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MiFID II and Brexit just don't mix

European Economic Area (EEA) members remain in the dark over the EU's authority to impose the second Markets in Financial Instruments Directive (MiFID II) after the January 2018 deadline, according to Finanstilsynet, the Norwegian supervisory authority.

Finanstilsynet plans to implement MiFID II into law in line with next year's deadline in order for Norwegian institutions to maintain parity with their peers based in member states, despite the rules not being incorporated in the EEA agreement.

In a statement on the country's regulatory roadmap, Finanstilsynet said: "[We] will in the near future adopt the Norwegian regulations as announced. However, much uncertainty relates to the European Securities and Markets Authority's (ESMA) assessment of the EEA legal basis for ESMA's treatment of Norwegian trading venues and investment firms."

For EEA members, ongoing equal treatment is dependant on the decisions of ESMA.

ESMA will be responsible for adding Norwegian financial services to its list of institutions that meet necessary requirements related to MiFID II and the accompanying regulation, MiFIR, immediately after the implementation date.

Finanstilsynet highlights problems that other third-party members and neighbouring economies will face in the future. For example, the UK will face similar issues in the years to come amid the uncertainty surrounding the Brexit negotiations.

The UK's Financial Conduct Authority (FCA) has indicated it will accept a soft roll out of MiFID II, come January.

Speaking at the AFME European Compliance and Legal Conference in September, Mark Steward, executive director of enforcement and market oversight, told delegates: "We [the FCA] have no intention of taking enforcement action against firms for not meeting all requirements straight away where there is evidence they have taken sufficient steps to meet the new obligations by the start date, 3 January 2018."

The looming pressures of Brexit mean that the FCA is unlikely to increase its investigative work against potential financial misconduct as the extra resources that would require are not feasible.

Deutsche Boerse subsidiary Clearstream confirmed it will continue to offer stable custody services to its UK-based clients no matter how the Brexit negotiations evolve.

Clearstream outlined its existential incentive in maintaining and nurturing its existing strong and proven relationships with London-based firms in its monthly transaction data report for September.

The international central securities depository said it is preparing for Brexit by joining forces with all other entities of Deutsche Boerse Group.

Despite the uncertainty that came after the referendum result, Clearstream said its main objective through Brexit is to minimise risk of cross-border settlement.

However, it is unclear how Clearstream and other financial services providers will be able to provide for their UK clients if the current Brexit negotiations fail to yield a viable deal for financial services to operate across the channel after the March 2019 deadline.

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Nex targets SFTR TR ESMA approval

Nex Regulatory Reporting has applied to become a Securities Financing Transactions Regulation (SFTR) trade repository.

Depending on the issuance of the final technical standards from the European Securities and Markets Authority (ESMA), Nex aims to launch a dedicated reporting solution.

If its application is accepted, Nex will add the SFTR trade repository and solution to its Global Reporting Hub to provide clients with an end-to-end solution for the securities lending and repo markets.

Nex promises to build and host the SFTR trade repository in the cloud and will connect to the BrokerTec and ENSO platforms to ensure clients can automatically transfer their transaction data to the SFTR trade repository.

SFTR was originally due to come into effect in Q4 2017, with a nine-month phase-in period, however, the market anticipates that SFTR will now come into effect during Q2 2019.

Currently in review with the European Commission, final draft technical standards are expected to be released in the coming months.

Nex Regulatory Reporting's application comes just weeks after NEX Optimisation promoted Ken Pigaga to CEO. Nex Group also achieved a 30 percent increase to its EU repo activity in October, compared to the same time last year.

Pigaga said: "While we await the final technical standards from ESMA, we have begun to put the building blocks in place for an SFTR solution and trade repository which will not only support our existing client base within NEX, but also the wider securities lending and repo markets."

"It's important that service providers and clients alike begin to prepare for the impending regulation now, to avoid the last-minute rush for compliance that many in the market are currently experiencing ahead of MiFID II."

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Collin Coleman, head of NEX Regulatory Reporting, added: "While most markets are used to a degree of regulatory reporting under EMIR, MiFID I and in now preparing for MiFID II, securities lending has to date been an unregulated market and so the introduction of SFTR will impact many global and regional banks and the buy side."

"Pending detail on the regulatory technical standards, we look forward to launching a complete SFTR solution and providing direct reporting access to NEX's BrokerTec and ENSO clients."

Wematch goes live in Asia

Wematch.SecuritiesFinancing has expanded into Asia and completed its first trade with Hong Kong users involving Japanese equities.

The trade, which involved Bank of America Merrill Lynch and an undisclosed counterparty, was a total return swap and completed on the platform's first day of trading in the new region.

The digital broker has gone from strength to strength since it first launched in February, with the inclusion of its first two lenders last month.

Wematch initially launched with a focus on total return swaps and European equities, before moving into securities lending and repo services, which went live on 18 September, along with an expanded list of available asset classes.

David Raccat, CEO of Wematch, said: "We are very eager in supporting our clients' needs in Asia and quite impressed with the immediate traction in this exciting region."

"Our credentials keep on increasing, as we have broken the threshold of 1,000 interests in the platform on 9 November."

"We are still working on multiple initiatives to cope with the specificities of the securities financing industry and with the permanent objective to increase liquidity and transparency."

London Stock Exchange and APIR Systems to bring LEIs to Australasia

The London Stock Exchange (LSE) has partnered with APIR Systems to offer a legal entity identifier (LEI) solution to firms in Australia and South East Asia.

APIR Systems will be able to utilise the solution to comply with LEI requirements under the second Markets in Financial Instruments Directive (MiFID II), and other regulatory frameworks.

LEIs are required as a global standard providing improved transparency of financial transactions across jurisdictional borders.

According to exchange, the process of acquiring an LEI has recently become more complex, with level-two data requirements requesting mandatory information on an entity's parent-child hierarchy.

Industry estimates suggest more than 250,000 entities are still without the required LEIs, according to LSE.

APIR Systems, who will act as a registered agent in the region, will continue to assist clients with understanding their LEI requirements but will now send details to LSE for validation and approval.

The European Securities and Markets Authority (ESMA) has stated that firms should not trade with counterparties that do not have an LEI as they will not be able to submit valid transaction reports.

Chris Donohoe, CEO of APIR Systems, said: "As Australia's identification standard for a range of unlisted financial instruments since the late 1990s, it is a natural evolution for APIR Systems to join the global LEI initiative."

"In 2015, APIR began issuing LEIs and it has now evolved that service by partnering with LSE to leverage their technical expertise and global scale."

"Although MiFID II is relatively new to Australian entities it does impact a broad range of financial services firms that transact with European counterparties, including funds, self managed super funds and traders."

"The relationship with LSE offers benefits for both our existing clients and the new client segments that will soon be impacted by these changes."

Pritha Sharma, manager of LEI and information services at LSEG, added: "This partnership between LSE and APIR systems demonstrates our ongoing commitment to help market participants comply with a wide range of regulation."

"This partnership between LSE and APIR looks to promote the LEI and raise awareness of the use of the identifier particularly in the Australasian market."

NZ super fund starts lending

The New Zealand Superannuation Fund has started lending its holdings of stocks and bonds, a new report has revealed.

The fund currently holds NZ$35.36 billion ($24.5 billion) in assets.

In May 2017, the fund was able to gain State Street Bank and Trust Company's support, appointing them as agents to lend a portion of the fund's securities for its new securities lending programme.

New Zealand Superannuation Fund said that the new programme "will help us to earn additional returns from our large passive holdings of equities and bonds".

Clearstream partners with Citi to increase Chinese bond connect trades

Clearstream has announced a new partnership with Citi, offering international market participants access to China's fixed-income market via cross-border trading programme, Bond Connect.

Bond Connect is a mutual access scheme that allows institutional investors from mainland China and overseas to trade in each other's bond markets, through a connection between China and Hong Kong's financial hubs.

The first phase of the scheme, allowing for northbound trading, went live on 3 July, after Citi announced it had been selected as an official Bond Connect trading dealer by the People's Bank of China.

Starting from 20 November, Bond Connect will extend the China Interbank Bond Market (CIBM) to Clearstream clients throughout the rest of the world, via Hong Kong.

The new service adds to direct access to the China onshore bond market available via Clearstream's China Bond Link.

However, Bond Connect also offers overseas investors an international central securities depository custody and connectivity infrastructure, which includes corporate action processing and reporting.

Cindy Chen, head of securities services at Citi Hong Kong, said: "As the leading global bank on Bond Connect, Citi is pleased to partner with Clearstream to provide further ease of access to global investors and financial institutions to access the local China bond market."

Philip Brown, co-CEO of Clearstream Banking, said: "China Bond Connect represents a major breakthrough in the opening of the Chinese capital markets, contributing to the growing international recognition of the important global role that the CIBM has assumed over the past years."

HKMA expands eligible collateral list of to include US dollar bonds

The Hong Kong Monetary Authority (HKMA) has expanded its list of eligible collateral for the Renminbi (RMB) Liquidity Facility to include US dollar-denominated bonds.

The bonds were first issued in Hong Kong by the Ministry of Finance of the People's Republic of China on 2 November with a total issuance size of $2 billion, including $1 billion of five-year bonds and $1 billion of 10-year bonds.

For overnight repo, eligible collateral consists of exchange fund bills and notes, Hong Kong government bonds, and RMB-denominated bonds issued in Hong Kong by the Ministry of Finance of the People's Republic of China, and RMB-denominated bonds issued in London in 2016.

