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ISSUE197 Conference Special

Putting in the legwork

Pierre Khemdoudi and Edward Marhefka of IHS Markit discuss preparation for the implementation of SFTR

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Delta Capita forms alliance with The Field Effect

Delta Capita and The Field Effect have teamed up to address transformational change and regulatory requirement initiatives including the Securities Financing Transaction Regulation (SFTR).

The alliance will deliver a combined capability in prime brokerage, securities finance and collateral management designed to help clients tackle regulations such as SFTR, which aims to increase the transparency of securities financing transactions.

As part of the partnership, The Field Effect will combine its strategy, operating model, road mapping and business case expertise, with Delta Capita's technology and data and integration solutions, managed services and consortia management capabilities.

Commenting on the alliance, David Field, founder and managing director of The Field Effect, said: "The combination of our respective strengths will serve to provide both our clients with the very best of solutions spanning consulting advice, technological solutions and delivery, and managed services."

Joe Channer, Delta Capita, founder and CEO, explained: "We are delighted to announce this strategic alliance with The Field Effect. SFTR is a very significant piece of regulation impacting almost every aspect of the trade lifecycle. It requires changes to operating models, considerable data engineering programmes and new technology solutions to address these challenges."

Channer added: "This collaboration will allow both our firms to best service their respective clients and meet the inbound interest by offering a full scope service at scale."

"Delta Capita is highly experienced at facilitating industry consortia and in creating and managing shared industry platform solutions. Meeting the SFTR requirements has created some common challenges across the industry and we are evaluating collaborative and mutualised models designed to help the industry meet its regulatory commitments in the most cost-effective and efficient way."

Contents

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Publisher: Justin Lawson
justinlawson@securitieslendingtimes.com
+44 (0)203 750 6028

Acting Editor: Becky Butcher
beckybutcher@blackknightmedialtd.com
+44 (0)203 750 6019

Senior Reporter: Barney Dixon
barneydixon@blackknightmedialtd.com
+44 (0)203 750 6017

Junior Reporter: Jenna Lomax
jennalomax@blackknightmedialtd.com
+44 (0)203 750 6018

Contributors: Ned Holmes and Brian Bollen

Creative Director: Steven Lafferty
design@securitieslendingtimes.com
+44 (0)7843 811 240

Marketing/Sales Support: Paige Tapson
Tel: +44 (0) 203 750 6020
paigetapson@blackknightmedialtd.com

www.securitieslendingtimes.com

Twitter: @SLTimes_

Office fax: +44 (0)20 8711 5985
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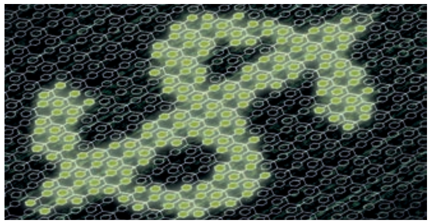

WEF creates consortium to address financial technology cybersecurity

The World Economic Forum (WEF) has created a consortium to strengthen cybersecurity for financial technology companies and data aggregators.

The group will produce a new framework for the assessment of cybersecurity in financial technology.

Citigroup, Zurich Insurance Group, the Depository Trust & Clearing Corporation (DTCC) and financial technology lender, Kabbage, are among the consortium's founding members.

The launch of the consortium comes after leading cybersecurity experts identified the growing threat of cyberattacks to financial services providers as a key concern at the WEF.

Their assessment and proposed solutions have been published in a white paper, 'Innovation-Driven Cyber-Risk to Customer Data in Financial Services'.

The consortium will commence work immediately in consultation with the World Economic Forum's new Global Centre for Cybersecurity in Geneva, Switzerland.

The group will develop common principles for cybersecurity assessments, guidance for implementation, a point-based scoring framework, and counsel on improving an organisation's score.

Matthew Blake, head of the financial and monetary system initiative at the WEF, commented: "Financial technology can only deliver on their customer experience promises if the financial system is able to manage the risks adequately. This consortium will offer technology companies a clear goal post and thus enable them to implement sound cybersecurity measures at the product design stage."

Michael Bodson, president and CEO of DTCC, and a founding member of the consortium, said: "Cyber risk is the number-one threat to the financial services industry and its infrastructure, so it is critically important that we work together to share insights and drive best practice."

Mario Greco, CEO of Zurich Insurance Group, Switzerland, and a participant in the consortium, stated: "Cyber breaches recorded by businesses have almost doubled since 2013 and the estimated cost of cybercrime is $8 trillion over the next five years."

He added: "We expect the consortium to help adopt best cybersecurity practices and reduce the complexity of diverging cyber regulation around the world."

ESMA publishes CCP consultation responses from its draft guidelines

The European Securities and Markets Authority (ESMA) has published a range of responses to the consultation on its draft guidelines on procyclicality-mitigating margin measures for central counterparties (CCPs).

Eurex Clearing, the London Stock Exchange Group (LSEG) and LCH Group are some of the prominent names to have shared their thoughts on the subject.

Eurex said that regulators view margin procyclicality from at least two perspectives.

The first is microprudential and pertains to the impact that procyclical margin revisions could have on the liquidity needs of market participants who need to meet such additional requirements.

The second is macroprudential: the procyclical margins fall in the period of low volatility allowing market participants to increase their financial leverage.

Eurex said the margin revisions associated with an increase in market volatility necessitate deleveraging, which itself might accentuate the effects on the markets.

Eurex added: "The impact on the liquidity of a market participant caused by initial margin revisions in a period of increased market volatility is a valid consideration."

However, it concluded that the effect of a change in the initial margin "is dwarfed by the liquidity needs that arise from variation margin payments (intra-day and daily collateralisation)".

Eurex Clearing went on to argue that the most appropriate steps to mitigate adverse effects of procyclicality are an outcome-based approach where outcome measures are clearly aligned

with explicit regulatory goals, regulatory harmonisation of outcome-based measures at a global level, and public disclosure of harmonised key metrics allowing transparency for both market participants and all regulatory bodies.

It suggests that the first step in such strategy would be an alignment on which measures are most relevant from a regulatory point of view in the sense of addressing a specific regulatory goal.

LSEG said it supports the notion of clear guidelines and believes that clear and documented measures to avoid procyclical effects should be part of a proper risk management framework.

LSEG added that the proposed examples of quantitative metrics for monitoring the efficiency of anti-procyclicality margin measures should be complemented by the analysis of co-movement of market indicators and margin requirements changes.

It said that the absolute change in margin parameters over a certain time span cannot be considered sufficient to assess the effectiveness of the anti-cyclical measures.

LSEG concluded it has reservations about the ESMA proposal that CCPs that adopt article 28(1)(c) of regulatory technical standards should not use modelling procedures to alter the weights of the observations when computing the margin floor using the 10-year volatility estimate. Where a 10-year lookback period is used, margin calculation should be

ESMA updates EMIR validation rules

The European Securities and Markets Authority (ESMA) has updated its validation rules regarding the European Markets Infrastructure Regulation (EMIR).

The updated validation rules relate to the revised technical standards on reporting under article nine of EMIR.

The new rules declare an allowance for the reporting of exchange-traded derivatives in products for which the effective date may be earlier than the date of execution.

It also clarifies how the identification of the product should be validated in the reports submitted on or after 3 January 2018.

A white paper jointly released by Minium, IBM and Promontory in February, explained the importance of EMIR in establishing "prudential and risk-mitigation techniques and operational requirements for derivatives transactions".

It added that EMIR will also require central counterparties and trade repositories to "fulfill prudential minimum requirements".

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fed with at least a 99 percent confidence level and a two-day holding period.

It said that scaling must be allowed using the 10-year volatility estimate, provided that the input parameters do not fall under the minimum required by the European Market Infrastructure Regulation. Any restriction on scaling would weaken CCP incentives to establish more conservative policies than the minimum regulatory requirements, according to LSEG.

In its response, LCH considers procyclicality to be a very important issue for a CCP and that it implemented rigorous standards in this regard several years ago.

There are also considerations coming from product specific characteristics, according to the clearing company, for example, repo contracts can involve physical settlement risk and this is not present for financially settled products such as interest rate derivatives.

LCH added: "CCPs might develop metrics and thresholds that cover a wider scope than those proposed in this consultation and these would likely differ between CCPs due to the potential sources of procyclicality contributing different degrees of procyclical risk."

Voya slapped with fine for securities lending conflict

The Securities and Exchange Commission (SEC) has ordered Voya Holdings to pay $3.6 million over alleged conflicts of interest and misleading disclosures that were detrimental to its customers.

According to the SEC, Voya recalled portfolio securities of mutual funds they advised, before the dividend record date. This practice enabled the insurance affiliates to take a tax deduction and resulted in lost securities lending income for the mutual funds.

Voya offers retirement, investment and insurance products and services to individual and institutional customers, including over one hundred mutual funds. The SEC said this recall practice resulted in an "undisclosed conflict of interest".

It added: "The insurance affiliates benefited from the dividend received deduction, while the funds and individuals invested in those funds through their variable life annuity contracts and variable life insurance policies lost securities lending income during the period when the securities were recalled."

The affected mutual funds will receive more than $2 million of the $3.6 million settlement.

Anthony Kelly, co-chief of the SEC enforcement division's asset management unit, commented: "These funds and those investing in them weren't told that they were losing income so that the Voya advisers could provide a tax benefit to their affiliates. Now money will be heading back to the funds to help investors."

He added: "Investment advisers must not place the interests of their affiliates over those of clients, depriving them of information necessary to make informed investment decisions."

European Commission should not create barriers to market development

The European Fund and Asset Management Association (EFAMA) has said that an EU agenda on sustainable finance "should focus on a market driven approach" and avoid creating any "unintended barriers to market development".

EFAMA was commenting on the European Commission's action plan on financing sustainable growth, in a statement released on 8 March.

It said that market driven approach "is crucial, given the constant evolution of products, practices and end-investor demands".

EFAMA added: "Any legislative initiatives need to be reviewed carefully to ensure that positive market-led trends continue to thrive."

However, EFAMA mostly agreed with other areas of the plan, which included a decision to explore a sustainable finance strategy for the EU.

EFAMA said: "The absence of a common language for sustainable assets and the lack of consistent and comparable corporate disclosure on sustainability have long been challenges in the integration of

sustainability in the investment decision-making process."

EFAMA added that because of this, it welcomes "many aspects of the action plan, notably the commitment to strengthen sustainability disclosure, as well as the proposal on an EU taxonomy".

However, EFAMA disagreed with the action plan's statements regarding asset managers not systematically considering sustainability in the investment process.

It stated: "Evidence suggests that integration of these factors has increased in the market over recent years."

"By embracing sustainability as an integral part of the investment process and supporting the development of responsible investment in all of its forms, asset managers play a pivotal role in supporting sustainable economic growth and long-term financing of the European economy."

FCA updates its LEI validation rule for its market data processor

The Financial Conduct Authority (FCA) has updated the second Markets in Financial Instruments Directive (MiFID II) rule, amending the legal entity identifier (LEI) rule in relation to its markets data processor (MDP).

The update comes after the European Securities and Markets Authority (ESMA) outlined temporary rules in respect of the LEI.

