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Deutsche Börse and HQLAX partner

Deutsche Börse and HQLAX have partnered for the creation of a securities lending solution using the R3 Corda blockchain platform.

The partnership between Deutsche Börse and HQLAX is expected to foster market adoption by enabling connectivity with HQLAX, for both trade execution and post-trade processing.

Using Corda's blockchain technology, Deutsche Börse and HQLAX aim to build a fully integrated front-to-back operating model to facilitate more efficient collateral management of liquid assets.

According to HQLAX, these assets are in increased demand due to the implementation of bank regulations for liquidity, mandatory clearing and margin requirements for over-the-counter (OTC) derivatives.

The trading layer will be delivered exclusively by Deutsche Börse's Eurex Repo platform, which will enable market participants to leverage existing connectivity to the Eurex repo service.

Deutsche Börse Group will also play a lead role in the custody agnostic, post-trade processing layer, which is designed to interoperate with multiple collateral agents and custodians.

HQLAX aims to help market participants redistribute collateral liquidity more efficiently, by improving interoperability for pools of securities residing in multiple, disparate settlement systems and locations.

In the HQLAX operating model, legal title transfer of baskets of securities will be achieved by the transfer of ownership of HQLAX digital collateral records (DCRs) while the underlying securities remain static within DCR-linked custody accounts.

The use of DCRs to effect transfers of securities will, according to Deutsche Börse, enhance regulatory transparency, mitigate systemic risk, reduce operational risk, and help financial institutions mobilise collateral and manage capital more efficiently.

Guido Stroemer, CEO of HQLAX, said: "Our goal is to mobilise liquidity across pools of collateral currently residing in disparate custody accounts around the globe."

He added: "Partnering with Deutsche Börse enables us to maximise the network effect that will drive widespread adoption of the HQLAX platform. We look forward to further collaboration with the broader community of collateral agents and custodians."

David Rutter, CEO of R3, commented: "Partnering with a market leader like Deutsche Börse is a major milestone for HQLAX, and Corda is the perfect choice of platform. It was built from the ground up to enable businesses in complex and often highly regulated markets to overcome real-world challenges like those associated with securities lending."

Philippe Seyll, executive manager at Deutsche Börse, said: "With the creation of a neutral custody agnostic control layer, Deutsche Börse is embracing distributed ledger technology and complements it with a neutral and trusted market infrastructure role open to multiple custodians and collateral agents."

He added: "This way Deutsche Börse supports market participants to deal with the global regulatory framework whilst reaping the benefits of the leading edge distributed ledger technology."

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ESMA updates its Q&A on MiFID II commodity derivatives topics

The European Securities and Markets Authority (ESMA) has today updated its questions and answers (Q&As) on the Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR) regarding commodity derivatives topics.

These Q&As provide clarification on issues related to the MiFID II/MiFIR for commodity derivatives, including on position limits, position reporting, and ancillary activity.

New or revised answers are provided on position limits stating the Q&A clarifies the circumstances under which less liquid contracts may receive bespoke position limits established by the relevant national competent authority (NCA).

ESMA stated that this also introduces a tailored approach to the development and application of commodity position limits for spread contracts—spread positions are disaggregated, and the subsequent individual constituent positions are added to the relevant overall position for the relevant contract.

On position reporting ESMA's Q&A clarifies to which NCA positions in an over-the-counter commodity derivative contract, which is economically equivalent to more than one EU exchange-traded derivative (ETD) contract, must be reported when the ETD contracts are not the same contract.

According to ESMA, the purpose of the Q&As is to "promote common supervisory approaches and practices in the application of MiFID II and MiFIR. They provide responses to questions raised by market participants in relation to the practical application of the provisions relating to commodity derivative issues".

ESMA said it will continue to develop these Q&As in the coming months and will review and update them where required.

Tesla the subject of heavy shorting

Tesla's driverless cars could be in for a rocky road ahead, according to Samuel Pierson, director of securities finance at IHS Markit. Pierson explained that the company is heavily shorted across its capital structure.

With the share price moving negative for 2018 to date, Tesla shares may be nearing a crossroads, he suggested, after trading up nearly 15 percent on the year in late February.

While equity short sellers continue to hang around, shorts in the company's most liquid TSLA bond have made a tidy profit so far in 2018. They have not covered to lock in the profit, suggesting that they think the credit will continue to deteriorate, he continued.

The 5.3 percent coupon issue maturing in 2025 saw short demand trend up last autumn, he noted, pushing over $280 million in early November, according to IHS Markit evaluated data.

Coming in to the end of last year, some short covering coincided with the bonds trading back up to 96 cents on the dollar.

This week, IHS Markit showed the mid-close price hit 92.5, the lowest level following issuance of the bond in August last year.

Short sellers have not covered, and there is still a par value of $251 million short in the 5.3 percent 2025 issue, equating to 13.2 percent of the total issue size, he observed.

That represents the vast majority of $261 million total short demand across the four TSLA bonds with short balances.

The limiting factor for short sellers has been the available supply of bonds, with the utilisation of lendable supply currently at 99 percent having not been less than 90 percent since October.

Borrowing costs have thus trended up and are currently at the highest level recorded for new borrowings.

Pierson said: "For equity short sellers, there isn't currently much limitation on size, with active utilisation of supply from lenders at 70 percent, though that's well above the lowest level observed in 2017, just below 50 percent."

"The cost of borrowing the shares is elevated beyond general collateral rates, but remains a far cry from the rates observed in late 2016."

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Pirum/IHS Markit adds five firms to SFTR DPG

Pirum has added five firms to the Design Partner Group (DPG) of its Securities Financing Transactions Regulation (SFTR) reporting solution, in partnership with IHS Markit. The five firms joining the DPG are Citi, Morgan Stanley, RBS, UBS and Vanguard.

The Pirum/IHS Markit SFTR reporting solution enables market participants to comply with their transaction reporting obligations through a modular platform.

These modules will assist in handling the data challenge posed by SFTR from data exchange, enrichment and warehousing to reconciliation and reporting via the approved trade repositories.

Rajen Sheth, Pirum CEO, said: "The addition of these five firms, representing all aspects of the securities finance business, to the DPG extends our collaboration across an even broader spectrum of market participants ensuring delivery of the most complete SFTR reporting solution."

He added: "I look forward to working with all our clients in the coming months to help them meet their reporting obligations."

The proxy record date (on 7 February) caused rates to blow out to double digits for new borrowings. He added: "Some shareholders pulled back shares they had lent out so that they could vote them—and those who lent their shares were able to charge a premium to forgo their voting rights."

He said the current short borrow is 29.8 million shares, up from 27.8 million on 15 March. The next exchange short interest publish on 26 March was collected for settlement on 15 March, so it may print lower than the last observation, but given the increase in borrows since then, he predicted the subsequent number released on 10 April will reflect the recent increase in short demand.

The current equity short balance is $9.4 billion, making Tesla the most shorted US equity in dollar terms.

Pierson explained: "With the short demand for Tesla increasing through the recent sell-off—and the short demand for bonds fully utilising the available supply—it appears short sellers are looking for more downside before they begin to cover."

Given the limited supply from lenders, the short balances are only $250 million for that issue.

So far this year the bonds have decreased in value, so trading below 100 cents on the dollar, making it a profitable trade, but shorts haven't started to cover yet. On the equity side, TSLA remains the most shorted US equity in dollar terms, with over $9 billion currently short.

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UnaVista extend partnership with IHS Markit

UnaVista, part of the London Stock Exchange Group (LSEG), and IHS Markit have extended their alliance to prepare for and comply with the upcoming Securities Financing Transactions Regulation (SFTR).

UnaVista said the extended relationship will enable it to provide firms with an end-to-end solution that combines leading data management capabilities from IHS Markit with UnaVista's own trade repository capabilities to simplify SFTR reporting for firms.

It added that by providing firms with an SFTR trade repository service, firms can benefit from centralising their global regulatory reporting through a trusted partner.

UnaVista said that SFTR transaction reporting is expected to follow the same structure as European Market Infrastructure Regulation (EMIR) and will require financial and non-financial counterparties to report all of their securities financing transactions to an EU-registered and approved trade repository on a T+1 settlement cycle.

The new regulation is currently expected to be implemented in Q2 2019.

Pierre Khemdoudi, managing director of IHS Markit, said: "The industry is thirsty for guidance on this regulation and partnering with UnaVista is a great opportunity to showcase our expertise in the field of securities lending and financing."

Wendy Collins, managing director of global strategic partnerships at UnaVista, said: "UnaVista values the importance of our partners in the regulatory reporting landscape and we are happy to deepen this relationship with IHS Markit. We look forward to working together to help firms and their clients comply with SFTR, the next big regulation on the horizon."

He said: "Is this the same road we've been down before? Or are we perhaps just further along the road we've been on the whole time?" He concluded by answering his own question: "Only time will tell."

FSB seeks industry response on legal barriers to OTC derivatives

The Financial Stability Board (FSB) is seeking responses from financial institutions and other reporting entities on issues they may face with legal barriers to the reporting of full transaction information about over-the-counter (OTC) derivatives.

The FSB explained that the requested responses will provide input to the board's ongoing work to evaluate the extent to which its member jurisdictions have met their commitments to remove such legal barriers.

The barriers can arise from client confidentiality, data protection, blocking statutes, or other official requirements, either in FSB member jurisdictions or other jurisdictions where counterparties may be located.

In 2009, the G20 agreed a comprehensive reform agenda for OTC derivatives markets.

The agreed reforms included trade reporting of OTC derivatives; central clearing and, where appropriate, exchange or electronic platform trading of standardised OTC derivatives and higher capital and minimum

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The survey comes after some FSB members raised concerns that restrictions on reporting complete OTC derivatives transaction information to trade repositories can limit its usefulness to authorities in carrying out their regulatory mandates—including monitoring and analysing systemic risk and market activity.

The FSB published a thematic peer review of OTC derivative trade reporting in November 2015, which identified a number of legal barriers to reporting of transactions.

FSB members agreed as a follow up that, by June 2018, all jurisdictions should remove barriers to reporting of full transaction information and have a legal framework in place to permit authorities' access to data in accordance with their mandates and in accordance with the domestic regulatory regime.

The FSB will report on the findings from its evaluation to the November-December G20 Summit in Buenos Aires.

Volatility is back, according to BIS review

Sharp corrections in global equity markets, rising and falling equity valuations, and unusual levels of intraday volatility have shown that volatility is back, according to the Bank for International Settlements' (BIS) quarterly review of international banking and financial market developments.

The report, which was released on 11 March, focused on the return of volatility in Q1 2018, as well as the changing roles of lenders in Asia in the wake of the three crises episodes, including the Asia financial crisis of 1997 to 1998, the great financial crisis of 2007 to 2009 and the European sovereign debt crisis of 2010 to 2012.

BIS noted that the banks that have dominated the business of lending to Asia have been changing places over the last two decades. When Japanese banks cut their credit sharply, and Indonesia, Malaysia, the Philippines, Thailand and then Korea came under pressure, European banks took their place.

On the eve of the GFC in June 2008, the leading bank creditors of emerging Asia were now the banks from Europe.

Banks from Europe and the UK jointly held almost 50 percent of the international consolidated claims on these five Asian countries, while Japanese banks accounted for only 15 percent. Against this backdrop, Chinese banks have become an increasingly important provider of international bank credit, to borrowers both within and outside Asia.

Other topics covered included the pre-eminence of cash, even as retail payment systems become faster and more convenient. The report observed that since 2000, cash in circulation is up from 7 percent to 9 percent of gross domestic produce (on average).

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The report also considered the creation of new US intermediate holding companies (IHCs) in response to the requirements of the Dodd-Frank Act and whether this has had the effect of reducing the assets on the balance sheets of non-US banking organisations or simply shifted them elsewhere.

BIS noted that every new IHC created has reduced its assets and therefore its required capital. While 'old' IHCs kept their total US assets unchanged at $1.3 trillion, the new IHCs shrank their trading assets by $50 billion, moving or cutting treasury securities but keeping agency and corporate bonds roughly unchanged.

EFAMA releases UCITS net sales results for January

Net sales of UCITS peaked in January, supported by a very strong demand for equity funds, according to The European Fund and Asset Management Association (EFAMA).

The report, EFAMA's latest Investment Funds Industry Fact Sheet was released on 26 March.

It provides a breakdown of net sales of UCITS and alternative investment funds (AIFs) for January 2018.

EFAMA found net sales of UCITS and AIF totaled €142 billion, down from €28 billion in December 2017.

UCITS registered net sales of €125 billion, markedly up from €29 billion in December 2017.

Long-term UCITS (UCITS excluding money market funds) recorded net sales of €88 billion, up from €49 billion in December 2017.

Net sales of equity funds totaled €48 billion, up from €15 billion in December 2017.

Multi-asset funds totaled €17 billion, up from €16 billion in December 2017.

EFAMA found that UCITS money market funds saw a reversal in flows, increasing from net outflows of €21 billion in December 2017 to net inflows of €38 billion in January 2018.

Elsewhere, AIF recorded net sales of €17 billion, up from sales close to zero in December 2017. Total net assets of UCITS and AIF totalled €15,927 billion at end January 2018, compared to €15,696 billion at end December 2017.

Bernard Delbecque, director of economics and research at EFAMA, commented: "Net sales of UCITS surged to an all-time record level in January, as investors remained upbeat on equity markets through most of the month."

Cyber breaches cause 'very real impact' on the value of a corporate holding

Cordium has questioned how knowledgeable equity firms are about the cyber risks within companies in their portfolios.

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According to Cordium, cyber breaches and data security violations, can have a very real impact on the value of a corporate holding.

Cordium used the search engine Yahoo as an example, as the search engine was forced to reduce the sales price of its email and digital services to Verizon Communications as a result of two large cyber breaches in 2013 and 2014.

Cordium said: "Since the breach, dozens of lawsuits have been filed, and Yahoo is under investigation by regulators. The company recently announced that up to three billion people could have had their personal information compromised. Cyber risk—and organisations' exposure to it—is increasing."

Cordium stated that to protect revenue and preserve the value of their investment portfolio, "it makes sense for private equity firms to ensure that the companies they have stakes in are not only compliant with industry rules, but are also applying good practices to properly manage the cyber risks and data protection threats they face".

The business consultant said the US federal government has a large cybersecurity programme that "will, very quickly, translate into new rules and practices across industries", while the General Data Protection Regulation (GDPR), which comes into force in May 2018, has "extraterritorial impacts for firms that engage with EU-based clients".