Haircut on collateral for exchange fund bills and notes and the HKMA bonds stand at 2 percent per year of remaining maturity, plus 2 percent for cross-currency haircut.

Haircut collateral on US bonds will follow the same terms and conditions.

The introduction of US bonds comes in the same week as the Hong Kong Securities and Futures Commission (SFC) announced it would be conducting a review of prime services relating to equity derivatives activities across the market.

The SFC aims to identify potential conduct issues arising from the practice adopted by prime brokers, to assess the internal controls in place, and to provide guidance on how the risks are managed.

SEC forms fixed-income committee

The US Securities and Exchange Commission (SEC) is set to create a new Fixed Income Market Structure Advisory Committee (FIMSAC).

FIMSAC will provide the commission with different perspectives on the structure and operations of the US fixed income markets, as well as to give advice on matters related to fixed income market structure.

SEC chairman Jay Clayton has appointed Michael Heaney, non-executive director for legal and general investment management for the Americas at the SEC, as the initial committee chairman.

The board will have 22 other members.

Clayton said: “This committee will help the commission ensure that our regulatory approach to these markets meets the needs of retail investors, as well as companies and state and local governments.”

“I appreciate the committee members’ willingness to participate, and I would like to thank commissioners Kara Stein and Michael Piwowar for their highly collaborative efforts in establishing the committee.”

According to the SEC, the committee will be “balanced fairly in terms of points of view represented” and will “make any determinations of actions to be taken and policies to be expressed, with respect to matters within the commission’s jurisdiction”.

FIMSAC is expected to operate for two years from the date the charter is filed.

In a speech at the FINRA and Columbia University Market Structure Conference in October, Piwowar, commented: “I am excited about this new group and hope that there will be public steps to advance it in the near future.”

“I fully expect the FIMSAC members to engage in difficult conversations, tackle challenging issues, and to generate constructive recommendations for the commission to consider.”

“Of particular importance to me in the fixed income market structure space are areas like pre-trade transparency and the appropriate role of regulators vis-à-vis market-based solutions in providing that transparency.”

He added: “We cannot form a fixed income market structure committee without expecting them to discuss the long running topic of bond market liquidity.”

“There are enough issues within that topic alone to keep the committee members busy for some time, including the impact of bond exchange traded funds (ETFs) on liquidity in the underlying securities, the evolving role of the buy side in the provision of liquidity, and the impact of regulatory and monetary policy decisions on fixed income markets.”

In its latest market report, IHS Markit highlighted that as much as $4.3 billion is now managed by ETFs, globally.

“The even larger sum allocated to passive fund trackers is now starting to make waves in the securities lending space,” the report explained.

At the RMA’s Annual Conference On Securities Lending in September, FIS Astec Analytics showed that US fixed income revenue has been the star of the show with regard to securities lending revenue in 2017.

Following a 15-basis point (bps) drop off in 2016, returns on lendable assets for government bonds rebounded in July to the 2015 highs of 25 bps, an FIS spokesperson stated.

At the same time, FIS revealed that the government bond intrinsic loan rate has seen an almost unbroken growth run since January 2014, to sit at just over 0.2 percent, as of July 2017.

Strong revenue in the fixed-income space during the first two quarters of 2017 served as a safety net to industry participants that suffered from a significant fall in equities revenue, compared to the opening months of 2016.

Speakers noted that, as the US entered a bull market, the returns of rising interest rates could stall the impressive growth of demand for government bonds.

Panellists partly attributed the success of government bonds to the rising demand for high-quality liquid assets driven by new margin requirements that came into effect in March and September.

Japan earmarks Q2 2019 for T+2 shift

London | Reporter: Drew Nicol

Japan has unveiled a "tentative" timeline for its exchanges' shift from a T+3 to T+2 settlement cycle, with eye towards Q2 2019.

The implementation date will be determined by the middle of 2018 and is susceptible to changes due to discussions with market participants and "other matters".

In-scope exchanges include the Tokyo Stock Exchange, Osaka Exchange, Nagoya Stock Exchange, Fukuoka Stock Exchange, and the Sapporo Securities Exchange.

SBI Japannext and Chi-X Japan will also shorten their cycles in line with these exchanges.

This decision to shorten the cycle is based on a Japanese work group report on the possibility of a shorter settlement cycle, published in June 2016.

In a statement on the initial timeline, the Japan Exchange Group said: "This decision was made in recognition of the urgency and importance of realising a secure and efficient securities settlement system for enhancing the international competitiveness of Japan's securities market."

It added: "The tentative implementation period is scheduled for April or May 2019, as described in the final report."

A move to T+2 has the advantage of bringing Japan in line with the major US and EU markets, among others.

North American securities markets cut their settlement cycles from T+3 to T+2 on 5 September.

Affected securities include equities and corporate and municipal bonds, and unit investment trust (UIT) trades in the US, Canada and Mexico, Peru and Argentina.

The EU moved to a T+2 settlement cycle in 2014.

The transition aims to reduce operational and systemic risks by forcing securities through the market infrastructure quicker, thereby allowing counterparties to avoid trade failures.

Hong Kong to review prime services

The Hong Kong Securities and Futures Commission (SFC) is set to conduct a review of prime services relating to equity derivatives activities across the market.

The SFC aims to identify potential conduct issues arising from the practice adopted by prime brokers, to assess the internal controls in place, and to provide guidance on how the risks are managed.

As well as reviewing the front-to-back business processes of prime brokers and the interaction between prime services and related equity derivatives activities, the review will also cover key risks and controls for prime services.

Evaluation of risks and controls will specifically concentrate on risk management, governance and compliance with existing regulations, and will explore areas for future regulatory focus.
Due to the growth of asset management businesses and the hedge fund industry in Hong Kong, prime services have become "a key revenue stream for financial institutions".

The commission said it would also measure derivative activities of prime brokers against other major financial market regulators and try to lessen common problems the industry is facing.

The SFC said it has engaged an external consultant to assist in conducting the thematic review, which will be conducted through a combination of industry surveys, meetings and on-site inspections.

Findings of the review "would form the basis for the SFC to issue further guidance to the market".

CCPs could be more vulnerable than we thought, says OFR

Central counterparties (CCP) could be more vulnerable to failure than conventional stress tests have shown, according to a new report by the Office of Financial Research (OFR).

Conventional stress tests usually estimate the ability of a CCP to withstand non-payment by its two largest counterparties, but, the report indicated that the safeguarding via beneficial DTCC data and the 'Cover 2' standard, draw a "different conclusion when [they] take into account network contagion".

In the report entitled How safe are central counterparties in Derivatives Markets?, economists and researchers Mark Paddrik and Hobart Peyton Young, explained that the introduction of the network contagion model in a stress test highlights new vulnerability to central clearing models.

Paddrick and Young further indicate how the network contagion model, coupled with the Cover 2 standard, increases the likelihood of a CCP defaulting during a stress test of similar magnitude to the Federal Reserve's 2015 Comprehensive Capital Analysis and Review (CCAR) shock. This shock was "specifically designed to subject the financial markets to a severe but plausible market stress".

Such a shock triggers a sudden drop in the value of credit instruments, which translates into large and sudden VM payments on CDS contracts.

The report stated: "When we take account of these network spillover effects, we find that the CCP for this market is potentially more vulnerable to default than conventional stress tests would suggest."

Paddrick and Young suggest the advantage in their investigation is mainly due to their "use of credit default swap data to estimate the direct and indirect impacts of a default by CCP counterparties in derivatives trades".

The contagion model changes the game by tracing how payment delinquencies by some firms can increase as they travel through the network of credit default swap (CDS) exposures.

The report states that the "Cover 2 standard is typically applied to a scenario where the two defaulting members are assumed to be those with the largest net variation margin (VM) obligations to the CCP".

"A novel feature of this model is the treatment of stress transmission, which depends on firms' liquidity buffers and their risk management policies. We demonstrate the sensitivity of the model to different values for the shock and stress transmission parameters."

"The model allows us to estimate the probability of a CCP failure relative to the probability of a member's failure while making minimal assumptions about the degree of correlation among member failure rates."

Millennium Management settles in $630,000 SEC security law violation

Millennium Management has agreed to settle charges of illegal short selling in advance of stock offerings.

The New York-based investment advisory firm agreed to pay more than $630,000 to settle the charges after it admitted that it shorted US stocks in companies planning follow-on offerings, and then illegally bought shares in those follow-on offerings.

The US Securities and Exchange Commission (SEC) claimed that by purchasing shares in the follow-on offerings, Millennium Management gathered $286,889 in illegal profits. Millennium must pay back all ill-gotten gains, plus interest of $51,820 and a penalty of $300,000.

The SEC found that Millennium Management violated an anti-manipulation provision of the federal securities law, Rule 105, across four occasions back in 2012.

In a statement on the ruling, the SEC explained: "Rule 105 prohibits short selling an equity security during a restricted period (generally five business days before a covered public offering) and then purchasing that same security through the offering."

Sanjay Wadhwa, senior associate director of the SEC in New York, said: "Millennium established and maintained certain accounts that improperly participated in public offerings despite other firm accounts being short the relevant securities."

"We will continue to actively surveil for, and charge, violations of Rule 105 where appropriate."

Passive funds dominate lending pool

Passive funds now make up more than 60 percent of the global securities lending inventory, according to IHS Markit.