In December 2017, ESMA issued a delay to the enforcement of LEI requirements for MiFID II, explaining that leading up to the deadline, it had learnt that not all investment firms would succeed in obtaining LEI codes from all their clients by 3 January 2018.

The FCA's statement released on 2 March 2018, explained that ESMA's approach requires the FCA to amend the LEI validation rule in its MDP. It communicated to ESMA and the industry that the change would not be possible before the implementation date of MiFID II.

The FCA said that the revision to the LEI validation rule was implemented in the MDP on 10 March 2018.

Firms with any outstanding transaction report where the trade date precedes the LEI registration date, were able to resubmit it from 12 March 2018. MiFID II, part of EU legislation, was implemented on 3 January 2018 and stated that all legal entities involved in a trade are required to include their LEIs in European trade reporting.

ESMA prepared for UK to become 'third party' after Brexit

The European Securities and Markets Authority (ESMA) is "prepared for the UK to become a third party", according to panellists at this year's Association of the Luxembourg Fund Industry (ALFI) European Asset Management Conference.

The ALFI panel that looked at the European regulatory landscape, interviewed speakers from ESMA and the European Fund and Asset Management Association (EFAMA).

An audience member questioned the panel on whether ESMA was responsible for providing "a very short time frame within the industry, almost leaving us hanging off the edge of a cliff in preparing for Brexit".

The audience member added: "Could [Brexit] be a massive disruption to consumers and destroy what we're trying to create—a better Capital Markets Union?"

The ESMA panellist said that "both sides, [the UK and the EU], want a clear transition regime."

The representative from ESMA explained: "So much of UK rule is governed by UK law, what we're doing is being prepared for the UK to become a third party, working with trade repositories and others. We are saying 'tell us the plans you need to have ready."

He added: "We will do everything we can to get a memorandum of understanding in place with the UK."

The ESMA representative said that the agreement would probably "be similar to the one we have with Taiwan, Chile and Canada. We hope to negotiate with the UK and UK regulators".

He also listed custody services as a major priority in these negotiations.

The ESMA and EFAMA representatives agreed that "one year is not much time", alluding to the timeframe between now and March 2019, when the UK is expected to leave the EU.

Another audience member questioned passporting activity post-Brexit, he asked: "It's curious in a time of such globalisation, that passport arrangement for the UK looks like it will be very hard to achieve, it's so easy in Japan and similar countries. Are you cherry picking?"

The ESMA representative replied: "Prime minister Theresa May and the UK government have said that passporting wouldn't work. In an open financial market, there is a small difference in regulation, in terms of how and where business takes place. Once you're outside of [the EU] there are different elements to participation, but there are still possibilities for third countries. The idea of passporting is tied to EU membership, it is a very legal framework once you're out of the EU."

Top of the hot stocks: SMA Solar Technology and Roku

SMA Solar Technology led the FIS Astec Analytics hot stocks list for Europe, the Middle East, and Africa (EMEA) for the week ending 2 March.

SMA Solar, the Germany-based developer of photovoltaic systems for the solar power

industry, saw its short interest utilisation levels increase from around 72 percent to peak at 82 percent in January, before falling off steeply in February, closing last week at 63 percent.

Following SMA Technology on the hot stocks list was Ocado Group which was in the number three slot last week. Ocado, the UK-based grocery delivery company, saw short sellers continue to close out their short positions, reducing borrowing volumes by almost 11 percent.

The share price has also continued its previous trajectory, adding a further 4 percent over the last week. Roku was the top pick for the Americas. In the two weeks leading up Roku's earnings report, short sellers added 26 percent by volume to their outstanding positions, but more recently, they have added a further 34 percent, indicating that they expect further issues to pressurise the Roku share price.

Following Roku was Frontier Communications, which saw its utilisation of 100 percent for much of January and February, drop to 95 percent over the last week despite a 7 percent increase in short interest by volume.

FIS said: "With significant borrowing demand continuing, despite the 83 percent loss over the last 12 months, short sellers believe there are potentially more gains yet to come."

Financial Stability Board publishes SFT reporting guidelines

The Financial Stability Board (FSB) has published a set of reporting guidelines for securities financing transactions.

The guidelines provide detailed advice for authorities in reporting securities financing data according to the November 2015 Securities Financing Data Standards. This includes the main aspects of the FSB's securities financing data collection, data template for national and regional authorities to report to the global aggregator that contains all the data elements shown in the standards, the codes for classification and annexes aimed to help data reporting and improve data quality. The guidelines come five years after the FSB published its policy framework for 'Addressing Shadow Banking Risks in Securities Lending and Repos', which was published in August 2013, setting out final recommendations to address financial stability risks in relation to securities lending and repos.

These included recommendations for national and regional authorities to improve data collection on securities lending and repo markets in order to detect financial stability risks and develop policy responses, and for the FSB to aggregate the total national and regional data for these markets in order to assess global trends in financial stability.

The FSB's latest guidelines define the reporting guidelines for implementing the November 2015 FSB Global Securities Financing Data Standards.


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Putting in the legwork

Pierre Khemdoudi and Edward Marhefka of IHS Markit discuss how the firm has been preparing for the implementation of SFTR

Jenna Lomax reports

How have the data demands of your clients developed in the past 12 months?

Pierre Khemdoudi: Clients in securities lending are looking to automate routine tasks so they can focus on managing risk and driving revenue rather than blocking and tackling. To do that they need clean, accurate data provided promptly with flexible delivery mechanisms. We've also seen an increasing demand for independent consulting services from beneficial owners and lending agents.

Regarding regulation, we are working with clients on regulatory solutions where centralising best practices reduce the hurdle for individual market participants. Regarding regulatory tools, IHS Markit initiatives include new benchmarking features and intra-day tools. We're trying to get our data as close as possible to instant trading.

Being a trusted partner for our clients on regulatory solutions is key for IHS Markit, at a firm level, and the second Markets in Financial Instruments Directive (MiFID II) rollout has been a successful collaboration across product groups.

In securities finance, we see more and more clients asking questions about best execution as they are trying to navigate the regulation and its requirements for the securities finance products. Additionally, we have been very focused on developing our Securities Financing Transactions Regulation (SFTR) offering.

You mentioned regulatory hurdles, with less than 12 months to go for implementation of SFTR solutions, are clients engaged and prepared?

Edward Marhefka: Yes, we've seen broad engagement from our client base and have a full roster of design partners with many others highly interested in our platform and solution. We have 14 Tier 1 sell-side and buy-side organisations that have joined our design partner group, representing the whole spectrum of securities financing transactions needed to be reported under SFTR.

Putting in the early legwork has paid off, and our clients will be well positioned when the regulation goes live in Q2 2019.

Regis-TR collaborated with IHS Markit to create a reporting solution for the SFTR requirements. How has the solution fulfilled the SFTR obligation to report transaction details to a registered trade repository so far?

Khemdoudi: We've seen broad engagement across the securities finance community with our client base, and we have many others interested in our insight and platform solution. When looking at the workflow for the securities finance reporting, you have three elements in the ecosystem—the client itself, the vendor facilitating the reporting, and the trade repository. Working with trade repositories is a key factor for implementing a solution that produces accurate, matched and timely regulatory service. To that end, we are working with all trade repositories to ensure seamless connectivity for our clients.

Our task in the workflow is to make sure we make the transition through SFTR as easy and as painless as possible for our clients. To make it easier, we will increase the accuracy of the information that we send to trade repositories, and we will provide detailed monitoring of the process for managing the regulatory reporting.

We are pleased to see that clients, partner vendors and trade repositories are engaged with our SFTR teams.

What were the main themes you saw in 2017? And what do you expect for this year, how do you think some themes will differ?

Marhefka: Borrow demand, and total revenue has been robust. Last year delivered just over $9 billion in total revenue which represented a small decline versus 2016, but still the second best post-crisis year. Despite the steady demand for borrows, inventory growth has outpaced demand creating challenges for lender returns. Collateral flexibility has continued to take on greater importance for driving revenue for lenders, with utilisation declining for those who can only take cash.

There has also been a growing shift in borrowers needing to face off against lenders (and vice versa) in specific domiciles and legal entities for firms to properly allocate balance sheet and capital costs, which favours the firms with a strong global footprint.

Asia has been driving increased demand for equities/specials and was the only region to post a year on year increase in equity lending revenues. High-yield issues and private placements have lead increasing borrow balances for corporate bonds, which are at a post-crisis high. Demand for high-quality liquid assets remains a revenue tailwind for government bond holders.

From a sector perspective, retail was a key driver of specials in 2017, and this appears to be persistent in 2018, as shoppers continue to move online. Biotech and pharma also continue to be global demand drivers for equities. Other potential equity revenue drivers for 2018 include marijuana and shale in the Americas and semiconductors in Asia.

With equity revenue starting to come out of the shadow of 2016, along with drivers of government and corporate debt borrow demand remaining intact, there is cause for optimism for the industry in 2018.

How can market participants best leverage market data? And have you seen an increase in new clients over the past year?

Khemdoudi: Engagement is critical and regularly reviewing workflows with clients allows us to deliver data and analytics where they can be most impactful.

We've seen increasing demand for risk and exposure analysis and our consulting team is well positioned to customise solutions for all market participants. In a similar vein, beneficial owners have taken an increasingly proactive approach to benchmarking and view it more as an ongoing process versus a backwards-looking report.

With securities lending and repo data having increasingly broad applications across firms, we have found that dialogue between vendor and clients is critical to get the most out of the product. We talk about automation and artificial intelligence enhancements with cutting-edge technology: to achieve these efficiencies clients must have clean, accurate data, which is well supported.

With an increasing number of product users at client sites, it is imperative the product be intuitive and user-friendly while also delivering the flexibility for a range of client needs.

At a firm level, we're also looking to the technologies which will power the future of financial information including blockchain, cloud computing and artificial intelligence.

As the information and technology needs in securities finance continue to evolve, we will remain on the cutting edge while always sticking to our core competency of delivering the highest quality global securities finance dataset. **SLT**

A moveable feast

Industry participants discuss why blockchain is so appealing

Brian Bollen reports

The past few years have been an exciting place to be in State Street's securities finance unit where emerging technologies hold the potential to transform a decades old business. While State Street is pursuing multiple applications of these technologies, one of the most promising is the use of blockchain distributed ledger technology (DLT) in securities lending. Over the past few years, State Street has actively been learning, experimenting and deploying new technology, blockchain included, into the securities finance business.

The reasons behind why blockchain is attractive to the securities lending industry are well rehearsed.

Frank D'Agnese, head of product and technology for securities finance at State Street, says: "Securities lending has traditionally been a very manual business. Given the extensive interactivity among market participants, automation at an industry level has been hampered by the challenge in defining standards. As a result, there is an inordinate amount of reconciliation that needs to be carried out on a day-to-day basis both internally and externally, rendering the process very labour-intensive. There is a real opportunity for distributed ledger technology to virtually eliminate that element of securities lending."

D'Agnese continues: "What we think makes blockchain so powerful is the potential that it has to transform the way that our business works today. The ability to digitise and do away with manual reconciliation and the impact that could have on the overall business model should not be underestimated."