It said the EU is also starting a range of cyber risk initiatives that will also translate into new rules.

Cordium concluded: "Private equity firms need to ensure they have the capabilities to fully assess and manage cyber risks within their portfolio companies—to be able to do this could make the difference between a successful investment and one which suffers in value because of reputational risk, legal risk, and regulatory sanctions."

Global spend on financial market data and analysis tops $28 billion

Spending on financial market data, analysis and news in 2017, was its highest since 2011, according to a new report published today by Burton-Taylor International Consulting, part of TP ICAP's data and analytics division.

The report found that global spend was up 3.57 percent, to reach $28.4 billion, topping the 28 billion mark for the first time.

In terms of constant currency, the 2017 growth was 3.27 percent, as foreign exchange adjustments benefitted the market by about $80 million. At 33.22 percent, Bloomberg increased revenue but slightly decreased market share, as did Thomson Reuters and S&P Global Market Intelligence, while FactSet Research Systems increased share to 4.45 percent. Moody's Analytics led year-on-year growth with 19.06 percent, part of which was due to acquisition.

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Risk and compliance users again were the fastest growing customer groups in 2017 and have now delivered a whopping 9.71 percent compound annual growth rate over the past five years.

Pricing, reference and valuation products and portfolio management and analytics products were in highest demand, growing an average of 7.96 percent and 6.80 percent per year, respectively, over the same period.

Douglas Taylor, founder and managing director of Burton-Taylor, said: "The financial market data and analysis story continues to be one of unending demand for the information and tools necessary to ensure regulatory compliance."

He added: "Moreover, the continued posturing of global exchanges and traditional market data vendors to serve those data demands is causing significant 'hand-wringing' around the industry."

OCC continues to clear industry path

OCC "achieved a number of key milestones" in 2017, including a total cleared volume of over 4.3 billion contracts, according to the latest OCC News.

It also revealed this cleared exchange-listed options rose by three percent to 4.1 billion contracts and cleared future contracts grew by 32 percent to 138 million contracts, representing an increasingly diverse product mix.

The OCC said these achievements "position the company for continued resiliency, innovation and growth while providing its exchange partners, clearing firms, and market participants with open access and reliable central counterparty services with operational excellence".

It added that enhancing its resiliency as a Systemically Important Financial Market Utility (SIFMU) is critical to its continued ability to reduce systemic risk, increase market transparency, and provide capital and collateral efficiencies for the users of the US exchange-listed options markets.

The OCC said: "We continue to work to reduce systemic risk across the global financial markets, particularly supporting the efforts of the Securities Exchange Commission (SEC) to improve the registered clearing entities."

"The SEC's reaffirmation in 2016 of our capital plan allows OCC to continue to comply with domestic and global regulatory requirements on sufficient liquid net assets."

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A new world of securities lending

Steve Swain, CEO of Lendingblock, explains how the company's platform is bringing securities lending to the new world of the crypto economy

Where did the idea of Lendingblock come from?

My co-founder Linda Wang and I had worked together previously on Lendr, which provided a reverse auction platform for mortgages, connecting borrowers and lenders in a similar way to Lendingblock by disintermediating the mortgage platform. We both had some years experience in blockchain technologies, and I was previously a partner at Deloitte specialising in financial technology and regulatory technology. Our joint experience and exposure to cryptocurrency allowed us to identify the opportunity and need for a trusted lending marketplace. It was clear to us that just like in the traditional capital markets, as a market that generated $4 billion of revenue in 2017, the crypto economy required a parallel financial service for securities lending. We recognised that there was a once in a lifetime

opportunity to design a new financial system on a blank sheet of paper. Last autumn, we set about building an exchange for crypto asset-backed loans that will meet the needs of institutional and individual borrowers and lenders in the crypto economy.

How does Lendingblock work and what is the primary target audience?

Lendingblock is bringing securities lending to the crypto economy. Lenders, including individuals and institutions, can simply and safely earn additional income on long-term investments, while borrowers including funds, investors, market makers and traders can access assets to support trading, fund working capital, or investment funding needs.

The way we operate, however, is very different to conventional securities lending in two critical ways. Firstly, a real-time exchange links borrowers and (multiple) lenders transparently, providing best execution for borrowers and lenders and equal access for all participants. Secondly, we use smart contracts to automate the terms of the lending agreement, including the transfer of principle and collateral, distribution of interest payments, collateral management, default processing, and repayment.

In essence, the roles played by prime brokers and agency lenders don't exist in our model, meaning that the levels of transparency, equality of access, and efficiency are much higher, to the benefit of borrowers and lenders.

We have seen the planned launch of Oxygen, a decentralised crypto-repo platform, last year we had Tzero, do you feel this will become a crowded space pretty quickly and how will you differentiate?

We are the first and, so far, only platform to allow lending across multiple blockchains. Right now, the options out there are fragmented, and not robust enough for institutional investors, who have demonstrated they want access to these markets, but need the infrastructure in place to do so. That's what we are providing with Lendingblock.

In terms of competition, it is inevitable and healthy, and if you don't have competition, it's probably because you don't have customers.

When will the platform be live and trading commence?

We will launch the live Lendingblock exchange in Q3 this year, once our regulatory approval has been granted by the Gibraltar Financial Services Commission (GFSC).

How are the trades collateralised?

Lendingblock is a purely digital securities lending platform. This means the loans are digital assets, and the collateral provided by the borrower is also a digital asset. For example, a loan of bitcoin can be collateralised by ethereum.

Initially, Lendingblock will support the top-five cryptocurrencies (bitcoin, ethereum, ripple, bitcoin cash, litecoin), but will expand to support other assets including securities and debt instruments.

When making a borrowing request, borrowers specify the type of collateral they are offering as security; lenders may accept any form of collateral, or optionally elect to specify which forms of collateral they are willing to accept or exclude. Borrowers and lenders are then matched in terms of both loan and interest rates, and the smart contract manages the loan.

How does the recent volatility in bitcoin affect Lendingblock?

Firstly, it highlights that markets don't always go up, emphasising the need for borrowing to allow hedging and to support more diverse trading strategies.

Secondly, it shows that crypto assets are strongly correlated to each other, meaning that the levels of collateralisation required in our model are lower than they would be if loans were collateralised by fiat currencies.

Do you feel the regulatory environment is driving the securities finance market and creating opportunities for Lendingblock?

We don't think that the current regulatory framework for securities finance is directly creating opportunities for Lendingblock given our focus purely on crypto assets.

However, we believe that cryptocurrencies will be increasingly tightly regulated, and are actively planning and creating a platform that is aligned to relevant regulation, including Securities Financing Transactions Regulation (SFTR) and parts of the second Markets in Financial Instruments Directive (MiFID II).

Our decision to incorporate and establish Lendingblock operations in Gibraltar is in part driven by the progressive position the GFSC has taken in defining a regulatory framework for distributed ledger technology (DLT) businesses.

Where do you think you will be this time next year?

In a very exciting position. We have been working extremely hard since launching the business last Autumn to get the exchange off the ground, and are right on track. We have a formidable team of high calibre, experienced individuals who are all passionate about the possibilities that the blockchain provides. Looking ahead to this time next year, we will have been operational for six months and will be at the very forefront of the growth of the brave new world of securities lending for the crypto economy. **SLT**

The securities lending dream

Will upcoming government rules and regulation mean US financial services will be dancing in the dark or marking the beginning of some glory days?

Jenna Lomax reports

Born to run securities lending?

Now is an unprecedented time for securities lending in the US. Not only is the industry faced with collateral reviews, it faces a wave of governmental change, headed by a controversial president aiming to deregulate its financial services.

From its own side of the pond, the US has the Dodd-Frank Act (also known as the Volker Rule) to consider, and from Europe, it has the Securities Financing Transactions Regulation (SFTR) to contend with.

Possibly, the most important regulation for collateral right now is Rule 15c3-3. First introduced in 1972 by the Securities and Exchange Commission (SEC), Rule 15c3-3 was initiated to protect client accounts in securities firms. Rule 15c3-3 cites the amount of cash and securities that broker-dealer firms must segregate in specially-protected accounts on behalf of their clients.

Broker-dealer firms must calculate the cash and securities they owe to clients and what clients owe to them. In the event that the amount owed to clients exceeds the amount owed from clients, the firm must keep hold of a portion in a special reserve bank account.

The SEC's reasoning is to ensure that clients can withdraw the majority of their holdings on demand, even in the midst of a bank's insolvency.

Peter Economou, head of markets, risk, and operations at eSecLending, says: "[Rule 15c3-3] could change the industry for the better."

"[The] ability for US brokers/dealers to pledge equities as collateral and the permission for Registered Investment Companies to accept equities as collateral [...] will increase revenue opportunities for beneficial owners at risk levels well within existing tolerances."

He also says: "We continue to believe that non-cash collateral will expand in asset types and preference to the borrower community. For some borrowers, the provision of USD cash as collateral is expensive; therefore, other options such as non-cash collateral are more attractive."

However, rules and considerations surrounding collateral are not the only challenge bearing down on US securities lending firms. Coming out of Europe, there is SFTR, expected to go live in 2019.

As George Trapp, head of client relations for North America at Northern Trust, global securities lending, explains: "Although the SFTR reporting regulation is specific to Europe, it will impact various securities lending participants in the US as well."

"The industry continues to make strides towards meeting the requirements, and vendors are engaged to facilitate collection and aggregation of the data elements required to be reported to the regulators."

The Wall Street shuffle

In 2010, the Dodd-Frank Wall Street Reform was signed into federal law by the Obama administration.

Though, the Obama administration brought in the Dodd-Frank Reform Act to damage control the crisis; making US financial services follow investor guidelines, it is clear Obama's successor, President Donald Trump, has a different agenda through his recent executive orders and last year's signing of the Financial CHOICE Act.

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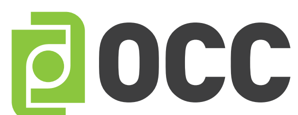

The Foundation for Secure Markets www.theocc.com

Just ten days after his inauguration day, on 30 January 2017, Trump signed an executive order titled "Reducing Regulation and Controlling Regulatory Costs". The order stated that for every one new regulation that is proposed, executive departments and agencies must remove two in its place.

In addition, the Republicans initiated the Financial CHOICE Act in June last year, which was fiercely backed by the president, and is predicted to directly affect foreign banking entities.

It scales back the authority of the Dodd-Frank Reform to regulate large banks and also repeals the so-called Volcker Rule (created by former US Federal Reserve chairman Paul Volcker), which prevents government-insured banks from making bets with investments.

The Dodd-Frank Reform expanded federal laws to potentially handle insurance companies and non-bank financial companies, changing these types of liquidation laws, which could affect securities lending.

As Stephen Malekian, North American CEO at Elixium, states: "It's hard to muster a counter-argument that rolling back regulation won't put the banks back to where they were pre-crisis."

"Whenever regulators and central banks intercede in markets and endeavour to make the banking system 'great again', there are inevitable repercussions", he says.

Also weighing in, Timothy Smith, general manager of FIS, Kiodex and Astec Analytics says: "It will probably be the case, as per usual, that the predicted dire consequences of removing Dodd-Frank will not arise, but neither will the exaggerated benefits of deregulation be as great as foreshadowed."

Only time will tell how future US government legislation will change the rules for securities lending specifically, though there are concerns about the Financial CHOICE Act and Trump's influence in US financial services after a year of his becoming commander in chief.

For instance, according to a TABB Group report, released in February of this year, the US options market is stagnating as a "result of political and regulatory change" in Washington DC.

The total volume in the US options market was 1.9 percent lower in 2016 than 2015, due to a lack of sustained volatility, TABB says.

The group explains that this was due to the inauguration of "regulatory-sceptic President Donald Trump [who] has caused a decline in market correlation".

However, according to Economou, option activity has "picked up slightly in February and March in lockstep with the increased volatility, as measured by the Vix index. We anticipate increased options activity throughout 2018, as long/short players re-enter the market this year".

Option activity looks like it's rising positively, however, that's only one slice of the American securities lending pie to digest.

Tougher than the rest

Post-crisis and under the Trump Presidency, what does the next few years hold for US securities lending, are we able to even predict it?

Despite some heavy regulation headaches and the actions of a controversial president, securities finances are still showing positive growth and positive discussion as we are now well into 2018.

In January 2018, the debate on the controversial leverage ratio rules under Basel III was reopened, showing a consideration for concerns within securities lending.

The rule, which many think currently stifles securities lending activity in the US, requires equity capital to be held against assets, including cash, on an unweighted basis.

Conflicting views around the appropriateness of the measures, which are less strict in other major markets such as the EU, has been ongoing since the rules implementation began in 2014.

Several major US banks, including BNY Mellon and State Street have waded in on the issue with calls to review scope of the ratio.

Trapp says: "A US proposal addressing the Basel revisions to the standardised approach would be a key development for the industry."

Elsewhere, the OCC has calculated that its securities lending activity was up 39 percent in new loans from February last year with 224,374 transactions for February.

It revealed that its year-to-date average daily cleared contract volume is up 39 percent from 2017 with 23,934,996 contracts.

As Trapp says: "We are positive about the prospects for the US securities lending market this year. Market volatility has increased, leading to more trading opportunities, and the breadth of specials is widening."

"In addition, beneficial owners are coming back into the market and/or increasing their asset participation, bringing additional supply to support these trading opportunities."

Trapp also states that moving forward, and in addition to regulations being a continued focus for the industry, the industry's adaption to automation will be important.

He adds: "Distributed ledger technology will improve the transparency and efficiency of the market [...] as confidence continues to grow in the technology, it could also open up future opportunities around account structures, regulatory reporting and digital issuance."

Economou says: "We are seeing improvement in the early part of 2018 as the rules and regulations have become known, and borrowers have incorporated the impacts into their securities borrowing businesses." **SLT**

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Matt Wolfe, vice president of product development, OCC

Clearing the way for future growth

As the US securities lending market reached an all-time high of $19 trillion, Matt Wolfe of OCC discusses how the central clearing space has evolved

Becky Butcher reports

Describe the current state of the US securities lending market?

At the end of 2017, Datalend reported that the US securities lending market reached an all-time high of $19 trillion worth of securities available for lending and that 2017 revenues exceeded $4.85 billion. Seeing an all-time high in securities available is evidence of widespread acceptance of securities lending, but I think market participants are eager to see higher utilisation rates. In Q3 2017, IHS Markit reported that five percent of US securities available for lending were out on loan with average balances around $525 billion. I'm receiving a lot of inquiries about how to expand the cleared securities lending business and we've had a number of new participants become highly engaged over the last year.