As part of its latest securities lending market report, IHS Markit revealed that passive funds earned 14 percent more than their active peers over the past three years, representing a 0.6 basis point revenue boost.

According to IHS Markit, this may be because passive funds are more pragmatic in what collateral they will accept for securities lending transactions.

Active funds are nearly twice as likely to accept only the highest quality non cash collateral, and these scruples are affecting their bottom line.

IHS Markit data indicates that 36 percent of active funds will only accept the highest quality G7 bonds as non-cash collateral.

In contrast, 80 percent of passive inventories are available to borrowers with lower-quality collateral, such as G10 bonds or equities.

In the report, author Simon Colvin said: "Much like more parochial niches such as retail, food distribution or even mattresses, the twin siren songs of improved efficiency and lower cost promised by upstart passive funds have proved too much of a temptation for investors to resist."

He continued: "Spurred on by the desire to cut costs, and the growing realisation that the extra costs levied by incumbent fund managers don't guarantee outperformance, the steady trickle of inflows into passive funds has now turned into a deluge."

IHS Markit data revealed that as much as $4.3 billion is now managed by exchange-traded funds globally.

"The even larger sum allocated to passive fund trackers is now starting to make waves in the securities lending space," Colvin added.

Deutsche Boerse launches new EMIR regulatory reporting system

Deutsche Boerse has launched its first reporting solution on its regulatory reporting hub.

The European Market Infrastructure Regulation (EMIR) solution will help the hub's users to adhere to EMIR technical standards and reporting obligations.

The reporting solution, which went live on 30 October, comprises all EMIR II-relevant reporting features, including an interface to Deutsche Boerse's trade repository, REGIS-TR.

According to Deutsche Boerse, the partnership with these regulatory technology providers will be a key component for the regulatory reporting hub.

Deutsche Boerse's clients have already been able to test the solution via a pilot programme released before 30 October, in advance of the solution launch.

Georg Gross, head of regulatory services at Deutsche Boerse, commented: "We are very pleased with the smooth launch of our EMIR reporting solution and will continue to enhance and extend our service offering for regulatory reporting."

Overstock CEO fails to scare off the bears

London | Reporter: Drew Nicol

Online retailer and blockchain incubator Overstock has seen its share price rise by 81 percent to close last week at $44.55, but short sellers are jostling to position themselves for a downturn.

FIS Astec Analytics put Overstock as the top pick for its hot stocks list for the Americas for the week starting 30 October.

According to FIS data, short interest has gathered pace since the start of September, increasing more than five-fold to a peak of 97 percent of the available shares, before ending the week at just over 92 percent.

The share price increase has been partly attributed to that fact that Overstock subsidiary tZero is planning an initial coin offering, with final details expected by the end of November.

The revelation came as part of a conference presentation in October by Overstock CEO Patrick Byrne, who used the platform to argue that the settlement crisis of September 2008 was caused by "mischief on the securities lending desk".

Over-allocation of locates by agent lenders, resulting in borrowers engaging in naked short selling, was at the heart of what went wrong in 2008, said Byrne, speaking at the Money20/20 financial technology conference in Las Vegas.

Byrne stated: "2008 was a settlement crisis. The thing that actually caused the government to act was when the settlement system froze on the morning of Wednesday 15 September."

He explained: "It did that because of the mischief on the securities lending desk that underlies short selling."

The outspoken CEO has been a vocal critic of short sellers of his company in the past, and only recently settled a long-running legal battle against with a group of broker-dealers, after securing a $20 million settlement from Merrill Lynch.

Merrill Lynch Professional Clearing Corporation was the last defendant standing in the litigation over allegations of naked short selling, which were first brought in 2007 and concluded in 2016.

Byrne and a group of shareholders initially brought the litigation against 11 broker-dealers in California, claiming they engaged in naked short selling that drove down the retailer's share price and hindered capital raising efforts.

The retailer settled out of court with all of the defendants, except Goldman Sachs and Merrill Lynch.

The case against Goldman Sachs was eventually dismissed due to a lack of jurisdiction, but Overstock filed a fresh case in New Jersey, making racketeer-influenced and corrupt organisation (RICO) allegations and accusing the bank of securities fraud.

Goldman Sachs agreed to settle the new action out of court, while admitting no liability.

SEC's reforms on money markets had profound impact, says OFR report

The US Securities and Exchange Commission's (SEC) 2014 reforms on the money market industry had a profound impact on the composition of money market funds, according to a report by the Office of Financial Research (OFR).

The report's authors, Kenechukwu Anadu and Viktoria Baklanova, suggested that this shift was driven primarily by money fund investors' preference for stable net asset value (NAV) funds against myriad new regulations.

The OFR report stated: "In the nine months leading to 14 October 2016, assets in prime funds declined by over $1 trillion (or 64 percent) to $562 billion, while those in government funds increased by a similar magnitude."

The International Securities Lending Association's (ISLA) market report, published in September, highlighted that money market mutual funds and pension plans account for 65 percent of the global lending pool, representing the largest proportion of assets made available for lending globally.

This reallocation from prime to government funds has contributed to the increased demand for debt issued by the US government and government-sponsored enterprises, such as the FHLBank System.

Specifically, NAV funds, which are not subject to liquidity fees and redemption gates, make a "funding run seem unlikely" with their link to the US government.

The SEC's 2014 reforms were intended to strengthen liquidity and run risk in money market funds.

The two main components of the amendments were "a requirement that institutional prime and tax-exempt funds transact at a floating NAV from the then-stable NAV structure"; and a requirement to "grant the board of a non-government fund the ability to impose liquidity fees and redemption gates if it breaches certain liquidity thresholds".

Some of this increase in large US banks' borrowing from the FHLBank System is attributed to the liquidity coverage ratio requirement, which requires banks to hold an amount of highly-liquid assets equal to or greater than their net cash outflow over a 30-day period.

Borrowing from the FHLBank System is also driven by other incoming regulations, such as Basel III and the second Markets in Financial Instruments Directive II (MiFiD II) .

The SEC announced on 27 October that it would allow US brokers temporary relief regarding research payment obligations under MiFiD II.

The division of investment management issued three no-action letters, providing 30 months relief under the Investment Advisors Act of 1940, allowing US broker-dealers to receive payments in hard dollars, or through MiFID II-governed research payment accounts, from MiFID II-affected clients, without being considered an investment advisor.

The relief will also allow investment advisers to continue to aggregate orders for the purchase and sale of securities, with some clients paying different amounts for research, but all receiving the same average price for security and execution costs.

The news has been welcomed by an industry scrambling to make final arrangements for MiFID II research unbundling.

SEC commissioner Kara Stein, who is central to US regulatory reform, raised concerns over the no-action letters, saying the solution "merely kicks the can down the road".

MiFID II still a concern for buy-side

Some 28 percent of buy-side representatives were still unsure if and how their firm will be affected by the second Markets in Financial Instruments Directive (MiFID II) just 90 days before the implementation deadline, according to a SimCorp survey.

In the survey of 150 North American buy-side participants from across 68 firms, 58 percent of participants confirmed that they will need to comply with MiFID II.

However, out of that figure, only 23 percent feel "extremely confident" that they will have a plan in place in time for the 3 January implementation deadline, while 77 percent are either "somewhat" or "not at all" confident.

Respondents were also questioned on what they thought were the top operational challenges.

Over half, 56 percent, thought that complying with transaction reporting requirements would be a biggest challenge, while 50 percent named understanding the new market structure as an issue. Finally, 45 percent thought the unbundling of research and execution would be an operational challenge.

The survey found that almost half, 47 percent, admitted better education is required on the details of what MiFID II requires of them, while only 42 percent said people in their firms are "aware of MiFID II and are familiar with the requirements".

Perhaps a bigger concern was the 7 percent of those surveyed who said that employees are still "not aware of MiFID II and are not familiar with the requirements".

Gernot Schmidt, product manager of MiFID II at SimCorp, described MiFID II as "one of the biggest pieces of regulation to ever hit the buy-side industry".

Lombard Risk provides AgileReporter regtech solution to OneSavings Bank

Lombard Risk is to supply OneSavings Bank with its regulatory reporting platform, AgileReporter, under a 10-year contract.

According to Lombard Risk, the platform will help the bank to streamline regulatory reporting, data management and analytics.

The solution is intended to enable OneSavings to gather key management information and analytics around trends, variances for audits and approvals.

James Phillips, head of regulatory strategy at Lombard Risk, said: "We've been a regtech pioneer for a long time, and it's rewarding to see forward-looking companies such as OneSavings investing in systems and processes already suited for the further evolution of the reporting industry."

Cameron Joe, head of regulatory reporting at OneSavings, commented: "Lombard Risk offered the best solution to fully streamline our regulatory reporting and ensure we are on time, regulated, and compliant."

New rules mean changes for US GSIBs

The US Board of Governors of the Federal Reserve System's final rule on global systemically important banks (GSIBs) to foreign GSIB exposures will mean banks will probably need to amend their trading documentations, according to Todd Zerega, a partner at law firm Perkins Coie.

In a buy-side overview guide, Zerega discussed the contractual provisions that need to be considered by US buy-side financial institutions concerning the final rule, which was announced in September.

Zerega stated that the final rule will affect contractual default rights for qualified financial contracts (QFCs), including repo and securities lending contracts, as well as derivatives and reverse repo.

This means banks will "likely" have to amend their trading documentation, with various exceptions.