Recent times have been fascinating both at State Street and in the broader marketplace. Nick Delikaris, head of trading and algorithmic strategies for securities finance at State Street, explains: "If you go back a few years it was all about bitcoin, but it is really the underlying technology (blockchain) driving the excitement now."

Delikaris adds: "As people dissected the underlying technology of blockchain, it was apparent there could be widespread uses for a broader transformation in finance."

State Street's securities finance business partnered with both internal technology groups as well as external financial technology providers to map out a use case in the business. The last two years have seen two proof-of-concepts created, which cemented how this technology could transform the business. Delikaris says: "It is important to note the seamless collaboration between the business and technology. Leveraging State Street's unique vantage point in the market and marrying the right skill sets of the people working on the project allowed us to build these proofs of concepts in just a few months."

A key part of the research and development process has been the hiring of significant technical expertise, particularly those with blockchain experience. These new employees have implemented the technology elsewhere, understand the possibilities as well as the constraints, and stay at the forefront of new developments through participation in and contribution to open source efforts.

D'Agnese continues: "That technical expertise combined with State Street's existing industry expertise is equivalent to adding one plus one and seeing the answer is three."

Beyond the immediate business case of reconciliation reduction, blockchain offers many future possibilities as well, one of which could include State Street's making data available to other parties, including regulators. This could clearly reduce the cost of compliance with the many directives currently affecting the organisation and others that are yet to be implemented. While the blockchain-based opportunity for cost savings in the near term and assistance with regulatory compliance longer-term is evident, there are further implications. Every individual securities lending programme has its own set of client-driven parameters relating to commercial terms and conditions, listing such things as approved borrowers and collateral restrictions.

D'Agnese suggests: "Imagine rolling some portion of these parameters out to clients to give them the power to control key aspects of their lending programme directly."

Delikaris points to the new regulations that the financial world has seen imposed since the global financial crisis struck a decade ago. He says: "Securities lending has become more complex in terms of tracking and transparency. Traders and lenders all have new constraints to think about in order to transact in an optimal way. The industry must move on from historical practices."

When asked who will benefit from the transformation enabled by a blockchain-based regime, D'Agnese remarked: "Everyone. The benefits of a more efficient product will be shared across the entire financial ecosystem."

"Fast forward a few years and we could potentially see atomic transactions allowing for near-instantaneous settlement, removing the concept of intra-day risk and the associated capital requirements."

A popular claim across the international financial services industry is that blockchain will be as transformative as the invention of the steam engine, the building of railways, the internal combustion engine and the internet. D'Agnese concludes: "Blockchain, however, is not a silver bullet on its own, but one piece of technology, albeit a very important one, in a larger jigsaw puzzle." **SLT**

The final countdown

With less than a year to go, the financial services industry should be well into the preparation stages of SFTR. As the final countdown begins, industry participants speculate on the challenges and opportunities the regulation could bring

Becky Butcher reports

With the Securities Financing Transactions Regulation (SFTR) implementation less than 12 months away, the financial services industry should be well into its preparation stage.

Following the recommendation by the Financial Stability Board (FSB) and European Systemic Risk Board (ESRB) to mitigate the inherent risks in shadow banking and increase transparency in the use securities lending and repo, the European Commission published SFTR in January 2016.

Securities financing transactions are any transaction where securities are used to borrow cash or vice versa.

Sejal Amin, head of membership services and events at ISLA, suggests that SFTR will fundamentally change the global securities lending market.

She says: "In terms of the UK, what is unclear is what role the Financial Conduct Authority will play in the context of SFTR in a post-Brexit world."

Andreas Ferrise, compliance officer, UnaVista, the London Stock Exchange Group (LSEG), explains that SFTR represents a "significant move towards enhanced transparency in the securities lending market and risks reduction associated with shadow banking".

However, Ferrise suggests that from a regulatory standpoint, market players will face various challenges once the regulation goes live in Q2 2019.

Ferrise notes that the collateral re-use practice could lead to complex collateral chains, especially referring to situations where there is extensive rehypothecation, meaning the same collateral will need to be reported several times.

Another situation, he suggests, could be where pools of collateral are used against multiple trades, causing difficulty allocating each element of the collateral against a specific transaction. He also explains that wila default on one transaction can cause a domino effect with other counterparties defaulting on their respective securities financing transactions if the same collateral has been used in all of these.

SFTR will require daily reporting of all securities financing transactions including securities lending transactions to ESMA as part of the financial stability mandate.

Andrew Dyson, CEO of the International Securities Lending Association, says: "We are still waiting for the European Commission to start the formal adoption process of the draft technical standards for the SFTR that were published by ESMA in March 2017, but we expect the reporting obligation, that sits with the parties to a securities loan, to commence in mid-2019."

SFTR covers EU counterparties, non-EU branches of EU firms and EU branches of third country firms. According to Ferrise, market participants are concerned about the involvement of non-EU counterparties in the reporting chain.

Ferrise says: "These may be impacted when they trade in securities financing transactions, as the reporting entities will be required to obtain certain information to fulfil their reporting obligations, for instance, the legal entity identifier (LEI) of their counterparty or matching unique transaction identifiers (UTIs)."

"When SFTR transaction reporting goes live in 2019 firms will be able to report all of their securities financing transactions to UnaVista. UnaVista is already an EU-registered Trade Repository for European Market Infrastructure Regulation (EMIR) and will be extending our capabilities to cover SFTR reporting."

The UK securities lending market and the rest of the financial services industry was "committed and worked very hard" for the launch of the second Markets in Financial Instruments Directive (MiFID II).

Ferrise explains: "It is evident now that market participants need to analyse the impact across firms in terms of resources and budget to be compliant in time for SFTR reporting."

"Currently, many firms are considering whether to assign additional resources for the completion of MiFID II and to begin the build-up and implementation of operational models and infrastructure for SFTR."

However, he suggests that this uncertainty may have a "detrimental effect on the success of other projects as SFTR".

He says: "It is quite evident by now that the SFTR is more than a simple trade reporting practice, which impacts a wide-range of financial and non-financial firms."

However, Ferrise adds that the real challenge for regulators is to ensure a high level of data quality. The industry should have already started planning and implementing all the necessary measures to tackle this mandate.

In ISLA's recently published Securities Lending Market Report, Jo Hide, trade repository SME at REGIS-TR, explains: "This time next year, we expect firms will be progressing well through their SFTR transaction reporting projects and gearing up to start sending the first records to trade repositories (TRs) across Europe."

"As with over-the-counter (OTC) derivatives before, this transaction reporting is a new endeavour in the securities financing and repo world, with new terminology, new workflows and, inevitably, new concerns arising as the reporting start date approaches,", Hide says.

Commenting further on SFTR, Hide cited ISO 20022 as a "great benefit" in preparation for the regulation."So much of the data validation is contained within the format definition—the successful creation of a file already guarantees the quality of a great deal of the data you're submitting, before it even reaches the TRs," Hide adds.

Hide concludes there are three main things that the industry can do to help make a success of SFTR. These include ensuring the unique transaction identifiers have not already been used for another trade and validating certain data against reference data lists—for example, legal entity identifier, currency codes, venue codes.

Records which pass all the checks will be submitted to the TR. For those which don't, the firm will need to correct the errors and re-submit the affected records within the reporting deadline.

The new regulation could also bring opportunity the industry. Broadridge recently suggested that incoming regulations, such as SFTR, that require vast amounts of data generation could pave the way for the introduction of artificial intelligence.

The data that will come from compliance with SFTR could allow firms to employ artificial intelligence to "second guess moves by counterparties, clients and regulators and central counterparties", Broadridge predicted in a recent whitepaper.

The paper stated: "For example, regulators may react to certain trends in the SFTR data that signal a buildup of risk by raising haircut floors or increasing capital requirements. If market participants can use artificial technology to predict better when this type of activity will occur, along with other key events such as bond market squeezes, then this can inform strategic decision making."

"This could provide an opportunity to apply cognitive computing algorithms against SFTR and EMIR data." **SLT**

ETFs firmly on the ground

As ETFs establish themselves in the securities lending market, industry players suggest that there is the potential for strong growth

Brian Bollen reports

As exchange-traded funds (ETFs) establish a firm footing in the securities lending market, market participants suggest that there is a potential for strong growth, especially as the European market continues to lag behind its US counterpart. However, lenders need to be sure that demand exists and would-be borrowers need to know that liquidity exists.

ETFs are bundles of securities such as stocks or bonds that track an index and can be traded on an exchange. They aim to provide investors with diversified access to specific markets.

For investors, ETFs have two potential sources of revenue from securities lending activities. Firstly, lending of the individual securities that make up the ETF—the proceeds of which aim to benefit fund holders in the form of tighter tracking to the benchmark index. Secondly, whole ETF units can be lent, providing the owner with the potential to earn additional income. Lending ETF units are no different to lending individual equities or bonds, as it is a transferable security.

Mohamed M'Rabti, Deputy Head of FundsPlace, Euroclear, said: "Market-makers say they want to lend, but there is no pool, while agent lenders say they want to lend, but there is no demand."

He suggested that the chicken and the egg in the ETF securities lending world is the equivalent to demand and supply.

Beyond the anecdotal, there is mounting hard evidence that ETFs continue their inexorable rise. Matt Fowles of the iShares Europe, the Middle East and Africa (EMEA) capital markets team at BlackRock, explains: "Figures from IHS Markit show that European ETF availability for lending has risen dramatically, up by around 80 percent in the last two years."

He adds: "The US ETF borrow market provides a useful lens on the direction of travel for Europe, as we develop into a well-established market where ETFs are regularly used to hedge portfolios."

Samuel Pierson, analyst at IHS Markit, agrees. Pierson suggests: "Flows into ETFs have contributed to the increasing supply for securities lending, which recently moved past $20 trillion globally."

Pierson says: "The lending of underlying shares is meaningful and securities lending revenues have increased," he adds. "The revenue generated by lending ETFs and their constituents have played a meaningful role in the trend toward lower fees for passive index products."

According to M'Rabti, securities lending involving ETFs "will increase in Europe".

He explains: "Currently in the US market, around 15 percent of the lendable pool is lent. The equivalent figure in Europe is just 5 percent."

One driving force is a result of Euroclear's work to reduce fragmentation in Europe by internationalising settlement into a single location, at Euroclear. M'Rabti says: "If you buy in one market, sell in another and need to deliver in a third, you incur higher costs and experience inefficiency."

"Adopting the international model delivers economies of scale which reduces costs and increases efficiency." He calculates that around 35 percent of total ETFs outstanding in Europe have already converted to the international model.

Another form of utility ETFs bring to the securities lending ecosystem is in the form of collateral. Jamila Jeffcoate, head of agency lending, EMEA at State Street Global Markets, says that ETFs have been an acceptable form of collateral in State Street's agency lending programme since 2012. "Our borrowers put forward suggestions as to

the ETFs they would like to pledge and we review those requests on a case by case basis," she says.

Jeffcoate adds: "We follow a rule of thumb regarding eligible criteria as opposed to a set in stone approach but we take geographic focus, market cap and liquidity into account as well as setting a minimum price threshold for each ETF we take in."