At the same time, it seems like there are several other initiatives and new businesses launching that aim to provide new and more effective securities lending programmes. My sense is that beneficial owners, who have historically used securities lending as a way to offset costs by lending out their securities, are increasingly looking at securities lending as a source of generating alpha. The rising volatility that we've seen over the last couple of months should help drive demand from short sellers and provide opportunities for higher utilisation and greater revenues for lenders.

How has the central clearing space evolved since the global financial crisis of 2008?

OCC is celebrating 25 years of its stock loan programme this year, and it's interesting to look back on the history because there have been three different phases of growth and we're on the cusp of our fourth wave. OCC's stock loan programme was created in 1993 with the goal of providing margin savings to options market makers that were hedging their delta risk through the lending and borrowing of stocks. The second wave of growth began in the build up to the financial crisis when the primary driver of growth in OCC's stock loan programme shifted from brokers seeking margin savings to brokers seeking credit substitution. When a stock loan is accepted by OCC, we step in and become the central counterparty between the lender and borrower. Our 'AA+' credit rating and neutral position as a central counterparty (CCP) that provides a financial guarantee allows lenders and borrowers to establish much larger positions within stock loan clearing than they typically can on a direct bilateral basis. It's important to note though, that there is an ongoing relationship between the original lender and borrower to manage lifecycle events of the contract. In the wake of the financial crisis all firms took a much closer look at their counterparty risk. That review produced a new-found appreciation for the financial guarantee and counterparty credit substitution that OCC offers and, as a result, brought a big increase in the number of firms using OCC's stock loan programme.

The third wave of growth began around 2012 as a result of regulatory reforms. Beginning with Dodd-Frank and continuing through today, regulators have recognised the relative safety and stability of clearing, and have built in preferential treatment and incentives for clearing. When I talk to clearing members, the margin offset and benefits from the credit upgrade are still valuable, but these days most firms cite the favorable capital treatment as the greatest benefit of our stock loan programme. Now, I see the clearing spaced poised for a fourth wave of growth.

Historically, agent lenders and beneficial owners haven't participated in clearing, but the opportunity for credit intermediation and preferential accounting treatment is driving an intense amount of interest from lenders. At OCC, we are working on expanding our membership requirements in order to permit access to a broader set of lenders. Once those changes are approved by the regulators I expect we'll see another decade of growth.

Are the changes driven by regulation? If so, which ones and why?

The changes to the capital requirement calculation that were introduced by Basel and have been adopted here in the US are the most significant drivers for clearing. The regulators wanted to strengthen the capital markets by making sure that market participants were appropriately assessing counterparty credit risk and setting aside adequate amounts of capital to account for that risk. This is done by looking at the riskiness of different types of exposures as well as the riskiness of the counterparty to those exposures. Fully collateralised equity exposures, such as stock loans, are relatively less risky than other types of exposures, but the counterparty can have a significant impact upon the amount of capital that must be set aside. Exposures to corporations and broker dealers must use a risk weighting of 100 percent.

Exposures to banks have a risk weighting of 20 percent. Exposures to a CCP have a risk weighting of two percent. For example, an agent lender bank lending $1 billion of stocks versus 102 percent in cash to another bank must set aside approximately $5.5 million in capital for credit risk and indemnification. The capital required for that same $1 billion exposure shoots up to about $24 million if the borrower is a broker dealer. If however the counterparty is a CCP, the capital requirement drops to about $0.4 million. The same capital requirements and savings also apply to borrowers. Cleared exposures are on average 95 percent cheaper than non-cleared exposures.

Another example is the US Federal Reserve single counterparty credit limit. Exposures to CCPs are exempted from this requirement.

What are the benefits of central clearing for beneficial owners?

Beneficial owners will see many financial benefits from central clearing. The cost of indemnifying against the default of a CCP is significantly cheaper than other counterparties. This will cause less of a drag on lending revenues. I expect lending revenues will also be higher as a result of the lower capital requirements for cleared exposures. Based on some calculations that spread could be 5 to 25 basis points for stock loans, which is roughly in line with the cleared vs. non-cleared rates seen in repo markets. Finally, also as a result of lower capital requirements by borrowers, beneficial owners are likely to find higher utilisation rates within clearing.

Is the cost of using a central counterparty prohibitive to beneficial owners?

From a fee perspective, definitely not. OCC currently charges $1 per new loan from the lender. Whether that same fee schedule will apply to agent lenders or beneficial owners hasn't been determined, but OCC operates as a market utility and, governed by our users, prioritises cost controls, passing savings back to the users. For 2017, OCC declared a refund of nearly $80 million to its clearing members.

The unanswered question is whether or how beneficial owners may need to collateralise the risk of their cleared positions. Typically, clearing members with lending positions present downside risk to the CCP because of the requirement to return collateral. This risk is assessed as a margin requirement and is typically collateralised using treasuries or equities. Beneficial owners present a different risk profile than typical clearing participants, so the risk methodology is still under development. This may end up adding some cost of capital if collateral is required, but that will likely be met through pledging unlent equities so the cost is likely to be trivial, especially considering the financial benefits clearing can offer.

What other benefits are to be had going through a central counterparty?

Clearing is a highly automated and efficient process. Almost all of the interactions are message-based and straight through processed. This leads to less breaks and reduces the need to reconcile against multiple counterparties. The agent lender disclosure (ALD) process is also simplified, because agent lenders simply need to provide ALD files to the clearing house as opposed to all of their borrowers. From a borrower's perspective, they see OCC as their counterparty and do not need to look through to the beneficial owner.

The clearing house also provides a greater level of resilience during times of market stress and volatility. During the financial crisis many participants got out of the market for fear that their counterparty could be the next to fail. This same fear-based reaction wasn't seen within clearing due to the safety and security of having a 'AA+' S&P rated, systemically important market utility as counterparty.

What are your views on the market structure of the future for securities finance?

OCC is working on a set of market structure changes to strengthen and improve the process flow for cleared stock loans. We are working with vendors like Equilend and Loanet to enhance the pre-trade validation of terms and to automate the submission to clearing, which will have straight-through processing in to depository trust company and other custodians. This market structure will more closely resemble the market structure of exchange-based markets and will provide a greater level of accuracy and efficiency over the current bilateral market.

Centralisation and standardisation tends to lower costs over time and to increase liquidity. However, we recognise that there are important differences between securities finance and cash equity markets. Most important is the ongoing bilateral relationship between lender and borrower from the time that a loan is initiated to the time it is terminated. Preserving this relationship is a foundational design principle.

I think that the US securities financing market will continue to see growth in non-cash loans, particularly if regulators permit equities to be used as collateral. The triparty custodians have robust systems to provide operational efficiency while providing the security interest and control that lenders require.

It is also interesting to watch the development of peer-to-peer markets. For certain participants, I can see how that could be an attractive alternative and down the road it would be interesting to explore a cleared peer-to-peer market where a CCP would provide credit intermediation between beneficial owners and hedge funds. **SLT**

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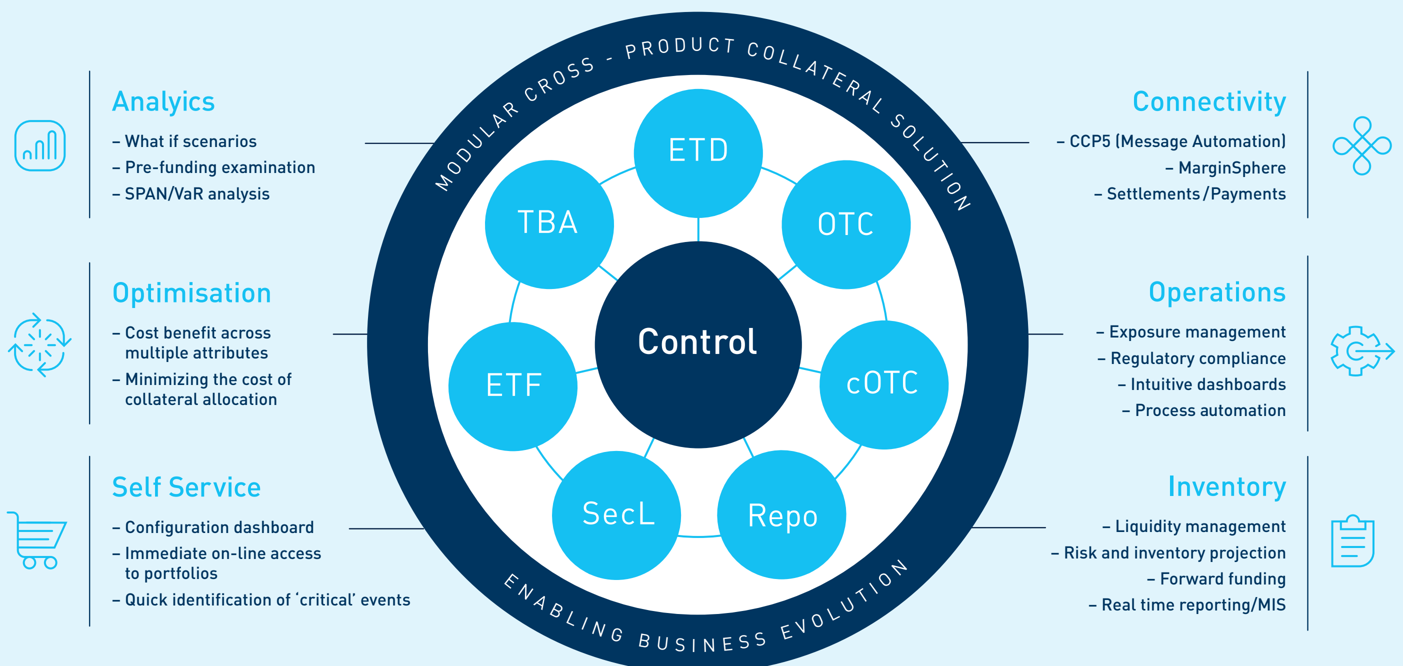

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Equities as Collateral

As the acceleration towards a higher percentage of non-cash collateralised transactions continues, it is for the benefit of all US market participants to support the expansion of this change

Brian Bollen reports

As the acceleration towards a higher percentage of non-cash collateralised transactions continues, it is for the benefit of all US market participants to support the expansion of this change.

According to Mike Saunders, head of trading and investments, securities lending at BNP Paribas Securities Services, the trend is certainly towards non-cash collateral as the US seeks to align with the rest of the world in their implementation and expansion of permitted collateral.

Saunders explains: "Historically, the US securities lending market has been biased towards cash collateral. However, this is changing and at a frenetic pace. The preference to accept non-cash collateral will continue in the years ahead."

He also suggests that the preference for non-cash collateral has grown rapidly over the last three years and the growth is expected to accelerate as beneficial owners and the regulatory environment shift towards greater collateral flexibility.

Although the market share of non-cash collateral transactions has grown, challenges still remain which prohibit beneficial owners from engaging in non-cash collateral-based transactions to fully reap the benefits offered in a non-cash transaction. He notes that the shift towards non-cash collateral as the result of several factors with regulatory and balance sheet constraints at the forefront. The

demand side under Basel III is forcing dealers to pursue balance sheet reduction exercises prior to critical reporting periods causing a significant reduction in reverse repurchase transactions in the cash market. The focus on balance sheet allocation naturally shifts the demand to borrow to non-cash transactions which offer broker dealers an opportunity to net and move transactions off balance sheet. As such, non-cash collateral-based transactions are less balance sheet-intensive than cash collateral-based transactions hence the growth in non-cash collateral.

It can be argued that the benefits of engaging in a non-cash collateral-based transaction outweighs transactions collateralised by cash. A non-cash transaction enables the netting of transactions as it is one lending contract, removes the cash collateral reinvestment risk, promotes dealer balance sheet efficiency and negates the negative or low interest rate environment globally. In addition, non-cash transactions are less strenuous on the document front, removing the need for a master repurchase agreement/global master repurchase agreement (MRA/GMRA).

Sam Pierson, an analyst at specialist data provider IHS Markit, also weighs in. He says the issue is that brokers are motivated to do non-cash because it will be more efficient from a balance sheet perspective. Lenders in the US are often unable to take anything except cash or potentially treasuries as collateral, partly as the result of regulation, partly the result of their wishing to generate extra revenue by investing the cash collateral and partly wanting to have the security of cash collateral versus a riskier form of collateral.

Saunders states that despite the growing demand from borrowers to engage in non-cash transactions, beneficial owners continue to face regulatory hurdles, which limit their participation in non-cash transactions.

The largest hurdle to unlocking a tremendous amount of liquidity and supply in the US remains SEC Rule 15c3-3, which currently limits the collateral type posted by borrowers to cash, US treasuries and US agency debt. This rule is also applicable to SEC 1940 Act Funds causing additional challenges such as a collateral look-through calculation.

The acceleration of the acceptance of non-cash collateral has led the prominent industry working group in the US, the Risk Management Association (RMA), along with several leading market participants to engage in a major campaign to amend the SEC 15c3-3 regulation. These efforts would permit the pledging of equity collateral versus an equity borrow but not cross-asset transactions (for example, fixed income versus equities).

Regulators and the SEC Market's Division appear open to discussing the expansion of 15c3-3 and have been prudently examining the benefits and impact of such a change, explains Saunders. Recent communication as of February 2017, support the progress and open dialogue. While these discussions have been years in progress, a final ruling is to be expected in the very near future, he observed.

Fran Garritt, director of securities lending at the RMA, identifies two issues with equities as collateral, the first being getting equities approved as a permissible collateral. The second is the broker/dealer debit calculation where the collateral used has a certain capital requirement that must be held by the broker.

Garritt explains: "In the case of equities, it's 100 percent making the trade uneconomical. Is it likely to change any time soon? I don't know. Hopefully. If it does, brokers will need time to get their systems up and running, he said. Some will do so quicker than others."

"They will also want to do this as soon as possible as they get capital relief under the stock loan return (SLR) for equities instead of cash as collateral. On the beneficial owner side, there will be a few issues. First, sovereign wealth funds, central banks, endowments will not need any clarification from any regulator to accept equities as collateral."

Garritt adds that the 1940 Act funds (mutual funds) and the Employee Retirement Income Security Act (ERISA) funds (pension funds regulated by the Department of Labor) will need to get approved, or at least clarification that they can accept equities.

