilities around margin finance management, cash and collateral management, and triparty reconciliation as "critical in its decision" to expand its relationship with SS&C.

"The appointment followed a detailed search and due diligence process across the major fund administrators in the market," said Tara Norton, senior vice president and director of hedge fund and alternative asset operations for Acadian.

"SS&C was able to clearly demonstrate their ability to service large, complex, long/short

fund managers across a broad range of asset classes and they were unrivalled in terms of technology offering. Above all, we selected SS&C because of their commitment to client service and integrity."

Bill Stone, chairman and CEO at SS&C, said: "Partners such as Acadian are very important to SS&C. We look forward to continuing to support them as they work to deliver on their growth strategy."

"Our services are designed to help asset managers such as Acadian achieve high levels of service and transparency. This relationship demonstrates the range of our platform and expertise, which can support the full lifecycle of virtually any strategy employed by alternative funds today."

### BrokerTec and MTS embark on expansion of RepoFunds Rate suite

Fixed income trading platforms BrokerTec and MTS have added Dutch and Belgian repo indices to the RepoFunds Rate (RFR) suite.

The Dutch repo market transacts in excess of €11 billion nominal volume per day on BrokerTec, with an actively traded specials and general collateral (GC) market.

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The Belgian repo market typically sees volumes in excess of €12 billion a day across specials and general collateral baskets.

Each RepoFunds Rate index reflects the specific effective cost of repo funding for trades executed on BrokerTec and MTS, which between them typically trade volumes of €230 billion per day, according to BrokerTec.

The RFR indices are calculated and published by BrokerTec's parent company NEX Group's NEX Data, which offers market intelligence and price information for over-the-counter (OTC) data via third parties.

Both indices provide trade-backed data, which is used to measure the effective cost of funding within the Dutch and Belgian markets.

John Edwards, managing director for BrokerTec Europe, said: "The launch of both the Dutch and Belgian RepoFunds Rate complements the existing suite of RFR's with both markets historically being significant in their contribution to the overall Pan Euro RFR."

"This launch follows the Spanish RFR rolled out in September 2016 and continues to illustrate the level of interest and value now given to the funding facilitated through the use of the secured repo markets."

Oliver Clark, head of product at MTS, added: "We are constantly looking for innovative solutions for clients and the wider market and the further expansion of the RFR indices into the Netherlands and Belgium is another step in providing the kind of information the market needs."

"These new RFR indices demonstrate that the repo markets are an important indicator of the cost of funding in local markets."

### Geopolitical turmoil drives bond trading

Geopolitical events in the US and Europe were the most significant drivers of fixed income trading in the 12 months ending March, according to NEX Group.

NEX Group noted in its March-to-March yearly report that secondary market activity for European government bonds has steadily improved from the lows seen last year.

Trading activity remains concentrated around new bond issuance in addition to an uplift more generally in France and Holland in the run up to their elections.

The US presidential election produced the second highest recorded volume day at BrokerTec and speculation around President

Donald Trump's policies also continued to drive heightened volatility.

NEX Group also highlighted the actions of the US Federal Reserve, which, while keeping interest rates on hold, has embarked on a measured agenda of raising rates providing trading opportunities.

As a result of the uncertain political landscape, fixed income and repo trading platform BrokerTec's revenue increased by 17 percent to £155 million.

This performance reflects a 3 percent increase in US repo to \$219 billion and a 6 percent increase in European repo to €186 billion, but a 2 percent decrease in US treasury average daily volume to \$164 billion.

"The US repo product benefitted from the uptick in market volatility that began ahead of the Brexit vote and persisted through the US presidential election. Trading activity in the European repo market benefitted from increased volatility, demand for good quality collateral and a lack of supply from the buy side," NEX Group stated.

Michael Spencer, CEO of NEX Group, said: "Our performance remains strong in a tough market environment. NEX Markets has

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focused on expanding its product suite to a wider client base and continues to win market share in US treasury actives, EU repo and Asian non-deliverable forwards.”

### R3 raises record funds for DLT

The R3 group has raised \$107 million in two tranches of fundraising, securing the largest ever investment in distributed ledger technology (DLT) to date.

The first and second tranches of R3’s Series A round of fundraising was open only to R3 members, and attracted investment from 40 of the group’s institutions.

A third and final fundraising tranche, due for later this year, will be open to both member and non-member institutional investors.

According to R3, the funds will be used to further the development of DLT, and to expand strategic partnerships for product deployment. The development will focus on Corda, R3’s DLT platform for regulated financial institutions.

The funds will also be put towards R3’s infrastructure, supporting partner-built applications designed to interoperate with existing networks and systems.

R3’s 80-strong member base includes banks, clearinghouses, asset managers, trade associations, technology firms, professional services firms, and more

Member that contributed to the fundraising included Bank of America Merrill Lynch, BNY Mellon, Northern Trust, BNP Paribas and Deutsche Bank.

The record investment marks a return to form for R3, following the exit of founding member Goldman Sachs in November last year, followed closely by Morgan Stanley and Santander.

David Rutter, CEO of R3, said: “This investment is unprecedented. Many of the world’s largest financial firms have come together not just with capital support, but with a robust commitment to work with R3 in developing industry solutions that will be the building blocks of the new financial services infrastructure. We’ve got unparalleled momentum.”

“R3 has proven the collaborative model can successfully drive innovation in financial services to a degree never before seen,” Rutter added.

“In the space of less than two years, we have built a network of over 80 members, launched

an open-source distributed ledger platform specifically for wholesale financial markets, conducted over 60 detailed use cases across a variety of asset classes, led the way in regulatory engagement on behalf of the broader DLT community and are ahead of schedule for initial commercial deployments this year. We are on our way to becoming a new operating system for financial services.”

### Funds need to keep an eye on BEPS

Fund participants were encouraged at Guernsey’s Fund Forum to pay close attention to negotiations over base erosion and profit sharing (BEPS) rules.

The Organisation for Economic Cooperation and Development’s (OECD) BEPS project aims to harmonise global rules.

Speaking at Guernsey’s Fund Forum event on 11 May, tax experts Tony Mancini of KPMG and Abhijay Jain of PwC stressed that fund participants should remain alert as to how negotiations at the OECD unfold.

Mancini said: “BEPS is not intended for the investment management sector, but the problem we have is that we could be collateral damage. There’s a steamroller that, if it carries on, we could just get squashed.”



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A large, elegant cursive signature of "J.P. Morgan" in dark brown ink, positioned at the bottom of the page. The signature is highly stylized, with a large, looping initial "J" and a long, sweeping underline.



# Canada diversifies and expands

As the market continues to develop, the country's banks are putting more focus on growing their businesses south of the border and internationally. Donato D'Eramo of RBC Investor & Treasury Services and the Canadian Securities Lending Association explains what's to come for Canada

## How has the Canadian securities lending market evolved since the CASLA conference in Toronto last year?

Canada is the second largest securities lending market in the world with approximately CAD 1.36 trillion in lendable assets (according to Datalend, as at 25 May 2017) and active loans of CAD 166 billion, so the industry is mature.

The sector continues to focus on balance sheet and capital ratios as both affect borrower and lender behaviour, while the growth of non-cash capabilities, term and cash offerings and collateral optimal solutions for stakeholders remain front and centre.

The energy sector plays an important role in the Canadian economy and as the price of oil remains at suppressed levels, business investments continues to wane. The mining sector in general in Canada has seen lower initial public offering (IPO) launches as well as mergers and acquisitions (M&A) activity—both of which manifest demand in various ways in securities lending.

The demand for high-quality liquid assets (HQLA) continues to evolve with Canada being a large issuer of government and provincial debt, both of which are considered level one assets under the Basel regime.

## What are the main challenges that CASLA is looking to tackle?

I would say that the challenges from 2016 remain in play this year. Our priorities remain:

- Collaborating with regulators and industry partners to implement change and support an efficient and secure marketplace
- Developing strong linkages with similar global trade associations
- Advocating for the common interests of securities lending market participants, including custodian banks, beneficial owners, asset managers and broker-dealers
- Educating the public about the role of securities lending in capital markets

We also continue to focus on regulatory themes that affect capital and leverage ratios and potential downstream impacts for all constituents, including banks, broker-dealers and agent lenders. Working on regulations affecting certain segments of the market, including mutual funds and the national instrument, continue to be priorities.

## What makes the Canadian market stand out from its southern neighbour?

Canada is a very healthy securities lending market with utilisation rates on Canadian equities almost 60 percent higher than that of US equities. Historically, Canada has followed Europe in how its securities lending programme has been developed with non-cash collateral being the dominant form of collateral and the legal construct similar to Europe.

From a macro perspective, there is some uncertainty around consumer debt levels in Canada and its impact on the Canadian banks. Canada has been operating in a very low interest rate environment—slightly lower than the US.

## It could be argued that Canada was overlooked in the past as a lending market. Do you feel it now gets the recognition it deserves as a strong source of revenue?

I wouldn't say the market has been overlooked in the past but potentially viewed as a general collateral market concentrated in non-cash collateral. As the market continues to develop, collateral is diversified and the Canadian banks are putting more focus on growing their businesses south of the border and internationally. Cash collateral has been a growing space within the Canadian market with now more than 20 percent of balances versus cash. The specials market in Canada has picked up in the past year, which has contributed to stronger returns for beneficial owners.

The market continues to cope with balance sheet constraints and increased regulation where solutions within the securities finance space have played a role.