There are benefits both for lenders and for borrowers, she says. "Being able to provide an expansive collateral profile across all asset types has obvious benefits to the agency programme," she continues. "In terms of lenders, it provides additional opportunities for increased utilisation and enhanced returns. On the borrower side, it presents a cost-efficient way to pledge securities that are available as part of their prime businesses. We are adding to our eligible inventory for ETFs all the time, but the supply in European ETFs is still relatively thin compared to the US."

Simon Heath, head of agency trading for EMEA, State Street Global Markets, explains: "Clients are broadly increasing the amount of ETFs they hold, and the more they hold, the more they will naturally find their way into securities lending programmes."

Another driving force is increased in visible liquidity, thanks to the transparency delivered by the requirement imposed by the second Markets in Financial Instruments Directive (MiFID II) to report over-the-counter trading.

M'Rabtie also suggests that European interest in ETF unit lending will over time lead to a change in emphasis from the current operational focus on covering settlement fails and towards a more strategic long-term investment view, following in the footsteps of established specialist investors such as hedge funds.

According to Fowles, we are already experiencing this in Europe with borrower demand showing strong signs of evolving beyond traditional market maker activity. "We hear increasingly from hedge funds looking to use ETFs as efficient hedging tools and recently witnessed our Euro High Yield ETF (according to IHS Markit data) hit record on loan balances of $450 million as investors adopt a hedging tool for their portfolios."

ETFGI, an independent research and consultancy firm on trends in the global ETF/exchange-traded products (ETPs) ecosystem, recently reported that February 2018 marked 49 consecutive months of net inflows into ETPs listed globally.

The growth of ETFs is fuelling a surge in securities lending markets, according to IHS Markit in its Q3 2017 report. On average, there was 29 percent more ETF holdings in lending programmes over the quarter than Q3 2016. This surge in inventory, which has vastly outpaced the industry's assets under management growth, speaks to the increased adoption of ETFs among institutional investors, who provide a large part of the securities lending inventory.

Although inventories are rising sharply, demand and revenues remain concentrated, indicating there is still some way to go before ETFs become the go-to tool for actively traded markets. Increased interest on both sides of the equation, supply and demand, feed each other, says Fowles. "More demand will drive more revenues for investors, which in turn will provide more data and further demand from clients to lend. This is a classic virtuous circle."

For those uncertain whether to lend or not, the financial consideration could sway the decision one way or another. In an educational note published in July 2017, IHS Markit waxed lyrical about the possibilities for future ETF securities lending development, pointing to the revenue opportunities that exist. The ETF securities lending debate has largely revolved around what IHS Markit labels inside lending, where ETF issuers lend out the underlying assets purchased to replicate their chosen benchmark. What investors have historically been less aware of are the increasing opportunities and benefits from lending out the ETF units themselves, or "outside lending".

In several cases revenues from such outside lending, which is the prerogative of an ETF's ultimate beneficial owner, vastly outweigh those earned from the type of lending most commonly associated with the asset class.

In its treatise, IHS Markit identifies several ETF borrow demand dynamics. The forces driving demand to borrow physical ETF units are numerous, but the most common reasons include investors wishing to hedge assets tracked by an ETF, market making activity in the funds themselves, and the growing lists of derivatives that track them.

IHS Markit notes that although ETFs have been around for over two decades now, the asset class is still relatively underrepresented in the securities lending market, especially Europe, which means that the growing pool of investors looking to borrow ETFs often struggle to get their hands on the most in-demand lines. A quarter of the 2,200 ETFs that feature inside lending programmes have over half their inventory out on loan.

The combination of the constant demand for ETFs and the relatively high fees which can be drawn from this demand means that global ETF investors earned over $167 million from lending out ETFs over the last 12 months. This represents a return of 11.6 basis points on the ETF assets that are available in lending programmes over this period. As with the rest of the securities lending market, the bounty earned from lending out ETFs is unevenly distributed, with the 10 largest revenue-generating funds amassing one-third of all revenues.

For all the positive talk, much work remains to be done, cautions Euroclear's M'Rabti. It is important to continue to educate the market, he says, adding that Euroclear's annual collateral conference, industry papers, occasional roundtables and participation in industry working groups will help to achieve that goal. **SLT**

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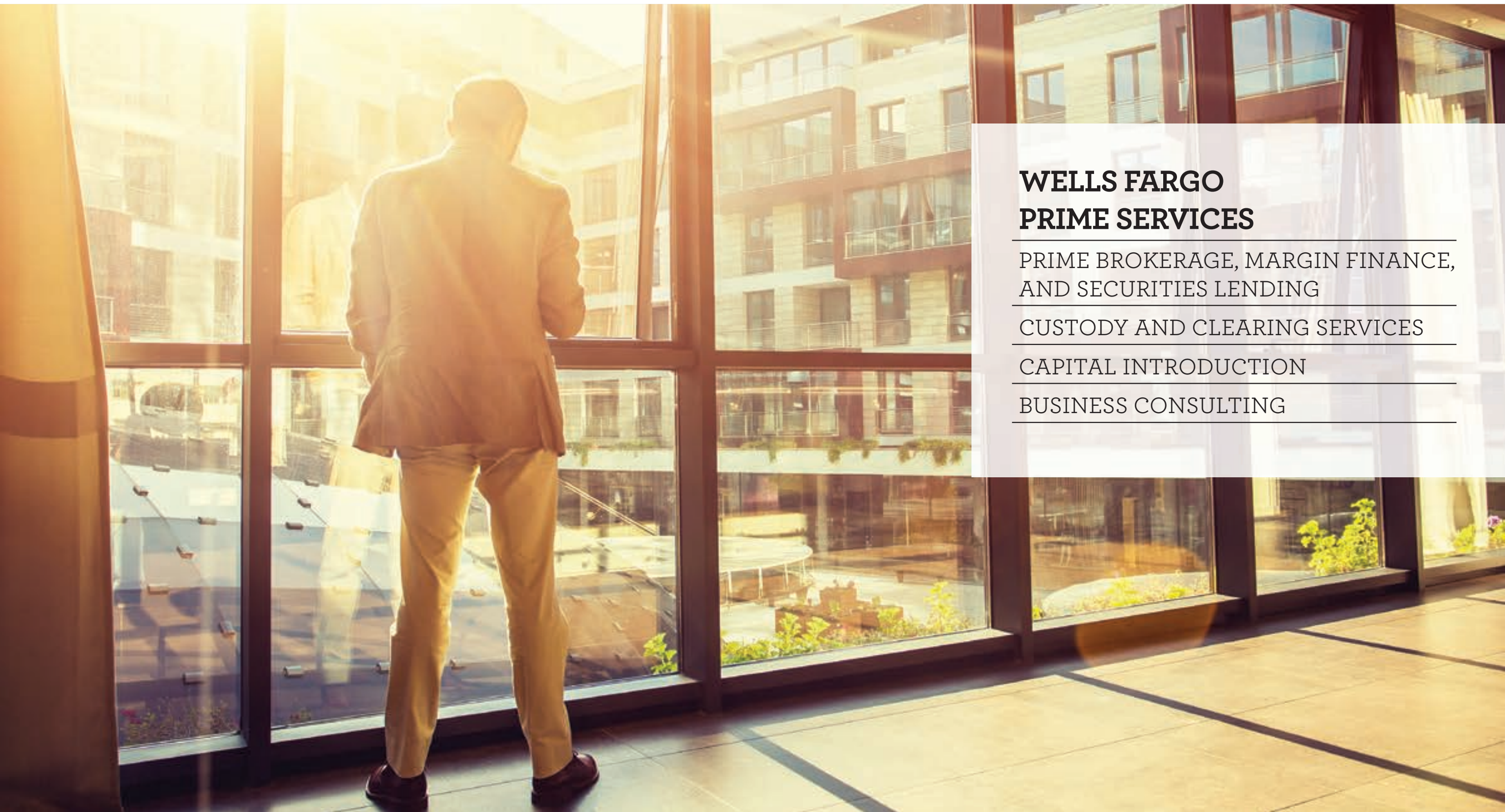

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Lending in the city of dreams

Growth in Hong Kong and Asia's securities lending market were hot topics at this year's PASLA/RMA conference

Becky Butcher reports

Attendees at this year's 15th Annual Pan Asian Securities Lending Association (PALSA) conference in Hong Kong heard how growth is continuing in Asia's securities lending market, an update on those individual markets within the region and challenges facing the industry.

During the welcome speech, Dane Fannin, co-chair of the conference and head of capital markets for Asia Pacific at Northern Trust, addressed a record-number of attendees revealing that Asia's significant growth profile is unlikely to change anytime soon.

Fannin suggested that conversations in this region are markedly "less defensive, more optimistic and focused more towards growth and opportunity, which is exciting, and it's not hard to understand why".

There are currently nine active lending markets in Asia, which continue to yield better returns than Europe and the US on a normalised basis, according to Fannin.

In addition, there are a range of emerging markets, such as the Philippines, India, Indonesia and China, which present "significant opportunity" for industry participants in the long term.

Fannin explained that from a beneficial owners perspective the industry is seeing increased engagement in many institutions, who recognise the benefits of a securities lending programme.

He added that there has also been an increase in assets under management from hedge funds in the region, which is helping to steer a healthy demand profile in Asia.

Fannin noted that spectators should not forget about Asia's fixed income and repo markets as they continue to develop. He suggested that this space is becoming a lot more relevant as firms pursue strategies of optimisation.

According to Fannin, there is a very vibrant securities lending market in Hong Kong and the securities lending framework is often used as a benchmark for others in the region.

Fannin said: "There is a lot of change here and the city does well to embrace the change, although it is not difficult to see why if one observes the successful implementation of innovative reform such as the connect platforms."

A separate panel was also held on securities finance in China and Hong Kong. The stock markets in Hong Kong and China have had a collaborative relationship since China's economic reforms in the 1980s. Since then many Chinese companies have since listed in Hong Kong. The securities markets trading links between Hong Kong and Mainland have become even more prominent since 2014 with the introduction of stock (Shanghai-Hong Kong and Shenzhen-Hong Kong) and bond connect platforms and more recently with the proposed exchange-traded funds (ETFs) connect between Hong Kong and the mainland.

During the panel, participants were asked to vote for what they thought were the key challenges to mainland securities lending expansion. Flying high as the biggest challenge was regulation at 80 percent, followed by inventory at 9 percent, willingness of market participants at 9 percent and information at 3 percent.

Commenting on the results, one panellist suggested that the landscape is still a little different in Hong Kong compared to the mainland, for example the difference in trading hours.

They explained that there is also a difference between the regulatory approach for the mainland authorities compared to Hong Kong authorities.

The panellist said: "There is a profile of investor difference, Hong Kong is predominantly participated by institutional investors, but if you look at the profile of securities that are eligible for lending, the Hong Kong market predominantly are Chinese-related listed names."

In terms of new developments, one panellist suggested that Hong Kong needs to improve the way it connects to mainland platform, via connects and their central securities depository.

The panellist said: "One example is Hong Kong's Investor ID initiative, which is due to launch this year. The new regime will be implemented for Northbound trading to entail the collection and use of personal data by the Stock Exchange of Hong Kong and its subsidiaries, as well as its transfer to the mainland exchanges and the China Securities Regulatory Commission."