He adds: "I also believe that some, if not most, will choose not to accept."

Brokers will want to use equities and will guide trades towards beneficial owners who will accept them. Garritt suggests: "Like central counterparties, it will be another arrow in the quiver of tools that market participants can use. Both central counterparties (CCPs) and equities as collateral help the broker with balance sheet/capital management."

Saunders also addresses the point that it is not only regulated mutual funds currently constrained by the rather limited collateral type. Insurance companies are regulated by the individual states in which they are incorporated thus leaving each state insurance regulator with the mandate to impose state statutes. But little or nothing is set in stone.

He says: "Our research and experience demonstrates that cash collateral remains the predominant collateral type for no reason other than historical reasons and the prioritisation of an insurance company engaged in securities lending to lobby their state regulator."

In contrast to insurance companies and the US Securities and Exchange Commission (SEC) registered 1940 Act funds, state-sponsored pension funds appear rather unconstrained on the permitted collateral type in a securities finance transaction. While this may appear on the surface a positive for non-cash collateral, legacy lending guidelines often require legislative or at a minimum, board changes to implement non-cash collateral into a securities lending agreement.

Again, on the agenda for sponsoring a change either at the legislative or board level, the voice for the implementation of non-cash collateral is rather muted, according to Saunders.

However, the underfunded status of a majority of state-sponsored plans and the search for increased revenues has driven pension funds to action to expand their collateral parameters. Those who have taken the initiative to implement these changes have reaped the first mover advantage of engaging in non-cash collateral.

Another important consideration when discussing pension funds is the shift from defined benefit plans toward defined contribution plans. The change in pension structure is impacting the securities lending market indirectly. As contributors elect their investments, flows have been directed towards mutual funds. The effect has been mutual fund assets have grown substantially. Relating this to shift to securities lending, these new flows are now susceptible to collateral restrictions of cash, US treasuries and government-guaranteed debt and thus lower lending returns typically associated with a wider array of permissible collateral.

According to Saunders, the benefits and popularity of non-cash collateral are apparent as demonstrated in the securities lending market outside the US. Non-cash collateral typically is associated with higher levels of collateralisation while removing the cash collateral credit reinvestment and duration mismatch risk. The demand to lend under non-cash transactions permits greater liquidity in the market while reducing the correlation in the event of collateral liquidation. The benefits are so apparent that equities have become the dominant permitted collateral for UCITS, which are highly regulated fund structures throughout Asia, Europe and Latin America.

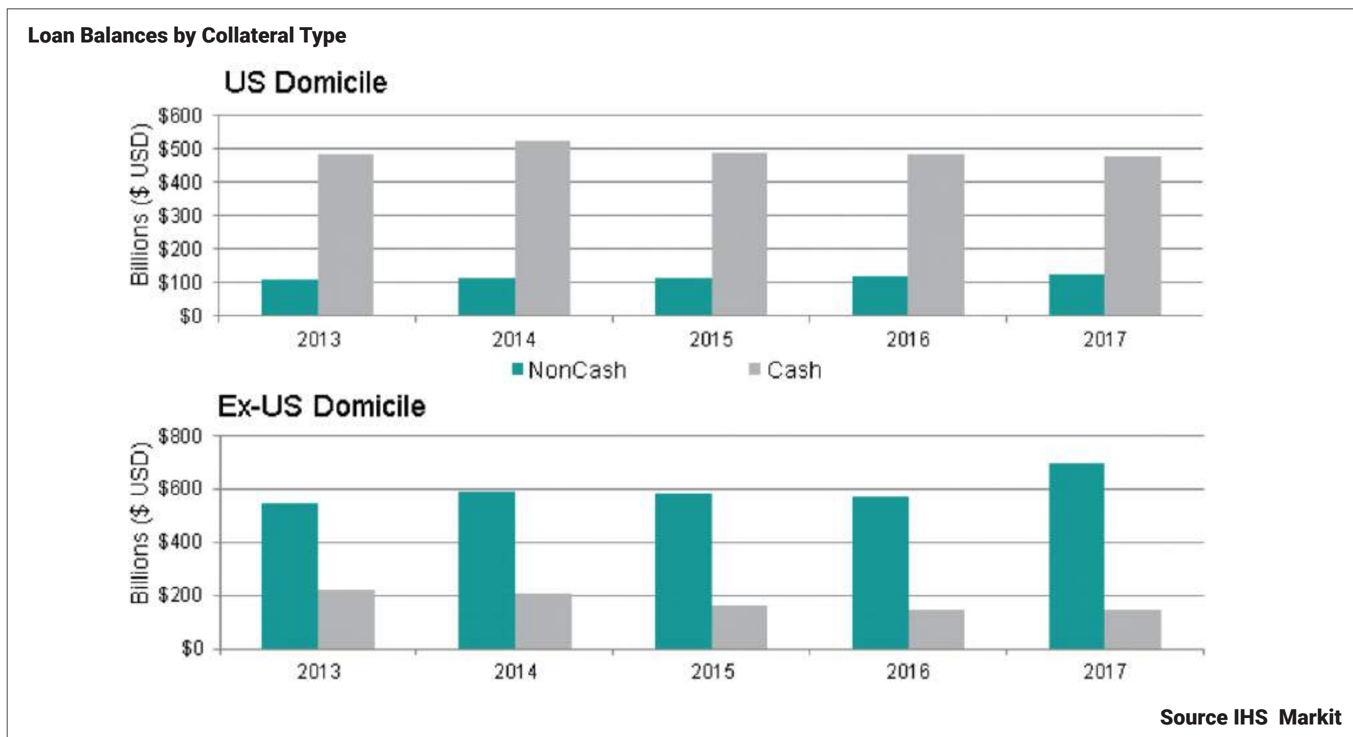
Turning to the collateral preference of official institutions such as central banks, sovereign wealth funds and supra-sovereign entities, Saunders observes that each of these entities possesses varying levels of engagement in their lending programmes and views as to their rationale for participation in securities lending.

While it is common for central banks to approach securities lending with their mandate to provide liquidity, in contrast, sovereign wealth funds typically are more focused on revenue generation, Saunders explains. Regardless of their intent in securities lending participation, a majority of official institutions accept a wide array of collateral including both cash and non-cash collateral including equities.

Saunders suggests that the correct implementation of both a cash- and non-cash collateral lending programme is imperative. Diversification and collateral monitoring are crucial. Agents and collateral managers possess the ability to impose granular diversification parameters on all collateral sets. Further, it has become market standard for beneficial owners to receive on a timely basis detailed reports of the pledged collateral to ensure all guidelines and collateral preferences remain compliant.

Looking at other live issues, Garritt suggests that another topic within the US that will need to be discussed when it comes to equities as collateral is how triparty will factor into the equation.

He says: "I don't think any bank will do an equities collateral trade bilaterally. It will certainly be done through tri-party. Brokers' systems will be a big deal. J.P. Morgan, Citi, Credit Suisse, Morgan Stanley, Goldman Sachs will be fine and will get up and running quickly." **SLT**



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The newest odd couple

The short-term pain of bringing the securities lending and collateral functions in-house is worth it, according to David Lewis, senior director of FIS

Around 20 years ago, when I worked on a fixed income repo desk, no one even spoke to the securities lenders who did equities. The concept of a combined collateral desk was incredibly innovative, but rarely came into being due to internal politics and fiefdoms.

Today, margin pressures and regulatory requirements—including the second Markets in Financial Solutions Directive (MiFID II)—are finally turning that idea into reality. The industry now recognises the efficiencies of putting the financing business under the same roof as collateral managers. This 'odd couple' makes a lot of sense. To be as efficient as possible in the use of the inventory for funding, yield enhancement and compliance with regulatory capital requirements and collateral managements, you need to bring together all of the asset pools for the securities finance business and your collateral requirements across business lines, and, indeed, across the whole enterprise.

However, accomplishing this means internal reorganisations and new workflows. Some buy-side firms are also bringing collateral management and financing in-house rather than paying agents to do this for them. With a rapidly increasing choice of platforms and options available to them, the barriers to entry are falling all the time. The short-term pain of bringing the securities lending and collateral functions in-house is worth it. Beyond the cost savings from cutting out the agent, if you optimise how you manage your collateral across the enterprise, you can reduce the impact of capital requirements on your balance sheet. In fact, by some estimates, you could save five to 15 basis points.

And that's not the only benefit of converging your business units. Firms that make this move can increase yields by making smarter decisions around what assets they allocate to their lending programme and collateral requirements. Second, with global optimisation, they can use their assets to cover exposures in one jurisdiction with excess balances from elsewhere. Third, they can mobilise assets across functions, transforming them into higher quality assets when needed to meet the ever-increasing regulatory demands for collateral.

It may sound daunting, but the benefits are clear, and your competitors are already taking action. Are you?

SunGard was acquired by FIS Global in 2015. **SLT**

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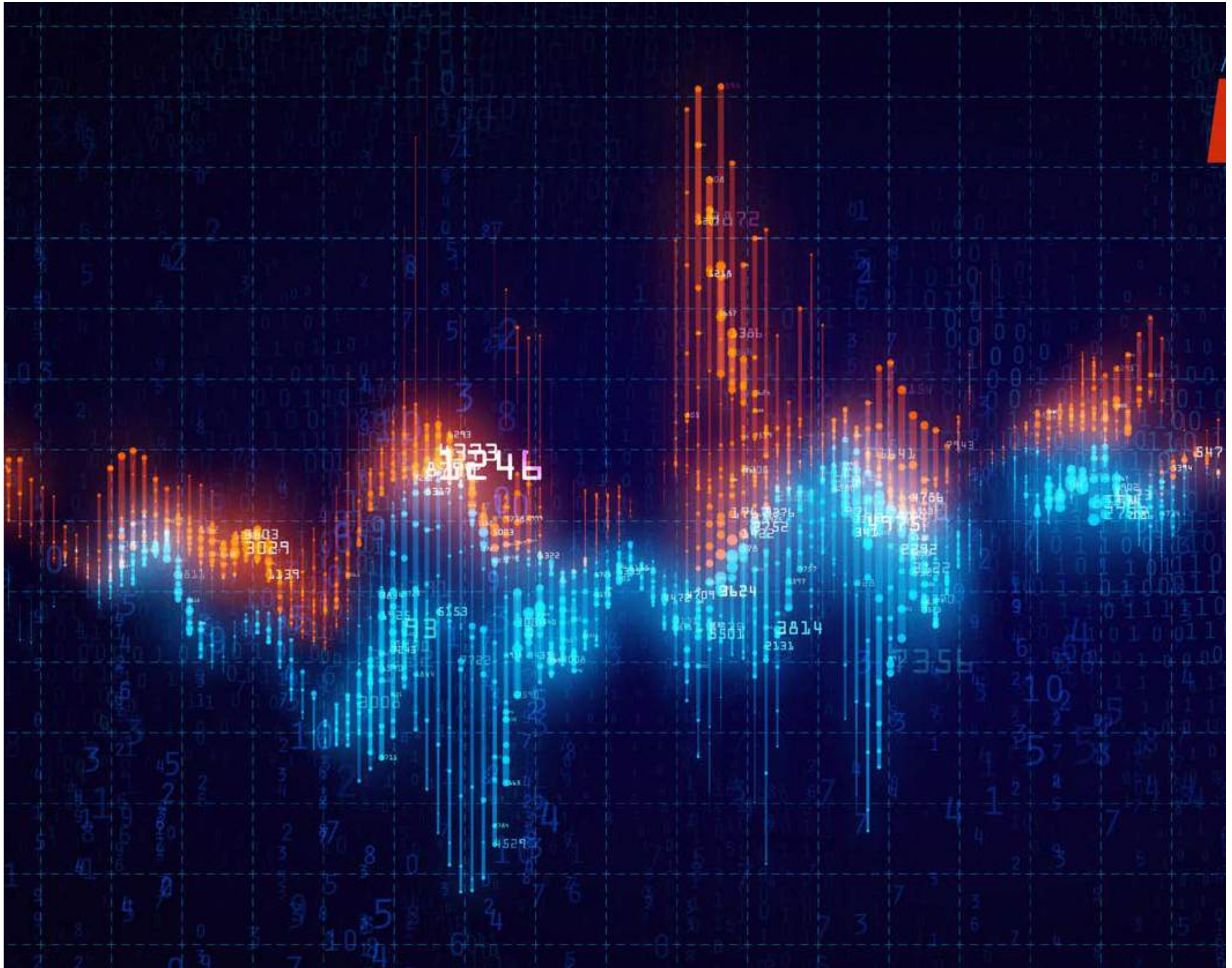


Evolving analytic approach

Robert Levy, head of business development of Hanweck, explores securities lending opportunities through the lens of the borrow intensity indicator

As the securities lending industry collectively focuses on the imperative of having clean, actionable data to complement existing data sources and inform lending opportunities in a more difficult market environment, Hanweck has recently developed and launched the Hanweck Borrow Intensity Indicator. The tool offers a new approach to better understand both market microstructure, and broader trends within the equity financing market. The borrow intensity indicator is derived from real-time exchange-based data, and offers rapid reaction to changing financing market conditions. Intraday updates provide opportunity to spot fast moving markets after events such as earnings reports, news, or corporate actions. This can be useful to borrowers when evaluating the economics of a prospective trade, or an agency lender looking to maximise return for a beneficial owner with the next repricing. Borrow intensity is expressed in a format analogous to lending rebate and can be rapidly incorporated into firms' valuation frameworks.

Borrow intensity indicators cover the breadth of the US equity universe with listed options, and offer a rich-term structure of term rates ranging from 45 to 360 days. Longer-term historical series reveal the demographics of security lending, highlighting and contrasting rate levels and trends in groups ranging from the hardest to borrow (high intrinsic) to general collateral. This information offers perspective

for benchmarking securities lending as an investment product, showing trends in rates of return across a range of intrinsic value classes, and also the number of securities falling into each valuation group. This data can demonstrate recent or longer-term potential to a beneficial owner considering participation in or looking to expand a lending programme, and complements existing market information such as utilisation rates and lending margins.

Broad trends through the lens of borrow intensity

Securities lending-faced headwinds throughout 2017, with collateral utilisation rates declining in the record setting low volatility environment, and persistent bull market conditions that discouraged short activity. Despite poor utilisation, there was some revenue support in the form of higher intrinsic value for the securities that remained hard-to-borrow. What did this look like within Borrow Intensity Indicator statistics?