## What are the top internal and external challenges facing the Canadian market today?

I think in addition to the themes mentioned earlier about the challenges that CASLA is addressing, continued regulatory pressure and their ongoing impact remains a challenge.

Securities lending is very much a byproduct of a healthy functioning financial services industry. From an external perspective, the current geopolitical landscape in the US creates uncertainty within the markets and has had increased pressure on the Canadian economy due to the future possible North American Free Trade Agreement changes. **SLT**



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# Canadian securities financing thrives

Of the two giant North American markets, Canada is the one going from strength to strength. Peter Madigan, editor-at-large at BNY Mellon Markets, reports

North American securities financing is very much a tale of two cities at the midway point in 2017.

While US securities financing has languished with record-low volatility amid climbing equity markets and ebbing demand for shorts, equity financing in Canada has gone from strength to strength.

Last year saw borrowed Canadian equities generate USD 330 million for beneficial owners, a 20 percent increase in revenues over 2015, according to data from IHS Markit. All told, the Canadian equities market held USD 443 billion in lendable assets last year, which saw a utilisation rate of 10.8 percent.

Although that may not sound very impressive, to put that level of penetration into perspective, the US securities lending market witnessed a utilisation rate of just 4.9 percent, albeit on an eligible base of USD 6.73 trillion in lendable assets, retaining its position as by far the largest market in the world.

The strong performance of the Canadian market has extended into 2017, with the first three months of the year seeing quarterly revenues surge by 19 percent year-on-year to USD 87.7 billion, average balances climbing 3 percent and lendable assets soaring by 31 percent compared to the same quarter the previous year. Over the same period, the US market has undergone a sharp reversal. Quarterly revenues are down 29 percent year-on-year, average balances are down 11 percent and average utilisation has slumped 27 percent, according to IHS Markit.

## A saturated fixed income market

The thriving business in Canadian equity financing can be contrasted with a less than glowing situation in fixed income securities lending.

While this heavily oversubscribed sector is undoubtedly a success story, as highly rated bonds are becoming increasingly hard to source, the fixed income business could be described as a victim of its own success. In fact, by some estimates the market is experiencing a shortage of supply in US and Canadian government bonds.

“The Canadian fixed income market has been high in demand over the last few years given the need for high-quality liquid assets (HQLA) and the fact that Canadian government bonds are AAA rated. As such there is a high degree of utilisation for Canadian government bonds on the shorter end of the curve,” says Phil Zywoj, managing director of securities finance at BNY Mellon in Toronto.

Ascertaining the level of saturation in the Canadian fixed income securities lending market is difficult. The detailed data compiled by IHS Market does not break out its government bond analysis by nation in the same way it does for equity financing. Anecdotal reports suggest, however, that perhaps as much as 80 percent of Canadian government bond inventories with maturities of 10 years and less are been utilised for the purposes of securities finance.

## Liquidity regulation driving demand

The drivers of this demand are relatively simple. Basel III liquidity and capital charges are requiring banks to hold large inventories of HQLA in order to meet their regulatory commitments. Two regulations are having a particularly strong impact on securities finance markets. The first is the Basel III liquidity coverage ratio (LCR), which requires banks to hold sufficient HQLA in order to fund themselves for 30 days under stressed conditions.

The second is the longer-term net stable funding ratio (NSFR), which obliges banks to establish reliable funding sources that can provide





the bank sustainable access to HQLA for up to one year. The result of both these measures has been to ramp up demand for long-dated funding among Basel-compliant banks.

Zywot explains: “The regulatory pressures in Canada are the same you’re seeing in the US and Europe: a demand for term-funding in securities lending to meet the LCR and the NSFR. Term structure trades have become very popular as they provide capital relief for the borrowers.”

“You are also seeing increased demand for longer duration term structures as we move along the timeline for regulatory implementation—moving from 35-day trades into the three-month range and moving out to the six-month to one-year range.”

As fixed income securities have become both harder and more expensive to source, the Canadian market, which has traditionally been a non-cash sovereign debt collateral market, is increasingly seeing cash and equities being pledged as collateral on trades. In Canada today, cash and equities can be the cheaper forms of collateral to utilise relative to government bonds.

Canadian securities finance has also been boosted by the reappearance of specials in the equities market. Specials—otherwise known as hot equities—are generally defined as stocks that trade at a wide bid/ask and are hard to borrow. According to one definition, an equity is hot if less than 25 percent of its shares are available on the open market.

The reemergence of specials can be attributed in part to the correction in the Canadian resource sector that began in the summer of 2015. This is due to the fact that the Canadian commodity sector is highly interlinked with the Canadian equity market.

More recently, the almost daily discussions of a potential housing bubble in the greater Toronto area has also moved alternative mortgage lenders into the sights of short sellers.

These two sectors have been—and look set to continue to be—the main drivers in the booming Canadian equity finance space for the remainder of 2017. [SLT](#)

## BNY Mellon in Canada: By the numbers

- BNY Mellon is the market leader in Canadian securities finance, the second largest securities finance market in the world, after the US
- CIBC Mellon, BNY Mellon’s sub-custodian for Canadian assets, has CAD 1.7 trillion in assets under administration in Canada
- Of that CAD \$1.7 trillion, CAD \$685 billion is utilised in the CIBC Mellon securities lending programme, a 40 percent penetration level

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## An energised market

The Canadian securities lending market remains the second largest in the world after the US, with average lendable balances of more than \$842 billion in 2016. Experts discuss the latest trends



## Dave Sedman

Head of sec lending trading for Canada

**Northern Trust**



## Alexa Lemstra

Director

**EquiLend Canada**



## Don D'Eramo

Global head of securities lending

**RBC Investor & Treasury Services**



## Phil Zywot

Canada regional trading head

**BNY Mellon Markets**

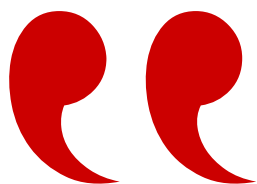


## Chuck Murray

Vice president of agency lending

**State Street**





Low volatility levels and higher equity values muted securities lending demand, especially in the top earning securities. There were pockets of demand in specific sectors

**Dave Sedman**  
Head of securities lending trading for Canada  
**Northern Trust**

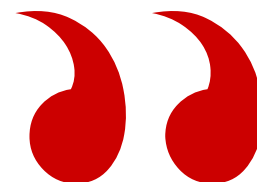
**Canadian pension funds easily beat their 2015 returns target last year. How did this affect the country's securities lending market and how are pension funds fairing in the opening months of 2017?**

**Don D'Eramo:** Canadian pension funds tend to outperform other investor segments such as mutual funds due to the application of different regulatory requirements. For example, the Office of the Superintendent of Financial Institutions (OSFI) governs lending activity for pension plans, while mutual funds are governed by various national instruments, which impose lending limits and provide for narrower collateral criteria. As a result, pension funds have the ability to capture a wider range of lending opportunities, particularly term loans in the high-quality liquid assets (HLQA) space.

**Dave Sedman:** Canadian defined benefit pension plan sponsors recorded an uptick in returns for Q1 2017, according to the Northern Trust Canadian Defined Benefit Pension Plan universe, a service that tracks the performance of Canadian institutional investment plans.

The median plan gained 3 percent, following a loss of 1.2 percent in Q4 2016. The positive performance was primarily driven by strong equity markets while fixed income also experienced positive performance in a reversal from last quarter. Global equity markets started the year on a strong note with all broad market indices registering positive performance. The median return on Canadian equity at 3.8 percent outperformed the S&P/TSX Composite by 1.6 percent.

Securities lending industry revenues in Q1 2017 were 11 percent lower than Q1 2016, according to DataLend. Low volatility levels and higher equity values muted securities lending demand, especially in the top earning securities. There were pockets of demand in specific sectors of the securities lending market, including the retail, biotechnology and home mortgage industries. There was also an increase in demand for fixed income securities, specifically for HQLA, which would include Canadian sovereign debt. Of course, a beneficial



owner's individual performance will depend upon the allocations they have to the sectors and asset classes that have the highest demand.

**Alexa Lemstra:** The Canadian market finished 2016 with \$492 million in revenue for clients. Securities lending revenue in Canada has shown stable growth, particularly in 2016, when a number of deal names, moving sectors and increased demand for sovereign bonds contributed to revenue.

Q1 2017 revenue continues with steady returns for clients, driven primarily by Canadian common shares at \$112.3 million, followed by sovereign debt at \$12.5 million. We are seeing a noteworthy increase in revenue from the lending of Canadian sovereigns. HQLA demand is on the rise, leading to an increased appetite for AAA-rated sovereigns, such as Canada's. The utilisation of Canadian securities averaged 36 percent in Q1 2017 and has been slowly increasing.

**Phil Zywojt:** Many of Canada's pension funds are sophisticated investors that continue to expand globally and diversify outside of Canada. Pension plans look to securities lending programmes to earn additional incremental revenue for their plans. Most funds have ventured outside of Canada looking at different asset classes to diversify their holdings and to try to maximise returns.

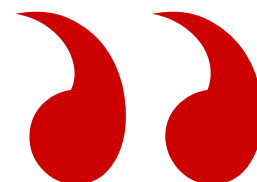
This has resulted in increased global asset holdings, creating a range of different opportunities within the global securities lending space. A majority of Canadian pension funds are fully funded and continue to grow their assets under management, which in turn has resulted in greater growth in lendable positions.