The Securities and Futures Commission has also revealed that it would implement the identification regime for Southbound trading "as soon as possible" after the Northbound implementation.

According to the panellist, the regime will provide "a number of considerations" and allow mainland authorities to better identify who investors are and how they are investing in the market.

The panellist also explained that new developments includes expansion in the market because the current securities borrowing and lending (SBL) market is limited.

PASLA also presented an update to the ASEAN markets, which focused on the launch of the Philippines short selling infrastructure, due to launch later on this year. However, a PASLA board member suggested that 2018 might not be a "realistic launch date".

After a consultation paper was released by the Philippines Stock Exchange (PSE) in November last year on the launch of the Philippines short selling infrastructure, a PASLA executive committee member suggested that there is still work to be done in certain areas, one being contracts.

A panellist explained that contracts are "tough" from an offshore perspective because they are controlled by Philippines law, not by the US or Europe.

There was also a discussion around if collateral was to be held onshore or offshore. The executive committee member said: "We are seeking further clarity from officials in the Philippines. We need these to be more clear-cut before the market can evolve."

After the launch of the consultation paper in November last year, PASLA organised four dedicated board members for the Philippines from January this year to discuss the securities lending market and proposals they have implemented within the short selling framework.

A panellist suggested that the SBL model that is going to be used in conjunction with the short selling regime is going to be largely domestic-focused, but over time the PSE has indicated that they will look to encourage participants from offshore participants.

However, there will be restrictions on trading participants and also securities that can be short sold.

The panellist concluded: "As PASLA continues engagement with the PSE, we are looking forward to having more discussions throughout the year in making updates to the existing SBL model and the short selling rules."

The panel also discussed updates in Taiwan. The board member revealed that the country is set to make further updates to its SBL model this year.

The panellist suggested that in 2018 it plans to make post-trade processes more efficient by establishing a pre-matching system as well as an information-exchange platform to increase the efficiency of daily trading between brokers and custodian banks.

Last year, Taiwan also made steps to improve its SBL model. As part of the update, it introduced extended trading hours, released an SBL daily short selling limit, introduced relax qualification for participating systems, as well as extending the rollover time from once to twice.

Based on the upcoming changes and those already made in 2017, another panellist suggested that the "changes we have seen are very positive". They suggested that the rollover has been difficult to handle, so the extension was "great for us".

The panellist said: "Increasing the quota from 20 to 30 percent is a big increase."

According to a panellist, the Taiwan SBL market has remained stable for the last six years showing growth year-on-year since 2012.

During the panel, delegates were asked which market requires the most work to develop to full lender participation via an interactive voting system.

Taiwan was joint top with Malaysia at 37 percent. Thailand was in third place with 27 percent of the votes, followed by India with 3 percent.

The conference also focused on challenges in the industry. During one panel, attendees revealed that challenges from a lack of regulatory harmonisation remain the biggest hurdle in terms of managing the balance sheet.

Panellists asked delegates to vote via an interactive survey on what they felt were the biggest challenges affecting the management of the balance sheet.

Following on from the top answer, which was the lack of regulatory harmonisation at 35 percent, the second biggest challenge was the changing regulatory environment at 27 percent, followed by internal technology, structural considerations and restrictions at 19 percent and finally the development of systemic industry solutions at 8 percent.

A further 12 percent of delegates voted for 'all of the above' suggesting that all the challenges listed were affecting balance sheet management in some way. Panellists also agreed that all challenges were a hurdle when managing the balance sheet.

One panellist said you have to "manage challenges the best you can", while another explained that while tools and resources are good to help overcome these challenges, "tools are only as good as the input".

During the same panel, a second question was given to delegates, asking what solutions to capital constraints is the most important.

Both synthetic financing and specific counterparty selection come out on top, each receiving 27 percent of votes. Also on the list, was central counterparties at 24 percent and pledge at 21 percent.

Another panel discussed the growth and development of fixed income and repo trading across Asia Pacific, identifying key opportunities for participants. It also focused on the development of these markets in Asia relative to other major trading hubs, outlining some of the key issues likely to challenge future growth.

During the panel, attendees were asked via an interactive survey what factor drives future participation of your institution in the Asian fixed income repo market. In total, 40 percent of those who responded suggested that the biggest factor driver was to service the requirements of buy-side clients. This was followed by 33 percent of respondents voting that opportunities to invest surplus cash and liquidity was a driver.

One panellist said: "I was surprised to see the figure for opportunities to invest surplus cash and liquidity so strongly, you might see this as a good sign for the region and could be a positive thing."

Another panellist explained that the industry doesn't actually know how big the market is because there are limited statistics available.

He explained: "After speaking to market participants it's quite clear that banks and the broker dealer community have experienced some growth over the past five years."

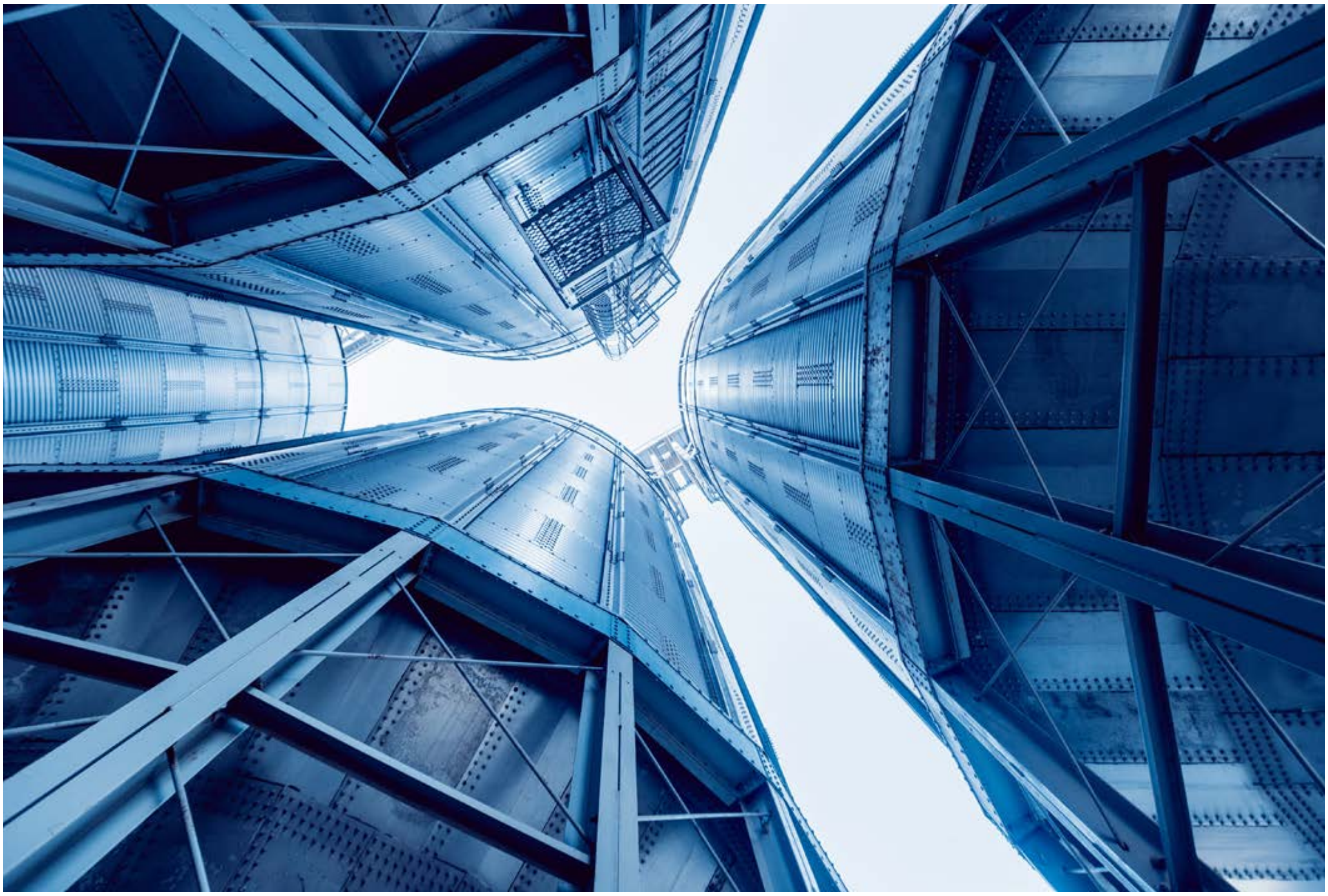
Other drivers included access to liquidity pools to borrow US dollar funding, access to liquidity pools to borrow local currency funding and borrow or lending securities for 'short cover' transactions.

Attendees were also asked what they thought could trigger Asia's growth in repo. Just over half (52 percent) of those who responded suggested that a regulatory push towards secured funding and more liquidity could trigger a growth, while 28 percent of respondents voted for the removal of legal/tax restrictions.

The use of collateral for investment management leading to collateral management expertise and creation of a pan-Asian collateral basket both received 10 percent of the vote from respondents.

Commenting on the results, a panellist said that having the right legal and tax framework is a first condition, repos have to be recognised in domestic law and must be enforceable in case of an insolvency situation.

The panellist added that it is also important to have the right framework to connect other regional players and international players to the market. **SLT**



Breaking down the silos in securities finance

William Gow and Nicholas Gant of Societe Generale discuss the benefits of moving to a more centralised clearing approach and the changing demands of the European securities lending market

Jenna Lomax reports

What are the benefits of a more centralised approach?

Nicholas Gant: The move to more centralised clearing enhances the ability to manage collateral effectively across asset types. Each of the past two year-ends has seen a squeeze in the liquidity of the repo market, which has made efficient management of capital even more important.

William Gow: From the agency lending side, the breakdown of silos and the bringing together of different asset classes—of equity and fixed income—allows for far more efficient balance sheet management and better management of scarce resources. That's particularly important when treasurers and counterparty banks need high-quality liquid assets to cover their liquidity coverage ratios (LCR).

We see more and more collateral upgrade and downgrade trades. That's really where the market is from an agency lending standpoint, and the merging of different asset classes has made a significant difference to efficient management.

But, while we see a movement in that direction, I don't think everybody has broken down these silos yet. It comes down to politics and people not wanting to give up their profit and loss; there has to be a firm-wide push to make these synergies work.

Gant: Traditionally, while the equity and fixed income divisions would have some similarities, they were seen as distinct and separate parts of a bank. Some of our peers have the prime brokerage department within the equity division, while others have it in fixed income. That means other influences can get in the way of what should be a practical decision.

Gow: Positioning prime brokerage as a separate division on its own enables collaboration; prime brokerage can do joint ventures with either fixed income or equity teams, or anyone else in the bank.

Gant: We decided to adopt this centralised approach in 2014, chiefly motivated by the centralisation of risk and optimisation of collateral across asset classes. Now each function that you would associate with a prime brokerage is in one area. With all the prime brokerage-focused activity in one division, we can be nimble and add extra pieces if it suits the client.

How has Societe Generale tackled the transition?

Gow: The agency lending side used to sit within our securities division. Bringing that into the prime brokerage has enabled us to invest in and develop the platform. This is valuable. In addition to sourcing mandates from our custodian, we are very focused on third-party and non-traditional agency lending, adding collateral and inventory optimisation to our offering for our clients. It is just looking at things slightly differently.