High intrinsic value groups

Two views are presented in the figure 1 of the segment of the market with 180-day borrow intensity below zero percent (meaningfully hard-to-borrow). In figure 1, the quintile view shows the fifth-tile, with the most extreme negative rates, pulling away from the other tiles to become increasingly hard-to-borrow, with average rates reaching minus 20 percent. The membership count of this quintile however, is declining with more days of smaller counts of 50 or less versus 100 and higher in the earlier part of last year.

The second view in figure 2, with securities bucketed by borrow intensity level, provides additional insight into trends from 2016 to 2018. Much of the decline in the total count of harder-to-borrow securities occurred from the decline in the mildly hard-to-borrow category of borrow intensity ranging from 0 to minus 2.5 percent (segment in blue). This category started at 200 names in January 2016, peaked at 800 names in mid-2016, and then steadily declined into 2018 to go below 200. Meanwhile, the higher intrinsic value categories had lower, but mostly steadier

Figure 1 - Quintiles 180-day Borrow Intensity, Harder-to-Borrow (Higher Intrinsic) names

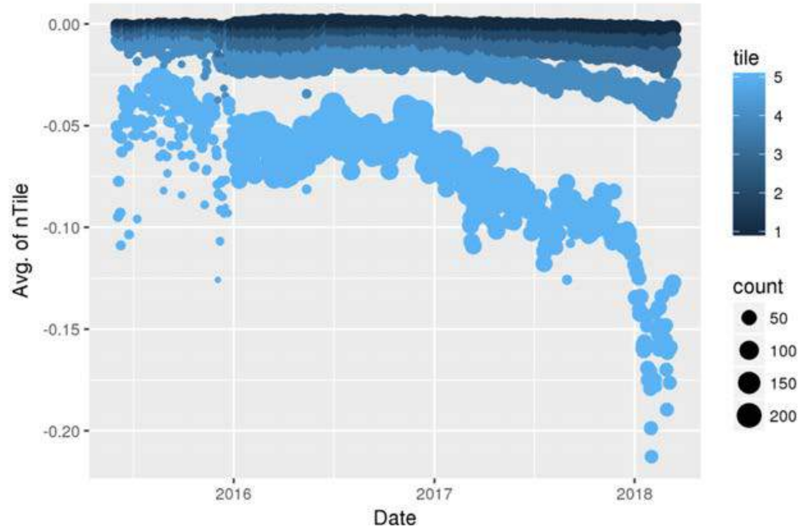


Figure 2 - Borrow Intensity: Counts of harder-to-borrow names in groups bucketed by intensity level

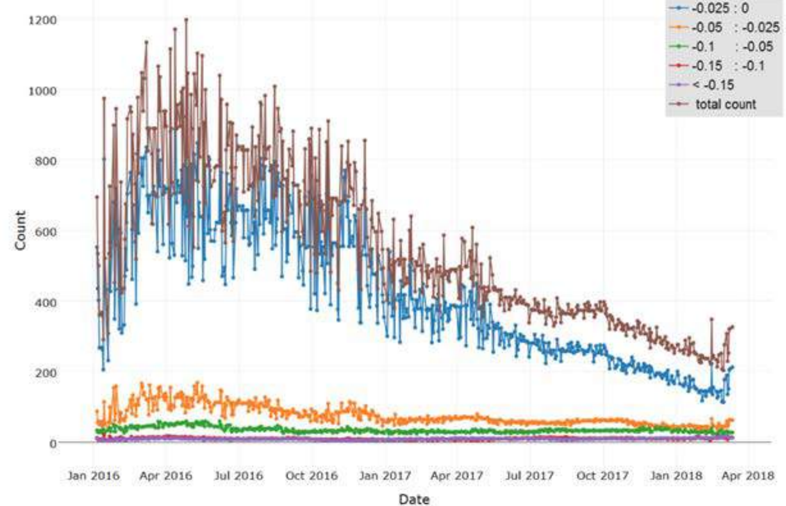
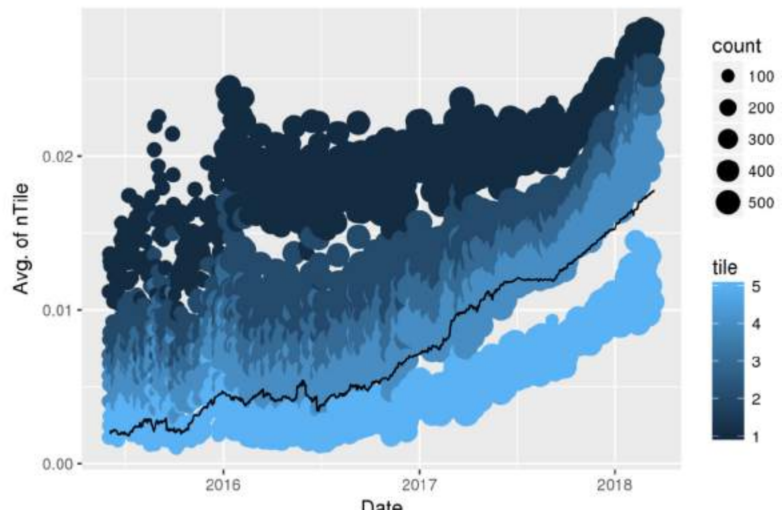


Figure 3 - Quintiles 180-day Borrow Intensity, Easier-to-Borrow groups vs. 6-mos OIS curve



counts throughout the entire period, pointing again to a small core of very hard-to-borrow securities that was critical to maintaining lending revenue.

Easier-to-borrow groups and term structure

Figure 3 displays securities from mid-2015 through 2018 that had six-month borrow intensity greater than zero, including some mildly hard-to-borrow names and much more general collateral (that can have borrow intensity rates exceeding comparable risk-free rates).

This plot also displays a six-month overnight indexed swap (OIS) curve (solid black line) for ready comparison to a term interbank rate. Here, the bottom of the fourth ntile tends to float right above the OIS.

The upwards slope in all ntiles run in sympathy to OIS, but with lower ntiles (For example, increasingly general collateral), there is a steeper rate of increase as the data moves into 2018. This data is useful to help calibrate borrow intensity versus actual lending rates (both risk free and collateralised).

It is not clear why synthetic-term rates display the sharper rate of increase, but this phenomenon has been observed in both large cap single stocks and exchange-traded funds (ETFs), and in part reflects the difference between a pure interbank rate, and the collective balance sheet cost of option market-making participants.

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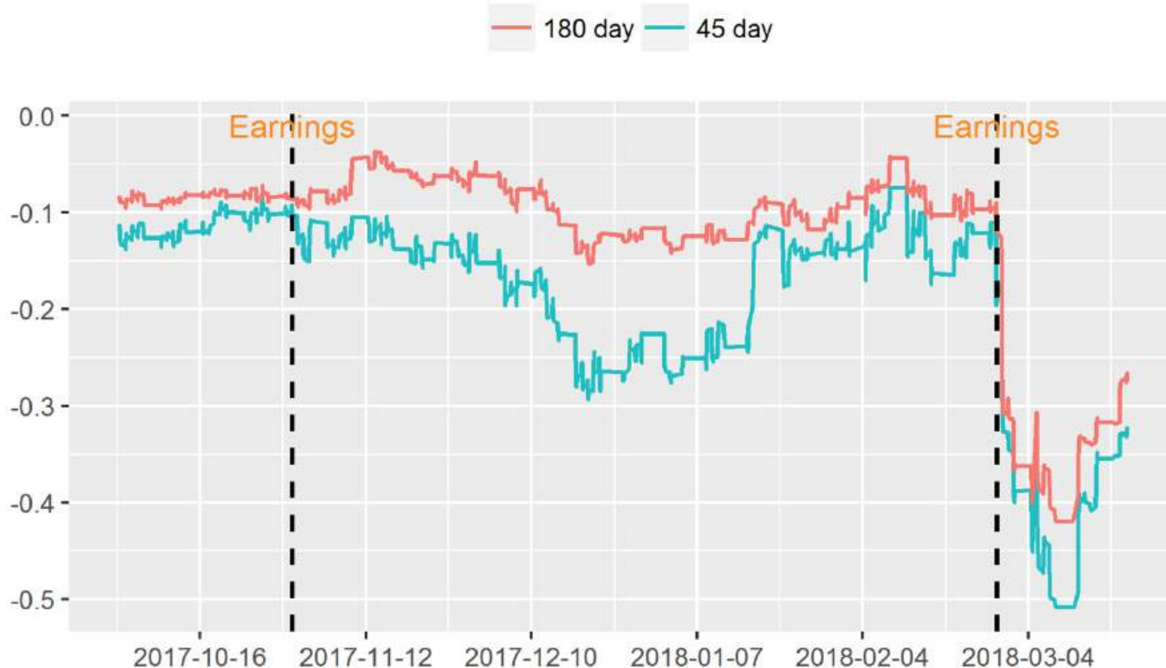
Security-level borrow intensity indicator case studies

Moving from the macro to the micro, intraday updates of the borrow intensity indicators can reveal rising situations either with significant changes automatically detected in new securities that cross the threshold into the hard-to-borrow category, or rapid shifts in securities already well known as hard-to-borrow.

Consider the case of frontier communications (FTR) in figure 4 below. FTR demonstrated high intrinsic value throughout the second half 2017, with 45-day borrow intensity ending the year at roughly -22.5 percent (expressed in the format of rebate rate). FTR experienced a major earnings miss after the close on 27 February this year, and the stock traded down sharply the next day. FTR had experienced similar misses and stock price behavior in the past—for example after earnings on 31 October last year.

The financing reaction in the latter event was far more severe. The 45-day borrow intensity showed a morning opening level of roughly minus 19 percent, with rates progressing rapidly more hard-to-borrow throughout the day with minus 30 percent at noon, and closing the day at minus 36 percent. Even longer-term borrow intensity

Figure 4 – Hanweck Borrow Intensity FTR, Q1 2018



indicators, such as the 180-day, showed parallel momentum—often a sign of a longer-term dislocation. This proved to be the case with FTR moving into March with 45-day borrow intensity moving below minus 50 percent.

Securities lending data is relatively opaque, and borrow intensity indicators at the intraday frequency can fluctuate, particularly in less liquid names due to the aggregation of data from varying levels of market liquidity throughout the day. To assist in discerning true event signals and new lending regimes in less liquid names, the indicators are paired with confidence series that can corroborate or question the borrow intensity valuation.

Confidence is based on millisecond observations of the liquidity of the underlying option markets, and this data is weighted and aggregated into 20 minute-intraday updates.

The combined information set gauges the strength of new updates, and can also inform recent changes coming through corresponding overnight rates.

This is visible in the data for Cara Therapeutics (CARA) seen in figure 5. The 180-day borrow intensity was fluctuating around zero percent in early May 2017, and the confidence indicator at that time ranged from 13 to 30, where confidence is measured on a scale of 0 to 100, with 100 being most confident.

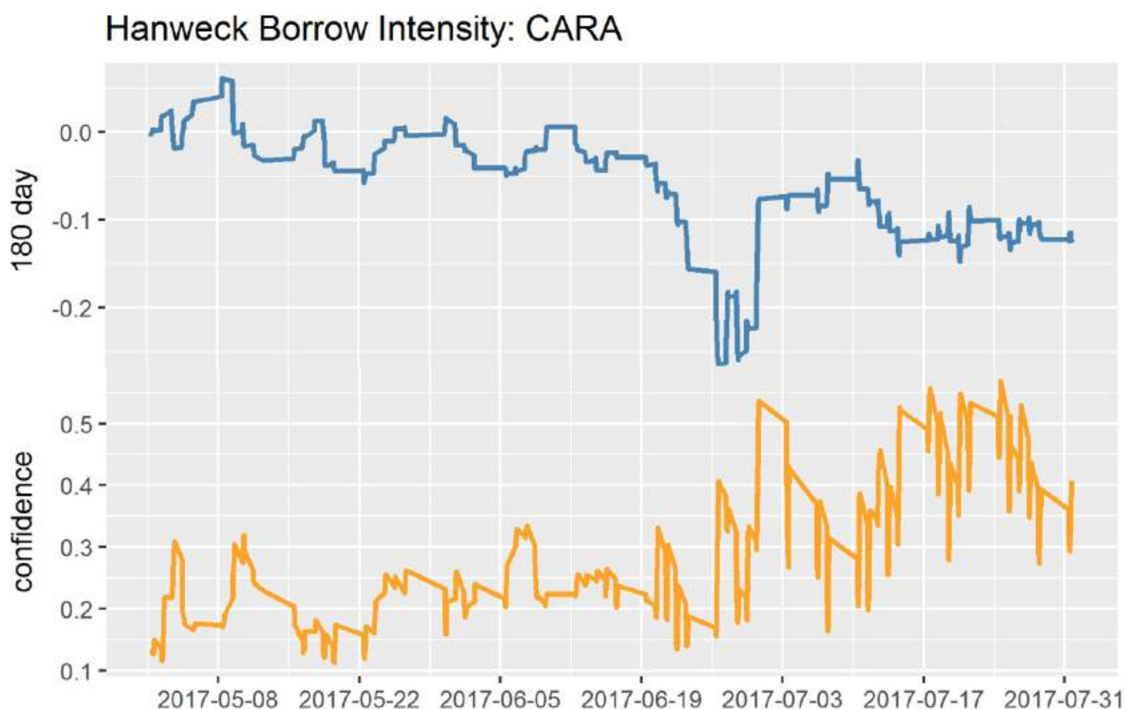
The CARA stock price showed considerable volatility in the latter part of June 2017 with the market anticipating and then later reacting negatively to disappointing research trial results. During this period, borrow intensity moved from minus 6 percent to minus 26 percent, with confidence gradually stepping up from 21 percent to 40 percent. The increased confidence and high momentum of the borrow intensity indicators suggested significant dislocation. CARA stayed persistently hard-to-borrow throughout the remainder of 2017.

Using borrow intensity to sharpen focus in securities lending decisions

The examples here demonstrate the range of views possible with Hanweck Borrow Intensity Indicator data, from single security to broad demographics of lendable securities. At the core, this data is based upon transparent and neutral data derived from quoted derivative markets. Borrow intensity indicators complement existing securities lending data, such as utilisation and percentage on loan, and borrow intensity convergence or divergence with other market data can signal changing market conditions and new lending regimes.