Canadian pension funds have embraced securities lending and look to it as a means to enhance potential returns and to partially offset operational costs, given the low interest rate environment that we've seen in Canada. Many economists are predicting that interest rates will remain unchanged in Canada this year.



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**Alexa Lemstra**  
Director  
**EquiLend Canada**



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Our strong and stable financial system, combined with a stringent and proven regulatory framework, continues to drive foreign investment in Canadian markets

**Don D'Eramo**  
Global head of securities lending  
RBC Investor & Treasury Services

**Chuck Murray:** As a result of funds beating their 2015 return targets, assets under custody and the value of securities on loan often increase. While positive, the effects of this on securities lending is nominal, in comparison to the incremental revenue generally generated by securities lending programmes.

In terms of what is being observed in the pension fund space, generally, we are noticing pension funds recalibrating from a risk perspective and broadening collateral, and accepting 'alternative collateral' (an expanded range of collateral) to enhance returns. We attribute these expansions in collateral parameters to our ability to monitor and mitigate the increased risk and understand how concentration limits are monitored. Additionally, we analyse how liquidity of the collateral is monitored and how the credit quality of the assets is monitored.

**A Deutsche Bank survey from October saw Canada voted as one of the most attractive regions for alternative UCITS allocation. Has this been reflected in securities lending?**

**Murray:** We have not observed any trends from a securities lending perspective that would necessarily support the Deutsche Bank survey that Canada is one of the most attractive regions for alternative UCITS allocation. Though lending rates for UCITS CAD assets have declined, the collateral requirements that UCITS must adhere to likely diminish the benefits of lending these types of assets in Canada.

**D'Eramo:** Canada continues to be an attractive region for investment, not only for alternative UCITS allocations but also for industry-wide strategic investment. Our high concentration in the commodities sector is particularly important for foreign investment. The prominence of commodities, coupled with a robust financial sector, has provided strong support to the Canadian market.

The S&P/TSX Composite Index return of more than 17 percent over the past 12 months is evidence of the strength of Canada's economy.



We continue to see demand in the resource sector, although it has somewhat levelled off with the rebound and stabilisation of commodity prices

**Phil Zywot**  
Canada regional trading head  
BNY Mellon Markets

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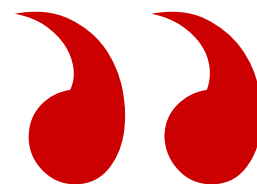
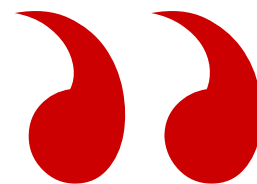
**How are stocks for Canadian companies being used within the country's lending market? Are there any stand out favourites stocks or industries?**

**Lemstra:** One of the most interesting securities in the lending market so far in 2017 has been Home Capital. The financial services company was the highest-fee stock in the Canadian securities lending market in 2016 and has continued its reign this year, with one-day fees dipping as low as 75 percent in mid-spring. Home Capital remained the top-revenue security in Q1 2017, having brought in \$18 million in revenue.

The healthcare sector, the hottest in 2016, continued its ride into 2017 with an average fee of 173 basis points (bps) in 2016 rising to 582 bps in Q1 2017. High fees on marijuana stocks in the pharmaceutical sector are driving the healthcare fees higher as the Canadian government moves toward legalising the industry.

**Zywot:** Canada experienced a return of specials in the equity market over the past couple of years. This was in conjunction with the correction that we saw in the commodities market that started in the summer of 2015 and continued until February of 2016. With this correction, we saw a corresponding increase in demand for resource-based companies (particularly in the energy sector) and firms that had ties to the resource industry.

We continue to see demand in the resource sector, although it has somewhat levelled off with the rebound and stabilisation of commodity prices. Any return of volatility within this space could spark increased demand in the commodity sector for securities lending. More recently, the booming housing market and the potential



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overheating of this sector (with the focus being on the Greater Toronto Area) has put the alternative mortgage lending sector in high demand over the past year.

**D'Eramo:** According to DataLend, the Canadian securities lending market remains the second largest in the world after the US, with average lendable balances of more than \$842 billion in 2016, and among the top five markets globally based on fixed income revenue. Canada has seen consistent growth in the general collateral space and capital markets continue to leverage securities lending as a means to optimise their flows. Event-driven strategies and corporate action optimisation remain significant contributors to lending revenues. Throughout 2016 and well into Q1 2017, the hottest sectors for securities lending were healthcare and real estate, both dominated by visible volatility and persistent directional demand.

**Murray:** As a natural resource-based economy, Canada consistently sees strong demand for mining industry names and the oil and gas sector. This strong demand did not diminish for the oil and gas sector when crude experienced lower prices globally, and the prospect of higher interest rates in the US has had a tangible impact on precious metals, specifically gold.

We have also seen increased demand in financials, including non-bank mortgage lenders and consumer lending firms, as well as healthcare and pharmaceuticals. These noticeable increases are likely the result of overleveraged Canadian consumers, the strong housing market, and the continued interest in biotech.

**Sedman:** The market continues to define itself with a mix of high-demand specials securities and lower demand general collateral. The specials tend to be very name-specific and associated with industries where there has been volatility in underlying share prices. The Canadian specials market benefited from continued demand in financials, specifically mortgage lenders, as their heavy concentration in non-prime residential mortgages implies greater vulnerability versus most Canadian banks.

Directional demand in the healthcare, pharmaceutical and specialty pharmaceutical sector was seen in 2016, over year-end, and throughout Q1 2017. An increase in mergers and acquisitions activity coupled with a negative outlook within department store retailers has fuelled demand for specific companies in those market segments.

A large portion of the revenue generated from Canadian equities is driven by dividend yield enhancement trades, coupled with the dividend reinvestment plan trade. Continued demand from borrowers to pledge various forms of non-cash collateral (equities and corporate debt) has dominated the securities lending market, providing opportunities for beneficial owners who can accommodate this collateral within their risk parameters.

**At last year's CASLA conference it was suggested that a Canada-based CCP was an unlikely prospect given the size of the country's securities lending market. Has that changed?**

**D'Eramo:** This view has not changed significantly over the past year. There is currently no dominant central counterparty (CCP) in most of the major financial markets that cater to the functional needs of agency securities lending, and Canada is no different. However, it continues to be a viable model as global markets have already committed the scale and resources to leverage existing CCP solutions that have proven successful within other market products.

**Sedman:** Northern Trust and other industry participants remain committed to developing a workable CCP model. Our goal is to provide the beneficial owner with the best risk adjusted return for their securities lending programme.

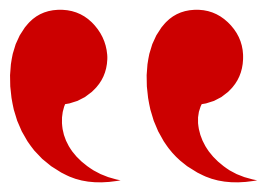
**Zywot:** CCPs are gathering steam in the US but in the past year we have not seen a noticeable change with respect to a Canadian CCP. Potential implementation of regulations, such as the single counterparty credit limits, could be a driver increasing the importance of a Canadian CCP for securities finance. Risk-weighted assets are another potential motivator that could spur on the CCP in Canada. Currently, the method proposed for how CCPs would function in Canada is not suitable for securities lending—they would need to modify the CPP model to accommodate the clearing of these products.

The size of the Canadian securities lending market is another potential reason why CCPs have not got off the ground in Canada when compared with the much larger US market. Canadian banks are very well capitalised and generally are not as highly-leveraged as their American counterparts, possibly contributing to the lack of desire for utilising a CCP in Canada. Currently, Canadian market participants don't seem to have the same drive to use CCPs as their American counterparts.

**Lemstra:** When the Canadian market implements a CCP workflow, EquiLend will be involved to facilitate the trade flow and provide novation. We are currently doing this with EquiLend Clearing Services (ECS) in the US, which interacts with OCC.

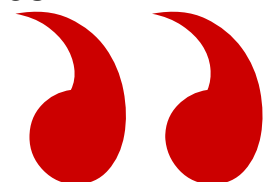
We have been working closely with the Canadian marketplace to ensure, as the existing CCP providers move to allow participation by foreign institutions, that ECS likewise will extend its services to Canadian firms.

**Murray:** Though the industry's perspective is unlikely to change, the Canadian market could conceivably support its own Canadian-based CCP. The repo market CCP has consistently seen volumes grow over the past few years, with the majority of repo trades going through its facility. **SLT**



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**Chuck Murray**  
Vice president of agency lending  
**State Street**







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# Speeding toward the finish line

Canada's move to a T+2 settlement cycle is nearing. Lou Lesnika, assistant vice president of trade settlements at CIBC Mellon, explains what there is left to do

## How prepared is the Canadian market for T+2?

The Canadian Capital Markets Association (CCMA)—a federal organisation launched to identify, analyse and recommend ways to meet the challenges and opportunities facing Canadian and international capital markets—is overseeing the T+2 initiative from a participant perspective. The CCMA's related committees include the T+2 Steering Committee, T+2 Operations Working Group, T+2 Legal and Regulatory Working Group, T+2 Communications and Education Working Group and the T+2 Mutual Funds Working Group.

CIBC Mellon is playing an active role in the readiness and consultations taking place across the industry leading up to the implementation of T+2 in Canada. CIBC Mellon is represented on all of the CCMA's T+2 industry groups and has been meeting with Canadian market participants on a monthly basis for 15 months now.