Gant: We all have dialogue across all teams on a daily basis just to see what we can optimise between us. I am agnostic as to whether we are providing our customer with a principal solution or an agency solution. The idea is that we have multiple offerings and then choose the one—or ones—that are most appropriate to give an individual client a better experience.

If you look at the historic model, prime brokerage was the liquidity provider for the client. The regulatory shift has brought a reduction in the capacity for all banks to provide liquidity. We are here to provide liquidity, but can also provide other solutions so clients have access to liquidity and can efficiently use scarce resources through a mix of agency and principal offerings.

What new initiatives are addressing the changing demands of the European securities lending market?

Gant: The 2016 year-end spike in the repo market was very well documented and very severe. 2017 had a much more orderly year-end, but that had been flagged well enough in advance.

The International Capital Market Association (ICMA) posed the question of what would happen if there was a sudden market shock. One institution made the point that it had 14 liquidity sources during the month, but this dropped to four at the month end. That is enough, but what happens if that four drops down to two? They wanted to ensure some future-proofing of their liquidity. As part of our suite of products, that's something we felt we should be offering our clients.

Historically, client repo market activity was governed by multiple global master repurchase agreements (GMRA) between clients and their liquidity providers—typically the banks—who could then partially or fully hedge these repos with other banks either bilaterally or through central counterparties (CCPs) such as LCH and Eurex. The buy side did not have access to the deep liquidity pools and balance sheet netting opportunities available when trading into the CCP. However, this is now possible through a sponsoring model, and Societe Generale sponsors clients into the CCP, thus allowing them to reduce administration and increase liquidity.

How has increased disintermediation contributed to the markets' evolution?

Gant: We see disintermediation as an opportunity. In general, there is a requirement to make maximum efficient usage of scarce resources—at bank and client level. The most efficient possible management of the collateral process and the inventory is part of that. If we are offering both agency and principal, that allows the client to maximise their return on their collateral pools as well as their usage of their collateral pool.

Gow: Banks in many respects are contributing to disintermediation themselves by promoting agency platforms. It's effectively taking flow off the balance sheet so by default they are disintermediating that connectivity. But banks still want to have that client relationship, and an agency model is an efficient way of maintaining that.

Electronic platforms can allow clients to trade directly themselves, but banks will provide a service, which involves more heavy lifting, the back-office outsourcing functionality.

In reality, banks aren't going to be completely cut out of the picture. Clients still need banks and like the credit intermediation that banks offer. And banks, although often much maligned, still have very good technology—and the resources to be able to service that technology.

Gant: Maybe the role of the bank is slightly different to what it was 15 or 20 years ago. The cost of capital has risen over the past 20 years, and I would be surprised if it goes down again. From the bank's viewpoint, it's about making the best use of the resources available, providing the services that are the best fit for the customer, and embracing the opportunity that comes from a change in market practices.

Are there any particular challenges that come from conducting business across international markets?

Gant: All challenges come down to mindset. You can look at anything as a challenge, but if you're nimble enough and your DNA and mindset are built around providing solutions for your clients, then it's not so much a challenge as an opportunity to provide something for our clients. **SLT**

Keeping up with collateral

Market players discuss the changing landscape of the collateral industry

Panel participants

Todd Crowther
Business development and head of client innovation
Pirum Systems

Roberto Verrillo
Head of strategy and markets
Elixium

David Raccat
Founder and CEO
Wematch.SecuritiesFinancing

Graham Gooden
Executive director of collateral management
J.P. Morgan

Ted Allen
Director of business development, Apex Collateral
FIS

Martin Seagroatt
Marketing director
Broadridge

Regulation is often a catalyst for technological and operational change, how is the collateral industry changing?

Todd Crowther: Collateral management has become more complex by way of regulation based on the proliferation in the amount of margined products and venues as well as the number of affected geographies and participants. Furthermore, regulation has also adversely affected the overall cost of collateralisation both in terms of the price of collateral (demand and supply) and the capital impact (or returns impact) to market participants.

Firms need solutions that offer simplified and centralised inventory and position management, a cost-effective and efficient means of processing margin exposures and the corresponding delivery of eligible collateral as well as optimisation tools, which enable best use of inventory and/or collateral.

Martin Seagroatt: Regulation is driving operational improvements in the entire end-to-end collateral process, facilitated by technology. As the number of firms impacted by collateral rulemaking expands this will continue to promote industry-wide change. The biggest change is the sheer amount of collateral required, particularly on the buy side. Collateral requirements have significantly increased due to mandatory clearing for certain asset classes of over-the-counter (OTC) derivatives as well as the collection of margin in respect of uncleared OTC derivatives between certain types of counterparty. At the firm level, different collateralised trading activities are converging into a centralised function and this is supported by technology solutions for managing global inventory and collateral across products in one place. This in turn is enabling a significant proportion of the industry to optimise collateral in some form or another.

> *Regulation has also adversely affected the overall cost of collateralisation*
>
> **Todd Crowther**
> Business development and head of client innovation
> Pirum Systems

We are beginning to see industry associations such as the International Swaps and Derivatives Association, the International Securities Lending Association and the International Capital Market Association facilitate collaboration between market participants on industry standards to meet the demands of regulatory reporting mandates such as Securities Financing Transactions Regulation (SFTR), European Market Infrastructure Regulation (EMIR), Dodd Frank and the second Markets in Financial Instruments Directive (MIFID II). The resulting improvements in data quality and management across the industry will lead to significant efficiencies.

In parallel to this, a more integrated and networked collateral ecosystem is emerging with the rise of peer to peer/all to all networks, collateral trading platforms, collateral highways and potentially blockchain solutions for mobilising collateral.

> ***The collateral industry is looking for solutions that can streamline and upgrade their businesses for this new world***
>
> **Roberto Verrillo**
> Head of strategy and markets
> Elixium

Graham Gooden: Regulation has intensified the focus on sourcing, mobilising, and allocating collateral optimally. As collateral moves from a largely back office function to an important component of front office decision-making, we are seeing corresponding changes in technology and operations.

Firstly, institutions are working on making their own processes and decision-making more efficient. Many sell-side firms are focusing on optimisation strategies, building algorithms that help them allocate collateral based on their own binding constraints.

Secondly, we see enhanced collaboration on common goals such as SFTR or Pledge, where industry participants are working with each other, technology solutions or service providers to define a 'networked' solution. These require broad adoption to be effective, and may face challenges in competing for finite resources given that mandatory requirements will take precedence.

Thirdly, emerging financial technology options are capturing the imagination with new, potentially innovative solutions. Commercial use cases and operational viability are hot topics as these options move from the hypothetical to the realistic and the impact on the collateral ecosystem is better understood.

Ted Allen: These are interesting times for collateral managers and many are turning the challenge of regulation into an opportunity for change. They have the attention and focus of their organisations they may not have had in the past. Collateral managers now demand a centralised view of collateral assets across securities lending, repo, OTC and listed derivatives and the tools to optimise how that inventory is allocated across lending, liquidity and collateral programmes. EMIR, Basel II, Uncleared Margin Requirements (UMR) and MiFID II combined have driven the industry to innovate to minimise collateral costs and to automate to handle the huge increase in collateral movements. Specifically we see three main trends: insourcing of lending programmes to maximise yield; insourcing and centralisation of collateral operations to minimise cost and ensure control; increasing use of market utilities: CCPs, triparty, electronic messaging and so forth.

David Raccat: The collateral industry is changing dramatically these days. Regulation is obviously pushing for more transparency, more price discovery, best execution, reporting to trade repositories, and all those initiatives are a very strong catalyst for technological innovation. Platforms have the ability to accompany the market into this journey and usually embrace those changes. Regulation is offering very exciting opportunities for technological innovation and is leading the market to the next level.

Roberto Verrillo: Following the 2008 financial crisis, governments and regulators instigated capital requirements on the industry which severely curtailed the availability and consequently the cost, of executing business. Secured financing, being a high volume low margin business, got hit hard and banks had to pass the costs on to their customer base.

Further regulatory pressures, mandatory margining of OTC products, Net Stable Funding Requirement (NSFR) and eventually SFTR are all aimed at increasing transparency and improving the resilience of financial markets but the unintended consequence is that it has a direct impact on the pricing and liquidity provided by traditional intermediaries.

The collateral industry is looking for solutions that can streamline and upgrade their businesses for this new world. From trade execution via all-to-all trading platforms such as Elixium to post-trade and margin processing and reporting.

How has the increasing use and developments with central counterparties (CCPs) affected the collateral marketplace?

Gooden: CCPs are a potential enabler for securities lending and continue to be the subject of ongoing discussion in securities financing. In the absence of a mandatory imperative, however, CCP adoption will be a very considered decision with the relative advantages and disadvantages reviewed by the whole supply chain. The benefits will need to be clear and compelling, as widespread migration to a new model will require a significant resource commitment, and widespread adoption will be needed to attract the critical mass that will ultimately deliver significant benefits.

Progress is slow but steady, with indications that some participants may move to CCPs for selective trades, counterparties or markets. For other activities, options such as pledge structures may offer similar benefits without the need to overhaul the existing end-to-end model or adding new participants into the system.

Verrillo: The use of CCPs to help access liquidity is clearly something which some counterparties may well find attractive. A number of buy-side firms are engaging with different CCPs in order to evaluate whether clearing the repo and swaps side of their businesses provides sufficient benefits—for some the CCP route to market may well be a preferred route.

Crowther: The phased implementation of mandated central clearing means that more products as well as more participants will be increasingly caught up by the requirement to post margin and manage collateralised exposures with counterparts. The global nature of these regulations means the process of margin and exposure management should now be managed holistically across different time zones, to strict regional cut-offs, along differing eligibility rule sets and over an expanding set of margin venues as well as individual account structures.

Allen: Central clearing has completely transformed the OTC derivatives markets. Now around 75 percent of all OTC derivatives by notional are cleared and although not all buy side firms are mandated to clear, still over half of the initial margin posted comes from the buy side.

In total the CCPs globally tie up about $750 billion in initial margin and default funds, primarily government bonds and cash. This extra demand for high quality liquid assets increases the value of an optimisation programme.

The decision to clear or not to clear for those firms that are not mandated is based on price, liquidity and cost of collateral and in the OTC derivatives world. More sophisticated banks are calculating Margin Value Adjustment (MVA) to understand the cost of initial margin at a trade level. Although the trend is not yet to pass this on to the end clients, this will probably change in the future.

What trends are we observing around the reuse of collateral?

Raccat: At the moment it looks like beneficial owners still do not benefit from re-use options, but we hear more and more lenders challenging the current model as their own collateral needs will dramatically increase with upcoming new regulations, for example, EMIR.

Crowther: It is difficult to see trends when there currently is not a lot of granular data available. This is currently proving to be a challenge in regards to SFTR reporting.

Verrillo: Collateral re-use can limit certain counterparties ability to access markets, segregation of collateral accounts for these counterparties are being looked at by tri-party providers.