Firstly, if all parties to a covered QFC adhere to the International Swaps and Derivatives Association (ISDA) 2015 Universal Resolution Stay Protocol, this constitutes compliance.

Also, a covered QFC does not have to conform with contractual requirements under the final rule if all parties, other than the covered entity, are based in the US; governed by the US; or do not explicitly prove that any of the US special resolution regimes are excluded from QFC rules.

Zerega explained: "Accordingly, a US-domiciled mutual fund with a repo or ISDA agreement with a US GSIB that is governed by US law and does not explicitly exclude a US special resolution regime would not have to be amended."

According to the Fed's new rule, any US top-tier bank holding company, identified by the board as a GSIB, would be subjected to restrictions regarding the terms of their non-cleared QFCs. The final rule enables a GSIB subsidiary to enter into a master securities lending arrangement with a foreign bank as agent for a US-based pension fund.

The report, released upon the announcement of the final rule, stated: "The GSIB would document its role as agent for the pension fund, and would generally provide its customer a securities replacement guarantee or indemnification for any shortfall in collateral in the event of the default of the foreign bank."

The final rule also "amends certain definitions in the board's capital and liquidity rules".

This means that the new rule will "ensure that the regulatory capital and liquidity treatment of QFCs, to which a covered entity is party, is not affected by the final rule's restrictions on such QFCs".

The final rule will apply to Bank of America, BNY Mellon, Citigroup, Goldman Sachs, JP Morgan, Morgan Stanley, State Street and Wells Fargo.

The report said the final rule is safeguarding against a repetition of the 2007 and 2008 financial crisis and the recession that ensued.

Although securities lending was not a direct cause of the crash, the sector gained a degree of attention in the aftermath because of its loose association with shadow banking.

Elixium secures FINRA approval

Elixium NA has become the first electronic all-to-all repo platform to secure the right to operate as an alternative trading system (ATS) with the approval of the Financial Industry Regulatory Authority (FINRA).

The global all-to-all secured financing and collateral marketplace, Elixium Group, has also opened a European base in Paris.

Elixium aims to provide liquidity in an unbiased marketplace by allowing counterparties to view and execute transactions directly within a regulated environment.

The latest successes come shortly after Elixium teamed up with Lombard Risk to pair its marketplace with the Lombard Risk cross-asset collateral management solution, Colline.

The partnership is intended to provide market participants with collateralised liquidity and a complete end-to-end automated repo trading and margin call management system.

Do you have a story we should cover?
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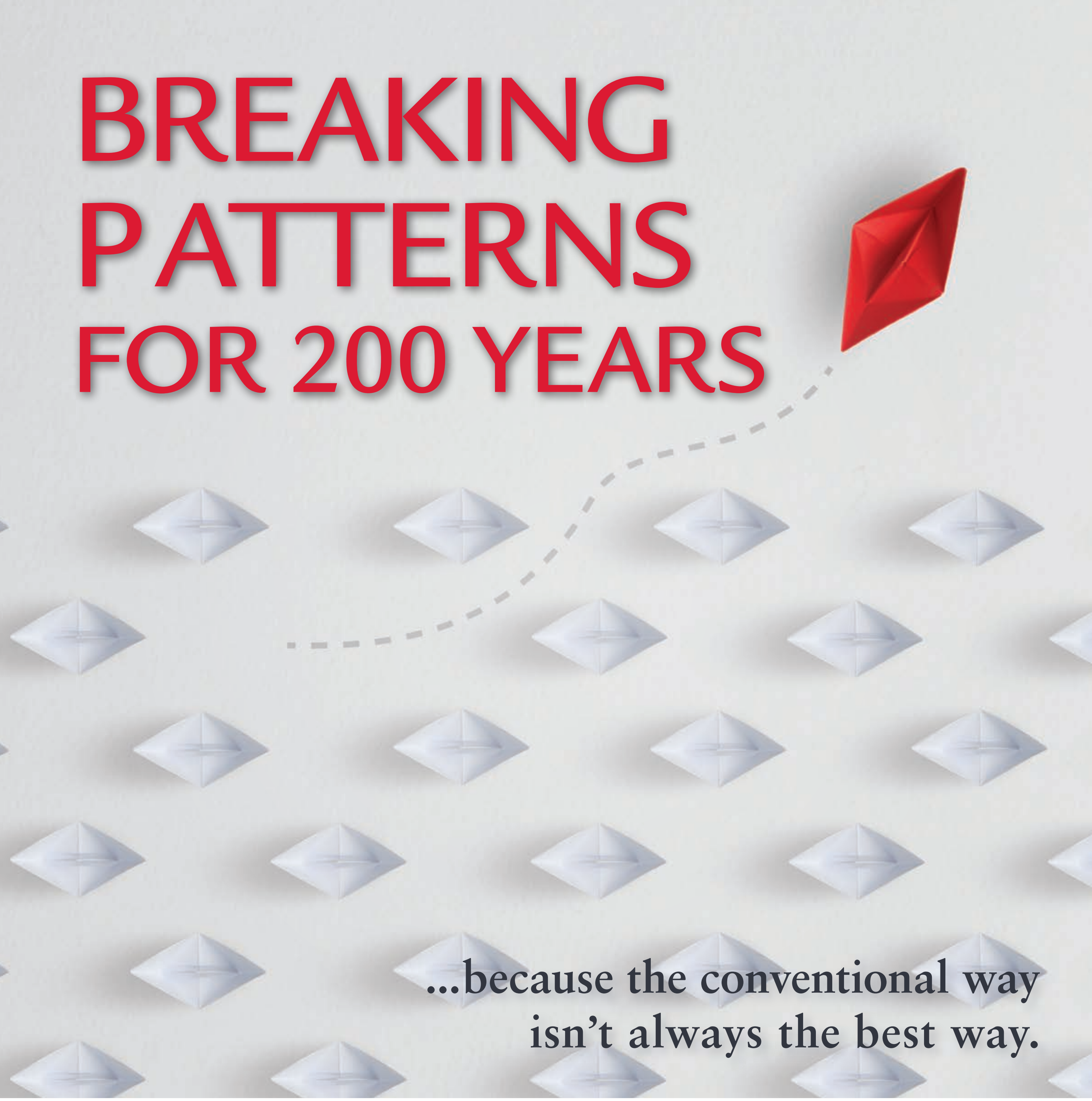
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isn't always the best way.

Pilot blockchain achieves lift off

Broadridge has finished its latest blockchain pilot, focused on bilateral repo. Horacio Barakat discusses the progress made, and where the firm will go next

Broadridge recently completed a DLT pilot for bilateral repo. Why did you choose this area?

One of the reasons we tackled repo was Broadridge's position in the fixed income markets — in the US, Broadridge has 18 of the 23 primary dealers in the US in its system. Our position provided the necessary network for any blockchain of distributed ledger technology (DLT) solution to be adopted.

The point of the technology is to standardise processes in order to accelerate adoption, and this was one of the key parameters of selection for our test case. We are seeking the ability of a blockchain DLT to provide sufficient process efficiencies, but also to take advantage of the networks that Broadridge has, in order to drive adoption on repo. And we don't see it just stopping here.

We hope for it to be the foundation that stretches into much broader functionalities in order to achieve a broad collateral management solution. This is part of a much longer road map.

Our thought process is to find specific pain points for specific areas of the market that could be significantly improved in the short term. But, by tackling the foundational aspects, the effects can be compounded to help us tackle much larger problems.

What were the successful aspects of the pilot? And what were the main issues it highlighted?

We worked closely with other collaborating banks to reimagine how we want non-cleared bilateral repo transactions to be. To do this, we recreated the entire process from beginning to end.

Firstly, we onboarded the participants' collateral into our blockchain environment, and once it was uploaded, we created the application for participants to be able to enter trades directly into the DLT so it captures trade terms in their physical form.

It will then allow us to perform lifecycle activities such as mark-to-market, repricing, re-rates and other modifications to the repo contract. Other areas we tested were collateral substitution, cancellation of the repo, rejection of the repo and, finally, the return of the collateral.

All of these activities were conducted seamlessly using DLT, allowing the participant to interact directly. If one person changes the terms, the other party is instantly aware and can approve, reject or modify them without the need of an intermediary, making the process much more efficient.

Over the course of the heavy development, we have been working to the mantra "work and adjust". During the hard testing of the technology, there were some points where you could see instability in the technology, and there are things that still need to be worked out and stabilised in the near term for it to be production ready. Firms like Broadridge will achieve this. By testing all the different platforms, we will make it happen.

In what other areas are you testing DLTs?

Everything we have done and are doing follows longer-term road maps. In the most recent case we piloted and tested the product for over a week and we continue to work on it as part of that roadmap.

In April, we did another operational test around global proxy voting, collaborating with J.P. Morgan, Santander and Northern Trust, shadowing an annual meeting from beginning to end. It is something we have continued to focus on because we want to broaden participation in the market, but also to deepen the functionality in order to reimagine the global proxy processes. Even though we announced it in April, it is continuing on its roadmap towards a much larger solution. We have other test cases we are working on, but we tend not to announce them prior to testing.

What can other institutions do to help progress DLT?

One of the key factors for success for all blockchain solutions is the broadening of participants. Assuming that the benefits are useful, which we proved in our case, we need more people to participate, and this is something we are working hard to achieve.