More broadly, this data is an example of evolving analytic approaches to creating alternative data sets, and it is exciting to apply such techniques to inform the securities lending market. **SLT**

Figure 5 - CARA, Borrow Intensity 180-day (upper panel) with Confidence (lower panel)



Meet the forerunners

Regulatory change and its added challenges are the forerunners to opportunity in the securities lending industry. Mark Jones of Northern Trust explains more

Securities lending is a historically dynamic marketplace. Lenders, their agents, and the borrower community have consistently sought to adapt and improve, using innovative technology, new markets, and strong working relationships to keep the industry moving forward. The industry has also been subject to significant regulatory change that has shaped the way market participants interact.

The current landscape is no different, with regulatory change at the forefront, shifting supply and demand patterns, and evolving distribution mechanisms meaning that the industry will look very different in five years' time.

Regulatory focus

Regulation has been, and will continue to be, a major influence on how the industry operates. From balance sheet management to transparency, a number of the innovations currently being worked on or contemplated are a direct result of regulatory change.

By the time we reach 2023, the securities lending industry will have undergone a major transformation with respect to transparency. The Securities Financing Transactions Regulation (SFTR) will be live across Europe and we believe it likely that other countries will have adopted and implemented their own reporting regimes, including the US. It is safe to assume that we will see post implementation changes to reporting regimes as regulators come to better understand the data they are receiving and adjust based on patterns they see or areas they wish to investigate further.

Our hope is that we see some level of global consistency from regulators, with a major concern being that the industry is left having to deal with multiple, widely varied reporting requirements. The challenges inherent in SFTR have been widely discussed and we would hope that lessons are learnt as other regulators roll out their own regimes.

An interesting point to consider is what the impact of the increased transparency might be—will we see new regulation based on patterns in the data that regulators will have to review? We think it likely that further changes to regulation could emerge as a result.

Borrowers have been challenged in recent years by regulatory constraints such as regulatory capital rules, liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). As a result, lender type and jurisdiction has become a key determining factor in lending activity. Looking forward, client type will become part of the upfront trade criteria requested by borrowers for certain transactions, and we are already seeing this demand today. Agent lenders will have enhanced their systems and trade filters to account for this new trading attribute. Borrowers will be more discerning in who they trade with to allow them to manage these constraints and it is likely that this enhanced transparency will promote greater pricing differentiation on loans. Client types with a more favourable treatment under certain regulations will benefit from better utilisation and pricing levels, especially for general collateral loans. Similarly, there will be a greater demand for transactions collateralised with non-cash collateral.

We also expect that the industry will have benefited from changes to the capital treatment for securities lending transactions. Regulatory capital requirements will be reduced by approximately half of the levels required prior to the change. We are hopeful that the US will have adopted the Basel standards for the standardised approach as issued in their post crisis reforms in December last year. With other regulation such as single counterparty concentration limits in the US still to be finalised we believe it likely that further impacts will feed through.

Markets and distribution channels

Over the coming years emerging and frontier markets are expected to be an important new source of revenue as the industry looks to both diversify and expand its global footprint. Increased liberalisation of global capital markets, particularly in developing countries, should offer opportunities for the industry to expand into new regions and areas across the globe. The Middle East, Sub-Saharan Africa and pockets of Eastern Europe all remain relatively untapped from a securities finance perspective. However, as these regions develop more sophisticated capital market infrastructure we can expect securities lending opportunities to follow. We have already seen this theme develop in the Middle East, with the Saudi Arabian Capital Markets Authority recently announcing a series of new regulations to help facilitate securities lending and covered short selling. Countries such as Nigeria, Kenya and Romania have all been talked about as longer term opportunities. However, much will ultimately depend on the short selling models these countries introduce, and how effective they are at attracting international investors.

In Asia, emerging market activity already makes up a significant part of the revenue that's generated from the region. There are already nine active lending markets in Asia, which on a normalised basis generally yield more attractive returns than the US or Europe, although many of these jurisdictions bring operational complexities as a function of the fragmented regulatory landscape across the region.

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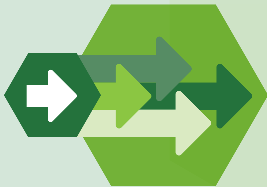

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Asia's longer term growth prospects are compelling with a number of significant emerging markets expected to be launched over time including India, Indonesia, Philippines and of course China. The latter represents, in our view, one of the most significant opportunities for the industry globally given the sheer size of the economy and expected growth in domestic stock markets. Encouragingly, reform is trending in the right direction as China seeks to liberalise its capital markets to the global community. The Stock Connect platforms have been successful and have paved the way for MSCI inclusion of Chinese shares into their benchmark emerging markets index in mid-2018. This is a positive step towards progressive market changes elsewhere which we hope will extend to development of a feasible offshore securities lending framework.

Alongside global expansion, we will see the development of new routes to distributing lendable supply, some of which are already taking shape. Perhaps the most significant could be an increase in centrally cleared lending transactions. A number of providers are either live with offerings or in the process of developing them, and we would expect that in the five year time period a significant proportion of transactions will be routed through central counterparty (CCP) solutions. The potential game changer here is if regulators move to mandate clearing as they have in other markets. Should this occur the proportion of cleared loans would rise significantly.

Beneficial owners

Beneficial owners providing supply are the key to a successful securities lending market. We think it likely that regulatory change such as SFTR will cause some beneficial owners to consider their ongoing participation in lending activity. For some the overhead created by compliance may be seen as burdensome. From our own perspective we will be ensuring that we can support our clients in their reporting obligations, and that in five years' time facilitating transaction reporting will be a core component of the product offering, allowing our clients to base their choice to lend on the key benefits rather than concerns over the operational burden.

Over the next five years, we expect to see growth in the participation of two key industry sectors, namely asset managers and beneficial owners from jurisdictions where lending has not previously been widespread. Regarding asset managers, the on-going competition to lower costs for their investors coupled with increasing market and regulatory costs to operate their business we believe could promote a more pro-lending philosophy. The ability for their lending agent to customise a programme that does not interfere in their day to day core business will be an important differentiator. Similar to our comments above about new lending jurisdictions, a logical conclusion will be that these new jurisdictions will bring new lenders from that jurisdiction. Whether this growth comes from China, Indonesia, Saudi Arabia or Romania, the most apparent source of the supply in those markets will be from lenders domiciled in those markets.

Finally, the growth of environmental, social and governance investing cannot be ignored. With the industry's current structure today where the ability to vote proxies passing from lender to borrower, we believe there will need to be a shift in operational processes (for example, easier automatic recall to vote process), a shift in technology (for example, distributed ledger/blockchain) or a combination of both. There is no reason why securities lending cannot sit side by side with an environmental, social and governance mandate where voting is important to a manager and investor.

Technology

We cannot look forward to the future of our industry without considering the impact of technology. Advances in technological capabilities have the potential to completely transform our industry and the broader financial markets to a degree unthinkable 10 years ago. At Northern Trust we are working with a number of new technologies such as machine learning and robotics as well as developing our data analysis capabilities. We believe these technologies can and will be employed to enhance everything from trading strategies through to operational efficiencies, and we only see them becoming commonplace in the coming years. Combined with increased transparency, we are likely to see the use of automated pricing mechanisms with lenders being more able to predict and determine appropriate pricing levels for specials.

It is highly likely that the use of blockchain technology will be much more widespread in five years time. Northern Trust believes blockchain technology and distributed ledger technology (DLT) have the potential to drive major industry-wide improvements and opportunities. This is supported by a wide industry view that blockchain technology can significantly change the manner in which market participants interact and conduct financial transactions.

Through our experience and expertise in deploying blockchain technology for private equity markets, Northern Trust believes DLT will improve the transparency and efficiency of the market, as well as provide potential opportunities to achieve industry cost efficiencies across the value chain. As confidence continues to grow in the technology, it could also open up future opportunities around account structures, regulatory reporting and digital issuance.

For Northern Trust, our priority is to ensure that we remain well positioned to bring our clients together with the borrower community in a way that maximises returns for our client base while not compromising the principles they apply to their lending programme. At the same time we need to ensure we are providing borrowers with the flexibility they require. This is no small challenge in times of significant change, so over the next five years our approach will be to continue to ensure we engage with our clients on the new types of activity available in the market, the impact of regulation, and advances in technology, thereby allowing them to make well informed decisions on how they structure their programme based on full transparency of the risk/reward equation. By investing time in client education and by taking advantage of the new technologies and distribution channels available, we will ensure our lending programme continues to deliver excellent risk-adjusted returns to our client base. **SLT**

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No shortcuts

Martin Seagroatt of Broadridge explains why doing the bare minimum to comply with SFTR gives little thought to the long-term effects

The short-term view

The sheer scope of data that firms must report for Securities Financing Transactions Regulation (SFTR) means it is tempting to do the bare minimum to hit compliance deadlines. This short-term tactical view gives little thought to the long-term effects of SFTR and the direction of travel the securities finance industry is heading in.

One of the key lessons learned from European Market Infrastructure Regulation (EMIR) and the second Markets in Financial Instruments Directive (MiFID II) was that many firms did not think about the consequences of sub-optimal systems and processes and poor quality data. This then resulted in subsequent tactical projects post go-live to address technical debt and higher ongoing maintenance costs around IT and operations.

With SFTR, it is important to seriously think about whether a short-term solution is going to simply add to your complexity and data problems.

Turn challenges into advantages

It can seem daunting to redefine operating models and implement major projects to improve data quality. However, taking the time to design a solution that enables your firm to achieve future benefits and recover some of the costs of SFTR compliance need be no more difficult than cobbling something together to get over the line.

While taking some initial effort in the short term, getting your data model in order now while you are digging up the road anyway will provide cost savings in future. Selecting vendors such as Broadridge with a proven track record in getting clients live with previous reporting mandates and who can provide a long-term vision around

how SFTR can provide competitive advantage can also make the process significantly easier.

Advantages of the long-term view

When combined, these benefits can result in a significantly lower long-term cost of ownership for the systems and processes required to successfully comply with SFTR. They also help your firm to position for subsequent industry evolution and future trends coming down the pipes. (See figure 1) As a bare minimum, an SFTR solution needs to provide timely, accurate reporting that meets regulatory deadlines. This is the basic view of compliance.

However, past experience with MiFID and EMIR has shown that two other components are also critical in any effective reporting solution:

- Clear data lineage (where the data has come from, where is it held, how it has been enriched)
- Traceability (why this data is being reported/not reported)

A reporting solution that provides a clear view of the origin and evolution of data flows from multiple systems makes it far easier to verify the quality of that data. It can also help the firm to unlock added value from the data it holds.

With the European General Data Protection Regulation (GDPR) coming into force on 25 May, it is also becoming more important to demonstrate good data lineage and traceability. Ownership of data—and reducing the number of third parties it is shared with are critical components to consider.

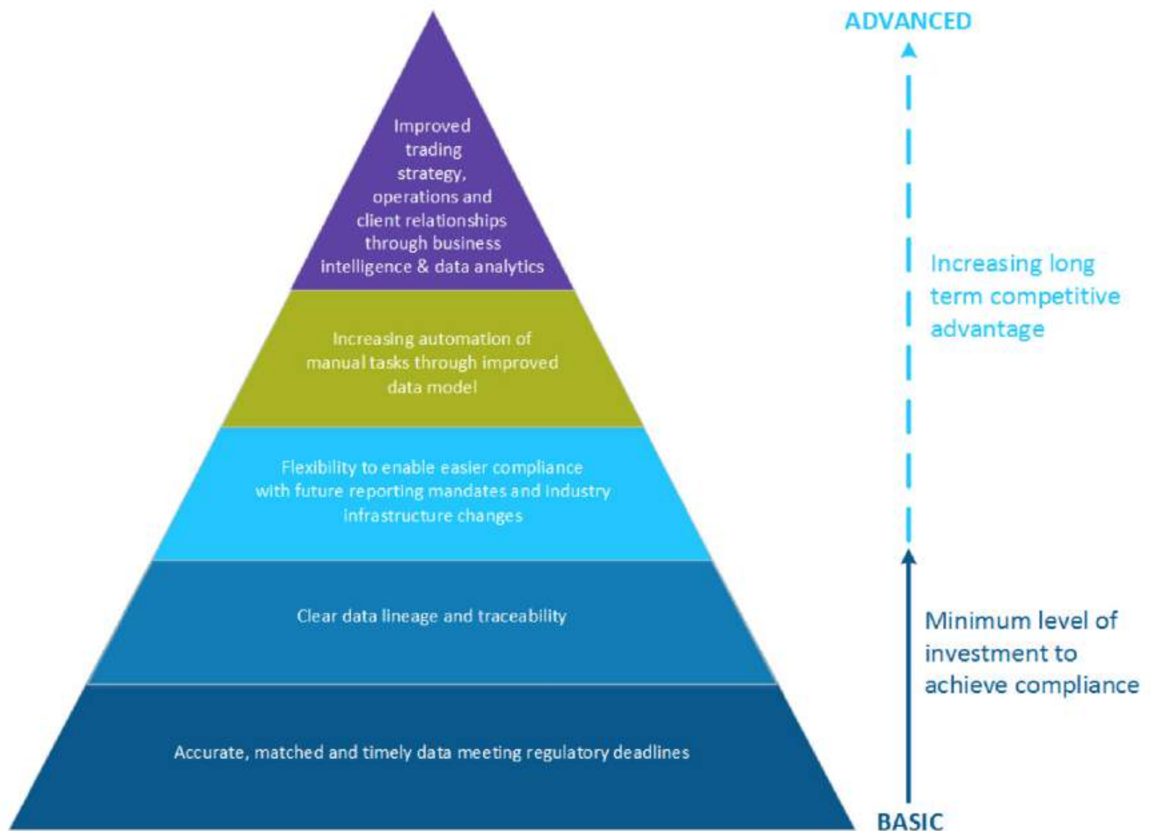
Increased flexibility and scalability

Regional regulators globally have indicated a desire to align with the Financial Stability Board's (FSB) recommendations around transparency in securities finance transactions. Furthermore, once SFTR is live in Europe, ESMA will no doubt require future iterations of the rules. There is also overlap with other regulations; for example, firms falling under the ECB's Money Market Statistical Reporting Regulation (MMSR) will benefit from having a robust SFTR solution.

Likewise, industry evolution such as increasing electronification, a move to trading via central counterparties (CCPs) and the emergence of peer to peer/all to all networks may have an impact on the SFTR data that firms need to report.