Allen: We see the expansion of the use of triparty agents as the location for collateral across asset classes. This consolidation of collateral pools allows for operational simplicity, removes settlement risk and with the right collateral platform firms can monitor settlements and positions in real time. However we see increasing demand for solutions allow banks in particular to optimise their asset allocations across their triparty agents and their bilateral collateral requirements for all asset classes. The triparty agents will only have the view of inventory and log box within their domain but when firms have to allocate assets across more than one agent, to bilateral counterparties and to CCPs, they need a global view of inventory and an optimisation solution.

At the moment it looks like beneficial owners still do not benefit from re-use options, but we hear more and more lenders challenging the current model

David Raccat
Founder and CEO
Wematch.SecuritiesFinancing

Gooden: Collateral reuse supports liquidity raising in times of stress and assignment of the right collateral to the right entity to facilitate optimal allocation. This is particularly important as firms seek to move collateral to different legal entities globally as they decentralise and fund locally.

Reuse could also be used to reduce the net collateral requirement firms must post for initial margin. Given that uncleared margin rules for segregated initial margin have resulted in a net increase of collateral of over $100 billion, firms are looking to reduce the sourcing costs of that collateral by reusing received assets as part of their securities lending or repo transactions.

Is the US still dominated by cash as collateral and Europe as equities? How does Asia compare?

Crowther: We are seeing increasingly strong demand for triparty connectivity (non-cash collateral) in both the US and Asia as the demand for more efficient means of collateralisation (and best use of assets/inventory) is trickling down to each region. Reg 15c3-3 in the US will certainly be driving some of this demand as the scope for non-cash collateralisation expands across a wider participant set.

Even before 15c3 comes into play, there is an increasing requirement for non-cash collateral management in the US relating to US Treasury and other fixed income collateral.

Verrillo: High-quality liquid assets is the focus of all markets given the aforementioned regulatory push, coupled with a drive for collateral and cash margin efficiency.

Gooden: In the US, we see a shift to non-cash fixed-income collateral where possible, backed by collateral providers who are eager for related capital benefits. Further, potential rule changes could eventually allow equities to be used as collateral in certain securities loans. Given available dealer equity inventories, that would significantly shift the US market to act more like the European model, and could result in some existing European and Asian business moving back to the US. Europe remains a mix of equity and fixed income as collateral, with regulatory-driven binding constraints dictating the mix of an individual firm's financing strategies and assets deployed. In Asia, we see a balanced mix of cash and non-cash collateral. For cash, USD and EUR are the dominant currencies, followed by local currencies (AUD, HKD, and JPY). In non-cash collateral, JGB is most widely used followed by Hong Kong and Australian equities. We also see significant interest in unlocking assets in difficult-to-finance markets such as Korea and Taiwan and using them as collateral. These local markets require specific local solutions: we have worked closely with local institutions and regulatory and industry bodies to successfully develop and deploy these market solutions.

> ***To operate effectively, these tools must have out of the box connectivity to CCPs, triparty agents, custodians, SWIFT and other electronic messaging platforms***
>
> **Ted Allen**
> Director of business development, Apex Collateral
> FIS

Raccat: The US market is still very much weighted with cash collateral, and the Fed rate hikes might consolidate this trend with increasing opportunities on the cash reinvestment space. In Europe and in Asia we see a lot of non-cash collateral axes, especially on the upgrade space, where lenders are pushing high-quality liquid assets government bonds against equities and/or corporate bonds as collateral. We also see an increasing pressure to post exchange-traded funds (ETFs) as collateral.

Have we seen any changes in clients collateral allocation and their available assets based on pre-established eligibility?

Gooden: Yes, clients are seeking to minimise the overall cost of posting collateral, considering the capital and liquidity impacts under various regulatory regimes. They are taking an 'all in' view of the cost of posting collateral with respect to its implications for risk-weighted assets, liquidity coverage ratio and net stable funding ratio, to name a few. This requires a holistic view of their global inventory, including the source of the assets (proprietary or client), to understand how they are priced or best allocated internally. This information is overlaid on asset quality, counterpart and tenor in order to make more sophisticated optimisation decisions that help clients retain existing business at profitable margins and compete for new business in an increasingly competitive market.

This front office focus on collateral must complement the operational requirements of running a collateral book. Translating a theoretical view of the most optimal allocation, based on that day's binding constraints, to an actual and efficient operational deployment across multiple settlement locations and counterparties can be challenging. As a triparty agent, we see that challenge first hand, and work closely with our clients to provide tools and data that help them identify optimal collateral allocation and then execute efficiently.

Verrillo: Clients are increasingly willing to make high-quality liquid assets available for upgrade vs lesser quality collateral via collateral upgrade trades.

Crowther: This is a main focus for industry participants and one of the main benefits of our new CollateralConnect product. A technical solution to collateral efficiency has to be quick, easy to use, and intelligent in order to add true value to the process. Visibility and efficiency are central to the decision making process; the ability to make effective exposure coverage decisions around 'what collateral needs to be used where and when' is based on the multitude of factors that affect whether the decision is an optimal one.

What can technology do to take the market to the next level of efficiency?

Crowther: A better question is 'what can't technology do?', to which we would answer technology has the power to improve any logical process. Nevertheless, as an industry we are cost constrained, hence the smart firms are increasingly looking for technology vendors to act as outsourced partners for development. These firms in turn benefit from delivered solutions which give the highest return for the most reasonable, socialised cost.

Allen: Securities finance and collateral management are now combined in many firms where collateral managers are able to achieve a big picture view of collateral assets supporting OTC and listed derivatives, repo as well as securities lending and potentially insurance collateral and other requirements. This requires enterprise tools that can operate across the traditional asset class silos. To operate effectively, these tools must have out of the box connectivity to CCPs, triparty agents, custodians, SWIFT and other electronic messaging platforms. Apex from FIS provides a single platform to manage, trade and optimise inventory across all the silos. Our clients typically see a five to 15 basis points drop in the cost of collateral and significant benefits from the efficient workflows and standard connectivity to market infrastructure. Savings such as these drive the business case to invest and renew technology.

Gooden: Technology solutions are key to increasing efficiency and scalability. They have been most successful when deployed against a specific problem, but we also see new technology driving a variety of services that can be plugged into the collateral ecosystem.

> ***Technology solutions are key to increasing efficiency and scalability***
>
> **Graham Gooden**
> Executive director of collateral management
> J.P. Morgan

Interoperability, industry solutions such as CCPs, vendor solutions, and the ability to assemble components into partially bespoke solutions are giving institutions more choices than ever before in managing their financing and collateral portfolios. The traditional supply chain is likely to expand to include non-traditional solutions; however, new options will require adaptation and adoption to be effective.

Regulatory compliance remains a principal focus of investment, with technology solutions being developed to meet SFTR reporting requirements (aggregation of data across multiple entities and data points) as well as inventory management as legal entity structural changes increase the bifurcation of collateral pools. We believe that technology and the efficient use of data is at the heart of any investment strategy and—for all the talk of disruption—view technology as an enabler.

Seagroatt: The regulatory reporting mandates are pushing the industry towards better data management and increasing standardisation of how data is reported from one firm to another. These improvements will lead to major operational efficiencies, especially when coupled with simpler views of complex data in one place, across business lines at the firm level. Initially, it looks like there will be a significant number of breaks in matched data reported through SFTR. However, as the industry adjusts to this it should result in a more streamlined process for everyone.

We are now also seeing more advanced pre and post-trade analytics around the impact of a specific trading activity, counterpart, client, trading venue or collateral selection on profit and loss, and once again this is driven by better quality data. For example, in derivatives trading, firms are starting to factor collateral costs into pricing and profit and loss, leading to margin value adjustment (MVA) calculations (MVA), although this is still a subject of some debate.

As artifical intelligence continues to develop, we will see predictive analytics that can utilise an ever growing volume of big data to guide collateral and liquidity management strategy. There is also still scope for greater automation in our industry; once again we will begin to see artificial intelligence driven robotic process automation solutions emerge to take a lot of the manual effort out of collateral management, freeing up time for strategic decision making.

Finally, solutions to improve collateral mobility will make it easier to get collateral to where it needs to be in a timely manner and to unlock idle liquidity.

Increasing volumes of electronic trading will also reduce manual effort and enhance straight through processing through the ability to better integrate a firm's global inventory with opportunities to trade collateral in electronic markets and networks.

Raccat: Technology can help on multiple angles. Platforms can embrace the upcoming regulatory requirements around best execution, price discovery, transparency, reporting to trade repositories, and more automated and systematic risk management. Connectivity is another dimension where technology can help users benefit from operational efficiency and neutralised operational risk.

Finally, execution venues/trading platforms can develop machine learning and artificial intelligence to optimise dealer's time, and help them focus on value-added processes. Those concepts are a bit new in our industry but so far have been very well received by individual users, who immediately see the benefits on the day-to-day activity.

> ***As artifical intelligence continues to develop, we will see predictive analytics that can utilise an ever growing volume of big data to guide collateral and liquidity management strategy***
>
> **Martin Seagroatt**
> Marketing director
> Broadridge

Verrillo: Technology can help provide connectivity to new market participants and liquidity, as well as providing a centralised marketplace which provides for best price execution and through which all trade reporting and compliance can be achieved as well as providing for straight-through processing and connectivity to CCP's and triparty service providers. **SLT**

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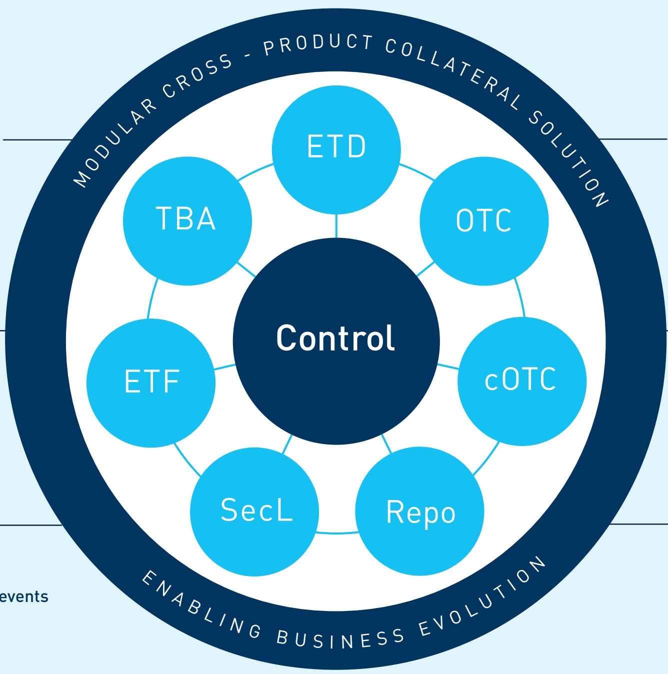

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Lawson's view

A trip to 'Not So Happy Valley'

I recently attended the 15th Annual PASLA/RMA Conference on Asian Securities Lending in Hong Kong, a fantastically well-run conference at the J.W. Marriott Hotel. Unfortunately, for me personally, things did not run as smoothly as they could have.

After the conference drinks reception on Wednesday evening, a trip to Happy Valley, the local horse racecourse, was in order. Lots of other attendees of the conference were due to be going along, so why not? Sharing a taxi on the way to the Happy Valley Racecourse I felt my mobile phone vibrating in my jeans pocket.