We do this through broadening the network to work into this bilateral repo pilot and expanding functionality to move towards a more fully-functioning collateral management solution, which is going to be very exciting for a lot of institutions. We are excited to be collaborating towards that goal.

Have you set a timeline for full functionality?

It's very difficult to envisage a timeline, but we are already working on it. We have the road map and are currently working through our phases.

We are done with phase one and we have already started on phase two. It is very difficult to time those, but we are working through it.

Phase two is all about expanding the functionality of the movement of collateral in a blockchain environment. The further we progress with that functionality, the more it will provide benefits to the ecosystem.

Is there still any skepticism from the big institutions surrounding DLT use in financial markets?

It depends on the use of the technology. In the test cases we have focused on, the technology has proved that it can provide operational efficiency and reduce counterparty risk.

Obviously, the technology still needs to evolve—it is relatively infant, but it has made some significant progress over the last six months. The way that the technology and platforms are evolving is strong, but there are things that need to be worked on.

In terms of operational efficiencies that we tested, we were proven right, so we are very optimistic and bullish about the effects it will have in various areas of capital markets.

To stress the point for all the test cases, but primarily for bilateral repo, it is all about the roadmap. We are hoping to work towards a full collateral management solution, which would address an area that a lot of institutions see as a big pain point within the industry. **SLT**

> ***We worked closely with other collaborating banks to reimagine how we want non-cleared bilateral repo transactions to be. To do this, we recreated the entire process from beginning to end***

Horacio Barakat
Vice president in corporate strategy
Broadridge

True or False? MiFID II & Dodd Frank are positives

With so many new rules, it is getting more difficult to conduct business. Are regulations choking the markets or are there some benefits? Alex Lamb, of The Technancial Company, examines each side of the coin—after all, there are two

So, let's begin with what we all know and talk about, the challenges or negatives of regulation. There are six key areas including cost; complexity, change, collateral, checks for risk, and crisis.

- Cost: All regulation is bad, in that it drives business costs sky high.
- Complexity: Implementing all the new rules hurts on many levels. The more compliance rules that need to be monitored mean more details need to be kept. This affects the way we record activity and the way individuals are monitored (surveillance).
- Change: Record keeping changes, established processes require modification and additional (mostly technical) skills need to be learned. Included within these changes are the ways of doing

business, which participants were previously free to formulate.

- Collateral: Now, it's impossible to make a deal without first checking that the client (or counterparty) has enough in place. Not just to cover the trade, but to fund it should something go wrong. Introducing more controls such as real-time valuations of collateral, initial margins and the 'best' market price for an instrument affects this process and adds to the cost.
- Check for risks: Keeping trades on an account can no longer be a 'do it and forget it' thing. Evaluation for risks that might affect the account is now required, ensuring it passes certain tests. These have to be performed in accordance with rules, which takes us back to point two—complexity.
- Crisis: Positions need to be automatically stopped from expanding, or even liquidated, if they are identified as being out of compliance.

But, are they really challenges? In the face of complaints, the fact is these points have extremely strong positive benefits, which include:

- Cost control: More firms are re-examining existing systems and not just software. Communication, back office and risk management, market data and monitoring systems are all under scrutiny. The big question is: how can these systems be implemented holistically? The result is well-thought through, consolidated business processes, with adequate redundancies of course, to reduce single system dependency.
- Complexity: Simplification of process implementation through the aforementioned holistic approach means adopting a uniform message (with information exchange structures) and conferring with other experienced and cost-conscious players. It's also vital to be able to rapidly pick evolving and well-established industry standards, such as FIX Trading. Finally, it requires thinking of the transaction as the constant whose journey through processes is used by variables applied to it.
- Change: Accept it, change is here and already embraced. Changes already in progress won't stop, as the momentum is being driven by the uncovered value of improvement. Change is good—new ideas for old problems, new problems are challenges to beat, generating added value beyond that change. Why else would there be so many regulatory technology startups? While many will fail, large numbers are being embedded in the business corpus and are here to stay in some form or another.
- Collateral: The dusty asset storage vault is now a fresh new place to earn money from dynamic valuation, better utilisation and better storage costs, and turning this into a business line can generate additional revenues, thereby reducing costs. Participants know more about all aspects of their business than before. Collateral, initial margin and risk are now all part of the controls that the broker, client and regulators can use as part of their business tools.
- Checking Risks: Without awareness there are risks. Every aircraft (even light aircraft) has radar and electronic navigation systems. These were once too expensive and hard to calibrate. Learning and experience have made them standard utilities. Risk management and stress testing tools are no different. They are often poorly calibrated, unfocused and prone to poor quality data inputs. However, they are improving and rapidly becoming as essential to the industry as air is to animal life!

Real-time information moves these tools from looking at theoretical outcomes, based on old data and account ranking criteria, to now useful exception reports based on latest data on all accounts. Sorting and alerting is based on the latest user actions and market moves, rather than market move values based on last night's positions. Consider: What time was the market closed? Was next session market opening for today being ignored at the time of the account output? At the same time, moving markets make these stale outputs largely irrelevant.

- Crisis controls: Firms must look at prudent and practical damage control methods, which are not unaffordable or impossible to implement. Simply, our industry requires interoperability of systems, which given all of the above, is rapidly moving into place.

Some firms started modifying their systems a while ago, driven by a desire to improve client service, which of course is why most of us are here. A big element driver towards a uniform approach to message formats (transactions for example) was and is the desire for easier integration or onboarding, whichever you prefer. Data storage and data exchanges need to be simpler and more useable. The old approach, meaning silos, required different methods for various uses. Narrower views resulted in many different formats (lack of standards) within even a single firm. This is no longer acceptable.

The FIX Trading Community isn't just about trading. It is about communication, collaboration and change. It's open and consultative approach is instrumental in positively impacting all market participants. It is an association of members whose common goal is making business better. The most major and many minor firm members are active in pushing for standards that continue to improve the entire trading lifecycle.

In sum, regulations will have done all of us a huge favour, perhaps not the intended consequence. Like renewable energy, once seen as a 'pie in the sky', an imposition on us, regulations are moving us away from fossil fuels as energy sources, for sake of the health of humans.

Yet the message is out, alternatives appear to work. The momentum of change in protecting the health of the financial system is gathering. Rolling back the rules will not stop transformation or innovation in the industry, especially now that we have started to realise the benefits. **SLT**

> ***The dusty asset storage vault is now a fresh new place to earn money from dynamic valuation ... turning this into a business line can generate additional revenues***

Alex Lamb
Head of business development for the Americas, and head of marketing
The Technancial Company

Calm before the storm

Ted Allen, of Apex Collateral, sits down with Jenna Lomax to talk Brexit, MiFID II and the effects they might have on the collateral management space

What are the most important things going on in collateral management at the moment?

There's a lot of discussion around the regulation, and a big focus on how the market has reacted to variation margin rules for non-cleared over-the-counter (OTC) derivatives, which came out earlier this year and affected most financial firms.

This year, there have also been discussions around the preparation for the initial margin exchange for uncleared OTC derivatives in terms of getting organisations ready and the connectivity to various market infrastructure platforms.

There are also still a lot of questions around the effect of the second Markets in Financial Instruments Directive (MiFiD II), which comes into force in January. It will be interesting to see if there will be another increase in volumes, caused by the inclusion of foreign exchange (FX) forwards under the OTC derivatives margining regime.

How does Apex fit into that?

Wonderfully well. We've done a lot of work with our clients to help them get compliant. We're lucky enough to have a number of clients who have been in the 'first wave' of rules for the uncleared OTC derivatives. With those clients, we've helped to get our system ready with the functionality that's needed to support all of those regulations. Also, the connectivity to the collateral utilities is now available out-of-the-box for their clients.

How will MiFID II affect the collateral management space next year?

We are already seeing the impact of the reclassification of FX forwards to come under the European Market Infrastructure Regulation margining regime. This is driving a significant uptick in volumes of collateral calls as many funds trade FX only and will suddenly have to start exchanging collateral. We have asset manager clients expecting a three-fold increase in the volume of variation margin calls post MiFID II.

Is there any part of MiFiD II regulation that concerns you, or do you welcome it? Will it affect automation processes for any area of Apex specifically?

Yes, we have created a highly-efficient collateral operations tool to provide full straight-through processing of the margin call process. Our clients experience significant efficiency gains from deploying Apex Collateral. Each collateral operations professional can now process several hundred collateral calls per day as we achieve near-full automation. The only manual intervention in the process is in error resolution and exceptions in data validation. Every human touch point that can be eliminated has been automated.

As director of business development, how will regulatory changes affect buy side operations for you?

With the current wave of regulation, it's interesting for me to find out how prepared the market is and to ensure we have the solutions to support it. We have recently gained several buy-side clients who had previously outsourced their collateral management.

These firms are bringing the processes in house and investing in platforms, such as Apex Collateral, to reduce costs and to ensure they are compliant with the regulations. They cannot outsource regulatory compliance.

How do you think Brexit might affect your job role in London in the future?

Everything around Brexit seems unclear at the moment. Until we really know what all the terms are—and where we stand in terms of how it will affect the market structure, treasury and liquidity models and general operation processes—it's all rather speculative, unfortunately. We will also see many banks and asset managers shifting more operations out of London, of course. Luckily for me, my clients are spread across the globe.

The CEO of Goldman Sachs recently tweeted that he expects to be doing a lot more business in Frankfurt due to Brexit. Do you think that will also be the case for you?