The CCMA and Canadian market have been working through issues and resolving them from an industry viewpoint, to help plan for a smooth transition to a two-day settlement cycle in Canada, along with the US markets on 5 September 2017. Planning a shorter settlement cycle well in advance gives stakeholders the time they need to assess and test their preparations.

## What will it mean for Canada to be in line with other markets such as Europe?

Shortening the settlement cycle offers a number of benefits for Canada, such as increased stability of Canadian capital markets, mitigating operational and systemic risk by reducing exposure between the parties to a trade, between the counterparties and central clearinghouses, and for harmonisation among various markets. Joining other global markets in a shorter trade cycle can support a more efficient marketplace and reduce operational risk. Opportunities to simplify and unify cross-border trading help to support efficient markets with increased global settlement harmonisation. A shortened settlement cycle helps better position investors in Canada to navigate the global environment, as investors' horizons and investment activity become increasingly global.

Looking to North America, around 40 percent of trades on Canadian exchanges are in interlisted securities and roughly a quarter of the trades settling in Canada are from cross-border transactions, according to the CCMA. Given the substantial volume of cross-border trading activity between Canada and the US, Canadian regulators and the CCMA have aligned the Canadian market timelines to those of the US markets and will be moving on 5 September.

## How heavy is the technology lift for individual entities to make the switch? Are there any real issues of cost or timeframe?

Overall, we are not aware of any cost or timing issues with a shorter settlement cycle for Canadian market participants. Having said that,

given complex regulations and market structure in Canada and the US, this extra time for planning is useful so that stakeholders have sufficient time to assess and test their preparations.

CIBC Mellon's systems are currently settlement cycle neutral, which means our custody platform will only undergo minor system changes, and the technology changes for CIBC Mellon are minimal. CIBC Mellon's custody system is currently settling trading activities across a wide range of settlement cycles in support of clients' cross-border activities, with cycles ranging from same-day settlement on T+0 through T+2 and T+3, to T+5 and beyond. CIBC Mellon is ready and able to handle T+2 settlement in Canada.

We are in the process of completing our internal technology checks and integrated testing with the Canadian Depository for Securities (CDS) and Fundserv. We will continue to test all relevant scenarios to prepare for service continuity by 5 September, and to make certain that our technology and operational procedures are adequately updated.

## What is CIBC Mellon/BNY Mellon doing to assist Canadian clients in this area?

CIBC Mellon is playing an active role in the industry in preparation of Canada's move to a shortened T+2 settlement cycle. CIBC Mellon also participates in the CIBC T+2 working group and is plugged into the US BNY Mellon DTCC working group. We bring considerable settlement experience—in addition to our daily settlement activities, a number of CIBC Mellon employees have the experience of having been active participants during Canada's previous, successful shortening of the settlement cycle to T+3 from T+5 in 1995, and we will continue to remain active and provide clients with T+2 related updates on Canada and CIBC Mellon's supportive efforts

## Are Canadian regulators and trade bodies taking an active role in the day-to-day management of the transition?

Canadian regulators, the CCMA and securities firms are taking an active role in properly preparing Canadian stakeholders for the transition to the new settlement cycle. Through its T+2 committees, the CCMA has been working with the Canadian market to help plan for a smooth transition to a two-day settlement cycle in Canada. Additionally, the CCMA regularly publishes its newsletter, T+2: What's New, in an effort to communicate details of the Canadian securities marketplace's move to shorten the securities settlement cycle and to help Canadian market participants understand and address the changes ahead.

From a regulatory perspective, on 27 April 2017, the Canadian Securities Administrators published two notices outlining its amendments—including final amendments to National Instrument (NI) 24-101—to support the transition to T+2 on 5 September to be consistent with the US market. [SLT](#)

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## Data will set you free

The US needs to pay attention to SFTR, says Melissa Gow of IHS Markit

### Do you feel that the North American markets are suitably aware of the challenges posed by SFTR?

Initially, the Securities Financing Transactions Regulation (SFTR) was seen as something that only Europe had to contend with and there wasn't an understanding that the rules can apply to non-EU entities as well.

IHS Markit has done a tremendous amount of outreach here in North America with all the different market segments to make them aware of their reporting obligations, as well as highlighting how we are best placed to help them meet these requirements.

We've built our way up from the most basic understanding of what the regulation means and we are now fielding much more sophisticated questions on unique trade identifier generation and legal entity identifiers. The conversation has advanced significantly and that

shows us that the North American market is actively educating itself on the potential effects of SFTR.

### There is a chance that an SFTR-style regulation may be drafted in the US. Are you anticipating this?

We don't yet know how the current administration will influence existing or future regulation but the solution that we're building with Pirum will be flexible enough to accommodate any future regulation. It will be structured in such a way as to incorporate any regional variations in the reporting rules.

### Is there anything North American market participants can learn from their European peers on this score?

To steal a page from the Girl Scouts's guide book, it's best to 'be prepared'. We in North America have the advantage of being able to

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learn from and leverage the efforts that European market participants are putting into managing SFTR.

In North America, we are focused on educating the industry by replicating the SFTR workshops that we held in Europe, starting in Toronto and New York. These events are a great way to learn about the regulation and how it will affect non-EU entities.

Furthermore, for those that are part of a global business, which is most of our industry in one way or another, you really need to ensure you're connected to what your firm is doing elsewhere to meet these regulatory challenges. Some regulations have a potentially global reach and therefore it's logical when developing a solution that it can work in all the markets your firm is active in.

### Beyond regulation, another area of change in the market is the increasing demand for benchmarking services by beneficial owners. What's driving this?

We have seen a big increase in the number of beneficial owners interested in benchmarking services and there are a couple of reasons behind that. Firstly, as revenues compress, as they did in the first quarter of this year, we see beneficial owners taking a more active interest in how their lending programmes are performing, so that they know every possible revenue opportunity is being taken advantage of. At the same time, there are increasing requests for risk analysis-related data. The demand is coming from beneficial owners who want to understand the risks of their lending programme and the collateral that goes along with it.

IHS Markit is able to address this demand through some of our other data sets, including our bond liquidity scores, to enrich that analysis. Counterparty concentration and collateral profiles are other areas where we see greater demand.

Beyond the traditional data sets you associate with securities lending, the broad spectrum of markets that IHS Markit is tapped into means we can provide less obvious data that allows for effective risk analysis associated with arbitrage trades in markets that might otherwise be quite opaque. For example, if you take corporate actions, which the IHS Markit Quarterly Review showed to be an area where more active lenders can earn additional revenue, the ability to understand and take those opportunities requires access to the relevant data to make the value of that trade apparent.

IHS Markit tracks oil firms that may be refinancing debt, which leads to arbitrage trade opportunities. As a lender, if you want to benchmark and partake in these trade-types, you need to understand the risks and the dynamics in order to effectively incorporate it into your securities lending programme—and all this requires access to reliable and usable data.

### How can greater access to data help maintain strong revenue in a shifting market landscape?

Access to more widespread and also more granular data is advantageous when identifying where the new revenue opportunities are coming from effectively. At the moment that could mean focusing on corporate bond lending or understanding the components of a cash collateral programme.

Lenders that are able to best leverage good market data will be rewarded for it. However, simply being able to identify the revenue opportunities is not enough. A beneficial owner must possess the flexibility in their programme to facilitate changes that may be outside the typical market conventions and opportunities we see day-to-day.

### How does IHS Markit approach sharing this type of market data with beneficial owners?

IHS Markit is independent and a third party so we do not necessarily advocate a strategy or offer opinions on what changes lenders might make to their programmes. All our analysis is data driven, meaning we're able to spot missed opportunities and quantify certain scenarios where, if a lender had more flexibility, they might earn additional revenue. The rest is up to them.

Some beneficial owners have such strict lending rules set down by their own clients and boards that they will never be able to fully utilise their assets, but other are beginning to see these opportunities and make changes to meet them. It's only a small portion of lenders that are active and flexible enough with their programmes to utilise this data effectively, but it's a growth area.

### Are there other revenue opportunities in the North American lending market that are not being fully acknowledged?

Our data shows there are some good trends in corporate bond lending and cash collateral, from a revenue standpoint. IHS Markit has also issued a research paper that shows how using our fixed income data in conjunction with equity data can lead to stronger returns. At the same time, we're in the process of writing a whitepaper on trends in term trading. This analysis will be available this year, along with our next quarterly review, and will shed further light on these areas.

Also, once SFTR is rolled out, this may be the catalyst for US regulators to finally loosen up collateral parameters to allow for equities and other securities to be used as collateral.