Choosing not to answer, I waited till I got out of the taxi to reach into my pocket and get the phone out. However, after checking all my pockets, it dawned on me that it had either fallen out into the taxi or been lifted from my pocket. A great start to the evening.

Not even the cheap entrance to the racecourse of HKD 10 or a few beers could lift my spirits. I was probably the most miserable person in attendance. After already starting the night on a loser, I chose not to back any horses for fear of losing even more!

The evening got even more depressing when on the way back to the hotel, walking along with a colleague and another conference delegate about a thousand taxis refused to stop to pick us up, no matter how I tried to hail them, which resulted in a 45-minute walk. The only shining light of this whole debacle was that the hotel offered to phone the police and make a report for me, posting the crime reference letter under my door for me to find in the morning. First-rate service by the hotel indeed.

The great adventure

The past few weeks have amazed me with the number of people leaving roles or in some cases, the industry.

Jeff Bonaldi has left Citi after serving there for more than 12 years. He has left the industry to dedicate more time to grow his adventure travel company, The Explorer's Passage, of which he is founder and CEO. Anyone who worked with Bonaldi knows that this was always on the cards with his love of adventure.

Bonaldi served as Citi's Americas head of sales for its agency securities lending, collateral management, and separate account cash management businesses.

I would love to think having read this you will have a look at his website: explorerspassage.com.

Another departure of note, which comes as a surprise, was the person who gave me the idea for Securities Lending Times, Sunil Daswani, who left his role as head of international securities lending at Northern Trust.

Daswani, who had worked at Northern Trust since 2002, was head of international securities lending for Europe, the Middle East and Africa, as well as the Asia Pacific from 2015. He also served as PASLA Chairman from 2004 to 2008.

One more to mention is Benga Sofoluwe, who I caught up with while in Hong Kong, he is leaving his role as managing director, regional head of securities lending and delta one sales, Asia Pacific, at Citi. Sofoluwe, who was based in Hong Kong, joined Citi in 2014 to run the bank's equity finance desk.

We wish Benga more joy in his job search than his beloved West Ham are experiencing this season

Short demand on the rise in Europe

Samuel Pierson, Director of securities finance at IHS Markit reveals that short demand for EU equities has continued to increase in early 2018

- EU short balances are up 18 percent year to date
- Spain has the largest short increase, on a country basis
- Materials is the sector with the largest short increase

Short demand for EU equities has continued to increase in early 2018, a trend which started in March of last year. In dollar terms, the current short position is $188 billion, just below the post-crisis high of $193 billion observed on 16 February.

Among the ten largest securities lending markets, Spain has seen the largest year to date increase in short demand, both as a percentage of total market capitalisation as well as in nominal terms. The Spanish stocks which most contributed to the increase were Siemens Gamesa Renewable Energy and Abertis Infraestructuras.

The only countries in the EU with declining short demand in 2018 are Poland, Portugal, Hungary and Turkey. The combined decline of those four is only $300 million, compared with an overall increase of $28 billion throughout the EU.

Taking a sector view of the EU reveals some interesting trends. Stocks in the Materials industry have seen the largest year-to-date increase in short demand, both by percentage of market cap and nominal value. Part of that increase is Anglo American, where a large portion of short positions are known to be a hedge against convertible bonds sold to help Indian billionaire Anil Agarwal acquire shares in the firm. That is only part of the story, however, as Materials would have still notched the largest nominal increase even without the nearly $1 billion increase in Anglo American.

Putting AAL aside, the next two largest short demand increases in materials were for shares of Lafargeholcim and Glencore.

On the flip side, it's interesting to note that retailing is among one the industries which have seen the largest year-to-date reduction in short demand. The retail sector has been out of favor in recent years, so while the reduction in short demand is coming off a relatively high base, the exit of some short sellers may suggest the easy profits may have been had. A similar story is emerging in the Commercial and Professional Services industry where, for example, the price decline in Capita has seen both market capitalisation and short demand decline by 50 percent year to date. Given that Capita made up a much larger portion of total short demand than total market cap, the decline in valuation puts downward pressure on short demand as a percentage of market capitalisation. **SLT**

Sector	Short Loan as % Mkt Cap	YTD Delta	Short Loan Balance	YTD Delta	YTD Delta %
Commercial & Professional Services	0.53%	-0.05%	$ 4,291	$ (245)	-5%
Retailing	0.19%	-0.05%	$ 8,850	$ (776)	-8%
Food & Staples Retailing	0.40%	-0.04%	$ 8,124	$ (45)	-1%

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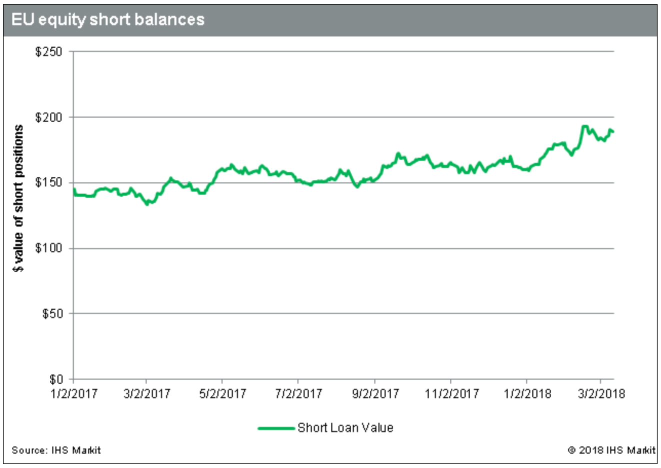
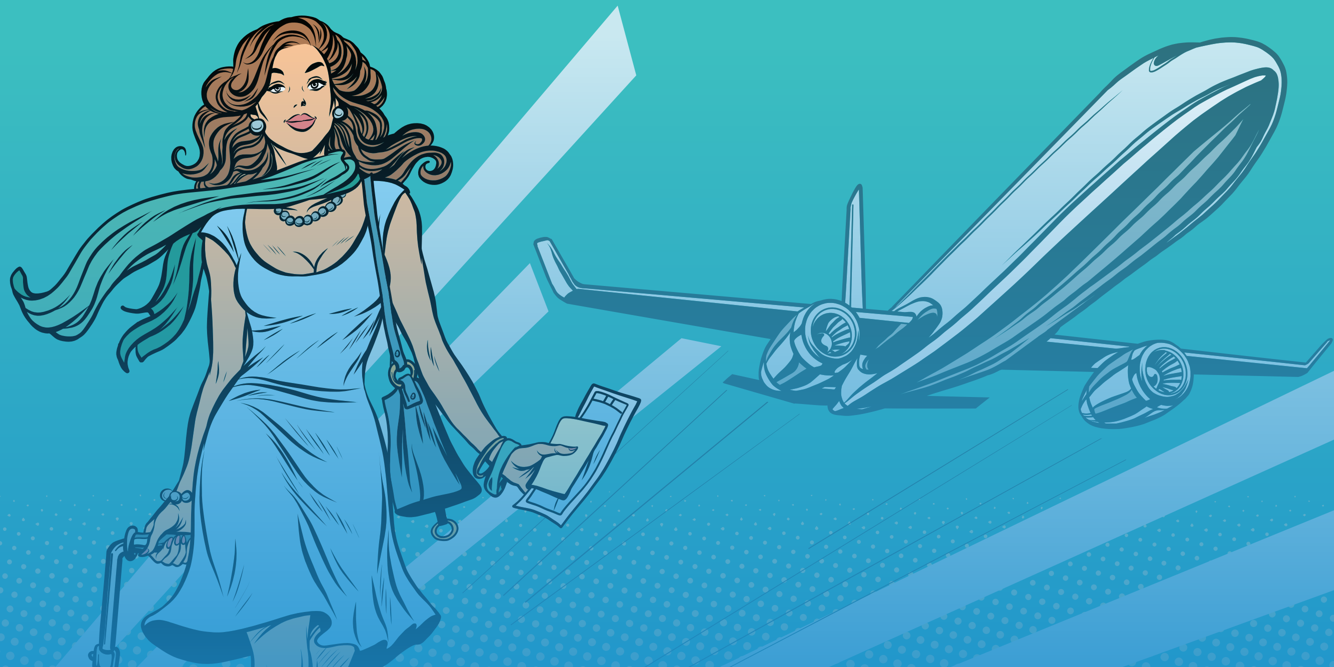
	Short Loan as % Mkt Cap	YTD Delta	Short Loan Balance (USD)	YTD Delta	YTD Delta %
European Equities	0.16%	0.02%	$ 188,766	$ 28,300	18%
Spain Equity	0.50%	0.15%	$ 7,134	$ 2,129	43%
Finland Equity	1.35%	0.13%	$ 5,308	$ 737	16%
France Equity	0.50%	0.10%	$ 27,422	$ 6,124	29%
Denmark Equity	1.15%	0.10%	$ 6,175	$ 497	9%
Sweden Equity	1.02%	0.09%	$ 15,402	$ 1,628	12%
Netherlands Equity	0.44%	0.08%	$ 9,892	$ 1,843	23%
Italy Equity	0.36%	0.02%	$ 12,279	$ 1,017	9%
UK Equity	0.24%	0.01%	$ 44,591	$ 4,088	10%
Switzerland Equity	0.13%	0.01%	$ 21,026	$ 2,369	13%
Germany Equity	0.05%	0.01%	$ 26,206	$ 6,004	30%



Samuel Pierson
Director of securities finance
IHS Markit



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Comings and goings at BNP Paribas, Citi and State Street

Matthew Pinnock has recently left his role as head of prime brokerage in Europe, the Middle East, Africa and Asia at BNP Paribas.

Pinnock joined BNP Paribas in 2012 and was based in the firm's London office.

Previously, he served at Nomura as co-head of prime services Europe.

Benga Sofoluwe has departed his role as managing director, regional head of securities lending and delta one sales, Asia Pacific, at Citi.

Sofoluwe, who was based in Hong Kong, joined Citi in 2014 to run the bank's equity finance desk. Previously, Sofoluwe served as managing director and European head of securities lending at Deutsche Bank from 1999 to 2012.

He also served as a stock loan trader at Morgan Stanley from 1994 to 1999.

State Street has appointed Lisa Lou as country head of global services for China and general manager of its Beijing office.

Based in Beijing, Lou will be responsible for managing the State Street's global services business and leading the firm's China strategy.

Lou will report to Richard Fogarty, senior vice president and head of global services for the firm's North Asia business.

Prior to State Street, Lou worked at J.P. Morgan Chase Bank China, where she was head of financial institutions and public sector clients for China and general manager of its Beijing branch. Before that, Lou held senior management roles at Standard Chartered Bank China and HSBC Australia, covering client segments and product lines.

State Street first established its presence in Beijing and Shanghai in 2005 and 2008 respectively, and has a technology and processing center in Hangzhou.

Beijing also has a branch license from The China Banking Regulatory Commission.

Commenting on Lou's appointment, Fogarty said: "Lisa Lou has a wealth of knowledge about financial services both in China and internationally."

"She will play a vital role helping to strengthen our local relationships with regulators and the financial industry in China, as we look to expand our servicing capabilities and grow our client base over the coming years." **SLT**