I would say that we expect to be doing more business, not just in Frankfurt but in all the financial centres, as the demand for collateral management solutions expands, globally. As a global technology partner, we are ready to support our clients as they adapt to all the prevailing regulatory, political and market conditions.

What do you predict the hot topics for collateral management will be in 2018?

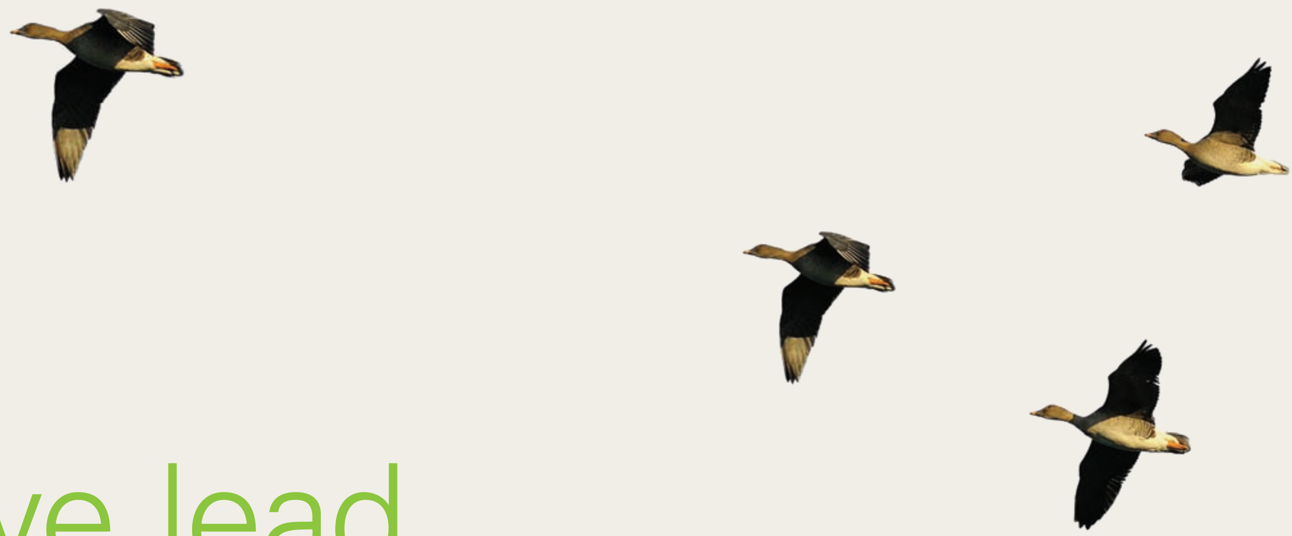
I predict that we will see many firms making the transition from tactical solutions to the regulations that have hit to a more strategic approach. Centralisation of the collateral function will be key, as will coping with rising interest rates and increased collateral requirements, which will start to drive optimisation.

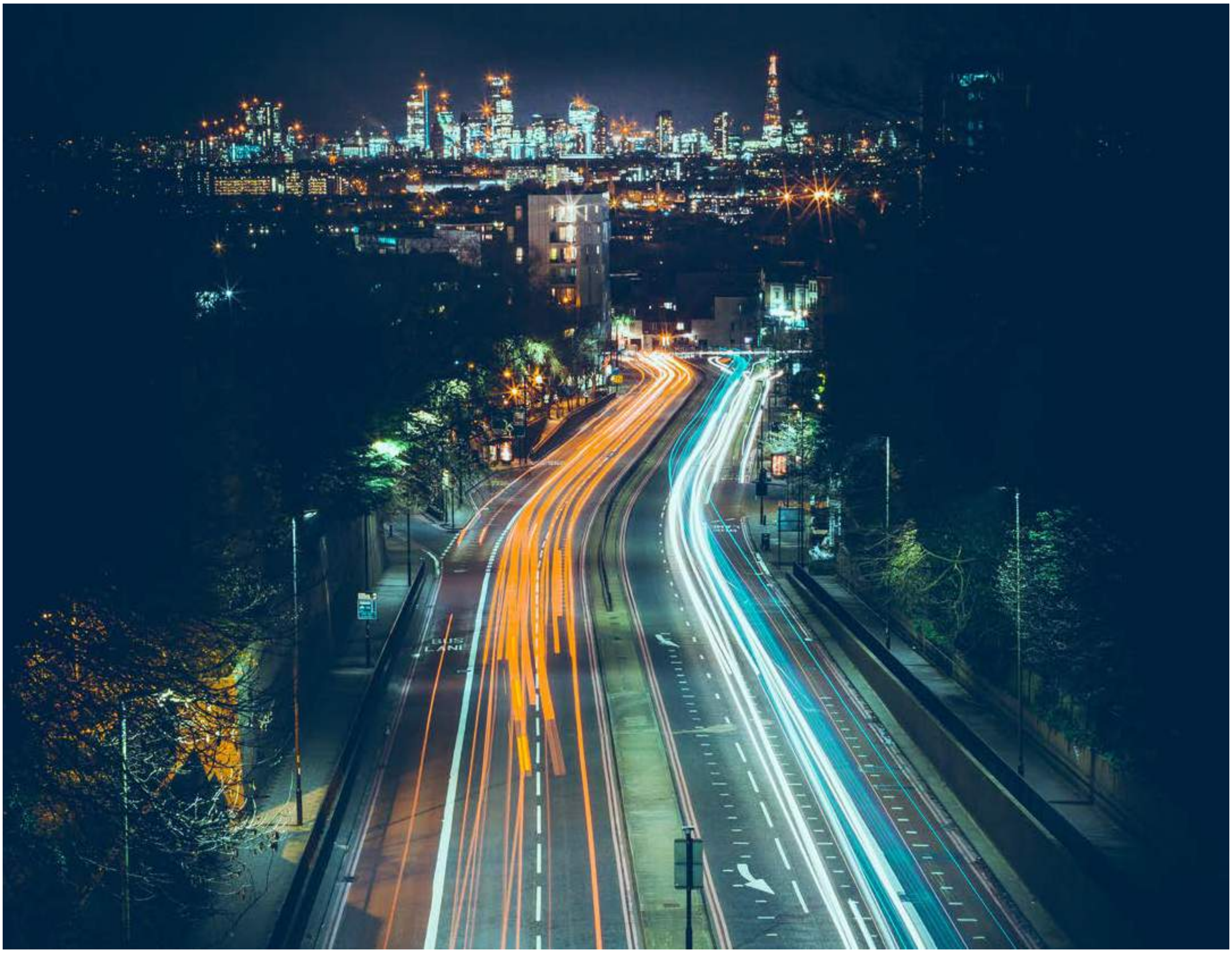
Apex can leverage the resources of FIS. How much does this help in managing clients' needs regarding regulation?

FIS is the world's largest financial technology firm. With over 55,000 employees and 20,000 clients, we have the strength and depth of resources to service our global client base. However, our size and scale are relevant only as they help our clients get where they want to go faster. FIS's role in reinventing the future of collateral management technologies has caught the attention of a global marketplace. We now serve firms of all sizes from tier-one investment banks through to niche asset managers, helping them deal with the challenges of the global regulatory regime. **SLT**

"With the current wave of regulation, it's interesting for me to find out how prepared the market is and to ensure we have the solutions to support it"

Ted Allen
Director of business development
Apex Collateral





The long and widening LGPS road

Between the LGPS pooling project, Brexit and changes in technology, fund managers in the UK, and their service providers, have a lot to think about

UK public sector funds are facing challenges from all angles—from the possibility of limited resources to the constant question of balancing risk and reward against asset safety. Throw that in with the 3 January 2018 deadline for compliance with the second Markets in Financial Instruments Directive (MiFiD II), and working with Local Government Pension Scheme (LGPS) funds is proving to be a challenge for all involved in the industry.

Since May 2017, asset managers working with LGPS funds have been able to sign up to a transparency code between investment managers and administering authorities. As a way of boosting managers' attractiveness for mandates, the code was designed to create greater clarity on investment fees, and applies to all listed asset classes.

Just a few months prior, a State Street-sponsored report into the pension scheme's asset allocation revealed a 61 percent spike in alternatives exposure by the 89 public funds participating in the LGPS, representing £16.6 billion in assets.

A further £34.7 billion in assets were given over to fixed income, leading to a 31 percent increase in that business line.

At that time, Andy Todd, head of UK pensions and banks for asset owner solutions at State Street, said: "Mounting cost pressures and persisting lower-for-longer yields have led pension fund investment committees to seek 'higher yielding' assets to assist them in meeting their strategic investment targets. Alternatives have historically been seen to provide this solution."

However, the asset allocation of the 89 member funds could still see considerable changes to their current portfolio construction over the coming years, with unprecedented changes in technology in the pipeline, in the UK alone.

When the State Street report was released, JR Lowry, head of State Street global exchange for Europe, the Middle East and Africa, noted: "LGPS [funds] are in a period of extreme change and technology will be the next stage of their evolution. As they reshape to adapt to their new size and structure, they have a significant opportunity to overhaul outdated legacy systems and benefit from new economies of scale."

"If embraced and properly harnessed, technology has the potential to help them confront these challenges."

Sid Newby, head of business development for the UK at BNP Paribas, which has secured five custody mandates under the LGPS framework, to date, says the custody provider is indeed embracing new technology.

He says: "In the last 18 months, the technology we can deploy and leverage is more powerful and provides more opportunities for providers and clients."