Implementing a flexible solution that will allow you to repurpose SFTR systems, processes and data for reporting mandates further down the

Figure 1: Benefits of the long-term view



line can therefore result in lower risk for implementations, migrations and system replacements in future.

This allows you to achieve a scalable, end-state regulatory reporting infrastructure that accommodates frequent changes while covering multiple jurisdictions and mandates.

Reduced reputational risk and market share growth

While focusing on transparency, SFTR is as much about improving and standardising the way people do things. Firms need to ask themselves whether they really want to be transparent in having sub-optimal data and processes. SFTR provides an ideal opportunity to work through the kinks in some currently cumbersome operational procedures.

To avoid headaches with reconciliations, counterparties will prefer to trade with firms who have their house in order around data and reporting. There will be little patience extended to counterparties who are inefficient and slow to cooperate with timely reporting requirements. Those with strong operational processes therefore have the ability to gain market share and trade flow. For service providers offering delegated reporting, providing clients with a solution that reduces the burden of SFTR by minimising exceptions will be seen as a key differentiator.

Greater automation and straight-through processing

Getting a clean, standardised data model in place now will enable automation of manual tasks further down the line. This will unlock great potential to achieve efficiency gains and cost reductions in the future and achieve some return on investment from the cost of SFTR compliance. As the industry becomes more standardised and industrialised this will become a 'must have' for firms who wish to remain competitive in a fast moving environment with increasing cost burdens.

Improved trading strategy, risk management and client relationships

Another longer-term benefit of taking a more strategic approach to SFTR is the ability to unlock new insights from the wealth of data required for SFTR reporting. There are clear opportunities to use this to improve risk management, management reporting and front office to back office reconciliations. The ability to create new analytics and business intelligence from SFTR data will also support better decision making around trading strategy and client servicing.

With the emergence of artificial intelligence (AI), a robust data model will be a prerequisite to designing effective AI applications. If you are not doing this, then some of your competitors are certainly putting the building blocks in place to adapt to AI now, as seen with recent examples of forward thinking securities finance market participants starting to launch AI driven solutions. Having a standardised taxonomy and clear ownership of your data to manipulate it in new ways is a fundamental requirement for this.

There is still time to stop and think

With tight regulatory deadlines and regulatory fatigue setting in, it is tempting to dive in and start moving forward with basic compliance. However, it is important to stop and think before you plunge in to consider about the long-term effects on your systems and processes and how SFTR can be seen as a strategic investment that adds incremental business benefit. **SLT**

Martin Seagroatt
Marketing director
Broadridge

Key considerations

Some key considerations include:

- Start planning early to avoid vendor onboarding crunches
- Understand the regulation. Make sure you have invested time in comprehending the requirements of the regulation, its complexity and how it affects your business
- Communicate with industry associations to help shape best practice
- Grasp internal requirements and the process changes required early on
- Define a long-term scalable operating model
- Identify data gaps and define coping strategies
- Get your data in order now to allow time for solutions implementation and testing
- Think about how reporting mandates will evolve and overlap with other regulations/jurisdictions and select a flexible solution with the ability to scale
- Select vendors such as Broadridge with a proven track record in complex regulatory reporting mandates to meet demanding deadlines. This allows you to leverage lessons learned from previous implementations to help you avoid sleepless nights
- Select vendors with a long-term vision around how SFTR and other reporting mandates can provide competitive advantage and who can offer a consultative approach

All of this will enable you to put in place a robust and scalable reporting solution that meets regulatory deadlines while minimising long-term costs and maximising competitive positioning.

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The journey to SFTR compliance

Firms are considering whether to continue deployment of resources until MiFID II completion or begin reallocating resources to SFTR, according to Andrea Ferrise of UnaVista

Following the recommendation by the Financial Stability Board (FSB) and European Systemic Risk Board to mitigate the risks in shadow banking and increase transparency in the use of securities lending and repurchase and reverse repurchase agreements, the European Commission published the Securities Financing Transactions Regulation (SFTR) in January 2016.

The financial instruments impacted by SFTR are securities lending, repurchase and reverse repurchase agreements, and any sell/buy-back transactions involving securities or commodities.

Historically speaking, the actions regarding this matter were initiated in 2013, by the joint effort between the G20 and FSB to identify the key risks

in shadow banking. The table below summarises the SFTR's path from the preliminary steps until the endorsement by the European Commission:

August 2013	The FSB published the policy framework for addressing shadow banking risks in securities lending and repos
January 2014	The European Commission published a proposal to regulate securities financing transactions (SFTs)
January 2016	SFTR entered into force
March 2017	ESMA's final report on technical standards under SFTR was published
Q4 2017	European Commission's review of the final report
Q2 2018	Expected endorsement of final draft RTS by the European Commission
Q2/Q3 2019	Estimated phased go-live of the SFTR Transaction Reporting obligation for financial counterparties to begin. 12 Months following the endorsement by the European Commission as well as non-objection period by Parliament and Council

Where does the industry stand?

The adoption of Level 2 measures is currently delayed and expected to be approved between Q1 and Q2 2018 for a phased go-live beginning 12 months after, for example Q2/Q3 2019.

In order for firms with an SFTR requirement to meet the deadline, the first compliance phase which includes design, build and test of the infrastructures should begin in H2 2018. This will impact the workload of the industry to perform the impact analysis and start implementing efficient operating models to take advantage of the opportunities provided by SFTR.

The industry was committed and worked very hard to meet the 3 January 2018 deadline for the go-live of the second Markets in Financial Instruments Directive (MiFID II). It is evident now that market participants need to analyse the potential impact across firms in terms of resources and budget to be compliant ahead of SFTR transaction reporting go-live in mid 2019.

At the current stage, many firms are considering whether to continue deployment of resources until completion of MiFID II or begin reallocating resources to build and implement operation models and infrastructure for SFTR.

This uncertainty might have a detrimental effect on the success of the aforementioned regulation. It is quite evident that SFTR is more than a simple trade reporting practice and impacts a wide-range of investment firms in areas such as businesses processes, controls, operations, IT systems and compliance. It is noteworthy that effort and costs will vary depending on the extent of system integration, the size of the firm and the transaction volumes. Further, challenges impacting the business model are the unique trade identifier (UTI) generation, the reporting obligation to the trade repository and, finally, the reconciliation process. Therefore, the industry needs to be prepared to tackle this objective rather than take a wait-and-see approach.

Following the footsteps of EMIR

From a technical standpoint, similar to the European Market Infrastructure Regulation (EMIR), SFTR includes two-sided reporting. This will affect both financial and non-financial institutions engaging in SFTs and will require them to report details of their transactions. This requirement will be phased-in according to the following timeline:

The main SFTR's cornerstones are the following:

Phase 1	• Investment firms • Credit institutions	Day one
Phase 2	• CCPs • CSDs	After three months
Phase 3	• Insurance • Pension funds • AIF • UCITS	After six months
Phase 4	• NFCs	After nine months

Disclosure of information: UCITS are obliged to specify the SFTs which funds are permitted to use and include a clear statement of which of those are used. The following information must be included in the UCITS prospectus:

- Description and rationale of the SFTs/TRSs used
- Criteria to select the counterparty, such as credit rating and legal status
- Collateral description with particular reference to asset types, issuer, diversification and maturity
- Description of the risks of SFTs/total return swaps and
- collateral management
- Collateral valuation methodology
- Description of any restriction
- Overall data for each SFT

Collateral Reuse: the counterparties involved in SFTR have the right to reuse financial instruments received as collateral if the following conditions are satisfied:

- Reuse in accordance with terms
- Express consent
- Duly informed in writing
- Transfer from account

Transaction Reporting: on the reporting side, the regulation is structurally identical to EMIR. They both require counterparties to report the details of any lifecycle event on a T+1 basis timely fashion.

Nevertheless, counterparties to an SFT will be required to keep record of the transactions that have concluded, been modified or terminated for at least five years following the termination of the trade, as is currently required under EMIR. Trade repositories will apply a two-way key legal entity identifier (LEI) and UTI regardless of whether or not both counterparties to each SFTR contract have reported to the given trade repository.

In terms of reporting format, in 2017, European Securities and Markets Authority (ESMA) released the SFTR final report, specifying the format and frequency of the report. The novelty is represented by requirement also on the counterparties' side to report to trade repositories using the ISO 20022 standard. The final target is to provide to the industry a single standardisation approach which will ensure open and transparent market's practices.

How is SFTR different from other regulations?

What is very interesting from a regulatory perspective is the introduction for the first time of the reporting requirement. The proposed regulation would cover SFTs conducted by any firm established in the EU, regardless of where the individual branch is. Furthermore, SFTR represents a significant move towards enhanced transparency in securities lending market and risk reduction from shadow banking. However, from a regulatory standpoint, the market participants will face the following challenges once the regulation is going-live:

- The collateral re-use practice can lead to complex collateral chains, especially referring to situations where: (i) there is an extensive rehypothecation, so the same collateral will need to be reported several times; (ii) where pools of collateral are used against multiple trades, there will be difficulty allocating each element of the collateral against a specific transaction. Finally, a default on one transaction can cause a domino effect with other counterparties defaulting on their respective SFTs if the same collateral has been used in all of these.
- Reconciliation: the process requires both counterparties of the trade to provide a UTI if they are in scope. However, in some cases such as CCPs, the industry is wondering who will generate the UTI for cleared trades considering that CCPs will enter into SFTR just in Phase 2. In addition, further clarity is required in situations whereby after reporting to CCPs, the transaction is subsequently novated. The industry is keen to know whether the different UTIs should be reported to the CCP by the counterparties.
- Counterparties in scope: SFTR will cover EU counterparties, non-EU branches of EU firms and EU branches of third country firms. The market participants have concerns regarding the involvement of non-EU counterparties in the reporting chain. Indeed, those may be impacted when they trade in STFs, as the reporting entities will require certain information to fulfil their reporting obligations, for instance, the LEI of their counterparty and matching UTIs.

Following the implementation of EMIR, lessons were learned. Before the go-live of EMIR many market participants decided to take a wait and see approach and, as result, most of them were not prepared. This turned into additional compliance and operational costs.

In addition, the most important lesson learned from EMIR relates to the industry preparation to deal with continuously changing regulatory requirements and new reporting regimes. For instance, EMIR has been amended several times since its introduction in 2012. During this evolutionary period, new regulations, such as benchmark, short-selling and MiFID II transaction reporting entered into force.

Preparing for the new reporting regime will provide a huge benefit not only from the regulatory standpoint in terms of transparency, but also efficiency and cost-minimisation. Indeed, the industry will get the chance to have access to a more data granularity and business intelligence. The regulators hope that this will dramatically improve the decision making process resulting in a better business outcomes. The SFTR text is just one step in a continuously changing regulatory landscape and it is essential that the industry integrates the rules prescribed by the regulator to increase transparency and integrity of the market.

In conclusion, the nuances of SFTR highlights the need to pick a trade repository with advanced data quality tools as regulators will be looking at rejection and matching rates. The onus is on firms to start putting their SFTR delivery team in place of others to fully assess the project requirement ahead of time. Firms with MiFIR and EMIR reporting obligations can leverage their existing infrastructure and vendor experience. Finally, the industry is in the information gathering stage therefore, firms can benefit from being part of industry groups, attending industry events and joining SFTR conversations. **SLT**

Andrea Ferrise
Compliance officer
UnaVista, London Stock Exchange Group

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A bright future

Walter Kraushaar of Comyno explains how regulatory requirements and new digital platforms can help to break down silos in the securities finance industry

Like many other global businesses, the securities finance industry is debating and discussing for a long time how to overcome internal silos. Silos can occur in global corporations or start-up ventures with 10 employees only. Regardless of the size, they are contra-productive to an organisation's need to succeed in a rapidly changing world.

It's also important to realise that silos can be vertical or horizontal. Business units divided into asset classes can either lead to high barriers between them or senior leadership completely isolating itself from lower management levels. As a result, an organisation split into silos cannot react quickly to upcoming opportunities that arise in a fast-paced digitalised business landscape. It is also not able to make productive decisions about how to change to seize these opportunities.

In general, silos cut off communication between different business/product/asset class units. Silos create an extremely high loyalty to the immediate unit, which at the same time prevents building trust into other business initiatives within the firm. This might affect the own business line, but would benefit the global organisation and as a result, the silos become inwardly focused, arrange with the status quo and lose contact with the outside world resulting into missing opportunities and new market developments.

Silos are also making it extremely difficult for a company to comply with the increased regulatory reporting requirements. Since the global financial crisis, the Financial Stability Board, the European Systemic Risk Board (ESRB) and the European Commission have started various initiatives. The initiatives look at measures to improve the transparency and monitoring of non-bank alternative credit provision, shadow banking, aside from the general new capital related banking regulations like liquidity coverage ratio (LCR), net stable funding ratio (NSFR), the second Markets in Financial Instruments Directive (MiFID II).

In an EU context, this has resulted for the securities finance industry in the regulation on the transparency of securities financing transactions and of reuse of collateral, the Securities Financing Transactions Regulation (SFTR), which came into force on 12 January 2016.

As those requirements are meant to create transparency for the regulators they also automatically create transparency for the securities finance firms themselves. The new regulations help unintentionally to overcome the established silos as they have to be performed across asset classes, products, business and reporting lines. SFTR will help any company to 'merge' their product silos through an integrated reporting disregarding the current silos. In other words, for the first time, regulatory reporting requirements will push any securities finance business into integration, and it will show new opportunities of allocating and optimise the firms collateral and assets thus creating new business opportunities and a new way of monitoring and managing risks and capital.

As a further result, the European Securities and Markets Authority (ESMA) is required to produce regulatory technical standards (RTS) and implementing technical standards (ITS) for the securities finance business, which also requires a new approach towards digitalisation and securities finance IT.

SFTR aims to enhance transparency and enable regulators to better monitor risks by:

- Introducing reporting requirements for securities financing transactions, similar to those already applicable to derivatives transactions under the European Market Infrastructure Regulation (EMIR)
- Introducing limitations on the reuse of collateral. Not just in the securities financing markets, but also in the wider collateral markets—thus, the application of these limitations is wider in scope than to just securities financing transactions
- Also, Article 4 of the SFTR sets out the transaction reporting and record keeping requirements. For example, the conclusion, modification or termination of a securities financing transaction must be reported to a trade repository (TR), which is in accordance with the SFTR

Comyno has taken a new approach on how to collect, display and merge the required information and developed a platform-based environment, which can be used and connected via various adaptors (interfaces) to almost any given securities finance infrastructures.