Although not necessarily a revenue opportunity, this change would provide benefits and efficiencies related to capital usage. We've got our eye on this as well. [SLT](#)



Melissa Gow, Director, securities finance  
IHS Markit

Once SFTR is rolled out, this may be the catalyst for US regulators to finally loosen up collateral parameters to allow for equities and other securities to be used as collateral



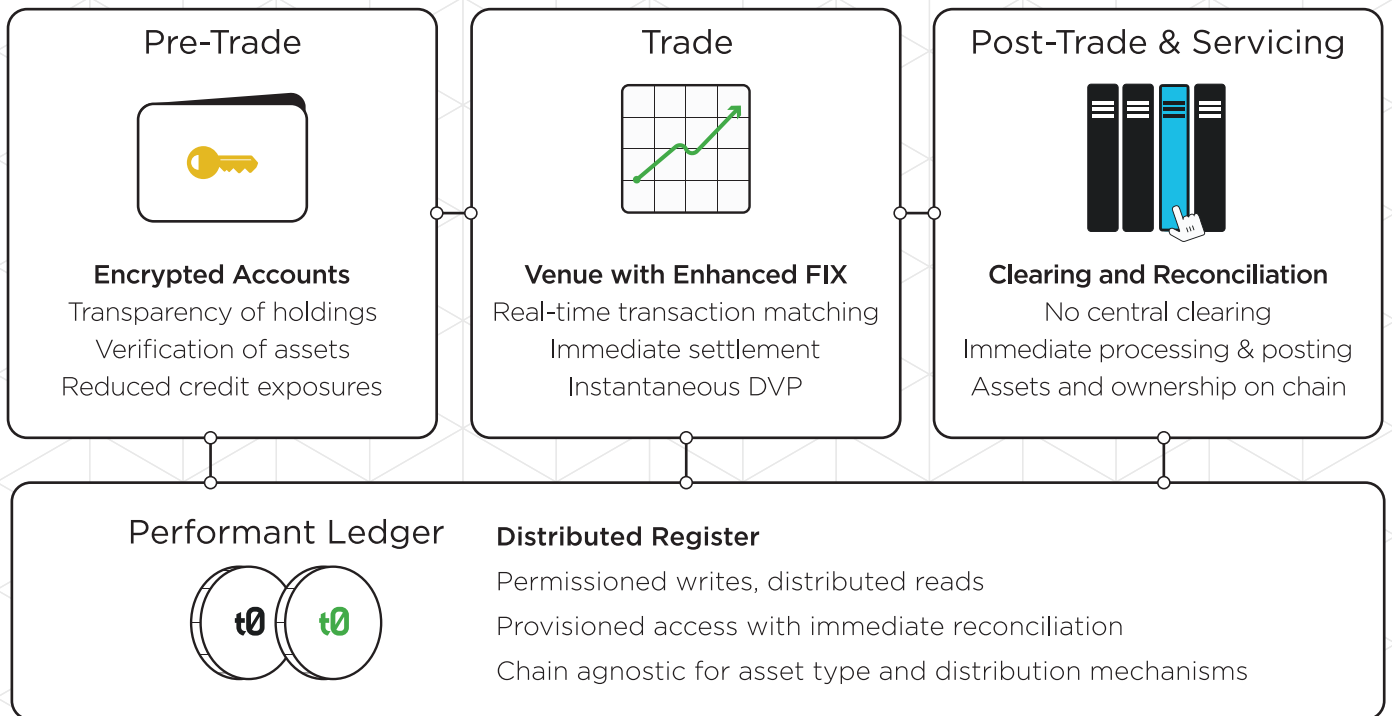
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## Trading Apps EquiLend Gateway: A conduit to liquidity

The EquiLend Gateway App offered by Trading Apps serves as the digital highway between a securities lending business and the EquiLend community. Chris Valentino, sales and client director for the Americas at Trading Apps, explains

Let's face it, the global securities lending market continues to be a predominantly fractured marketplace. And while some of the pockets of liquidity are relatively new, such as EquiLend's Next Generation Trading (NGT) and EquiLend Clearing Services (ECS) products, many transactions continue to happen the old fashion way: via email, Bloomberg, instant message and the telephone. With the increased cost of capital continuing to exert pressure on the industry, market participants are finding that technologies supporting trade automation and straight-through processing are no longer a luxury, but rather a necessity.

At Trading Apps, we have recognised the tangible value that speed, automation and efficiency can provide to a securities lending business since our foundation in 2011. Our targeted applications continue to raise the bar regarding trade and process automation, transparency, revenue optimisation and risk mitigation.

Just recently, Trading Apps embarked on a new relationship with a US broker-dealer that is an extremely active lender in the US specials market. Like many participants in the market, this broker-dealer was looking for a way to gain access to liquidity in the most efficient and automated way possible. The EquiLend NGT platform appeared to be the perfect fit with its growing popularity, impressive client roster, and standardised approach to conducting business. However, connecting to this pocket of liquidity presented a challenge. This particular broker-dealer (as do many others) utilises FIS Smart Loan as its front-end trading system. Capitalising on the growing liquidity on the EquiLend NGT platform meant being able to dynamically link the FIS Smart Loan platform to EquiLend NGT. This is where Trading Apps stepped in.

The EquiLend Gateway App offered by Trading Apps serves as the digital highway between a securities lending business and the EquiLend community. In this particular case, the app is serving as a digital translator between FIS Smart Loan and EquiLend's NGT platform. The previously mentioned broker-dealer has recently gone live with the app and is engaging in both borrowing and lending activities. The client is already experiencing an uptick in trading volumes with 1,000 additional trade messages being processed on a daily basis.

In the coming months, the client will roll out the availability portion of the project to round out the workflow. Once that is complete, the client will have the ability to post its real-time targeted availability (with rates) throughout the day. Counterparties that are on the EquiLend NGT platform will be able to consume that availability and dynamically respond with EquiLend AutoBorrow requests. Those requests will be translated by Trading Apps and fed seamlessly into FIS Smart Loan for processing.

This is just one example—and with one client—of how Trading Apps is collaborating with other vendors in the marketplace and providing solutions that enhance the speed, automation and revenue generating capabilities of our clients.

In this particular case, we have demonstrated our flexibility by connecting our EquiLend Gateway App to the FIS Smart Loan platform; our speed, by implementing at a market-leading rate; and our sophistication, by designing a workflow that has provided this client with a transformational experience, and a competitive advantage in the marketplace. **SLT**



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# Challenge accepted: Pirum targets North America

Phil Morgan and Justin Thiron, Pirum's first onshore US representative, discuss the technology company's vision for expanding in North America

**Justin Thiron joining Pirum represents your first onshore North American presence. Why have you chosen now to establish an office in the US?**

**Phil Morgan:** Until now, Pirum's entire team has worked together based in London. That has enabled us to build our products in an efficient, agile manner in response to client demand giving us a record in delivering real business benefit through innovative post-trade services. These services, however, have traditionally been utilised for international securities finance business. With recent developments in our product suite driven by both client demand and expected changes in industry practices, these services are now as relevant to the Canadian/US market as much as our traditional International market.

We have been looking for the right person to join our team for some time, and feel we have found the right credentials in Justin. He has excellent market knowledge, having worked at institutions such as Northern Trust and J.P. Morgan, great industry connections, and in-depth knowledge of service provider offerings.

**Can you elaborate on the products?**

**Morgan:** We have developed a rich interface with DTCC enabling the automation of special payment order (SPO) charges and planning transparency of real-time trade lifecycle. SPOs are the result of key post-trade processes such as billing, mark to markets, income collection and the prepayment of cash for non-delivery versus payment trades. For the majority of market participants, the current SPO process is manually intensive and operationally risky. The product has been very well received.

We remain hopeful the proposed US SEC Rule 15c3-3 changes allowing use of equities as collateral will happen in the near future. This makes our exposure-related services as invaluable for US market participants as it has become for the rest of the world, particularly our triparty required value (RQV) service, which is a single solution that calculates,

reconciles and processes RQVs across all counterparties (whether users of Pirum or not) and all triparty agents (BNY Mellon, Euroclear, J.P. Morgan and Clearstream). Clearly, the use of non-cash collateral is common practice in Canada so we have a ready-made solution for participants there.

While the Securities Financing Transactions Regulation (SFTR) is an EU regulation, its rules have significant extraterritorial effects. SFTR transaction reporting will apply to counterparties established in the EU, their branches outside the EU and to EU branches of third-country counterparties. Therefore, there will be a requirement for firms in North America to comply in terms of data. We believe that our joint solution with IHS Markit provides the most comprehensive solution for market participants to meet their regulatory obligations. We will continue with our automated connectivity hub philosophy, allowing our clients to seamlessly connect to the various infrastructure providers in the North America as well as internationally. This includes connectivity to new venues including Collex and Elixium, which will be actively trading in North American securities.

**Will Justin be working alone?**

**Morgan:** Rajen Sheth, Pirum's CEO, and I will continue to be in New York on a monthly basis and clearly our first hire is for the business development role. This will soon be followed with client support and service delivery experts, and over time, with further relationship management hires and perhaps developer roles. We are extremely excited by the opportunities in North America and will resource sufficiently to assist our clients.

**How will your connectivity hub aid the North American markets forward?**

**Morgan:** We will leverage the connectivity we have already built that would be applicable to markets on this side of the pond. For example, the trading venue connectivity will allow clients to trade US products

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Connectivity to the triparty agents will support US forms of triparty as it evolves. The same can be said for regulatory reporting, CCPs and other connections in the pipeline

Phil Morgan, Head of business development  
Pirum

once they are live at the venue. Connectivity to the triparty agents will support US forms of triparty as it evolves. The same can be said for regulatory reporting, central counterparties and indeed other connections in the pipeline.

**Justin, you left a service provider six months ago. Why have you chosen to stay on that side of the market?**

**Thiron:** Pirum has always been viewed as a global leader at the forefront of technology in the securities finance market. They are respected for their agility and foresight regarding the needs of the industry.

I was impressed with the clear vision of providing value added solutions to our clients, which includes rolling out new products and forming strategic partnerships with other complementary vendors. As I was weighing up options on new opportunities, I was incredibly impressed with the experienced talent at every level of the company.

Pirum is clearly on an accelerated path to grow their product and client base globally. This message and strategy is fully understood by all staff members and supported by the senior management team as well as many of its clients.