But, that's not to say everything is plain sailing in all areas of the industry.

Todd suggests that one of the most important challenges facing pension funds is the limitation of resources.

He says: "There are few trustee boards, management and investment committees or HR and pensions departments that would claim to have surplus resources beyond that required to meet the day-to-day challenges of running a pension fund. It is commendable how staff within the LGPS member funds have adopted the initiative, taken ownership and driven the project forward despite the resource challenge."

Asset managers also have to contend with the issue of balancing risk and reward strategies against asset safety, added to this is mounting cost pressures and persisting lower-for-longer yields. It is lower-for-longer yields in particular that have led pension fund investment committees to seek 'higher yielding' (often illiquid) assets.

This limitation of resources and juggling risk and reward against asset safety have been challenges that pension funds may have to deal with year-on-year. But, with the implementation of MiFiD II, among other regulations, the industry is playing a whole different ball game, particularly between now and April 2018.

You say you want some regulations

Todd suggests that a key thing to consider is MiFID II's re-classification of LGPS funds as retail investors, explaining that such funds are now working together with their advisors and asset managers to transition back up to professional investor status.

"Any that do not opt up are likely to part company with many of their assets managers—specifically, those managers that do not have the regulatory permissions and investment operational infrastructure to support retail clients," he says.

"The indirect consequences, which may be more far-reaching for the industry, are the provisions around transparency. We're seeing a demand for greater transparency, for example, in dealing especially, and in costs more generally."

Pension funds have also had to achieve a balance between some form of liability-driven investments—matching their investments with their liabilities—which they can do through a specific liability-driven investment manager or through direct fixed income investments.

Back to the EMIR

Newby also highlights the European Markets Infrastructure Regulation (EMIR) as one of the most difficult regulations to navigate, particularly because of the collateral requirements it will bring in. However, new requirements could also bring new opportunities.

He says: "While looking to derivatives for diversification or hedging, EMIR is requiring greater collateralisation. That's a pain if funds don't have the cash required for margin."

"One of the consequences, alongside the reporting that clients require, is the ability to optimise their collateral and optimise their cash positions. It's becoming a very keen topic for them to understand how they can do it efficiently, particularly with EMIR regulation."

Let it be Brexit

Closer to home, LGPS funds are also facing extra uncertainty on the road to the UK's exit from the EU, with negotiations due to come to a close in March 2019.

An audience poll at this year's Sibos conference in Toronto saw 46 percent of audience members suggesting that Frankfurt will take over from London as the world's financial centre, post-Brexit. It cannot be denied that the upheaval and uncertainty around the Brexit process brings some uncertainty to LGPS funds. But, ultimately there are still questions around how much of an impact it will really have.

In recent years, UK pension funds have diverted away from the London stock market in favour of foreign stock and bond markets, even before last year's referendum result. As Prime Minister Theresa May grapples with EU negotiations, organisations with pension funds are understandably concerned about the type of volatility on financial markets and the overall impact on asset managers.

Todd says: "The only element you can be sure of is that it's coming."

Although he warns that there is volatility in financial markets that has adversely affected asset prices, he reassures that LGPS funds will likely remain strong come March 2019.

He says: "Pension funds, including the LGPS, should not feel panicked or pressured into making sudden changes to their business models and asset allocations."

We can work it out

Amid the smoke and mirrors surrounding Brexit and the other market pressures, asset managers and pension funds alike are looking intently to the future, whether this means the reevaluating of funds, looking to outsourcing opportunities or considering the effect financial technology will have on the industry in the coming years.

Ultimately, funds are looking for the most efficient and cost-effective methods to generate returns.

Newby says: "In general, we are seeing the large pension funds re-evaluating how they're set up and looking more proactively to outsource certain functions, whether that is support with their private equity investments, in terms of managing the middle-office cash management of those assets, or whether it is reporting."

He adds: "Our clients' main question, and their business demand, is always: How can I operate most efficiently?"

On this point, Newby says, data is going to "change the game". Particularly he points to 'data-as-a-service' as something likely to become a big topic in asset management over the next few years.

He says: "We're talking to some sophisticated schemes about how, as a provider, we can help them manage their data and make use of the new tools available, in a way that they've never been able to do before."

LGPS securities lending update

For agent lenders, the LGPS presents an administration exercise along with an opportunity to re-open the book on historic securities lending agreements with beneficial owners and amend certain conditions.

According to Michael Huertas, counsel at Baker McKenzie, the creation of a new legal entity as part of the consolidation process, along with reclassification of terms and conditions of various agreements and order and/or best execution policies all require re-papering. Although this may initially appear to be an unnecessary resource drain during a critical implementation period for other incoming regulatory frameworks, it also presents an opportunity to update terms.

In a research note on the possibilities the scheme presents for securities lending published last year, Hywel Robinson, a partner at Clifford Chance, explains: "The government's current drive on LGPS asset pooling may, however, prove helpful here [for securities lending]."

"Certain types of pooled vehicle are treated as standalone entities for capacity purposes, meaning that, as long as the operator of the pooled vehicle is permitted to enter into the particular contract/investment, there is no need to look behind this and confirm the capacity of the vehicle's participants to enter into those underlying contracts."

"Investment via a pooled vehicle could therefore prove useful where there are concerns over LGPS funds' capacity to invest in particular arrangements directly as capacity to invest in the pooled vehicle itself may well be sufficient."

Opt up or opt out

One cause for concern for LGPS members and asset managers alike is that, as of 3 January 2018, certain public authority pension funds will likely have to be re-classified as 'retail clients' under MiFID II. The thought process behind this is that public authority pension funds should be afforded additional protections as investors to ensure their risk management process are secure.

However, in doing so, LGPS funds could be cut off from utilising certain strategies, such as derivatives, which are gaining popularity among investors as a way of diversifying their portfolio.

Huertas explains that public consensus on the issue indicates that most in-scope funds will choose to forgo the additional retail-level protections and opt-up in order access a wider arsenal of investment strategies, asset classes and transaction types in a search for yield.

The LGPS advisory board states: "Such a reclassification [retail] would severely limit both the financial instruments and providers available to authorities for pensions purposes, which could be both costly and reduce the potential for returns. Authorities should consider electing for a return to professional status in order to ensure they can access the full range of vehicles and managers to meet the needs of their investment strategy."

"The board, along with other stakeholders, has successfully lobbied for the opt-up tests proposed in the 2016 FCA consultation to better reflect the constitutions and decision-making processes of authorities and has worked with industry bodies to develop the standard opt-up process below."

"LGPS-administering authorities are strongly advised to make use of this standard process and documentation in order to provide for a smoother opt up."

Opting up within MiFID II involves a multi-stage process of providing proof of effective understanding of certain investment strategies and maintaining specific levels of liquidity and assets under management. Affected funds were recently warned by the LGPS Advisory Board that failure to begin the application process well ahead of MiFID II's January deadline may result in the application not being completed in time, or being rejected outright.

Speaking on the recent trend of LGPS funds discovering a taste for alternatives, Todd says: "Traditional asset classes such as equities and fixed income will remain core holdings. However, mounting cost pressures and persisting lower-for-longer yields have led pension fund investment committees to seek 'higher yielding' (often illiquid) alternative assets to assist them in meeting their strategic investment targets."

"Pension funds are becoming increasingly adept in the use of alternatives within their strategic asset mix and this is a trend that, as a consequence of the LGPS Pooling initiative, is set to continue."

"However, it's important to highlight that alongside this trend, one key consequence of MiFID II is the effective re-classification of LGPS member funds as retail investors, significantly limiting their ability to gain exposure to illiquid assets, such as alternatives."

"Such funds are now working together with their advisors and asset managers to opt back up to professional investor status."

Who's who in LGPS

Major players in the securities lending marketplace are taking full advantage of the opportunities presented by the pooling scheme to secure a plethora of securities servicing mandates.

Northern Trust has secured 13 mandates to provide asset services, including securities lending, to pension funds under the LGPS across the UK. Most recently, the bank was appointed to manage £6.7 billion in pension fund assets belonging to the Northern Ireland Local Government Officers' Superannuation Committee in April.

As well as securities lending, Northern Trust will provide global custody, accounting, performance management and foreign exchange services for the pension fund assets.

In March, Northern Trust was appointed to provide global custody services for £550 million in assets for the Scottish Borders Council. Meanwhile, UBS Asset Management secured one of the UK's biggest passive management mandates, worth £11 billion, from 11 UK local pension funds. The deal was signed with Access, a collaboration of funds from the Central, Eastern and Southern Shires, which boasts £33 billion in assets overall.

BNP Paribas holds five mandates, including providing global custody for £3 billion in pension fund assets for the West Sussex Pension Fund. **SLT**

Key facts

- The LGPS scheme includes 101 funds across the UK managing £217 billion worth of assets, as of 2016
- The pooling project is set to launch in April 2018
- From 3 January 2018, public pension funds will no longer be categorised as professional investors under MiFID II, unless prior approval has been granted
- Public pension funds must reclaim professional status if they wish to engage in more complex investment strategies
- The LGPS scheme was first introduced in 2015 by then-chancellor turned newspaper editor George Osborne

Cash no longer king to borrow US equities

Dramatic shifts in the demand to borrow US equities—the most traded asset in the global lending market—have caused an increasingly large portion of lendable inventory to remain unused. Simon Colvin explains

In the past, beneficial owners typically lent out US equities against cash collateral, but this trend has started to lose favour to non-cash collateralised trades in recent years. Non-cash collateralised trades accounted for less than 10 percent of the volume of US equities transactions back in 2012, but their market share has now surged to 40 percent of the aggregate volume.