With the help of this platform, we can provide customised reporting and inventory management for securities finance market participants across all asset classes and connect them to various central counterparties, agent lenders, tri-party agents as well as asset managers.

Even if new regulatory requirements usually cause more pain, frustration and cost without substantial benefits for the industry it is fair to say that this time, not a market, but a driven regulatory modification of the classic securities finance business models will have the power to overcome the old silos and can provide in combination with the new possibilities of digitalisation a fantastic business opportunity to emerge the securities finance business into a bright future. **SLT**

Nothing short of a trade war

David Lewis of FIS explains that as stock markets continue to rise, so too has the temperature of the rhetoric between the US and China

Much has been written and broadcast about the economic recovery that is said to be taking place around the globe. Talk has been of growth and a return to prosperity after years of interest rates at record lows and world economies suffering the post-financial crisis blues. The US Federal Reserve, along with the Bank of England, have been confirming not just their plans to raise rates this year, but in fact, to accelerate those rate rises in a move designed to squeeze off any inflationary effects the growing economic recovery may bring. The recent tax cuts in the US are likely to be a factor in those decisions as companies use some of their windfalls to raise employee wages, or deliver one-off bonuses. In the UK, the Monetary Policy Committee has left base rates at 50 basis points, but indicated that the expected increases could start as early as May. This brought positive news for the GBP on the currency markets, but perhaps not such good news for indebted consumers.

While booming stock markets do not necessarily correlate directly with a strengthening economy, rising share prices indicate the market's expectation of future value or income. On the same day in January 2018, the Hang Seng and S&P 500 both hit five-year peak levels, at 33,154 and 2,872 respectively. The Eurostoxx 600, three days earlier, also hit a recent peak of 402.8, just eleven points below its previous five-year high of 413.6. All three indexes have been on extended bull runs; the Hang Seng and Eurostoxx broadly since the start of 2016, while the S&P has been rising, with a brief hiatus in 2015, for the last five years straight.

However, the end of January brought the bull run across all three market measures to a shuddering halt. Since the January peak, the Asian market, as indicated by the Hang Seng, has fallen by 8.5 percent as of last week's close (23 March). The Eurostoxx 600 has fallen by 9.2 percent from its January peak to 23 March, but the S&P 500 has lost the most—dropping 10 percent between 26 January and 23 March. Putting that into context dampens the impact slightly. These drops return the S&P to levels seen as recently as last November, with the same levels seen for the Hang Seng three times already this year—in January, February and March. Prior to that, the index briefly exceeded 30,000 in November 2017, in line with the point the S&P has retreated to.

For the European markets, the index volatility matched the Asian fluctuations, matching the low points in February and March, but you would have to look back as far as August 2017 to reach the same level prior to January, suggesting that the European market has fallen further back down the growth curve than its Eastern and Western competitors. The threat of interest rate rises is only part of the story, however. As stock markets have been rising, so, more recently, has the temperature of the rhetoric between two of the world's largest economies, that of the US and China.

The US has applied tariffs to imports of steel and aluminum, levying 25 and 10 percent to each, respectively. The rules exclude Canada and the EU, which include some of its largest trading partners; but notably, it applies to China, where talk of various tariffs on around $60 billion

of trade have been mooted. China has responded with threats of like-for-like tariff application, meaning that if both parties carry out these threats, a full-on trade war will ensue. Modern economic theory would indicate that growth comes from the removal of trade barriers across the globe, but these arguments between the economic superpowers are not about growth, but more about domestic economic policy on the one side and the protection of exporting strength on the other. At the time of writing, there seems to be little chance that either side will back down and an escalation will bring a negative impact to trade, globally—not just between the main protagonists.

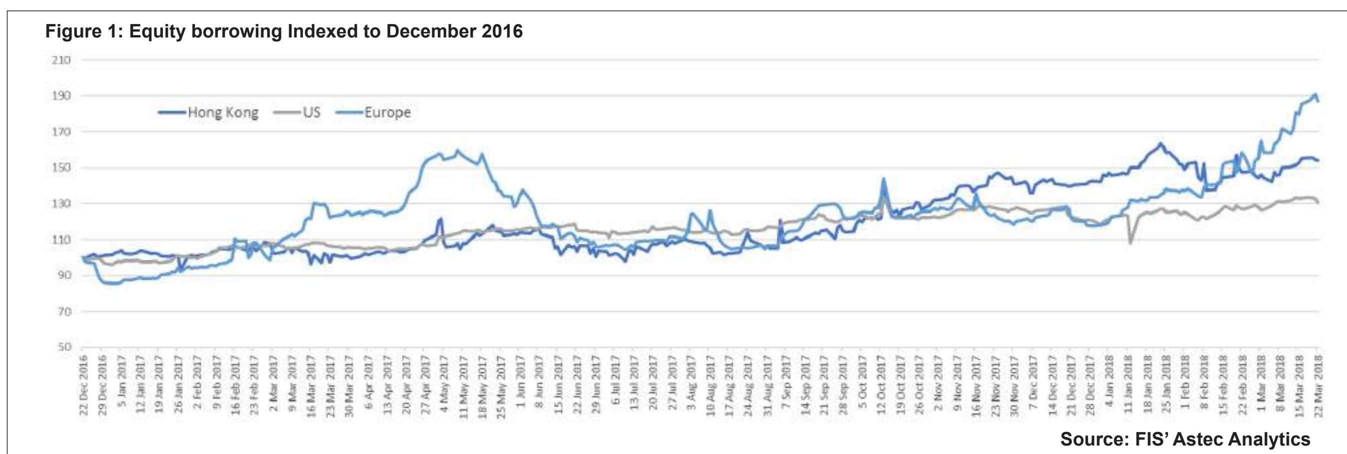
When a single company share is believed to be overvalued, short sellers move in to take advantage of the price correction that they expect to come. The same is true, by extension, for entire markets or even countries. Looking at equity borrowing across the three regions as a proxy for short interest activity suggests that there is a rapidly increasing level of negative sentiment in the markets, although it is not at the same intensity across all three zones. Over the last 15 months, from December 2016 to March this year, specifically, equity borrowing by value has risen in Europe, the US and Hong Kong, with Hong Kong being identified in this context specifically as a proxy for Chinese equities listed in the province.

When compared on an indexed basis, applying 100 to December 2016, Europe has seen growth in short interest that is, by far, the highest of the three markets. By March 2018, the value of shares on loan across Europe had advanced some 87 points. Over the same period, the Eurostoxx 600 had advanced just 1.6 percent, making the component impact of rising prices across the period, negligible. Over the same period, the value of US equities borrowed has risen 31 points, with the S&P 500 index rising a net 14 percent over the period, suggesting that rising share prices may have accounted for approaching half of that increase.

Shares in Hong Kong appear to have suffered the least, in terms of increasing short interest. The value of borrowed shares has risen 54 points over the last 15 months, but the Hang Seng has advanced just over 40 percent over the same period, suggesting that the uplift in actual shares shorted is the same, or just less than that in the US. Figure 1 shows the indexed values of borrowed shares across the three markets over the last 15 months.

With the potential for a trade war between two economic superpowers, both have seen their share values impacted, and both are seeing net rises in short interest activity. However, it appears that neither are facing such significant increases as are being seen across the Eurozone, indicating that hedge funds and other investors on the short side of the market are expecting a more dramatic correction across the European trading block than they might be envisaging between the increasingly aggressive economic titans. **SLT**

Figure 1: Equity borrowing Indexed to December 2016



Source: FIS' Astec Analytics

With the potential for a trade war between two economic superpowers, both have seen their share values impacted

David Lewis
Senior director
FIS

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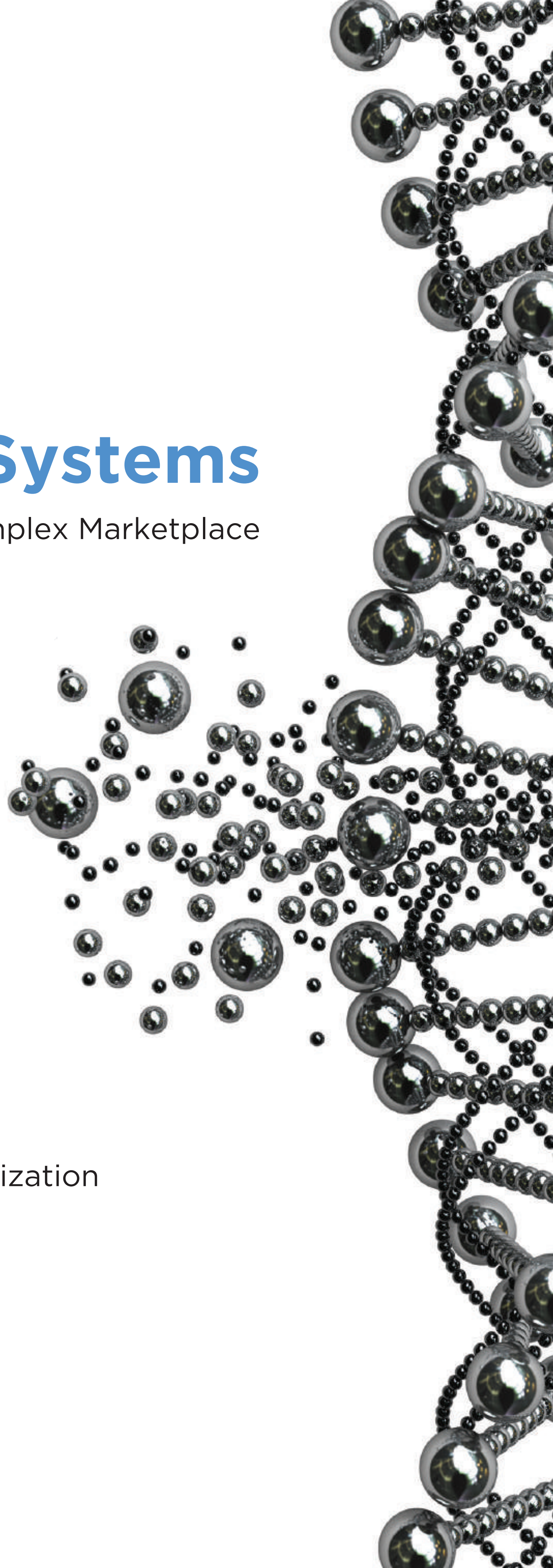

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Comings and goings at Crédit Suisse, Deutsche Bank, Capitolis and more

Crédit Suisse in New York has confirmed that a number of job losses have taken place at its US prime brokerage business.

This follows the departure of global head of prime brokerage, Indrajit Bardhan.

Crédit Suisse has stated that those leaving from a cast of hundreds employed include: Jeremy Siegel, managing director and global head of the consulting team; Robert Leonard, managing director and global head of capital services; Clay Mason, a junior on capital introduction team; Mike Wingertzahn, managing director and head of delta one sales; Gardy Berthoumiex, managing director and global head of the central collateral desk; Isabelle Krusen, director, prime services coverage; Julia Allen, director, prime services coverage; Stephen Webb, vice president, US equity finance trading; Mark Matulonis, vice president, prime brokerage transition management; Fred Nadd-Aubert, managing director and head of securities lending; Tony Palladino, director, securities lending; Shelby Tom, trading assistant, securities lending; Phil Maxim, vice president and delta one trader; and Jeffrey Janker, director, advanced execution services and trading coverage.

Crédit Suisse said that no units are set to close.

A spokesperson for Crédit Suisse explained that the bank continues to invest in the equities business and across the global markets division as evidenced by recent hires.

The bank has hired Paul Galietto as global head of prime services.

The spokesperson added that Crédit Suisse remains fully committed to its global investment banking and equities offering.

The bank concluded by suggesting that the eye-catching reductions in staff numbers will not bring about a reduction in capital allocated to the business.

Deutsche Bank has confirmed it has recently appointed Ruth Berry as a London-based director in the European capital introduction team in its hedge fund capital group.

Berry was previously head of marketing and investor relations and a former partner at GSA Capital.

She has also served at Aspect Capital and Instinet Corporation.

According to Deutsche Bank, the hire demonstrates the bank's commitment to its prime brokerage division.

Capitolis CEO and founder Gil Mandelzis has been appointed non-executive director of Euronext US, a pan-European exchange in the Eurozone.

Mandelzis, the former CEO of EBS BrokerTec, part of ICAP (now NEX Group) and founder of Traiana, which was acquired by ICAP.

Stéphane Boujnah, CEO and chairman of the managing board of Euronext, added: "The experience of Gil Mandelzis, our new non-executive director of Euronext US, will be a major asset for our group. As a successful serial entrepreneur in the field of capital markets platforms, Mandelzis will further strengthen our positioning in the US and our ambition to diversify the revenues of Euronext over the coming years."

Commenting on his appointment Mandelzis said: "Euronext is ideally positioned to grow and play a role in the future development of both US and European markets. The pace of change in market structure and as well as new technology and trading solutions has accelerated and I look forward to supporting Stéphane Boujnah and the Euronext team in leading the market through these changes."

RegTek.Solutions has made two senior sales appointments to support its growth in the core markets of North America and Europe.

Based in New York, Rob McGowan has been appointed head of sales for North America.

McGowan joins from SmartStream Technologies, where he served as senior vice president of sales.

In his role at SmartStream, McGowan was responsible for the transaction lifecycle process improvements and control for the middle and back office.

Tom Morris has been appointed as head of sales for Europe and will be based in London.

Morris joins from NEX Group, where he worked as head of regulatory reporting solutions.

McGowan and Morris will both report to Brian Lynch, CEO of RegTek.Solutions.

Lynch said: "Rob McGowan and Morris' domain knowledge, sales experience and contacts will help fuel our further growth and I'm confident that they will each play a significant role in helping us achieve our strategic ambitions, namely; being instrumental in helping as many clients as possible to achieve sustainable compliance for trade and transaction reporting."

Commenting on his appointment, McGowan said: "The firm's strategic approach combined with the rapid adoption of their technology by clients and partners provides a tremendous foundation of success to build upon in the coming year and beyond."

Rory Zirpolo has left his role as managing director at WallachBeth Capital.

Zirpolo has worked at the firm since November 2017. He moved to WallachBeth from Cantor Fitzgerald, a global financial services provider, where he was managing director of securities lending for two years.

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

Zirpolo has also served as managing director and head of Cowen Equity Finance Group between 2012 and 2015. **SLT**

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