I am fortunate to be the first person on the ground in the US. My experience with an operations and project background, as well as a technology vendor, put me in a unique situation to understand the market needs and make an immediate impact at Pirum.

I have the opportunity to lead the growth of business in the US and Canada, as well as expanding the team in New York and beyond.

Pirum is fully committed to rolling out US-specific product solutions and has listened to its clients around the need to offer local service. Personally, I know it is a great entrepreneurial opportunity with the full backing of a successful company and a solid established client base.

It will be my role to work with our clients to ensure we complete Pirum's evolution into a global connectivity and automation hub.

**What industry trends are you seeing?**

**Thiron:** There is increasingly a requirement to do more with less. Participants in the secured finance space are increasingly looking to automate and reduce manual intervention at all points in the value chain. Clients are becoming more comfortable in utilising service providers to resolve non-differentiating problems via technology.

Furthermore, the market is looking for one macro and consistent solution to their multi regional issues, with transparency and connectivity becoming paramount in their decision-making process

A trend that is consistent in US and Canada is the management and optimisation of non-cash collateral and overall financial resource management. The continuing rise of non-cash collateral, and potentially equity collateral, in the US will bring unique challenges for the post-trade and collateral management teams. Pirum's offerings have always allowed for a single process globally, regardless of collateral type, which can provide an immediate solution for growing issues with non-cash mark to markets, triparty RQV, and other services.

Also while SFTR is viewed mainly as a European issue, it will affect banks and brokers globally that trade or have clients in those markets. It is widely believed that it will likely result in considerable changes to market practice and processes in the coming year. As a result, the industry welcomes comprehensive vendor solutions such as with Pirum and IHS Markit that simplifies the overall complexity of the problem.

In summary, there is much to do, however, I am hugely encouraged by Pirum's ability to assist the market in gaining efficient and effective resolution of these challenges. **SLT**



Participants in the secured finance space are increasingly looking to automate and reduce manual intervention at all points in the value chain

Justin Thiron, Head of North American business development  
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## Keeping reform on track

Craig Donohue of OCC highlights the work being put into ensuring stability for the US listed equity options market

Over the past two years OCC, in its role as a systemically important financial market utility, has taken on a leadership role in advocating for the US listed equity options market with global policymakers on key legislative and regulatory issues.

It was in that context that, during the recent annual Options Industry Conference, I was asked by a member of the media if there was anything that kept me up at night. My answer: financial tax reform.

US President Donald Trump's administration and certain members of Congress leading the respective tax committees have indicated that tax reform is a priority this year, and proposals are being drafted to ensure introductions of bills to comprehensively reform the tax code. House ways and means committee chairman Kevin Brady and Senate finance committee chairman Orrin Hatch are leading congressional consideration of tax proposals in the 115th Congress.

These comprehensive tax reform proposals may include a financial products tax reform proposal that is based on prior legislation introduced by former House ways and means committee chairman Dave Camp. Such a proposal, if enacted, and others like it could make the use of listed equity options much less attractive to market participants than under current law. In this respect, the proposals would treat all listed equity options as sold at the end of the year, treat appreciated stock as sold if a taxpayer enters into an option to manage risk associated with owning the stock, and radically alter the tax treatment of stock while a related option position is outstanding.

Enacting these proposals would adversely affect individuals and other taxpayers using listed equity options to manage the risks associated with their investments in publicly traded stocks. It would discourage the use of options by distorting rational economic and risk management decision-making and replacing the well-established and relatively simple tax rules for listed equity options with a burdensome and overly complicated regime.

In addition to the broader efforts outlined above by chairmen Brady and Hatch, congressman Tom Reed, a member of the House ways and means committee, is leading efforts to develop a financial products tax reform draft that is intended to be more refined than the proposals noted above. OCC and the US Securities Markets Coalition have been meeting with the congressman and his staff to explain the issues raised by previous financial product tax proposals and to advocate for a different approach in the forthcoming legislative package.

In its role as an advocate for the US listed equity options markets, OCC understands the importance of these potential tax issues to our participating exchanges, clearing firms and market participants. Along with the coalition, we will continue to work to educate key members of Congress on the importance of having a viable US listed equity options market that functions effectively and efficiently on behalf of investors.

We also continue to work with US and global regulators to reiterate our belief that the implementation of the standardised approach for counterparty credit risk (SA-CCR) is important for an orderly and liquid listed option markets. Market makers are the primary source of liquidity in the listed options market and thus are critical to its proper functioning. Their ability to hedge the risks associated with the large options portfolios they maintain to provide such liquidity is critical to their commitment to supply market liquidity.

Market makers' approach to managing risk is being affected by the requirement that clearing firms use the current exposure method (CEM) under the risk weighted asset and leverage ratios to measure their exposures to the portfolios of their market maker clearing clients. The application of CEM, which neglects to consider the hedging benefits between options on the same underlying security and other attributes unique to options, results in vastly increased capital charges for clearing members that clear for market makers. Such risk-insensitive capital charges fundamentally threaten clearing members' business models and their ability to clear for such critical liquidity providers in the options market, which in turn could negatively affect the overall options market and related markets.

While the Basel Committee on Banking Supervision has adopted the SA-CCR methodology as a replacement for the CEM methodology in the context of the risk weighted asset ratio and has led an effort to reconsider the application of the CEM methodology within the leverage ratio, the lack of progress toward the uniform and national adoption of a SA-CCR-based methodology continues to create serious economic disincentives for market participants in the exchange-traded derivatives space. The adoption of a methodology based on SA-CCR for clearing members to measure their exposure to their clearing clients should dramatically reduce the unintended consequences the listed options industry currently faces under the CEM methodology.

Further, even if a SA-CCR-based methodology is adopted globally, the timing of implementation across the US and Europe, if not aligned, could result in significant regulatory arbitrage across these two jurisdictions. This arbitrage could impair liquidity in the options markets and undermine the central clearing models, which would be counter to the steps regulators across the globe have been pursuing in recent years pursuant to the post-financial crisis reforms to shape the over-the-counter derivatives markets to resemble the exchange-traded markets. The post-crisis financial reforms have clearly favoured central clearing and transparent trading of derivatives contracts to ensure that these markets become more standardised and transparent, and above all, serve to mitigate systemic risk.

These are admirable goals that regulators and market participants should desire, and which OCC and the US Securities Markets Coalition aspire to achieve. [SLT](#)



These are admirable goals that regulators and market participants should desire, and which OCC and the US Securities Markets Coalition aspire to achieve



Craig Donohue, Executive chairman and CEO  
OCC



## SFTR: The end of the beginning

Getting to the final technical standards may indeed just mark the end of the beginning, but it is a significant milestone on this particular road. David Lewis of FIS Global maps out the rest of the journey to be made

The European Securities and Markets Authority (ESMA) issued the final technical standards for the Securities Financing Transactions Regulation (SFTR) on 31 March 2017, under which the industry will have to report all its transactions to a registered trade repository. The road to this point has been a long one indeed, but 31 March did not mark its finish. In fact, as Winston Churchill said in 1942: "Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."

While there has been a great deal of work done so far by providers such as FIS Global, the final technical standards confirm what we all need to do to now to meet the new regulations coming into effect in Q3 or Q4 2018. While the various institutions in the EU go through their approval processes, technology solution providers are already working hard to develop the necessary systems to meet their client's requirements in order to roll them out in time to be live by the reporting launch date.

ESMA has chosen to gather much more data and at a greater frequency than is actually required by the Financial Stability Board (FSB), as the FSB gave each jurisdiction free rein as long as the minimum requirements were met. There is going to be a great deal of data that will need to be marshalled, cross referenced, organised and delivered in order to meet the detailed demands from ESMA. Despite the requirements being double-sided in nature, where both the lender and the borrower must submit their own trade and collateral data, the demand for data weighs disproportionately on the lenders. Technically, the lenders are the principals to the transaction and will commonly be the beneficial owners at the start of the transaction chain, but they will, with few exceptions, delegate this responsibility to their agents.