This shift in collateral preferences is even starker in absolute dollar terms: non-cash balances have jumped more than seven-fold to $140 billion since 2012, and cash collateralised trades have stagnated at the $200 billion mark.

Much of the shift towards non-cash collateral can be directly linked to the implementation of post-crisis regulations that aimed to reduce bank/broker-dealer funding and liquidity risks. In reality, the new rules forced them to drastically adjust operating practices. Chief among those regulations is the net stable funding ratio (NSFR), which gauges the health of a bank's assets against the liabilities used to fund its activities. Although NSFR, which is slated to go live in January 2018, doesn't implicitly dictate bank collateral practices, it creates a regulatory mismatch between the treatment of cash and non-cash collateral in securities lending transactions, making non-cash borrowing far more attractive for banks.

If lenders were free to accept non-cash collateral on equal terms, NSFR wouldn't lead to a dramatic shift in the US securities lending industry. However, the regulatory burdens placed on many US-domiciled lenders will cause a large portion of the US equity inventory to be less appealing to potential borrowers. This lack of appeal will be exemplified by diverging utilisation paths between funds that can accept non-cash collateral and those that can't.

According to the IHS Markit benchmarking analysis, in the past three years, the utilisation rate of $3.5 trillion in US equities held by funds that can only accept cash collateral has shrunk by a quarter to a very meager 1.5 percent. Funds that can lend either all or part of their US equities against non-cash collateral have proven much more popular with borrowers—these funds now see utilisation rates of 7.7 percent, or five times that of their cash-only peers.

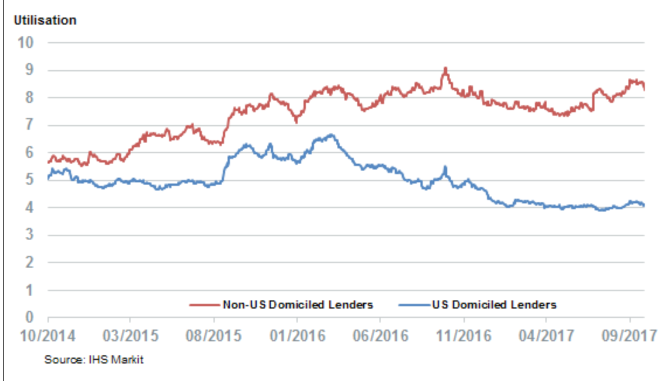
Although regulation has made cash-only lenders much less attractive to borrowers, borrowers still turn to them for high-value intrinsic lending. This has enabled cash-only lenders to charge fees nearly three times higher than their less constrained peers. Intrinsic lending isn't enough to overcome their regulatory handicap, however, and the average return for cash-only US-domiciled lenders has been less than half of those accepting non-cash collateral.

To rub salt on the wound for cash-only lenders, the returns made from reinvesting cash balances have remained anemic—despite the Federal Reserve's recent interest rate hikes. In fact, the average reinvestment returns on cash balances over the first three quarters of the year (26 basis points (bps)) have been more than a tenth lower than the 29.4 bps achieved over the same period last year. Astonishingly, these returns are even less than the 27.7 bps of cash average cash reinvestment return earned in the opening three quarters of 2015, which predated the Fed's interest rate hike.

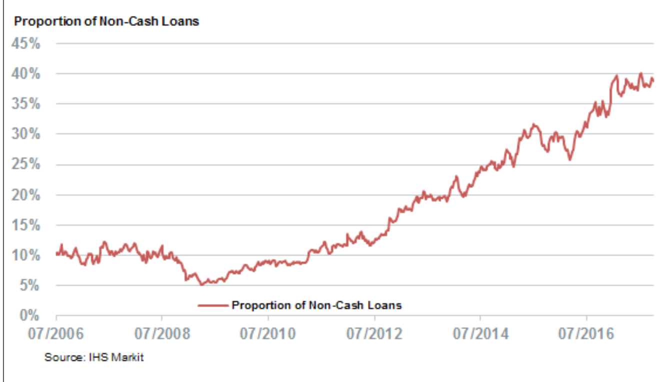
Beneficial owners domiciled outside the US are far more likely to accept non-cash collateral, and have been large beneficiaries of the shift towards non-cash. These lenders have seen their US equity book of business grow from $60 billion to $102 billion over the past three years. This has enabled them to eclipse US-domiciled lenders in utilisation terms, and these funds now see twice the proportion of their assets out on loan versus their US peers. That is a staggering reversal of fortunes, considering both sets of lenders used to achieve roughly similar utilisation levels for US equities three years ago.

Although the sands of securities lending are always shifting, the pace and severity at which US cash trading fell out of favour speaks volumes about the lengths to which borrower behaviour has changed over the past few years. And it also demonstrates how not catching the right regulatory trend can nearly wipe out the returns derived from securities lending. **SLT**

US Equity Utilisation



US Equity Loans



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Comings and goings at WallachBeth, COR Clearing, BNP Paribas and more

Rory Zirpolo has taken on a new position as managing director and equity finance relationship manager at WallachBeth, an institutional execution services provider.

Zirpolo moves to WallachBeth from Cantor Fitzgerald, a global financial services provider, where he was managing director of securities lending.

At Cantor, Zirpolo was responsible for five traders managing $500 million supply (cash) for US trading, including securities lending, pricing trades and monitoring position limits.

Prior to this, Zirpolo was managing director and head of Cowen Equity Finance Group, a clearing equity finance broker-dealer, between 2012 and 2015. He also served at Credit Suisse for 11 years.

Zirpolo is understood to be taking over some of the responsibilities of Brett Weiss, who moved to S3 Partners as a director of business development in September, but Zirpolo will predominantly be focused on relationship management.

At WallachBeth, Weiss provided financing solutions to global banks, broker-dealers and financial institutions through securities lending, repo and triparty services, among others.

COR Clearing has promoted Thomas Palmeri to managing director of its securities lending team, based in Edison, New Jersey.

Palmeri was previously securities lending executive with COR for more than seven years. Before this, he worked at South Street Securities.

COR has also hired Dennis Palmeri to join the team as vice president of sales for securities lending, and has promoted Rob Primiano to vice president of securities lending operations.

Lee McCormack has left CloudMargin after just over a year as its head of strategy and product development.

It is currently unconfirmed where McCormack is moving to, or what his role will be.


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Previously, McCormack was an executive director at Nomura, a role he held from September 2012 to May 2015.

At the bank, he was responsible for building, marketing and selling Nomura's OTC derivatives clearing business.

McCormack also served at Morgan Stanley, UBS and LCH.Clearnet.

The news of McCormack's departure comes just a few months after CloudMargin set up a new microsite, FlightPlan, aimed at clarifying new over-the-counter derivatives rules around the world.

According to CloudMargin, FlightPlan will enable financial institutions to identify and personalise information most applicable to their businesses, as well as prepare them for regulatory changes and mandate implementations expected up until 2020.

CloudMargin also announced a connection with DTCC-Euroclear GlobalCollateral's Margin Transit Utility (MTU) in August.

BNP Paribas has recruited Simone Broadfield as head of agency securities lending for Asia Pacific.

Broadfield will be based in Hong Kong.

Prior to BNP Paribas, Broadfield worked at Citi Hong Kong for its investor services as trading desk head for Australia and Japan.

Before Citi, Broadfield worked at Deutsche Bank, within the securities lending division.

US President Donald Trump has nominated Jerome Powell to become the next chair of the Federal Reserve.

Powell will replace current chair Janet Yellen, who took office in February 2014 on a four-year term, ending in February 2018.

Powell joined the Federal Reserve's board of governors in 2012 and was reappointed in 2014 on a 14-year term.

He is considered to be a centrist and pragmatist, according to colleagues.

The Senate will now vote to ratify President Trump's choice, before Powell can take office.

Prior to joining the Fed, Powell served as an assistant secretary and as undersecretary in the Treasury under President George Bush, responsible for policy on the financial institutions and the Treasury debt market.

A trained lawyer, Powell partnered at The Carlyle Group from 1997 to 2005. Before joining the Bush Administration, he worked as a lawyer and investment banker in New York.

Commenting on the appointment, Kenneth Bentsen, president and CEO of The Securities Industry and Financial Markets Authority (SIFMA), commented: "Governor Powell's tenure and experience at the Federal Reserve, Treasury, and in the industry, should give markets and investors great confidence that he will provide a steady hand in guiding this critical function."

Yellen, who welcomed the appointment of Powell, will become the first chair in 40 years not to be selected for a second term, despite falling unemployment and stable inflation rates during her tenure.

In a statement, Powell commented: "In the years since the global financial crisis ended, our economy has made substantial progress toward full recovery."

"By many measures we are close to full employment, and inflation has gradually moved up toward our target."

Powell continued: "Our financial system is without doubt far stronger and more resilient than it was before the crisis."

"Our banks have much higher capital and liquidity, are more aware of the risks they run, and are better able to manage those risks."

He added: "While post-crisis improvements in regulation and supervision have helped us to achieve these gains, I will continue to work with my colleagues to ensure that the Federal Reserve remains vigilant and prepared to respond to changes in markets and evolving risks." **SLT**

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