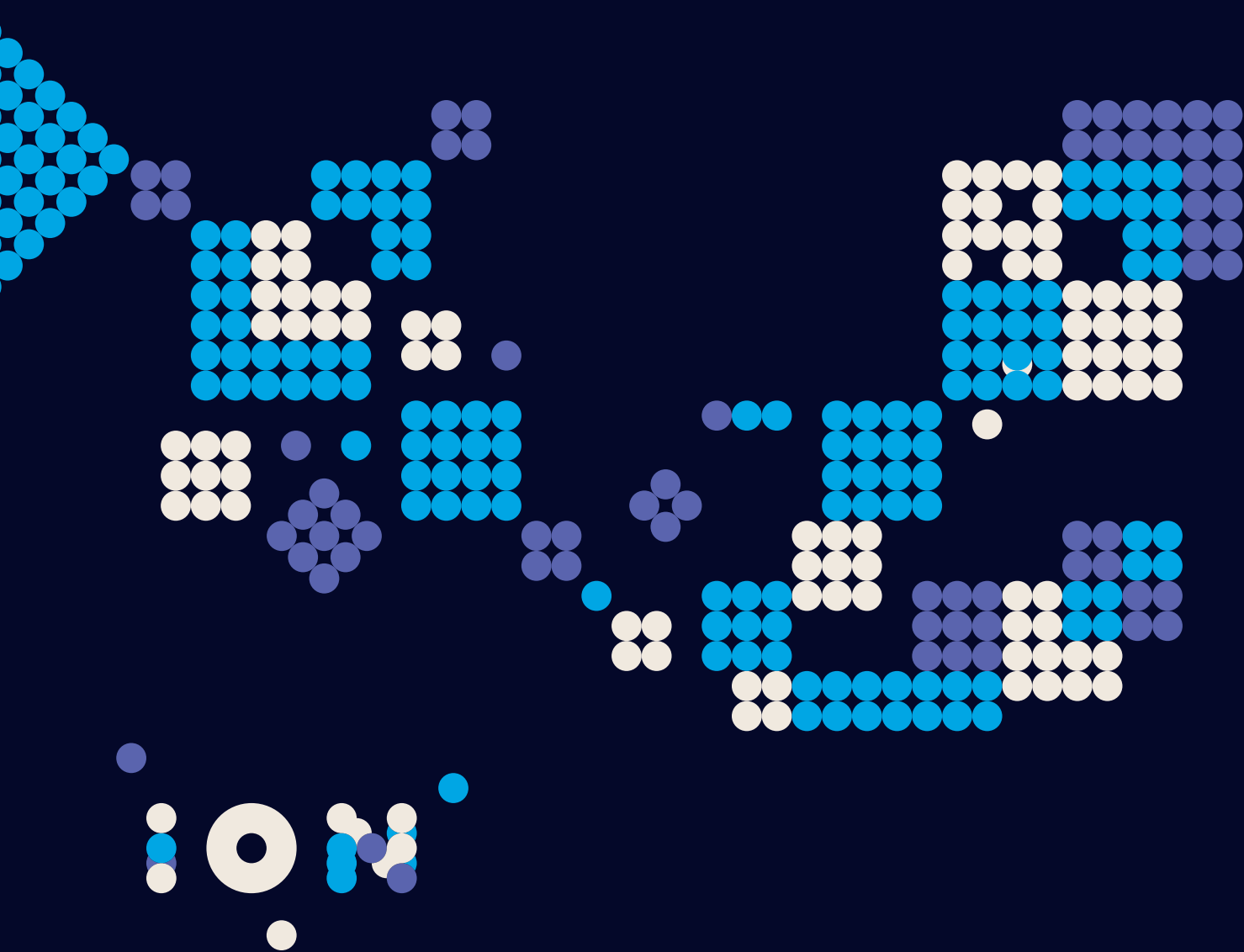
Those agents will not just be tasked with submitting their own client's data, but will need to share that data with their borrower counterparts

in order for them to meet their own reporting obligations within the set timeframes. Such data will include the underlying counterparties and details of how bulk trades and collateral were allocated. Due to the simple fact that the lender, or more accurately, its agent, is in possession of the lion's share of the data required for meeting the requirements of SFTR, they will play a significant part in the process with the intention that all parties can efficiently meet their regulatory obligations.

At this point it is key to understand exactly what meeting that obligation entails. ESMA requires all market participants to submit their trade and collateral data, at the end of T+1 and S+1 respectively, to an approved trade repository. While this is going to be a complex requirement to meet, particularly with regards to collateral details and trade allocations, amendments and all the other reportable lifecycle events, it should not be over engineered. The potential costs of over thinking this requirement, especially in an industry already facing rising cost pressures all along the transaction chain, are significant.

Trade repositories charge for their services. Although these charges are strictly controlled by ESMA, they will not be insignificant as those reporting under the European Market Infrastructure Regulation (EMIR) can testify. Part of the services they provide are the matching of trades with those provided by your counterparty, whether to the same trade repository or another. The FIS solution, matching our global footprint with our partner trade repository, will simplify this section of the process significantly. ESMA, in the final technical standards, has realised that it has set the industry a tough task with the number of matching fields in the data extracts it requires, and as such, ESMA has relaxed some tolerances and indicated that many of the matching fields will not need to be matched during the first two years of operation, as all of the participants in this programme get used to the new reporting regime.





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This is both pragmatic and sensible of ESMA, particularly given the difficulties that those reporting under EMIR have faced. Further, the International Securities Lending Association (ISLA) has been doing some excellent work in looking to combine the efforts of all the technology providers that are stakeholders in this process. We all have clients to serve and our industry will be best served by delivering a service as simple, cost effective and reliable as possible. This work has extended to include agreed formats for data fields where there is some latitude given in the ESMA technical standards, and, once agreed, it is to these standards that FIS and no doubt other trading system providers will code extracts to.

ISLA has also importantly suggested a draft protocol for the generation of unique trade identifiers (UTIs). Getting this right, and there is work to do on it yet, will ensure that the existing processes employed by the licensed trade repositories will deliver an efficient and timely matching

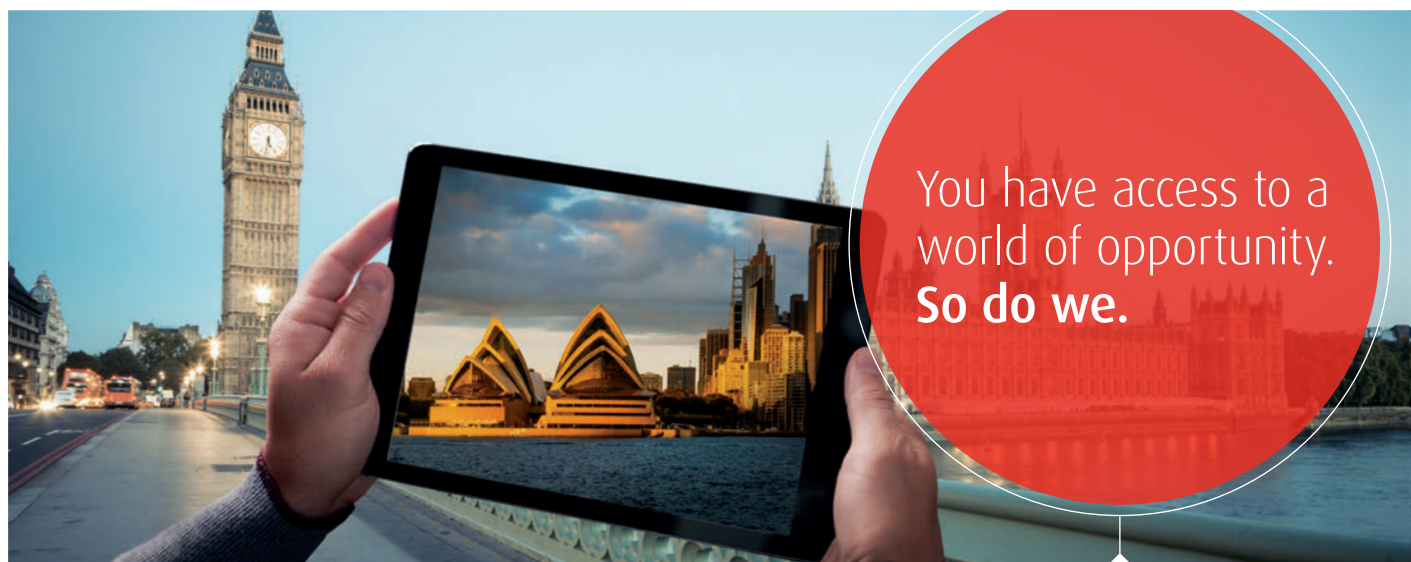
process, without the need for costly third parties duplicating this process, delivering compliance reports and exceptions back to their clients.

Getting to the final technical standards may indeed just mark the end of the beginning, but it is a significant milestone on this particular road. Ahead of us lies the actual build and release of new reporting technology and, arguably more importantly, some industry defining moments as we consider how best to approach the next few years. It is entirely possible that some of the paradigm shifts in counterparty disclosure and the potential changes in loan allocations based on the borrower's risk weighting of the underlying lenders will change the shape and process of our industry as we go forward, and likely for the better. One eye will have to be kept on the lookout for further legislation, of course. It is not unreasonable to expect that ESMA, and indeed the FSB, will be planning to do something with the massive amounts of data that they gather and the insight it brings them, however, such changes may be many years away yet. [SLT](#)



Ahead of us lies the actual build and release of new reporting technology and, arguably, industry defining moments as we consider how best to approach the next few years

David Lewis, Senior vice president, Astec Analytics  
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# Oil volatility fails to rouse short sellers

Short sellers are still largely steering clear of energy stocks despite the resurgence in oil price volatility. IHS Markit analyst Simon Colvin explains

Oil price volatility came back to life this month when as bumper US production numbers, ongoing questions about the future state of OPEC supply cuts and other technical factors, briefly sent the price of spot Brent crude barrel below the \$47 mark for the first time since November 2016.

This selloff brought back memories of last year's wild swings that sent energy stocks to multi-year lows and driving short interest in the sector ever higher. While the former has occurred to some extent, as evidenced by the fact that the largest energy sector exchange-traded funds (ETF), the Energy Select Sector SPDR Fund (XLE), extended its year-to-date underperformance against the S&P 500 past the 15 percent mark, short sellers are so far staying on the sidelines during this period of volatility. The past month has seen global energy shares register only a 3 percent increase in the sector's average percent of shares outstanding on loan.

Average shorting activity across all global energy firms has ticked up somewhat from the recent lows set over January, bearish bets are still way off the levels registered during the height of last year's volatility. In fact, the current average short interest across these 700-plus energy firms whose shares are freely available in the securities lending market, 3.3 percent of shares outstanding, is still a quarter lower than that seen in February of 2016, when oil prices hit their lows.

Median average demand to borrow energy shares, which gives a better indication of how broad the shorting activity is distributed across the sector, is even lower at 1.1 percent of shares outstanding, which is just about the lowest level in over two years.

The varying spread between these two gauges of bearish sentiment in the energy space indicates that short sellers are taking a much more precise approach to shorting the sector, which is a departure from the broad brush employed during the worse of last year's selloff. This coincides with the narrative on the ground, as well capitalised firms, with profitable operations, rebound strongly while industry laggards, some of which have large debt overhangs, struggle to regain momentum.

## Corporate action driving demand to borrow

The current high conviction short plays are also more likely to be targeted for reasons other than purely directional short selling.

Corporate actions such as warrants issuance, debt for equity exchanges and convertible bond issuance have made several stocks targets of arbitrage traders looking to take advantage of pricing anomalies thrown off by corporate actions.

One such firm is Premier Oil, the second most shorted oil firm at the moment. Premier recently announced a debt restructuring that saw it issue warrants representing 90 million shares.

Investors have hedged their warrant exposure by shorting Premier shares. Demand to borrow Premier shares has jumped more than tenfold in the past six months to the current 30 percent of shares outstanding. Ironically, this large short interest should be viewed as a vote of confidence in investors' long-term view of the firm as it indicates approval of its debt restructuring.

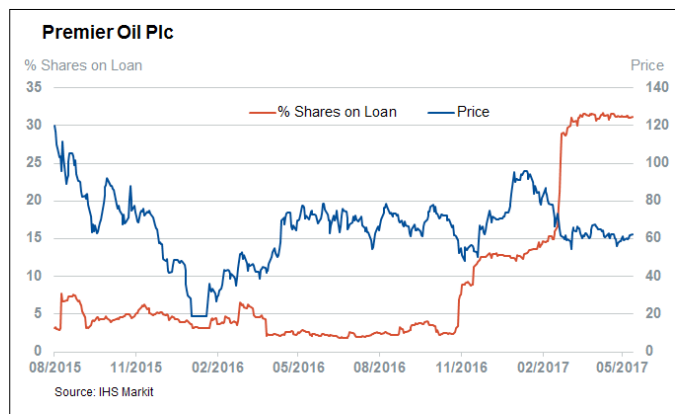
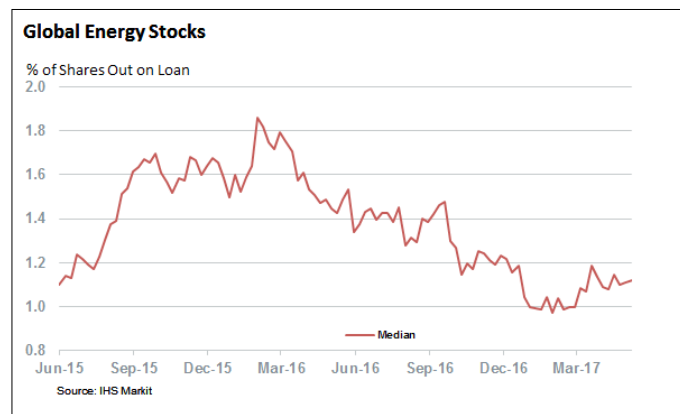
## Not all good news

Not every energy stock is out of the woods yet, however, as plenty of energy stocks still see more than their fair share of shorting activity. As previously mentioned, the current crop of high conviction shorts is mostly composed of the sector's laggards as the current 10 most shorted energy names have seen their shares fall 50 percent on average, which is over three times the fall registered by the XLE ETF.

A deeper dive into the current crop of top energy stocks finds a disproportionate number of services firms among their ranks. These firms tend to be viewed by investors as latter cycle plays that perform best when the sector is in a free spending mood, something that is still elusive in the current rally.

Tidewater, the most shorted energy firm at the moment, fits into both categories as the slump has taken the offshore ship operator's shares down by 97 percent over the past two years. This leaves precious little meat on the short trade as Tidewater's market cap is currently hovering around \$35 million.

Exploration firms, such as Sanchez and Scr Energy, which have 23 and 22 percent of their shares out on loan respectively, make up the majority of the remaining firms among the latest snapshot of the 10 most shorted energy names. [SLT](#)



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## Seconds with Darryl Aviza

Darryl Aviza is looking to leverage nearly two decades of securities lending trading experience and a healthy contact book of previous clients to a new role

### What is your background?

I graduated from college with a degree in English literature coupled with a concentration in writing. I was intent on a career in creative advertising or perhaps writing for a sitcom. Upon discovering that neither of these two fields were going to be my future, I opted to look elsewhere.

I attended an open house at State Street Bank in 1990 and was invited to interview for a position in a budding new industry called securities lending.

At that time, the lending balances were under \$1 billion. There were five traders, including myself, that sat on the US equity desk. There was one repo trader and no international product at all. As the industry grew, so too did the programme, and within a few short years I transitioned onto the international desk.

I stayed on that desk until 2000 when I joined Boston Global Advisors, which would later rebrand itself as Goldman Sachs Agency Lending (GSAL). For the majority of my time at GSAL, I was focused on the non-US markets.

### What industry qualifications or relevant certifications do you hold?

I hold the FINRA Series 7 and 63.

### What did you enjoy most about your last role in securities lending?

My last position was with GSAL, which I held for 16 years. I traded the international markets out of the Boston office, working in unison with the trading team in London. What I enjoyed most was the team

dynamic. It may sound cliché, but what I miss the most are the people that I sat with and those that I traded with every day.

### What area are you looking to get back into?

Having been a trader for my entire career, I would love to get back onto a trading desk. Certainly, most trading desks seem to be facing the same challenges with shrinking revenues and regulatory uncertainty, but opportunities often present themselves at the most difficult times.

### What do you feel you could bring to a future role?

My strongest belief is that people trade the most with those that they trust the most. Having spent my entire career building lasting, meaningful relationships, I would bring those business partnerships to any role. In addition, I bring a wealth of market knowledge and a strong sense of urgency.

### What do you feel the industry needs most?

Client engagement is the most important aspect of the industry. In my previous role, I was fortunate to be in daily communication with our largest client in all aspects of the international markets. The relationship allowed me to provide market insight to the client and to get a clearer understanding of what their expectations were.

Together we were able to mitigate a great number of risks as well as maximise lending opportunities. The industry as a whole would benefit greatly from more of these relationships, regardless of the client's size.

### What is the best way to contact you?

I can be reached at: [darrylaviza@gmail.com](mailto:darrylaviza@gmail.com) and on LinkedIn.



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## Actualize Consulting, IHS Markit, Pirum, Deutsche Bank and more feature

**Former BNP Paribas executive David Raccat has decided to go it alone with the launch of Wematch.SecuritiesFinancing, a web-based tool aimed at disrupting the dealing process of securities financing markets.**

Raccat is CEO of the new venture, which is based in London, but promises that the platform will gain a global client base.

He has spent the last 16 years climbing the ranks at BNP Paribas, first based in Paris and then from September 2014 in Singapore as global head of markets services, head of MFS (Asia Pacific) and CEO of BNP Paribas dealing services Asia.

Raccat said: "The platform is driving the securities financing markets into the new world where best execution, liquidity, price discovery, and regulatory reporting will be fully embedded in the dealing process."

**Actualize Consulting has brought on Mark Faber as managing director of collateral management services.**

Faber is a former Broadridge senior director for collateral management. He was product manager for the firm's CollateralPro solution between September 2014 and October 2015.

Most recently, Faber was owner and principal of MJF Solutions, between October 2015 and April 2017, where he advised firms looking to improve their operational processes or technology solutions. Faber will be based in New York.

Founding partner Chad Wekelo said: "We are excited to have someone with Mark Faber's experience and industry knowledge to lead our growing collateral management practice at a time of such significant change in the industry."

Actualize Consulting offers management and automation of financial functions and corporate financial events to mortgage firms, banks, corporates, insurance companies and other financial institutions, along with federal and state government.

**IHS Markit has welcomed Stuart Day to its Securities Financing Transactions Regulation (SFTR) team.**

Day will manage buy-side implementation for IHS Markit's SFTR solution, which is being created in partnership with Pirum Systems.

Previously, Day served as securities lending, repo, treasury and foreign exchange manager for Bluebay Asset Management in London for five-and-a-half-years.

A spokesperson for IHS Markit said: "We're very excited to have him onboard for the project."

**Pirum Systems have snagged EquiLend's Justin Thiron for its first onshore presence in North America.**

Thiron has been given responsibility for business development and will report to Phil Morgan, who is global head of business development. According to Pirum, Thiron will work closely with clients to implement and improve automation.

Thiron joins Pirum from EquiLend, where he served for just under nine years, most recently as relationship manager.

Morgan said: "We have taken time to ensure our first hire has strong relationships, business understanding and credibility in the market."

"Justin Thiron has all three in abundance and we are thrilled he will help us build our business in North America," Morgan added.

Thiron added: "I am excited to drive Pirum's North American expansion and look forward to working with our customers to deliver best in class automation to the market."

**Maurice Leo has returned to Deutsche Bank following 13 years at State Street.**

Leo left Deutsche Bank when State Street bought its global securities services business in 2003. Having returned to Deutsche Bank in January, Leo now reports to Andreas Richter, head of sales and relationship management for Europe, the Middle East, Africa and the Asia Pacific.

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